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BRAFF

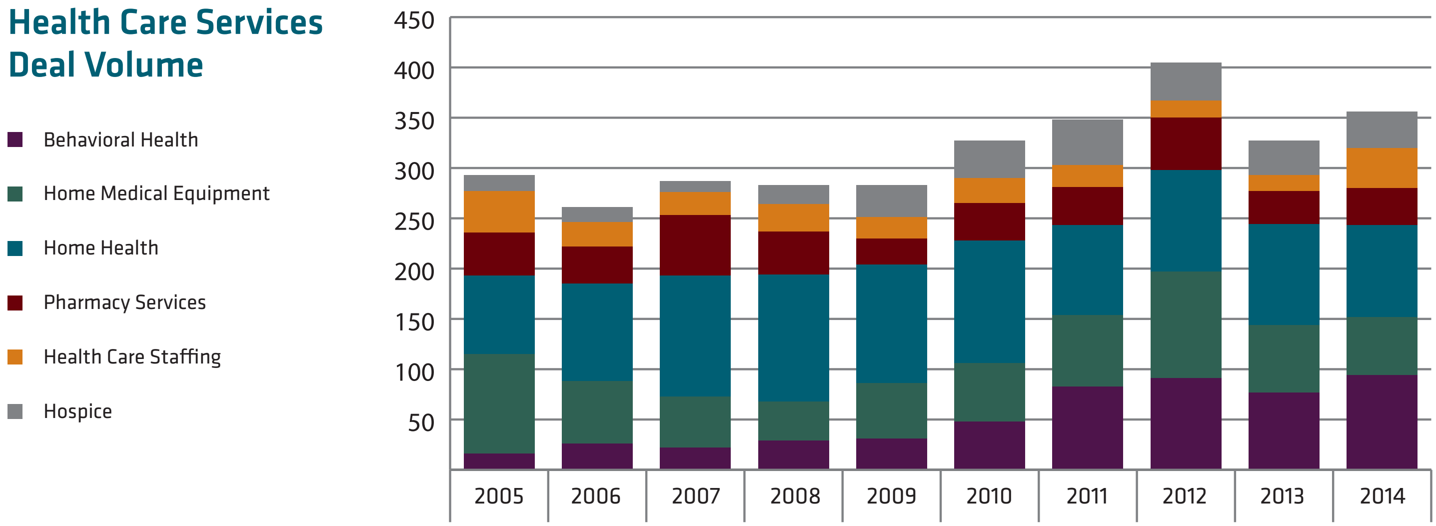
HOME HEALTH & HOSPICE

2014 M&A ROUNDUP:
AMIDST A 9% GAIN IN OVERALL HEALTH CARE SERVICE DEAL VOLUME, HOSPICE HOLDS SERVE AND HOME HEALTH SLIDES – UNEXPECTEDLY

With every sector except home health and home medical equipment recording year-over-year gains, aggregate health care service deal volume was 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 big winners were behavioral health, which continues to show no signs of slowing down as it posted a new record of 94 deals, and health care staffing, which posted its highest figures, by far, since 2005.

Health Care Services Deal Volume



Source: The Braff Group

Fourth Quarter 2014 M&A Activity

Fourth Quarter 2014 M&A Activity	2014 Q3	2014 Q4	Change	2013 Q4	2014 Q4	Change	2013 YTD	2014 YTD	Change
Home Health Care	24	15	-37.5%	30	15	-50%	100	91	-9.0%
Hospice	5	12	140%	10	12	20%	34	36	5.9%
Staffing	12	7	-41.7%	7	7	0.0%	16	40	150%
Home Medical Equipment	14	11	-21.4%	17	11	-35.3%	67	58	-13.4%
Pharmacy Services	14	6	-57.1%	14	6	-57.1%	33	37	12.1%
Behavioral Health	28	20	-28.6%	25	20	-20.0%	77	94	22.1%
Total	**97**	**71**	**-26.8%**	**103**	**71**	**-31.1%**	**327**	**356**	**8.9%**

Home Health – Medicare, Medicaid, Private Duty

In many respects, it was a blockbuster year in home health deal making. In 2014, we saw some of the largest, high profile, cross-sector transactions in a decade – deals that signal the depth and breadth of confidence in home care, and its role in an increasingly coordinated health care delivery system.

But the yin to this yang was an unexpected decline in deal volume over the course of the year – a trend that merits further explanation.

