

GREAT AMERICAN GROUP ADVISORY & VALUATION SERVICES

Healthcare Monitor
June 2011 - Volume 2

In this Issue:

Overview 4

Recent Appraisal Trends 5

Monitoring Points 6

Reference Sheet 7



Introduction

Welcome to the June 2011 issue of the *Healthcare Monitor* from Great American Group Advisory & Valuation Services (“GA”). This publication will provide you with market values and industry trends for medical equipment, devices, implants, supplies, apparel, and pharmaceuticals. This report is a compendium of GA’s industry expertise, well-respected industry publications, liquidation and appraisal experience, and discussions with industry personnel. The medical industry’s current across-the-board price increases and evolving regulatory environment make accurate and up-to-date information essential. GA chooses relevant and vital indicators in order to present a concise but detailed profile of this marketplace.

The *Healthcare Monitor* relates information covering the medical sectors listed above, including industry trends, demand factors, their relation to our valuation process, and current recovery trends. Our goal is to provide a brief overview highlighting specific sectors of the healthcare industry. Should you need any further information, please feel free to contact the GA Business Development Officers and other staff members listed in this and all *Healthcare Monitor* issues. GA welcomes the opportunity to make our expertise available to you in every possible way.

Trends in Recovery Values

Recovery values from collateral updates indicate that net orderly liquidation values (“NOLVs”) for companies in the healthcare industry continue to improve. Rising healthcare costs and anticipated demand increases, both from an aging population and the new healthcare bill, are primary drivers, though individual appraisals are still defined by highly specific factors.

Trend Tracker

NOLVs: **Increasing**

Sales Trends: **Increasing**

Gross Margin: **Increasing**

Inventory: **Increasing**

Pricing: **Increasing**

GA internally tracks recovery ranges for a variety of healthcare products including medical equipment, supplies, and pharmaceuticals, but we are mindful to adhere to your request for a simple reference document. Should you need any further information or wish to discuss recovery ranges for a particular segment, please feel free to contact your GA Business Development Officer.

ABOUT GREAT AMERICAN GROUP

Great American Group is a leading provider of asset disposition solutions and valuation and appraisal services to a wide range of retail, wholesale and industrial clients, as well as lenders, capital providers, private equity investors, and professional services firms. In addition to the *Healthcare Monitor*, GA also provides clients with industry expertise in the form of monitors for the metals, building materials, food, automotive, and chemicals

Headquarters:

21860 Burbank Blvd.
Suite 300 South
Woodland Hills, CA 91367
800-45-GREAT
www.greatamerican.com

Atlanta
Boston
Chicago
Dallas
London
Los Angeles
New York
San Francisco

EXPERIENCE

In recent years, GA has formulated bids and conducted liquidations for several hospitals including St. Vincent Catholic Medical Center, Mercy Medical Center, and Franciscan Medical Center. In addition, GA has worked with and appraised numerous companies within the healthcare industries, including several industry leaders. While our clients remain confidential, they include market-leading manufacturers and distributors of consumables, supplies, devices, and equipment from medical branches including biomedical, surgical, pharmaceutical, and dental. GA has appraised consumable products including wheelchairs, walkers, canes, hospital beds, medical scrubs, ventilators, defibrillators, and surgical gloves and masks. GA has also appraised local, regional, and national pharmacy script files in conjunction with appraisals and liquidations, and maintains a database of scripts sold over the last five years. GA's extensive list of healthcare-related appraisal experience includes:

- A distributor of branded but otherwise generic mobility-related durable medical equipment, whose primary products are walkers, manual wheelchairs, and motorized wheelchairs.
- A distributor of vendor- and company-branded non-surgical medical scrubs, lab coats, nurses' uniforms, and medical shoes.
- A national biomedical equipment provider, whose product range includes beds, blood pressure monitors, ventilators, and incubators.
- A large producer of generic pharmaceuticals, as well as a contract manufacturer for other pharmaceutical companies.
- A 25-location regional pharmacy chain focused on prescription drug business for local customers.
- An industry-leading distributor of vendor- and company-branded dental supplies with a more than 80-year history in the industry.
- A national distributor of a wide assortment of medical and dental supplies, sourced domestically and internationally, including surgical gloves, wound care items, diagnostic testing kits, and other physician supplies.
- A developer and marketer of specialty pharmaceuticals and medical devices primarily focused on acute and surgical applications, but also used in medical specialties including interventional radiology, ophthalmology, and tumor biopsy.

In addition to our vast liquidation and appraisal experience, GA maintains contacts within the healthcare industry that we utilize for insight and perspective on recovery values.

