

INTRODUCTION

Despite terrorism concerns and the current geo-political landscape, the outlook for the home health care industry appears extremely bright. With interest rates near historical lows, employment data improving and an economy that is in full recovery mode, the current economic environment is very growth-friendly for business in general. With favorable demographic trends, cost-containment pressures, a relatively benign short-term outlook on the Medicare reimbursement picture and improving patient preference all occurring simultaneously, the home health care industry is truly poised for a hearty, sustained growth phase.

CURRENT STATE OF THE INDUSTRY

Many of the home health care companies Victory Partners maintains relationships with are currently experiencing an upward revenue trend thus far in 2004 when compared to the first half of 2003. Estimates for annual revenue growth for 2004 are ranging from 0 – 20% more than 2003. This growth is being driven by a number of factors. Over the next 30 years, the number of seniors in America is expected to double, thus increasing the percentage of the overall population over the age of 65 from 13% today to 20% in 2030. As a result, the working population is

burdened with soaring healthcare costs. This drives the need to shift care from facilities into the home, where the cost is significantly lower. The average home nursing visit costs \$100, versus an average cost of \$2,400 for a day spent in the hospital. In addition, an inflation adjustment to Medicare reimbursement for home nursing services bumped rates up 3.3% in October 2003 and rates for rural patients went up an additional 5% in April 2004. Victory Partners estimates that these rate revisions will equate to a year-over-year increase in average revenue per episode of about 3.6% across the board from 2Q2004 through the end of the year. With the rural rate increase expiring after 12 months and the effects of the Medicare Reform Bill which was signed into law in December, we expect overall rates will be improved by at least 2% in 2005.

MIDDLE MARKET HOME HEALTH CARE VALUATIONS

Middle market valuations for home health care companies improved during the first and second quarters of 2004, reflecting the belief that revenue growth will continue and Medicare reimbursement risk is relatively benign. Victory Partners expects this trend to continue with home health care industry valuations rising through 2005.

Home Health Services – Comparable Public Company Analysis

Source: Raymond James

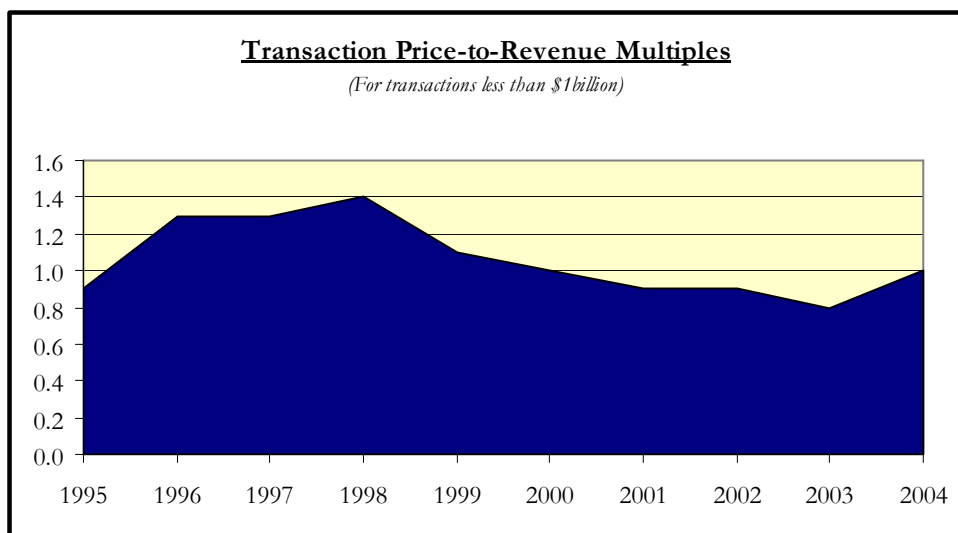
Valuation Multiples (Dollars in Millions, Except for Stock Price)	Valuation Statistics									
	Price/(b)		Price/(b)				Enterprise Value/			
			CY04	CY05	Enterprise	LTM	LTM		2004E	2005E
Stock Price (a)	Market Cap.	EPS	EPS	Value (c)	EBITDA	Revenues	EBITDA	EBITDA	EBITDA	
Apria Healthcare Group (AHG)	\$29.39	\$1,494	12.5x	15.1x	\$1,851	\$345.7	1.3x	5.4x	5.1x	6.2x
Amedisys (AMED)	26.70	325	19.9	17.2	302	11.0	2.7	27.5	9.5	7.9
Gentiva (GTVV)	16.17	413	25.7	22.8	302	31.1	0.4	9.7	8.6	7.7
Lincare Holdings (LNCR)	34.33	3,400	13.3	19.4	3,678	486.5	3.1	7.6	7.3	9.8
Pediatric Services of America (PSAI)	12.56	86	15.1	13.1	105	15.3	0.5	6.9	6.2	5.7
High		\$3,400	25.7x	22.8x	\$3,678	\$486.5	3.1x	27.5x	9.5x	9.8x
Median		413	15.1	17.2	302	31.1	1.3	7.6	7.3	7.7
Mean		1,144	17.3	17.5	1,248	177.9	1.6	11.4	7.3	7.5
Low		86	12.5	13.1	105	11.0	0.4	5.4	5.1	5.7