Let's peel back the data.

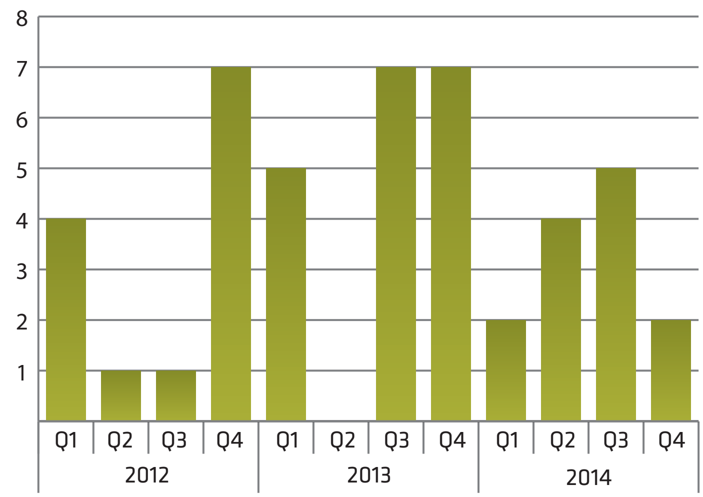
First, we note an unexpected, near across-the-board plunge in transaction volume in the fourth quarter – a 38% plunge vs. Q3, and an even greater decline of 50% vs. the same period last year. Notably, only hospice bucked this trend with a big quarter-over-quarter gain of 140%, and a rise of 20% vs. the same period last year.

We should point out that it is The Braff Group's practice to continue to research, collect, and update deal activity long after a particular reporting period. So as additional information trickles in, the initial figures will often rise. Accordingly, if past is prologue, the gap is likely to close somewhat, but almost assuredly not enough to reverse an apparent fall-off.

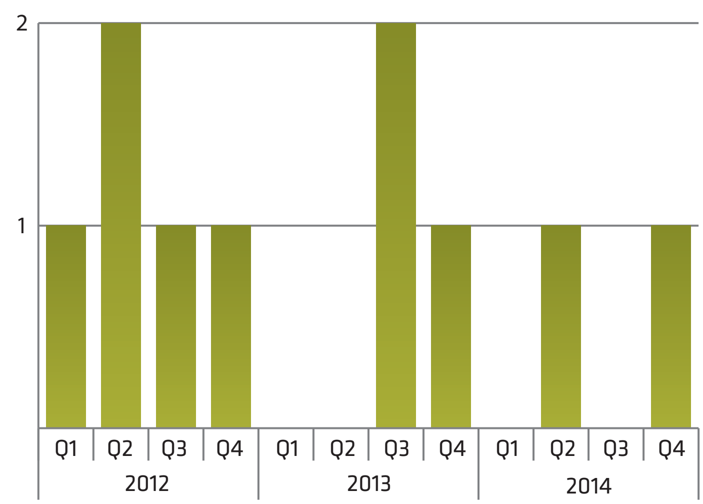
The data is more revealing when we drill down into the home health numbers.

First, the private duty segment, which showed some life toward the end of 2013, appears to have lost some steam. What's more, despite the surge in the stock of Medicaid-focused Addus Healthcare and continued proclamations that under health care reform, Medicaid is the new black, Medicaid home health has failed, to date, to gain any real traction in the M&A market. So all the real action has been in Medicare certified home health, which accounts for much of the recent trends.

Private Duty Deal Trends



Medicaid Deal Trends



Source: The Braff Group

And as the figure here clearly shows, after a pronounced run-up to Q1 2014, we have seen a steady decline in certified transactions. At the same time, as alluded to above, 2014 will be remembered for its mega deals in home health and hospice (more on hospice below): **Kindred's acquisition of Gentiva** and **HealthSouth's acquisition of Encompass;** not to mention numerous other large regional deals including (Buyer – Seller) **General Atlantic (Private Equity) – Great Lakes Caring; Graham Holdings - Residential Home Health and Hospice** (Braff Group deal); **LHC Group – Deaconess, and Celtic Home Care – VNA TIP** (Braff Group deal).

So how do we square up the obvious enthusiasm for Medicare home health, as demonstrated by the big bets buyers are making in the sector, and what appears to be a steady fall-off in deal volume?

Nothing has happened legislatively to dampen interest in the space. On the contrary, with rebasing in place through 2017 and no real congressional appetite at this point to double down on cuts, the space is arguably in its most stable period in years.