APPRAISAL & VALUATION TEAM

BUSINESS DEVELOPMENT

Mike Marchlik

National Sales & Marketing Director
mmarchlik@greatamerican.com
818-746-9306

Drew Jakubek

Vice President - Southwest Region
djakubek@greatamerican.com
972-265-7981

Daniel Levene

Vice President - Western Region
dlevene@greatamerican.com
818-746-9327

Ryan Mulcunry

Senior Vice President - Northeast Region, Canada & Europe
rmulcunry@greatamerican.com
617-692-8310

Fred Raccosta

Senior Vice President - New York/Mid-Atlantic Region
fraccosta@greatamerican.com
646-381-9204

David Seiden

Executive Vice President - Southeast Region
dseiden@greatamerican.com
770-551-8114

Bill Soncini

Vice President - Midwest Region
bsoncini@greatamerican.com
312-777-7945

OPERATIONS

Ken Bloore

Chief Operating Officer
kbloore@greatamerican.com
818-884-3737

Jorge Ventura

Senior Associate, Healthcare Specialist
jventura@greatamerican.com
818-746-9336

OVERVIEW

The fate of the most substantial attempt at healthcare reform since the Great Depression will likely be decided this October. Most analysts predict that by that time the legal challenges mounted by several states against President Obama's healthcare bill will arrive at the Supreme Court. It seems likely to be a politically guided decision: so far, all judicial rulings on the law have been decided along party lines, with judges appointed by Democratic presidents ruling in favor of the bill and judges appointed by Republican presidents ruling against it.

Should the bill survive examination by the nation's highest court, it will mostly likely face severe legislative challenges. Top Republicans have publically announced they will attempt to defund the bill should they gain control of the Senate following the 2012 election cycle. Full-scale repeal of the bill would be possible only in a clean electoral sweep, as efforts at repeal could be stopped by a presidential veto unless a Republican wins the White House.

As all parties await the legal verdict on the bill, the Obama administration has been busy making small tweaks to its contents. By October, the administration had granted approximately 30 waivers to insurers, employers, and union plans that allowed them to delay compliance with certain requirements of the law. In February, the administration granted broad short-term waivers to four states allowing health insurance companies within those states to offer less generous benefits than they would be required to provide under the law. More changes may be on the way. Obama has said he would support allowing states to opt out of some of the bill's requirements if they could demonstrate they were covering as many people with equal levels of insurance coverage.



Amid the uncertainty over the law, healthcare costs continue to rise. Prices for other consumer goods are rising faster still, according to government data, but patients continue to struggle to pay their bills. The Thomson Reuters Consumer Healthcare Sentiment Index, which measures if people postponed, delayed, or canceled medical care over the last three months or thought they would do so in the coming three, dropped to 95 in April from 98 in January. But the overall outlook is rosy for the industry, as many analysts see revenues rising in the coming years, especially given the aging U.S. population, which is driving up demand in all segments.

The following table illustrates average annual medical expenses for a family of four:

Year	Annual Healthcare Costs
2008	\$15,609
2009	\$16,771
2010	\$18,074
2011	\$19,393

Source: 2011 Millman Medical Index

The following table illustrates average annual percentage increases in medical expenses for a family of four:

	2009	2010	2011
Total medical cost growth	7.4%	7.8%	7.3%
Employee out-of-pocket portion	5.4%	6.6%	9.2%
Employee payroll deduction	14.7%	8.0%	9.3%
Employer portion	5.4%	8.0%	6.0%

Source: 2011 Millman Medical Index

RECENT APPRAISAL TRENDS

OVERVIEW

Even a faltering economic recovery seems unlikely to slow the headlong expansion of healthcare costs. Demand in virtually all segments is expanding, in some cases quite rapidly. The major demand drivers continue to be health providers' preparations for the recently passed healthcare bill, which if ultimately enforced will remove thousands of Americans from the rolls of the uninsured, and the graying of the Baby Boomer generation.

Recovery values continue to vary widely. While the industry as a whole is growing, individual appraisals can hinge on company-determined factors, such as the company's specific mix of inventory, sales trends, weeks of supply, and achieved gross margin. The industry does not follow commodity-like price trends, therefore recovery values exhibit significant variation.

MEDICAL EQUIPMENT, DEVICES, AND IMPLANTS

Already strong sales of medical equipment, devices, and implants are expected to strengthen in the coming years. If unemployment continues to fall despite recent hiccups, more Americans will go forward with operations postponed during the recession. Hospitals are stocking up on supplies to meet the added demand. The U.S. medical equipment industry is forecast to grow by 7.0% annually through 2016, driven largely by an expanding patient base that increasingly prefers self-diagnosis and home treatment, according to GlobalData.

