



HOME MEDICAL EQUIPMENT

2014 M&A ROUNDUP: AS AGGREGATE HEALTH CARE SERVICE DEAL VOLUME TICKS UP 9%, HOME MEDICAL EQUIPMENT ACTIVITY SLIDES 13%

Based upon proprietary data collected and analyzed by The Braff Group, every sector except home health and home medical equipment recorded year-over-year gains, propelling aggregate health care service deal volume up 9% over 2013. Moreover, if we exclude 2012, a year that was artificially juiced as sellers rushed the exits to beat an 8.3% increase in capital gains, 2014 was a record year, just eclipsing the tally posted in 2011.

The biggest winner was health care staffing, which rocketed 150% in 2014. With reduced unemployment and more beneficiaries (care of health care reform) accessing an already understaffed health care system, the sector recorded its highest tally, by far, in nearly 10 years.

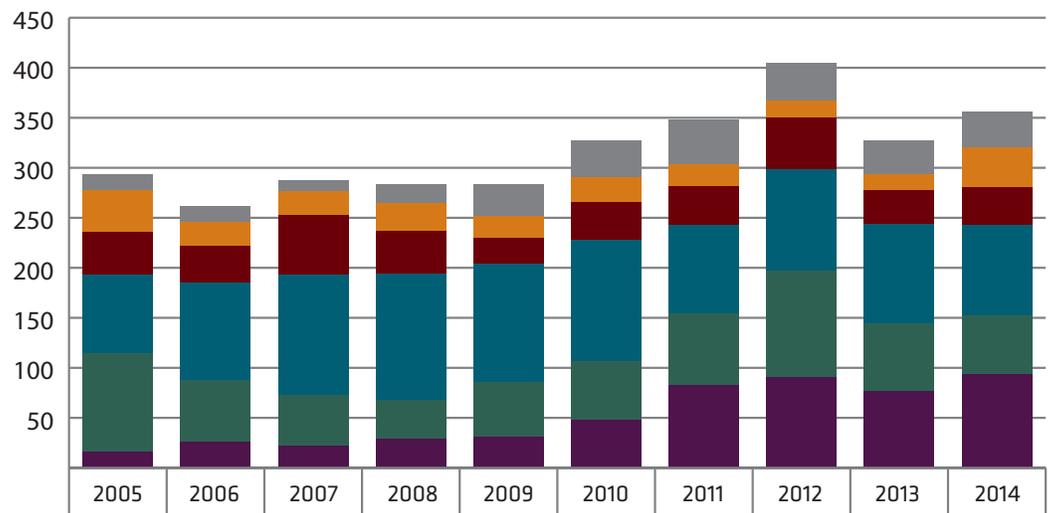
Home Medical Equipment

In 2012, optimism reigned supreme as the M&A market rocketed 50% over 2011 to set a new all-time high – a figure that eclipsed the peaks set in the early 2000s when “The Nationals” and others were duking it out to build respiratory empires. Moreover, in 2012, consolidation was more widespread, as buyers with aggressive appetites in areas such as rehab, supplies, and sleep seemingly rose from nowhere to put HME back in the M&A spotlight. But fast as the surge surged, it quickly purged, falling off 35% in 2013 and another 13% this year.

So how do we explain what appears to be such a short-lived binge?

Health Care Services Deal Volume

- Behavioral Health
- Home Medical Equipment
- Home Health
- Pharmacy Services
- Health Care Staffing
- Hospice



Source: The Braff Group



To gain some insight, we looked back on the last 10 years of deal making in the home medical equipment industry, particularly as it relates to investment activity in the sector by private equity. By plotting together overall and total private equity deal activity (initial platform **and** follow-on transactions), a clear story emerges:

As suggested earlier, in 2005 and prior, the Nationals dominated the scene, leaving little room in the sandbox for private equity to play. So at that time, PE accounted for only 5% (5 of 99) of all HME deals. But then came the Deficit Reduction Act of 2006 and the introduction of the 36 month oxygen cap. The Nationals retreated en masse, leaving a gaping hole in the acquisition market – and an opportunity for private equity to pick up the slack. By 2012, the second high watermark for the decade, PE accounted for 40% (42 of 106) of the year's deals. And with the oxygen market in disarray, they targeted previously untapped non-respiratory niches. Since then, however, as illustrated above, the pace of PE sponsored activity has slowed considerably, siphoning off deal flow in 2013 and 2014.

The looming question, then, is whether or not the fall-off in investment activity is attributable to a widely felt re-thinking of the investment theses that initially attracted PE to the sector. While it would be easy to jump to the conclusion that the more-than-anticipated reductions in reimbursement via competitive bidding took the wind out of the sales, it would probably be wrong or, at best, not entirely right.

