VICTORY PARTNERS
INVESTMENT BANKING ADVISORS

Hospice Care Industry Update and Outlook

Spring 2005 - Vol. II | Texas' Mid-Market Investment Bank | Research Report

INTRODUCTION

Despite increasing competition and a general lack of awareness, the outlook for the hospice industry appears very positive, in our opinion. With the hospice market currently underserved, the government continues to promote awareness and acceptance of the hospice benefit. With the expectation of continued rate increases and favorable demographic trends, we expect double-digit growth for the hospice industry over the next two years and continued pressure on acquisition prices.

INDUSTRY OVERVIEW

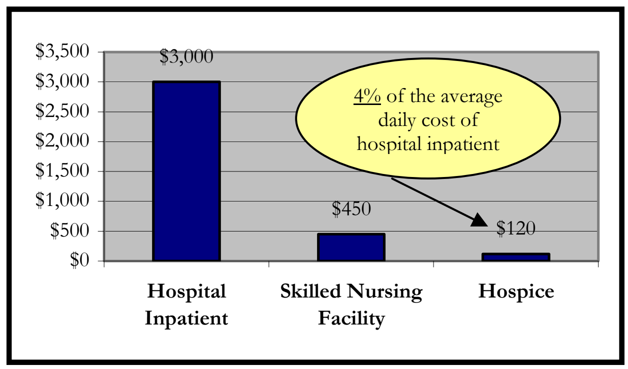
The number of hospice programs in the U.S. has increased dramatically over the last 30 years, from 1 in 1974 to 3,300 in 2003. Even with this large increase in providers, the hospice market remains underserved. In 2001, approximately 2.4 million people died in the U.S., with roughly 1.9 million people over the age of 65. According to the National Hospice and Palliative Care Organization (NHPCO), only 32% of total deaths received hospice care. As of May 2004, only 50% of all adult patients who died with a diagnosis of cancer (which accounts for roughly half of all hospice admissions) received hospice care.

According to the National Hospice Foundation (NHF), 80% of Americans wished to die at home. Of the roughly 2.4 million Americans who die each year, less than 25% actually die at home. In contrast, according to NHF, over 75% of patients who receive hospice care die at home. Additionally, NHF's research found that 66% of people would welcome assistance from an outside organization, such as hospice, while only 24% would prefer to take care of a family member themselves. We believe physician and the public's lack of knowledge of the hospice benefit have led to this disconnect.

The government has made several attempts in recent years to increase awareness and acceptance of the hospice benefit. The Medicare Payment Advisory Commission (MedPAC) has recommended in its reports to Congress over the last five years that increased focus should be placed on promoting the hospice benefit and end-of-life care. MedPAC believes that physicians have a difficult time referring patients to hospice, mainly due to a lack of education in medical school and the culture of American medicine toward curative rather than palliative care. According to several of Victory's contacts within the hospice industry, other reasons for the physician difficulty in referring patients early enough to hospice or at all include the inability to estimate true-life expectancy, inability and/or inexperience to discuss end-of-life options with the patients and the family, and loss of income.

The government's efforts in promoting hospice are twofold: 1) to ensure Medicare beneficiaries receive humane and appropriate care at the end of life and 2) to save money. Several studies have indicated that hospice care generates significant savings for the government. According to a Lewin-VHI study, for every dollar Medicare spends on hospice, it saves $1.52 in expenditures. According to CMS, the average charge per day for hospital inpatient was roughly $3,000 compared to skilled nursing facility average charge per day of $450 and hospice average charge per day of $120.

Average Charge per Day for Patient Care



Source: CMS

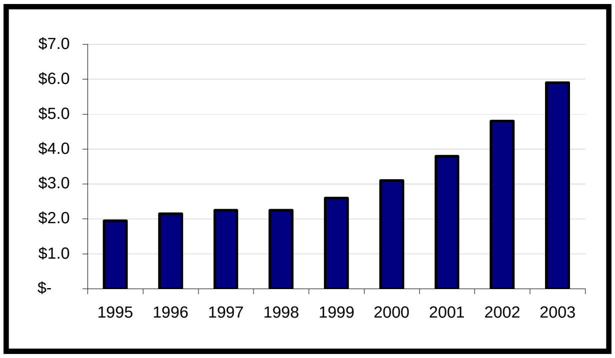
INDUSTRY REGULATION AND OUTLOOK

There appears to be a continued lack of knowledge of physicians and the general public on the benefits of hospice, and the government's relatively favorable stance toward hospice had limited impact on referral patterns over the past few years, according to industry insiders. Increased interest from the government contributed to a 30% annual growth rate in Medicare hospice spending from 2001 to 2003.

