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BRAFF

HOME MEDICAL EQUIPMENT

OVERALL YTD HEALTH CARE SERVICE M&A SURGES 34% AS HME KICKS IN 18%

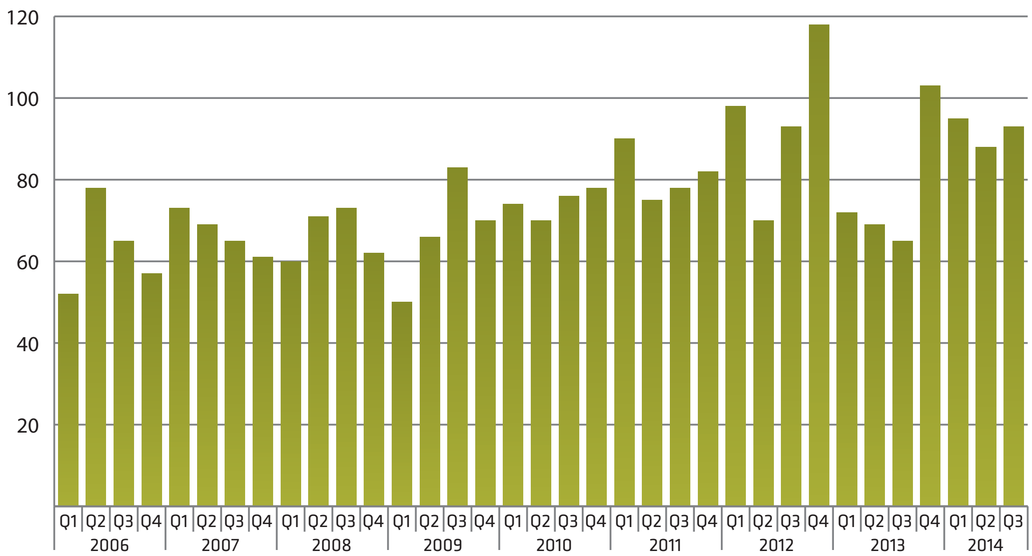
After an unexpectedly sluggish first quarter for health care service deals in aggregate – results that were consistent with other investment data points reported by other outlets – we went on record suggesting that with *"far more evidence to predict an upswing than there is to explain a downturn… we anticipate another strong year of volume and valuation."*

As it turns out, we're pretty good at reading the tea leaves.

Based upon proprietary data collected and analyzed by The Braff Group and illustrated below, despite the slow start, **aggregate deal volume through the third quarter year-to-date is up a stunning 34% in 2014 vs. the same period last year.** Notably, Q3 2014 results alone were more than 40% ahead of the same period last year.

Furthermore, the past four quarters have produced the most transactions – 379 – that we have ever seen during any previous four quarter period — far more than the then record tallies posted in 2010 and 2011 as recession weary investors turned to recession resistant health care, and just eclipsing the four quarter period in 2012 that culminated with the all-time record tally for a single quarter as sellers rushed to beat expected increases in capital gains taxes.

All Health Care Services Deal Trends



As is evident in the figures below, every sector has contributed to the M&A blowout, with home medical equipment generating 18% growth thus far in 2014 on the strength of what is now four consecutive quarters of plus/minus 15 deals.

Good as it is, the 18% pop pales when compared to health care staffing which has rocketed 288% due to (a) a declining unemployment rate and (b) speculation that a shortage of doctors and nurses will be even shorter given reform initiatives.

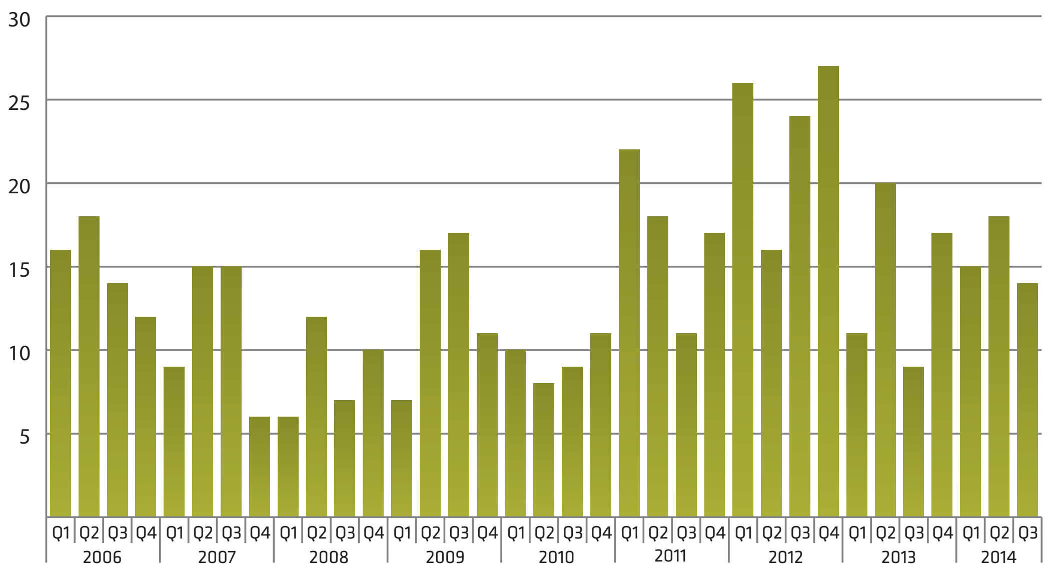
Deals of Note. The HME sector has also produced several high profile, sizeable transactions over the past few months.

