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# M&A in Durable Medical Equipment Market Trends and The Impact of COVID-19

*Merger and acquisition activity in the DME space is expected to gather momentum amidst the evolving market environment*

# Executive Summary: Market Trends Poised to Drive M&A Activity in DME

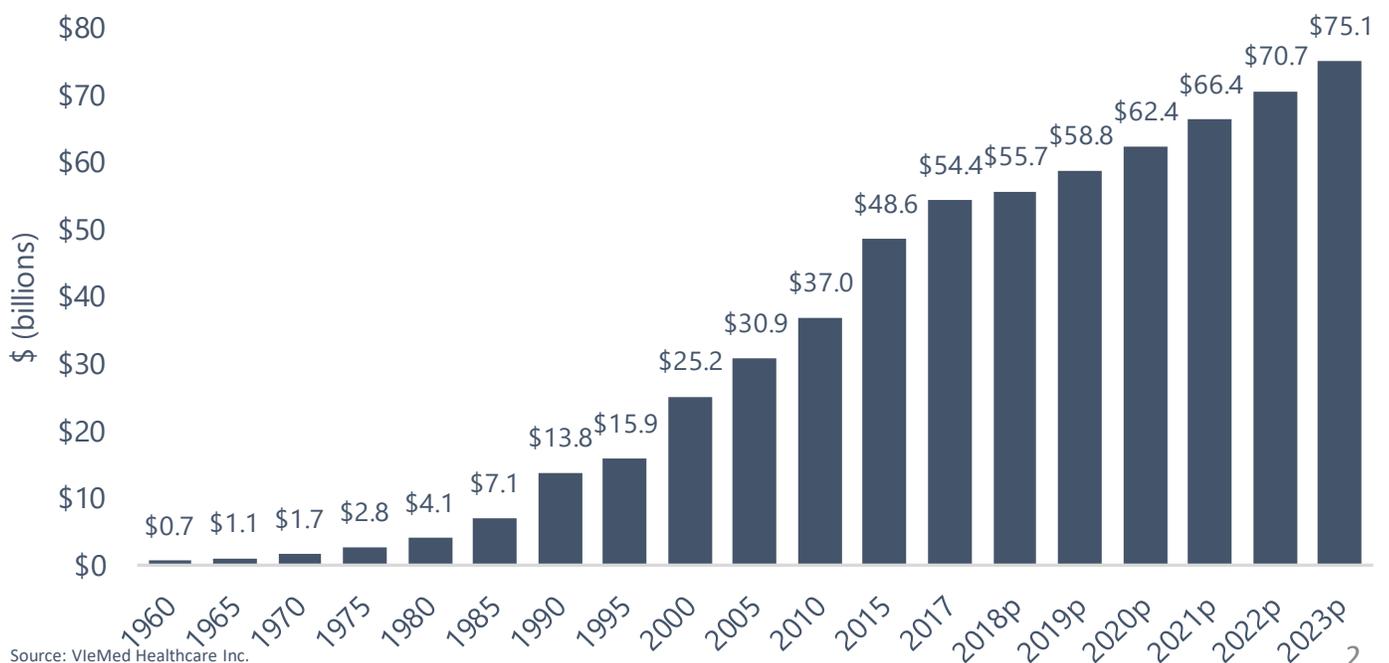
The Durable Medical Equipment (DME) industry has grown to approximately \$56 billion in 2018, a sizeable increase from \$37 billion in 2010, and is projected to continue its steady rate of growth at a 5.0% CAGR from 2019 – 2023. While this market is relatively mature, it has been significantly impacted in recent years by regulatory change and macro-level demographic trends. Most notably, the implementation, suspension, and impending re-introduction of competitive bidding, the aging U.S. population, the increasing prevalence of chronic conditions, and the growing patient preference for medical treatment in the home rather than an in-patient setting have resulted in significant changes to the operating landscape. Further, the shift to value-based care has accelerated the growth in home care businesses as the industry tightens its focus on providing quality care while controlling costs.

DME businesses provide medical products designed to treat and improve quality of life for patients in a home-care setting. While the equipment used can range from respiratory equipment, mobility products, sleep therapy devices, and other products, its end use is consistent in that it's intended to help the user complete his or her daily activities.

