

Thinking about accreditation



DealerProvider



HOME | NEWS | CURRENT ISSUE | BUYER'S GUIDE | ARCHIVES | RESOURCES

September, 2006



FOOD CHAIN CHECKUP



Will M&A activity heat up in 2007 or cool down? Is it a buyer's market or a seller's market?

Greg Thompson, editor, *Dealer/Provider*: Over the last 12 months, have you seen any shifts or trends in merger-and-acquisition (M&A) strategies?

Dexter W. Braff, president, The Braff Group, Pittsburgh: Yes.

With so much reimbursement pressure on traditional Medicare-reimbursed oxygen, the profile of the "ideal" acquisition candidate is evolving. While we still see buyers predominately interested in firms with a strong respiratory core, they are increasingly targeting companies that offer a wider breadth of respiratory services beyond oxygen including CPAP and bilevel, and those that serve a greater breadth of payors beyond Medicare, including managed care. Moreover, we are seeing select acquisition interest in firms that offer nonrespiratory products and services, including diabetic supplies, infusion therapy, and other supplies to chronic populations.

Bruce Burns, president, Affinity Ventures Inc, Albuquerque, NM: Due to the current and prospective changes in Medicare reimbursement and policy, buyers have been focusing on diversification in several product areas. Currently, the majority of buyers have chosen to stand on the sidelines regarding oxygen/respiratory companies until the capped oxygen dilemma receives clarification. Areas that previously were of no interest, and in some cases spurned, are now on the radar screen and are being pursued by certain buyers. Some areas of interest are sleep products, home infusion, power mobility, long-term care respiratory, and, in some cases, retail.

Richard Glass, president, Steven Richards & Associates Inc, Tarpon Springs, Fla: Clearly, the most significant shift has been a slowdown in acquisition activity along with a change in the nature of the active buyers. In reviewing the acquisition activity at SRA over this period, these trends are quite obvious. During the first 8 months of 2005, we completed the sale of 12 HME companies to six different buyers, three of which were nationals. Through August of this year, we have closed seven HME transactions, with four different buyers, none of which were nationals.

The four buyers this year consisted of three regional strategic buyers and one private equity group. The entrance of private equity players is an interesting new development. In addition to closing one such transaction this year, we are continuing to work with several other private equity players to find the right opportunities to meet their requirements. While we continue to find some outstanding opportunities for sellers, we do not look for a more robust market until sometime in 2007, when the numerous uncertainties in the regulatory/reimbursement environment should start to stabilize and provide more clarity of future reimbursements for buyers.

Dealer/Provider: Are buyers showing interest in companies that have significant non-Medicare revenue sources?

Braff: Yes. While buyers traditionally used to steer clear from companies that derive substantial revenues from managed care, they are now far more open to this payor source. This is due not only to the fact that Medicare is increasingly risky, but that in many cases, after learning the lessons in the past that the lowest cost provider may not always be the best choice, managed care firms are increasingly offering reasonable reimbursement to quality providers that keep their beneficiaries happy, and out of the hospital.

Burns: Yes. Many of the product areas discussed above are non-Medicare reimbursed items or a low Medicare percentage. Companies are also more flexible in looking at companies with larger segments of managed care and insurance reimbursement. With more and more Medicare recipients choosing the Medicare managed care plans, it is necessary to diversify into other payor sources.

Glass: With CMS' continuing reductions in reimbursement rates, non-Medicare payors' reimbursement rates have become more competitive. This, coupled with easier compliance and billing requirements (compared to Medicare), has made companies with these revenue sources more desirable to buyers over the last 18 months.

Dealer/Provider: What are the hottest areas of growth that are attracting interest from buyers?

Braff: For the most part, buyers are being extremely cautious and highly selective in their acquisition strategies. As such, beyond the characteristics of the "ideal" acquisition candidate described above, these strategies have more to do with a buyer's particular need, most notably filling out geographic service gaps.

Burns: The one single area in the HME portion of home care that continues to increase in popularity is the sleep segment. The other segment with renewed interest is home infusion.

Glass: Like always, buyers are most interested in companies that are showing solid profitability and a demonstrated ability to adjust to changing environments, while continuing to grow both revenues and profits.