First was the announcement of the merger of **MergeWorthRx** [MWRX], a special purposes acquisition company (SPAC, which essentially acts as a publicly traded private equity group), with **AeroCare Holdings**, a $150M provider of home respiratory services, a transaction which "will provide the post-merger company with additional capital as well as public company currency to enhance and expand its organic growth initiatives and for future strategic transactions." Not only does this deal provide some liquidity to its initial financial sponsor, Ferrer Freeman, but it resets the growth goals, resources, and investment horizon for AeroCare, keeping it very much in the M&A game for the foreseeable future.

Third Quarter 2014 M&A Activity

Third Quarter 2014 M&A Activity	2014 Q2	2014 Q3	Change	2013 Q2	2014 Q3	Change	2013 YTD	2014 YTD	Change
Home Health Care	25	22	-12%	27	22	-19%	67	74	10%
Hospice	9	5	-44%	7	5	-29%	22	24	9%
Staffing	10	12	20%	5	12	140%	8	31	288%
Home Medical Equipment	18	14	-22%	9	14	56%	40	47	18%
Pharmacy Services	4	14	250%	6	14	133%	17	29	71%
Behavior Health & Social Services	22	26	18%	11	26	136%	52	71	37%
Total	**88**	**93**	**6%**	**65**	**93**	**43%**	**206**	**276**	**34%**

Home Medical Equipment Transaction Trends



Second was the announcement that a bankruptcy court has approved the sale of Liberty Medical to an investment group led by Palm Beach Capital.

For context, consider that a little more than a year ago, after Landauer-Metropolitan, Inc. received an initial "stalking horse" bid from Quadrant Management to purchase the company out of bankruptcy, LMI received no other competing qualified offers by the auction deadline.

Flash forward to November this year when it was reported that **Palm Beach Capital had to out-bid 32 other prospective buyers to acquire Liberty out of bankruptcy with an offer that was $22 million more than the stalking horse price.**

Now we fully acknowledge that the financial condition and go-forward prospects for each company may have been vastly different. Nevertheless, at the very least, the Liberty Medical deal demonstrates that despite the challenges facing the supply industry, there are quite a few buyers out there that believe that (a) the sector has likely bottomed out, and (b) the best run – and best capitalized – players will be able to out-maneuver its competitors to capitalize on the imminent demographic wave of increased demand.

Why the Across the Board Run Up?

As we foreshadowed several months ago in our *viewPOINTS* commentary, *"Are We In the Midst of an M&A Bubble?"*, numerous factors such as a record-breaking stock market, more than 2 trillion in idle private equity and corporate cash, a relatively predictable reimbursement climate, a confidence building improving economy, and expectations of increased utilization driven by healthcare reform have converged to produce a climate ripe for extremely robust deal flow – and valuation.

Any one of these developments could create a spike in activity, but put them all together…you have a year of Black Fridays.

Factors Driving M&A Volume And Valuation

Outlook: What Will Bring It All Down?

Bubbles are fragile by nature. They rise fast – and often unexpectedly. And they deflate much the same way. Fast – and unexpectedly.

While we don't know the timing, we can guess the pressure points.

- A derailment of the stock market, possibly by external events – the middle-east, the Ukraine, domestic unrest, etc.
- A sudden and sustained reversal of the economic recovery, perhaps due to what many suggest is an inevitable rise in inflation and/or interest rates.
- A significant change in reimbursement policy. For prospective HME buyers, this probably ranks pretty low on their list of concerns. After all, how much lower can pricing really get? Moreover, as suggested above, for many, the investment thesis is built, in part, on expectations that razor thin margins will drive others out of the market leaving long-held market share up-for-grabs.
- Failure to deliver on the promise of healthcare reform. Right now, investors are giddy with the expectation of more covered beneficiaries and the increases in utilization (i.e. revenues) that come with it. But if the promise doesn't live up to the hype (as is quite possible given the number and interplay of all the moving parts that drive health care spending), a market that's fickle can quickly become a trickle.

But the Grinch won't steal Christmas this year.

We expect 2014 to close out in record-breaking fashion.

THE BRAFF GROUP DIFFERENCE

Since the firm's inception in 1998, we have closed more than 245 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 and for the six year period from 2008 through 2013. Four Time Winner Health Care Deal of the Year.

Call us to see how we can put our experience to work for you.

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