The strong influence of an increased end-user market offers prevailing tailwinds to this segment, driven by the rising geriatric population and projected growth in the prevalence of chronic ailments, coupled with a growing patient preference for home-based care rather than in an institutional setting. The potential for a less favorable reimbursement environment increases the need for DME businesses to focus on efficiency and cost-reduction through effectively scaling their operations, presenting a strong environment for M&A consolidation through both private equity and strategic operators in the industry. As a result, Provident expects to see an uptick in DME consolidation activity over the next 12-18 months.

M&A activity in the DME sector in recent years has been primarily led by strategic acquirers. Those acquirers have benefitted from the realization of cost synergies, revenue diversification, and increased market penetration in new geographies. In an industry that has been historically characterized by its relatively low margins and commoditized products, inorganic growth through M&A presents a strong opportunity for DME businesses to navigate these challenges.

Historical & Projected US DME Expenditures



# Key Trends and Observations

The aging population is expected to drive total addressable market growth...

The U.S. population age 65 and above represent the highest portion of DME users, a trend most evident in the percentage of men aged 61-100 with sleep apnea versus men aged 20-44 (Figure 1). As the baby boomer generation continues to age, the U.S. will see a significant change in patient demographic. The U.S. Census Bureau estimates that the population ages 65 and above will exceed 70 million by 2030, and 80 million by 2040 (Figure 2). Not only is this segment of the population expected to grow in absolute terms, it is also expected to comprise a larger percentage of the total U.S. population, growing from 15% in 2014 to a projected 24% by 2060. This demographic shift will increase demand for DME, and the need for these businesses to provide effective equipment at a reasonable cost to allow geriatric patients to avoid extensive time spent in an inpatient setting.

...along with an increased prevalence of chronic conditions

Along with the aging U.S. population, the increased prevalence of chronic conditions will further contribute to growth in the DME space. Common

conditions that require treatment from various types of DME include Chronic Obstructive Pulmonary Disease (COPD) which affects 16 million Americans annually, Congestive Heart Failure which impacts 5 million Americans annually, and sleep apnea, affecting 22 million annually. These conditions are persistent and are expected to remain prevalent for the foreseeable future, requiring the continued use of DME to effectively treat their symptoms.

These conditions affect a relatively larger percentage of the older population. In addition to sleep apnea, which is most common in adults over 60 years old, COPD affects 9.5% of people over 74 versus only 3.9% of people age 25-44, and congestive heart failure affects >5% of people age 60-69 versus 2% of people age 40-59. As the population grows older, the prevalence of these chronic conditions will grow with it. This trend will further drive demand for DME.

Transition towards home-based care

The significant expense associated with hospital-based care combined with patient preference for home-based treatment have contributed to an environment where it is financially favorable and

Figure 1: Percentage of Men with Sleep Apnea by Age Range

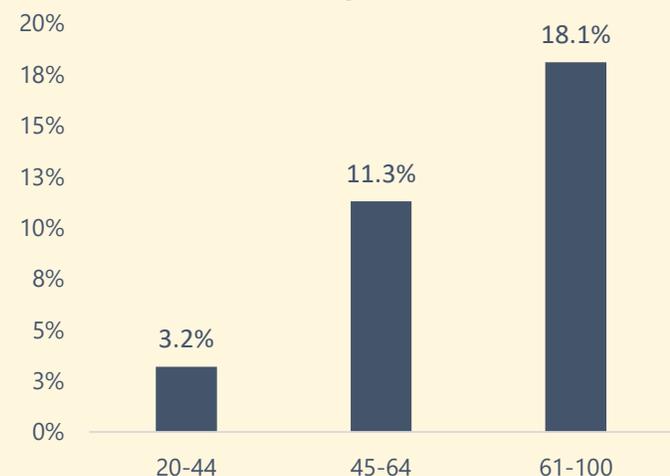
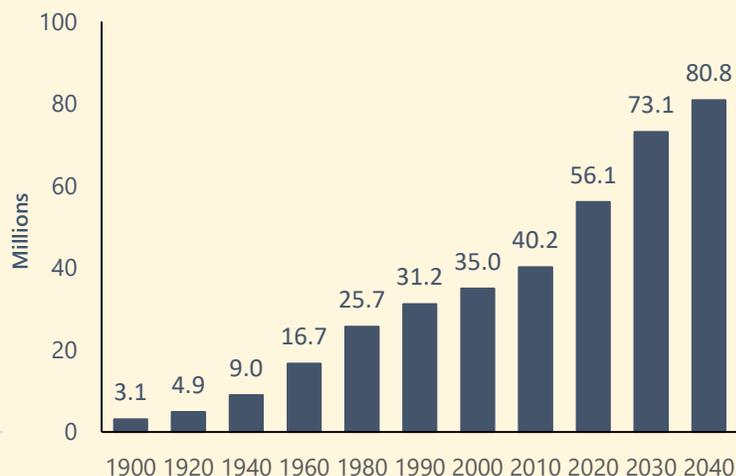


