November 1, 2012

Home Health Market Update

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Despite current reimbursement challenges, we believe that home health is a crucial part of the healthcare system as a lower cost provider of post-acute care.

**Home Health Industry Tailwinds**
- Aging population
- Need to reduce expensive institutional episodes of care
- Shift towards bundled services
- New penalties for hospital readmissions for three conditions that go into effect in October 2012
  - Acute Myocardial Infarction (AMI)
  - Congestive Heart Failure (CHF)
  - Pneumonia (PN)

**Fragmented Market**
- As of 2010, 11,500 agencies
- Four largest, publically traded home health providers account for 10-13% of agencies
- Provides acquisition rich market for growth

**Challenges**
- **Face-to-Face Encounter**
  - Increased administrative burden on physicians has had an adverse impact on some patient referrals
  - Impact should subside over time
- **Therapy Assessment**
  - Increased burden on providers putting pressure on margins
- **Regulatory Scrutiny**
  - Drastically increased focus on fraud and abuse prevention
  - In March 2012, Gentiva paid a $25 million settlement for Medicare fraud related to Odyssey
  - LHC entered into a $65 million settlement and a five year auditing and monitoring agreement with the Office of the Inspector General

Home health will be a part of the solution in the new cost containment paradigm of healthcare.
Reimbursement Landscape & Outlook

Home health is expected to continue to operate in a challenging reimbursement environment, which will drive M&A activity.

- On November 2, 2012, CMS issued the CY 2013 final rule for home health.
  - Negative 0.01% net update (2.3% market basket update, negative 1.0% adjustment required by Affordable Care Act, and negative 1.32% case mix creep adjustment)

- Even with recent negative payment changes, home health remains vulnerable to additional payment system reductions and reforms.
  - Policymakers continue to perceive the system as encouraging overutilization and overpayment
  - Accelerating the rebasing of home health payment system and imposing home health co-payments continue to be discussed
    - Rebasing expected to be 1.5% to 3.5% annually for 4 years starting in 2014

- Budget Control Act triggered sequestration scheduled for January 2013, which would reduce Medicare payments by 2% in 2013.
  - We believe Congress will modify sequestration prior to full implementation, perhaps in a late-2012 lame-duck session of Congress

- Given the current deficit situation, we expect deficit reduction efforts in Congress that will likely involve Medicare cuts to providers.

- Over the next four to six years, the home health reimbursement methodology could shift towards a single post-acute prospective payment system that would cover payment of:
  - Home health;
  - Skilled nursing facilities;
  - Long-term care hospitals; and
  - Inpatient rehabilitation facilities

- Potential for pay-for-performance payments to the home health sector, but not likely to happen in the next five years.
M&A and Home Health Market Overview

The overall middle market M&A environment is strong, and the home health sector has recently seen several transactions at attractive valuations.
- Two recent acquisitions by skilled nursing providers indicate the shift to integrated care delivery strategies.

### General M&A Environment

- **Lots of liquidity in the market**
  - $1.74 trillion cash balance on corporate balance sheets
  - $359 billion in private equity “dry powder”
  - Routinely seeing total leverage of >5.0x for quality businesses

- **Strong deal flow**
  - 2012 YTD healthcare deal volume in line with 2007/2008

- **Both strategic and financial buyers are willing to pay high multiples for premium assets**

### Home Health Sector

- **Home health remains fundamentally attractive**
  - Favorable demographic trends
  - Low-cost provider
  - Seen as part of “the solution” to rising healthcare costs

- **Public valuations are below historical levels**
  - Public comparables currently trading at 4.4x EV/EBITDA
  - Home health EV/EBITDA multiples down more than 65% since January 2007 versus an approximately 15% drop for the S&P 500

- **Four transactions in the past two months show that M&A activity is beginning to pick up**
  - Nurse On Call acquired by Emeritus
  - IntegraCare acquired by Kindred Healthcare
  - Interim HealthCare acquired by The Halifax Group
  - Celtic acquired by The Washington Post Company

- **Two recent acquisitions by skilled nursing providers indicate the shift to integrated care delivery strategies.**
Home health public companies have underperformed the S&P 500 since the beginning of 2007 but are up 37.7% YTD in 2012.

- Market is currently pricing home health companies at 4.4x LTM EBITDA.
After little M&A activity in 2009 and suppressed valuations in 2010-2011, home health valuations have established a new range in Q3 2012 with several deals trading between 7.0x and 8.0x EBITDA.

### M&A Activity 2007 – 2012YTD

<table>
<thead>
<tr>
<th>Date</th>
<th>Target</th>
<th>Acquiror</th>
<th>Estimated Purchase Price ($ mms)</th>
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<tbody>
<tr>
<td>Nov 12</td>
<td>Nurse On Call, Inc.</td>
<td>Emeritus Corp.</td>
<td>$113</td>
</tr>
<tr>
<td>Nov 12</td>
<td>Interim Healthcare</td>
<td>The Halifax Group</td>
<td>--</td>
</tr>
<tr>
<td>Oct 12</td>
<td>Celtic Healthcare</td>
<td>The Washington Post Company</td>
<td>$40</td>
</tr>
<tr>
<td>Oct 12</td>
<td>IntegraCare</td>
<td>Kendred Healthcare</td>
<td>$75</td>
</tr>
<tr>
<td>Jan 11</td>
<td>Jordan</td>
<td>Palladium</td>
<td>$107</td>
</tr>
<tr>
<td>Dec 10</td>
<td>Guardian (TN)</td>
<td>AccentCare</td>
<td>$215</td>
</tr>
<tr>
<td>Nov 10</td>
<td>AccentCare</td>
<td>Oak Hill</td>
<td>$101</td>
</tr>
<tr>
<td>Jun 10</td>
<td>Gem City Home Care</td>
<td>Guardian (TX)</td>
<td>$75</td>
</tr>
<tr>
<td>Jun 08</td>
<td>Patient Care Inc.</td>
<td>Almost Family, Inc.</td>
<td>$47</td>
</tr>
<tr>
<td>May 08</td>
<td>Omni Home Care</td>
<td>MBF Healthcare Partners</td>
<td>$63</td>
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<tr>
<td>Feb 08</td>
<td>Home Health Care</td>
<td>Gentiva Health Services</td>
<td>$55</td>
</tr>
<tr>
<td>Feb 08</td>
<td>TLC Health Care</td>
<td>Amedisys, Inc.</td>
<td>$395</td>
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<tr>
<td>Nov 07</td>
<td>National Home Health</td>
<td>Angelo Gordon &amp; Co.</td>
<td>$73</td>
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<tr>
<td>Sep 07</td>
<td>Encompass</td>
<td>Thoma Cressey Bravo</td>
<td>$284</td>
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<tr>
<td>Jul 07</td>
<td>IntegriCare</td>
<td>Amedisys, Inc.</td>
<td>$68</td>
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Source: Capital IQ & Thomson.

### Home Health M&A EV/EBITDA

- **Drivers of M&A Activity**
  - Diversification to create value:
    - Business lines
    - Hospice
    - LTAC
    - SNF
    - Payor mix
    - Geography

There are recent precedent valuations of 7.0x to 8.0x EBITDA.
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For further questions about HW&Co. or the home health sector, please call your senior coverage officer.

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