Broad economic conditions remain strong, feeding the mojo that has spiked M&A activity across all industries. Debt capital remains plentiful, and private equity is once again eyeing a space that generated such favorable returns when the sector moved from cost-based reimbursement to post-PPS profitability.

As evidenced by the continued calls we field from buyers, there has been **no fall-off in acquisition interest.** Moreover, with companies like Kindred, HealthSouth, and Envision pursuing acquisition strategies that emphasize multi-service coordinated care rather than narrow specialization (which was the strategy du jour in the early 2000s), **the pool of potential buyers has never been greater.**

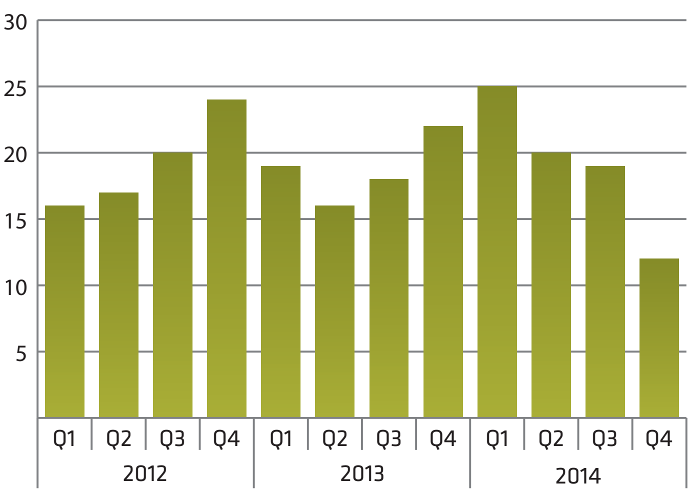
With so many indicators suggesting otherwise, our sense is that the decline is likely due to the relatively sudden acceleration of acquisition interest; interest that has been initially focused on extremely limited, large, market-entry deals. Buyers must now ramp up their deal sourcing efforts to find attractive acquisition candidates that are somewhat more downstream. Moreover, some of these transactions have almost assuredly disrupted the deal pipeline of buyers that have been acquired themselves. While most will likely return to their acquisitive ways, it takes time to re-prime the pipeline to generate closed deals at a steady clip.

Additionally, based on our proprietary research, in a sector that has produced more than a thousand deals over the past decade (1,042 by our count), the supply of acquisition candidates ebbs and flows over time, particularly following periods of accelerated activity. No surprise then that deal volume slowed following surges that topped out in the fourth quarter of 2012 and the first quarter of 2014.

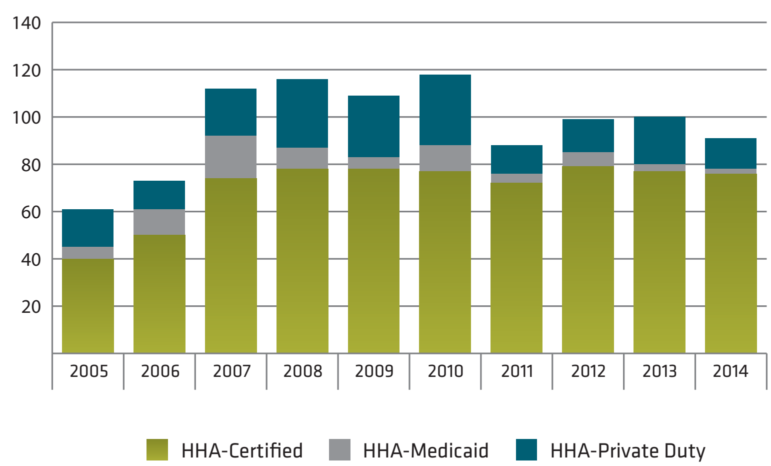
Finally, if we step back and look at the yearly data, a somewhat different picture emerges. While aggregate home health deal volume may have fallen slightly in 2014, the Medicare certified segment produced its seventh straight year of volume ranging between 74 and 79 deals, a remarkable record of consistency spanning a time frame that saw an economy in collapse, the first real cuts in reimbursement, intense regulatory scrutiny, face-to-face rate rebasing, and continued pokes and prods from the press.

So recent trends notwithstanding, we remain extremely bullish on home health M&A and expect a robust 2015.