Figure 2: U.S. Population Age 65 and over



## Key Trends and Observations *continued*

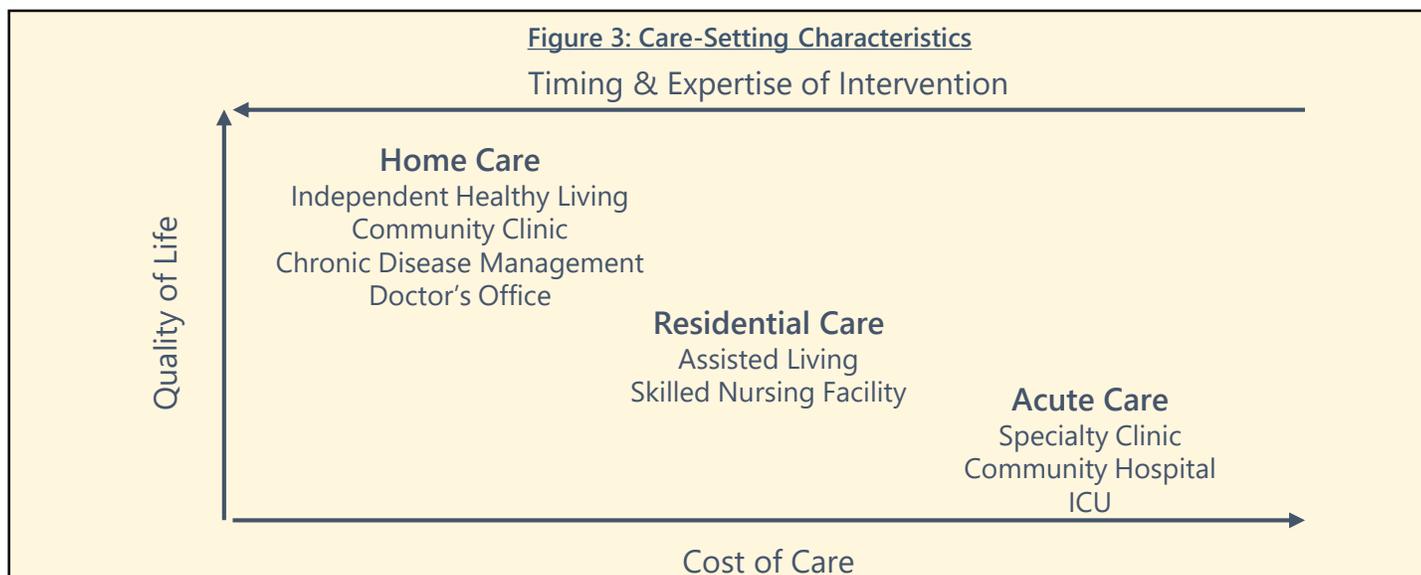
offers improved quality of life for patients to receive treatment in their homes (*Figure 3*). The financial strain placed on patients, Medicare, and other third-party payors created by extended hospital stays and treatment for chronic conditions creates strong incentives for patients to receive treatments for low-acuity conditions outside of an institutional care setting. The cost savings associated with this distinction in care center is significant. According to NIH, hospitalization was identified as the most important cost variable in COPD treatment, accounting for roughly 45%–50% of the total direct cost generated by COPD patients. On top of the meaningful cost savings, patients strongly prefer in-home care as their primary method of treatment. According to the AARP Public Policy Institute, 90% of patients over age 55 have indicated a preference to receive care in the home rather than in an institutional setting. This sentiment is driven not only by the increased quality of life but also by the increasing efficacy of home-based care to a level now on-par with facility-based care. This means that not only is in-home care more cost effective than treatment in an inpatient facility, it's nearly equally as clinically effective.