Dexter W. Braff



Richard Glass



Bruce Burns

Dealer/Provider: What impact will current legislative initiatives have on M&A interest and activity in 2007?

Braff: Recent legislation has had a dramatic impact on M&A activity thus far in 2006. Based on Braff Group research, through the end of the second quarter of 2006 there were 30 transactions announced and/or completed compared to 48 over the same period in 2005, a 37.5% decline. Moreover, we have seen a steady decline in the number of transactions completed by the traditional "nationals." We would anticipate a continued slowdown in acquisition activity through 2007 unless or until the 36-month oxygen cap provision from the Deficit Reduction Act is repealed. More than anything else, it is this legislation that has chilled the M&A market. While the 36-month provision is cause for concern by itself, the greater concern is that it will be ratcheted down even further over time, as the President's 2007 budget calls for. As such, the risk of "overhang" is substantial, keeping buyers close to the sidelines.

Burns: The current Medicare initiatives, if carried out, will cause the most dramatic M&A changes the industry has ever seen. The 13-month oxygen cap would essentially eliminate any future acquisition activity. If the 36-month cap is implemented, the valuation methodology will change. With the 36-month cap scenario, the buyers would then have a basis and financial foundation to move forward with their previous acquisition strategy, with obvious changes in valuations.

Print

The national competitive bidding program is currently influencing many providers into divesting their businesses. The many obstacles to participate in the program, with the obvious outcome being reductions in reimbursement, have helped them realize the value of their business has maximized and the future has many negatives. There is a reason why the past two chairmen of the American Association for Homecare have divested their businesses.

Glass: A long-held truism of M&A is that you can have good news or bad news, but the worst condition for M&A activity is uncertainty. We need stability out of CMS and the legislature. All the uncertainties have created an environment that makes it difficult for both providers and buyers to make good business decisions. Some of the pending legislation clearly would be positive for sellers. For example, proposed legislation to roll back the oxygen cap appears to have a good chance of success as manufacturers, providers, and patients have continued to pursue a grassroots lobbying campaign with an enthusiasm and determination that we have not seen in a long time.

Dealer/Provider: Is it a buyer's market or a seller's market?

Braff: With acquisition demand substantially down, conditions suggest that we are currently in a buyer's market. That said, for the most part, we have not seen buyers aggressively try to take advantage of this market shift.

Burns: The market has changed dramatically since the beginning of 2006. Acquisition activity in HME Medicare respiratory has decreased to a few small deals based on coverage needs. This has presented opportunities in other areas. We have several buyers searching for niche opportunities in peripheral home care services.

We expect acquisition activity to pick up in the fourth quarter of 2006 and accelerate in 2007. We continue to counsel and prepare our HME/respiratory clients for the next divestiture opportunity. With the acquisition landscape changing and supply and competition continuing to increase, it is important to be prepared for possibly the last divestiture opportunity some providers may experience.

Glass: In terms of supply and demand, clearly there has been a shift in favor of the buyers over the last 12 months. At SRA, we continue to see increased levels of seller interest coupled with lessened demand, certainly from some of the largest buyers. On the other hand, we see no sign of sellers being scared into fire sales or a hasty exit from the industry, and anticipate significant demand as we begin to get some clarity on future reimbursement rates.

Greg Thompson is editor of Dealer/Provider.



[News](#) | [Current Issue](#) | [Buyer's Guide](#) | [Archives](#) | [Resources](#) | [Reprints](#)

[About HHC](#) | [Contact Us](#) | [Subscribe](#) | [Media Kit](#) | [Editorial Advisory Board](#) | [Advertiser Index](#)

[24X7](#) | [Chiropractic Products](#) | [Clinical Lab Products \(CLP\)](#) | [Orthodontic Products](#) | [The Hearing Review](#) | [Hearing Products Report \(HPR\)](#)

[Home Health Care Dealer/Provider](#) | [Orthopedic Technology Review](#) | [Rehab Management](#) | [Physical Therapy Products](#) | [Plastic Surgery Products](#)

[Imaging Economics](#) | [Medical Imaging](#) | [RT, The Journal for Respiratory Care Practitioners](#) | [Sleep Review](#)