Only 21% of respondents to a recent survey stated that the government's effort in promoting hospice over the past few years has led to an increase in their hospice referral rate. We believe the main driver of growth for the industry has been an increase in admission of non-cancer patients, who typically have a longer length-of-stay.

Growth in Medicare Hospice Expenditures

(1995 – 2003 in $Billions)



Source: MedPAC and CMS Office of the Actuary

Educating the general public and medical professionals about the benefits of hospice care remains a key driver to industry growth, in our opinion. According to NHCPO, 75% of Americans are not aware hospice care can be provided in the home and 90% of Americans were not aware hospice care was covered by Medicare. Medicare is the largest payer of hospice care in the U.S., representing roughly 81% of hospice revenue. An increased interest in hospice care from the government in the late 1990s and early 2000s after a period of scrutiny in the mid-1990s has led to an increase in hospice use over the past several years. As a result of this favorable attitude toward hospice, the Centers for Medicare and Medicaid Services (CMS) generously increased rates.

Average Medicare Rate Increases, 1999-2005

1999	+1.9%	2002	+3.4%
2000	+2.9%	2003	+3.4%
2001 (mid year)	+5.0%	2004	+3.4%
2001	+3.2%	2005	+3.4%

Source: CMS

The aging of the population should be a significant growth driver for the hospice industry. According to U.S. Census Bureau projections, in 2005 the nation's elderly (age 65+) will represent 12.6% of the total U.S. population and is expected to grow to 16.5% of the population by 2020 and 20% by 2030. According to NHPCO, roughly 81% of hospice patients are 65+.

Projected Population of Elderly in U.S. (in 000s)

Year	Total U.S. Population	Total Elderly	Percent of Population
2005	295,507	36,695	12.4%
2010	308,936	40,243	13.0%
2015	322,366	46,791	14.5%
2020	335,805	54,632	16.3%
2025	349,439	63,524	18.2%
2030	363,584	71,454	19.7%

Source: U.S. Census Bureau

We expect the hospice industry to grow roughly 12-15% in 2005 and 2006 driven by a 10-11% increase in utilization (driven by improved awareness for the general public and medical community), price increases in the 2-3% range, and a modest increase in length-of-stay.

RECENT TRENDS IN HOSPICE CARE M&A

The hospice landscape represents a very fragmented market. There are several large national and regional hospice providers. Because of the low barriers to entry, competition has increased significantly over the past couple of years, mainly from new and existing hospice programs and skilled nursing facilities. Nursing home companies have expanded existing businesses (nursing home provider Beverly Enterprises purchased private Hospice USA in May 2004), existing hospices have expanded and/or merged (Texas providers American Hospice Inc. and Voyager Hospice Care announced merger plans in May 2004) and new venture capital-backed regional hospice companies have emerged. This has increased the number of buyers for small hospices. As a result of this activity, the acquisition price/average daily census (ADC) has increased to mid-$50K from mid-$30K or from 2-4X pro forma EV/EBITDA to 7-9X previously. Beverly purchased Hospice USA (annual revenue of roughly $37 million and 900 ADC at time of purchase) for $69 million, or roughly $77K/ADC according to reports. Further, the purchase of remaining interest of not-for-profit Vitas, the largest provider of hospice in the U.S., by Chemed in February 2004 gives Vitas the capital to reemerge on the acquisition front and further pressure pricing, in our opinion.

Victory Partners believes that expected growth in the industry coupled with increased competition will fuel merger and acquisition activity over the next 18 months. With improved valuation multiples and continued pricing pressure, owners of small to medium-sized hospice companies are in an excellent position to realize significant value for their enterprise.

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

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