Historically, only low-acuity conditions were appropriate to be treated in the home. Given

technological advancement in the DME space, the number of conditions that are able to be handled in the home continues to grow, most recently including chronic wound care, sleep testing, dialysis, and chemotherapy. DME businesses with strong capabilities in tele-health initiatives, such as remote patient monitoring, will be poised to capitalize on this shift. There will be greater opportunities for DME businesses to experience organic growth in these areas as the market continues to evolve to treat more acute conditions.

### COVID-19 impact should be less drastic relative to other healthcare sub-sectors

While the total economic impact of the COVID-19 pandemic remains to be fully realized, DME businesses are uniquely positioned to weather the negative effects of the virus on the global economy. The nature of DME as medically necessary products to treat a given condition provide support for the industry despite instability in the broader market, whereas businesses that are more reliant upon elective procedures would be more susceptible to a downturn. The strong volume demand drivers discussed previously will be largely unaffected by COVID-19 and it's market impact, allowing the DME space to continue along its growth trajectory.



# Regulatory Environment and Business Impact

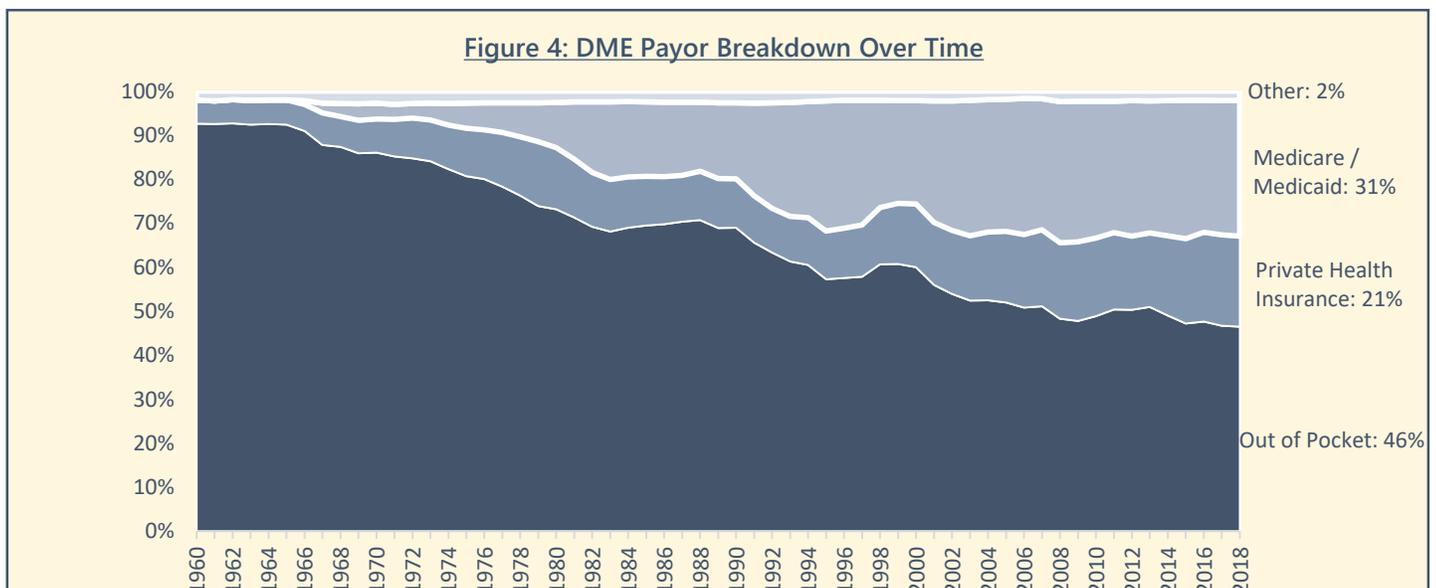
## Competitive bidding has shaken up industry landscape