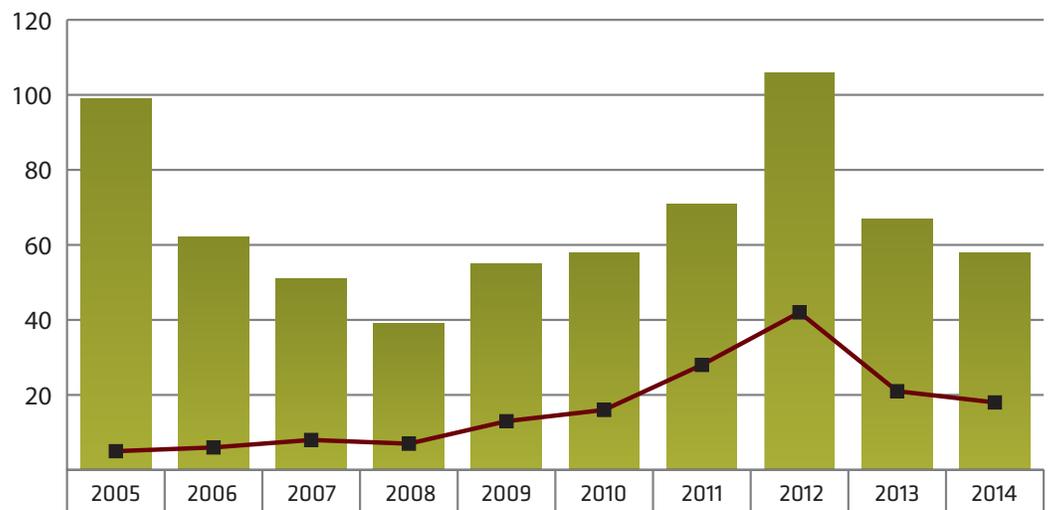
Notably, while total PE investment in HME was down in 2014, **5 of the 18 deals were new platform investments**, signaling continued go-forward optimism in the space. Moreover, with so much money (and reputation) on the line, private equity is loath to prematurely reverse course and realize poor returns, or even losses, while they still have time in their 3-7 year investment horizons to get it right. So even if the Jedi Masters of Wall Street sensed a disturbance in the force, we wouldn't anticipate such an abrupt contraction.

Accordingly, we suspect that the fall-off is largely a function of two basic themes:

(1) As mentioned earlier, with some exceptions, the wave of PE activity that began in 2009 was largely centered around non-respiratory niches – among them complex rehab, supplies, and sleep products and services. As niche providers, there are naturally far fewer players covering these segments than there are in traditional HME/RT. So, much as we have seen in other sectors following a sudden and rapid burst of M&A activity, the pool of the most attractive – and interested – sellers can diminish quite quickly, creating a simple shortage of supply.

Home Medical Equipment Deal Trends

■ Total HME Transactions
■ Private Equity Investments



Source: The Braff Group



(2) Additionally, in our detailed analysis of company specific buying patterns during the peak years between 2011 and 2013, we noted that some of these buyers were extremely busy during this brief span. For example, during this time frame, in the rehab niche alone, ATG and United Seating and Mobility closed at least 15 and 13 transactions respectively – and then they themselves merged in 2013. Similarly, though not quite as dramatically, we saw echoes of the same with other buyers targeting sleep, supplies, and to a lesser extent, traditional HME.

With the frequently immense challenges involved in integrating billing systems, customer service operations, warehousing and delivery, purchasing, and clinical protocols (not to mention all the humans with their very real emotions, corporate cultures, and company traditions), it's quite common (and often wise) for buyers to take a breather after buying sprees.

So here's how we see the M&A dynamics shaping up as we make our way through 2015:

- Private Equity isn't going anywhere soon: They are **in place** and **in need** of follow-on deals.
- A depleted acquisition pipeline will refill with sellers ready to exit, and...
- Buyers will adjust their acquisition criteria to include more potential candidates.
- The most active consolidators will emerge from self-imposed hibernation to forage anew for deals.
- Committed "last-man-standers" will continue to **stand by** to **make a buy**.

All things considered then, you don't have to be a cock-eyed optimist to believe that the HME M&A market has life in it yet.

(Though it couldn't hurt.)

THE BRAFF GROUP DIFFERENCE

Since the firm's inception in 1998, we have closed more than 250 transactions, more than any other mergers and acquisitions advisory firm covering like sectors.

According to Thomson Reuters, The Braff Group ranked # 1 in health care mergers and acquisitions advisory services in 2009, 2011, 2012, and 2013. Four Time Winner Health Care Deal of the Year.

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