Medicare Certified Home Health Deal Trends



Consolidated Home Health Deal Trends



Source: The Braff Group

Hospice

By comparison, hospice M&A activity in 2014 has played out more predictably.

Buyers continue to target the sector from multiple directions: (1) Hospices acquiring other hospices to expand market coverage, gain share, and leverage infrastructures; (2) home health agencies seeking new growth engines and diversification; (3) skilled nursing providers pursuing post-acute, multi-service, coordinated care initiatives; and (4) private equity executing traditional consolidation strategies. Just as in home health, some of the largest hospice deals in recent memory were completed in 2014, notably **Formation Capital's acquisition of Hospice Compassus, Thomas H. Lee's acquisition of Curo Health Services and Curo's earlier acquisition of SouthernCare.** All acquisitions of private equity sponsored consolidators. All conveying continued confidence in the sector.

And with payment reform initiatives seemingly more stale than Civil War hard tack, the climate remained ripe for sustained acquisition activity.

And the numbers bear this out:

Despite a sluggish 3rd quarter, M&A activity has been quite consistent four out of the past five quarters." Moreover, the 12 deals completed in Q4 was one transaction shy of the record 13 deals tallied in the fourth quarter of 2011.

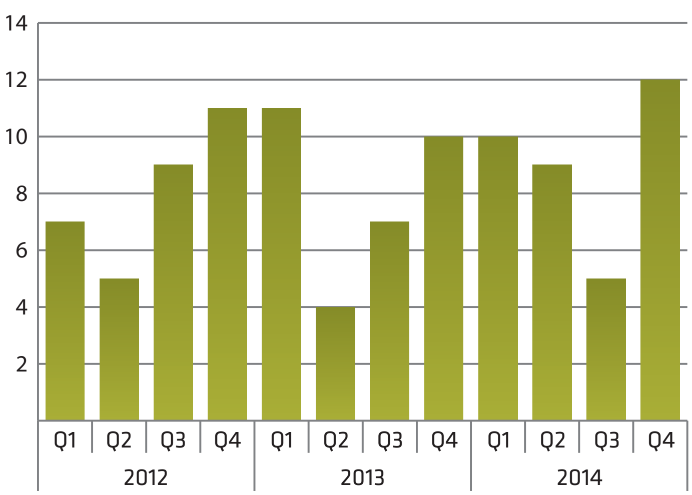
If we look at the annual data, a similar pattern emerges – steady (and elevated) activity since 2009.

And even though the requirement to estimate – and hence accelerate – repayments for exceeding cap limits may upend some unprepared providers, the industry has embraced reductions in lengths of stay for many years now, widely reducing exposure to this potential cash flow challenge.

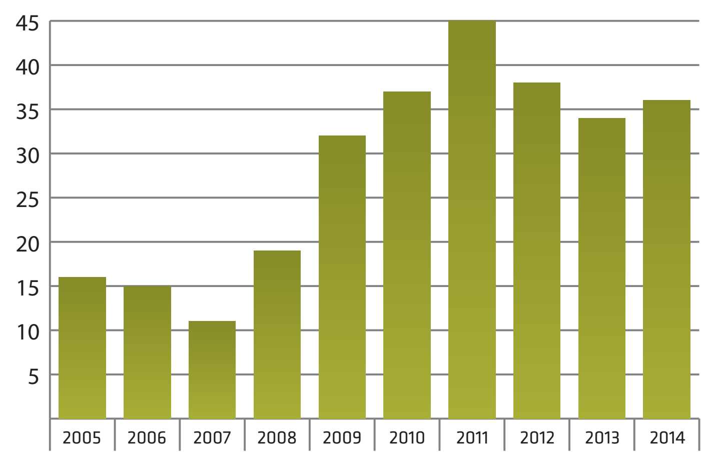
So in many respects: No drama. No disruption. Boringly predictable.

The trifecta for another vibrant year in hospice M&A.

Hospice Deal Trends - Quarterly



Hospice Deal Trends - Yearly



Source: The Braff Group

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

Reg Blackburn
Atlanta
866-455-9198

Ted Jordan
Atlanta
888-290-7080

Mark A. Kulik
Atlanta
888-922-1838

Nancy Weisling
Chicago
888-290-7237

Pat Clifford
Chicago
888-922-1834

Bob Leonard
Ft. Lauderdale
888-922-1836

Steven Braff
Palm Springs
888-922-1833