While roughly 46% of DME expenditure came from out of pocket payments in 2018 (per CMS National Health Expenditure data), reimbursement from Medicare and Medicaid comprise a sizeable piece of the market and are particularly sensitive to changes in the regulatory environment. Competitive bidding was introduced to the DME space in 2003 with the passing of the Medicare Prescription Drug, Improvement, and Modernization Act (MMA). Under the competitive bidding program, Medicare suppliers of select DME products within competitive acquisition areas are required to submit a bid for those products, with contracts then awarded to the suppliers who offer the best price and meet certain quality requirements. Medicare contract suppliers then must agree to fulfill all claims for bid items and will be reimbursed the single payment amount. This applies for all DME provided to Medicare supported patients in competitive acquisition areas, identified by CMS. The primary impact of this legislation on DME businesses has been diminished margins due to the downward pressure exerted on reimbursement rates from one of their largest payors. Medicare / Medicaid is the largest commercial payer in the DME space, comprising 31%

of the market in 2018 (*Figure 4*).

There have been several rounds of bidding in the time since MMA established the program in 2003. The most recent round of competitive bidding expired on December 31, 2018, and the program has been on hiatus in the period since. CMS has subsequently announced "Round 2021" of competitive bidding, which will re-institute the program as of January 1, 2021. DME businesses must prepare accordingly for this impending shift in the reimbursement environment that is likely to negatively impact margins and gross profitability for several products.

While competitive bidding has created challenges across the DME space, it presents opportunity for companies that are able to adapt. Businesses with a comprehensive product suite and low-cost manufacturing processes are most likely to successfully capture market share in this environment. This has enabled operationally sound businesses to persist and succeed. Further, many successful businesses have begun to push into new verticals to diversify revenue streams and increase customer retention. These ancillary products and additional value-add services to patients have come in several forms. Notably, technological advancements to facilitate remote patient interaction with physicians,



Source: CMS National Health Expenditure data

## Regulatory Environment and Business Impact *continued*

which is tied to increased patient compliance, and exploring new revenue streams such as the sale of refurbished or reconditioned equipment, have proven to be strong growth opportunities. Businesses with investments in these areas should be effectively positioned to navigate the changing payor environment coincident with Round 2021.

The downward pressure on margins also figures to make M&A an attractive option for businesses seeking to minimize manufacturing and back-office expense through scaling operations. Acquisition activity from strategic partners has experienced a notable uptick in activity in recent years (*Figure 5*), a trend we expect to persist.

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realize greater efficiencies in production, supply chain management, and product storage, the negative impact on bottom line performance can be offset meaningfully. This dynamic is illustrated in *Figure 6* below, showing four recent transactions executed by AdaptHealth and the ensuing cost savings.

**Figure 6: Sample Top Vendor Annual Cost Savings (\$ in millions)**

	Pre-Acquisition	Post-Acquisition	Savings	%
Transaction 1	27.5	25.4	2.1	8%
Transaction 2	19.3	17.4	1.9	10%
Transaction 3	7.1	5.5	1.6	23%
Transaction 4	4.4	3.3	1.1	25%

**Figure 5: Strategic-led DME M&A Transactions (2015-2020 YTD)**



# Consequences for M&A Activity

## Current M&A environment has picked up steam

As mentioned, the primary driver of M&A activity in the DME space is the impending competitive bidding Round 2021, which is expected to exert significant downward pressure on profit margins for many DME providers. This necessitates increased operational efficiency, revenue diversification, and access to well-functioning manufacturing processes and supply chains. For many DME businesses operating in the lower middle market, these goals can be achieved by targeting a strategic partnership through an M&A transaction with either a larger strategic player in the space or through a private equity-backed platform investment executing a “roll-up” acquisition strategy. DME businesses have generally faced strong headwinds from low profit margins and commoditized products, making it difficult to gain a sustainable edge over competitors. Achieving greater scale and the associated efficiencies will help to offset those headwinds.

Recent activity in the space has been headlined by a few notable transactions. In September 2018, Great Elm Capital acquired two separate entities, Valley Healthcare Group and Northwest Medical, to form Great Elm DME. Arizona-based Valley Healthcare specialized in diagnostic sleep disorder testing,

CPAP/BIPAP equipment, ventilators, nebulizers and other equipment for patients with sleep apnea and other respiratory deficiencies. Similarly, Northwest Medical focused on respiratory equipment delivery, setup, and education for the pediatric and adult populations in the Pacific Northwest. This transaction effectively illustrates a broader trend of merging distinct entities to gain operational efficiency, geographic expansion, and revenue diversity. Great Elm DME expects to target additional add-on opportunities to further augment the growth of the business.