Note: EBITDA, Net Income to Common, and EPS adjusted for unusual and nonrecurring items
 \$ in millions, except per share amounts
 LTM: Latest Twelve Months
 NM: Not Meaningful
 (a) Stock prices reported on this table as of 5/4/04
 (b) First Call Estimates as of 5/4/04
 (c) Enterprise value equals equity value plus straight debt less cash and equivalents

INDUSTRY REGULATION AND COMPETITION

To review the Medicare situation, in 1997 the Balanced Budget Act shifted home health from a cost-based reimbursement system to the Prospective Payment System. The initial fallout left more than 3,000 agencies closed or sold, representing 30% of the initial marketplace. In 1999, the Balanced Budget Refinement Act stabilized Medicare reimbursement allowing agencies whose care was both efficient and effective to be profitable. Going forward, the industry’s trade group, the National Association for Home Care (NAHC), does not anticipate any material changes to Medicare home healthcare reimbursement rates through the federal fiscal 2005 budget cycle. A recent study by the Centers for Medicare and Medicaid Services (CMS) estimates that of the total \$45.3 billion spent on home healthcare in 2001, about \$33 billion was spent on home

nursing services. One concern that many CEOs are facing is the well-documented shortage of nurses in the United States. The aging population in America continues to put pressure on the healthcare system and nurses are in high demand. Intensifying competition among employers to retain caregivers could increase cost of salaries and benefits, thus putting pressure on margins. CMS estimates that there are over 7,000 home health agencies in the country, mostly small, regional providers – still a very fragmented market. They also expect spending on home health care services to grow 5 – 10% annually. The factors spurring growth include a stable Medicare reimbursement environment, the aging of the American population, cost advantages favoring home care, patient preference, and incentives for hospitals to release patients earlier.



RECENT TRENDS IN THE HOME HEALTH CARE M&A MARKET

Victory Partners believes that growth in the industry is inevitable and increased competition will lead to rapid consolidation over the short term with a handful of well-capitalized companies emerging as clear leaders. Certainly, given the size and degree of fragmentation in the home health care industry, there are plenty of smaller providers that can and will be purchased in the 3-5x trailing EBITDA range. Some companies that are actively making

acquisitions include AccentCare, SeniorBridge Services, Interim, Guardian Home Health, and, of course, Amedisys, Inc. In the first quarter of this year, Amedisys purchased eleven home care agencies and two hospices in Texas, Louisiana, Mississippi, Tennessee, Alabama, Georgia and Florida from Tenet Healthcare for \$19.2 million in cash, or 0.7x expected revenue. Over the past ten years, companies with enterprise value below \$50 million have typically been acquired at a mean Price-to-EBITDA multiple of 3.0x and a median of 4.5x.

<u>Average Transaction Multiples</u>			
<u>By Size (\$ in millions)</u>	<u>Earnings</u>	<u>EBITDA</u>	<u>Cash Flow</u>
Less than \$10	3.3x	3.2x	4.4x
\$10 to \$25	1.7x	3.1x	5.2x
\$25 to 100	19.3x	15.7x	12.3x
\$100 to \$250	11.0x	8.9x	8.0x

(Over past 10 years)
Source: Done Deals

Victory Partners, LLC is actively involved in analyzing and representing companies in the Home Health Care Industry, having provided financial advisory services, completed recapitalizations, and M&A transactions for middle market companies.

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