More recently, AdaptHealth, one of the largest strategic acquirers in the space, completed transactions in the first quarter of 2020 to acquire Healthline Medical Equipment, a respiratory & CPAP equipment provider, and McKesson Patient Care Solutions, a supplier of wound care products. These transactions illustrate the eagerness of the largest DME players to pursue transactions which will provide new product exposure, and therefore, revenue diversification. The added revenue and patient base resulting from these transactions allows both the seller and acquirer to benefit from greater economies of scale and to be effectively positioned to counteract reduced profit margins.

### Provident Recent Transaction Experience

**Provident has been an active advisor to DME & Home Care businesses throughout the firms history**

Provident served as the exclusive advisor to Medical West Respiratory Services, LLC and Medical West Respiratory Central, LLC (collectively referred to as “Medical West”) who were acquired by Lincare Holdings, LLC a US subsidiary of the technology company The Linde Group. Medical West is a privately-owned company dedicated to providing a uniquely integrated network of healthcare resources, home medical products, equipment, and respiratory care services to the public. Medical West has three retail centers and three satellite locations throughout Missouri.



*Has been acquired by*



## Active Consolidators in the Space

### Several private equity groups have made platform investments in DME businesses

While much of the M&A activity in the DME space has historically been driven by publicly-traded strategic acquirers, private equity firms have refined their focus and have begun to deploy capital in the sector over the past several years. This increase in PE-led transaction volume comes amidst a period of record-breaking fundraising amounts from PE firms, arming them with substantial amounts of committed capital they need to deploy in a competitive and expensive deal environment. This has benefitted DME businesses that have found themselves on the receiving end of this PE capital.

Notable PE-led transactions in recent years include Silver Oak Service Partners' acquisition of DASCO Home Medical Equipment ("DASCO"), a founder-owned provider of respiratory therapy equipment, in March 2020. Silver Oak's investment in DASCO represents its first platform investment in the DME space. The firm expects to pursue add-on acquisition opportunities in the near-term, a common strategy employed by PE firms to grow a portfolio company inorganically post-investment. In January 2018, Blue Wolf Capital led the merger of StateServe and HospiceLink, two DME providers to the hospice and

post-acute care markets. Transactions such as this are indicative of the benefits of consolidation to achieve greater scale, leverage a combined brand, and expand service offerings into new areas. Additional PE-led transactions in the DME space are listed in *Figure 7*.

### Key strategic players have capitalized on strong macroeconomic environment

While PE firms have sought to capitalize on the strong tailwinds in the space, large strategic businesses have enjoyed similar growth, both organically and via acquisitions. Significant (non-PE backed) players in DME include Lincare (NYSE: LIN), AdaptHealth (NASDAQ: AHCO), Protech Home Medical (TSX: PTQ) and VieMed (NASDAQ: VMD). These companies are similar in that they have built a diverse set of product offerings and have effectively scaled their businesses. Their growth is representative of a general willingness industry-wide to capitalize on the availability of cheap debt and a strong macroeconomic environment to pursue organic growth opportunities and selective add-on acquisitions. Provident expects these organizations to continue to assert themselves as market leaders and drivers of acquisition activity in the DME space.

**Figure 7: Select Private Equity-backed DME Investments**

Investment Date	PE Firm	Platform Company
March 2020	Silver Oak Service Partners	DASCO Home Medical Equipment
November 2019	Claritas Capital	Virtue Technologies
October 2019	SkyKnight Capital	AeroCare Holdings
June 2019	Angeles Equity Partners	Mini Pharmacy Enterprises
February 2019	Monument MicroCap Partners	Montgomery DME
September 2018	AEA Investors	Numotion
August 2018	Rockwood Equity Partners	Lifeway Mobility
January 2018	Blue Wolf Capital	StateServe / HospiceLink
March 2017	The Halifax Group	PromptCare
November 2015	Jordan Industries International	Dre Medical
July 2015	Tailwind Capital	National HME

## Conclusion – Provident’s Perspective

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Driven by the impending re-introduction of competitive bidding and its projected impact on profit margins industry wide, Provident anticipates the trend of increased M&A activity in the DME space to continue. Growth through acquisition allows large strategic buyers and private equity investors to leverage greater economies of scale, reduce back-office redundancies, and diversify their product suite through the addition of ancillary services. In a fragmented market, these are critical steps in obtaining greater market share.

As the industry continues to evolve, firms that prioritize investments in tele-health and other remote care initiatives will be well-positioned for success. The correlation between increased compliance rates and businesses who have leveraged technology to promote remote interaction with care providers is significant. The continuation of these trends should continue to reduce the cost and improve the efficacy of home-based care, both key drivers of the growth in the DME market.

In addition to remote health services, other ancillary products will increase in importance. Businesses that are able to effectively scale alternative revenue streams such as the sale of refurbished or reconditioned equipment, or sale to non-traditional buyers such as nursing homes and other care centers will be poised to capture additional market share.

Increased patient preference for in-home care, rather than in an institutional setting, continues to grow the market for DME. As demand increases for the services provided by various DME, those businesses who can efficiently and profitably meet that growing demand will be positioned to capture increased market share.

Strategic and private equity buyers have begun to capitalize on these trends in recent years, as M&A activity in the sector has experienced a noticeable

increase. Provident anticipates this trend will continue, providing opportunities for both buyers and sellers to capitalize on prevailing industry tailwinds while protecting against a changing reimbursement environment and tightening profit margins.

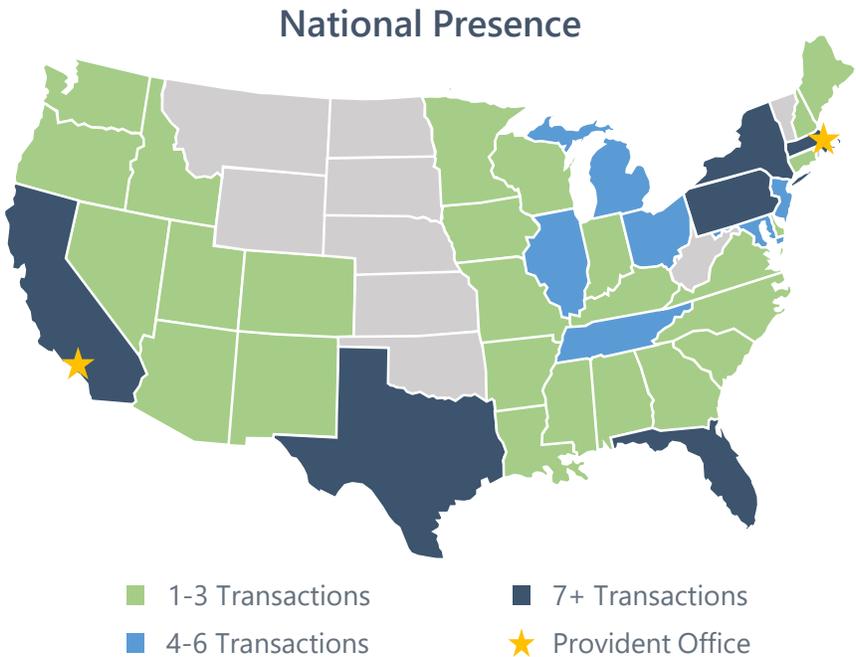
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# PROVIDENT HEALTHCARE PARTNERS

Provident Healthcare Partner’s investment banking team works with privately owned healthcare companies to provide advisory services related to mergers and acquisitions. Prior to formal engagement, Provident works with companies to provide the upfront education to shareholders necessary to understand the economics, structure, and motivation of a transaction. Following the education process, if formally engaged, Provident leverages their extensive knowledge of the buyer universe to find the most compatible partner and drive valuations for a company’s previously illiquid stock. Driving the entire transaction process, Provident facilitates and assists with deal structuring, negotiations, exit planning/processing, counseling amongst shareholders, and due diligence.



- 21+** Years of Healthcare Investment Banking
- 140+** Healthcare Deals Closed
- 12-15** Landmark Deals Per Year
- 27** Banking Professionals

Note: The above map represents states where Provident clients were headquartered. Provident has successfully closed transactions with clients operating in 45 states and Puerto Rico.

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Provident is the leading investment banking firm specializing in merger and acquisition advisory, strategic planning, and capital formation for middle-market and emerging growth healthcare companies.

The firm has a vast network of senior industry relationships, a thorough knowledge of market sectors and specialties, and unsurpassed experience and insight into the investment banking process.

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