Within the implant sector, explosive growth is expected. Demand for implantable medical devices is expected to grow 8.3% annually in the U.S. through 2014, while cardiac and orthopedic implants are predicted to expand 8.8% and 8.9%, respectively, through 2012, according to research firm IBISWorld, Inc. ("IBISWorld").

In the past 12 months GA has conducted appraisals with national distributors of medical equipment related to mobility and a provider of rental equipment to hospitals. Gross recovery rates were strongest for generic goods, such as canes and walkers, as well as for modern or well-maintained equipment. Specialized and nonstandard equipment such as motorized wheelchairs and beds trended lower, along with outdated or heavily used equipment. Slow-moving inventory recovered at nearly half the value of in-line inventory.

The levels of growth forecasted for the medical equipment, devices, and implants industries should boost those segments' recovery values. Yet due to the rapid pace of medical innovation, each company's valuation can depend heavily on their particular inventory composition.



MEDICAL SUPPLIES AND APPAREL

The medical supplies and apparel industry experienced steady, but weakened growth throughout the economic downturn. Annual revenue for manufacturers and wholesalers expanded at annual rates of 3.3% and 2.9%, respectively, between 2006 and 2011, according to IBISWorld. Each sector is expected to expand further if the economic recovery picks up and healthcare reform clears its various hurdles. IBISWorld predicts 5.0% and 4.3% growth for manufacturers and wholesalers, respectively. Like other sectors of the healthcare industry, an aging populace is another major demand driver.

Within the past year, GA has appraised leading distributors of medical apparel and durable medical supplies. Recovery values for a mix of inventory including non-surgical medical scrubs, lab coats, nurses' uniforms, and medical shoes continued to increase. Recovery rates remained strongly dependent on participation of all major customers, with rates approximately halved when major customers were absent.

Given the high forecasted rates of growth for medical supplies, their recovery values should also trend upwards. Values for medical apparel could continue to climb as more enter healthcare professions, such as nursing.



RECENT APPRAISAL TRENDS

PHARMACEUTICALS

New drugs and expanded healthcare coverage are keeping demand for brand-name pharmaceuticals healthy, though not quite as healthy as other medical sectors, reports a June study from IBISWorld. While industry revenue inched upwards approximately 0.9% between 2006 and 2011, the research firm’s analysts expect 2.4% annual growth through 2016. Like other segments, a graying population, improved technologies, and a large number of new entrants into the private health insurance market will fuel a robust expansion of the industry.

Manufacturers’ continued positive prognosis is threatened by the approaching patent expiration of several blockbuster drugs, such as Zyprexa, a popular schizophrenia drug. This is good news for the already thriving generic pharmaceuticals industry, which grew an estimated 5.0% annually between 2006 and 2011. Driven these expirations, along with a similar combination of factors as brand name drugs, industry revenue for generics will increase an average of 7.3% each year through 2016, according to IBISWorld.



GA has conducted appraisals with large and mid-sized manufacturers and distributors of pharmaceuticals in the past 12 months. Gross recovery values for pharmaceutical products have remained fairly consistent. Values for both traditionally higher and lower recovery items have remained stable. As the nation’s healthcare bill has not yet gone into effect, the industry has not yet experienced the expected expansion of demand.

MONITORING POINTS

Monitoring Point	Impact
Monitor healthcare costs.	Steadily rising healthcare costs will effect decision-making at multiple levels of the healthcare system. Hospitals may cut back on capital improvements, the federal government may further limit policies and procedures covered by Medicare and Medicaid, and patients could opt for fewer voluntary procedures.
Monitor the legal battles over the healthcare reform bill and the 2012 election season.	If all or part of the healthcare reform bill is declared unconstitutional by the U.S. Supreme Court, the law’s impact on healthcare providers could be significantly altered or entirely voided. Similarly, if Republican lawmakers gain control of the Senate, the bill could be defunded. If a Republican presidential candidate is elected, the full bill could be repealed.
Monitor efforts at Medicare and Medicaid reform	Medicare and Medicaid reform, such as the proposal by Congressman Paul Ryan, would result in reduced benefits, decreasing overall demand for healthcare.
Monitor the levels of aged and returned inventory, as well as expiration dates and return rates.	Outdated equipment, expired or near-expiration pharmaceuticals and other aged inventory has little or recovery value, nor do recalled products.
Monitor unemployment levels	As most Americans health insurance is tied to employment, unemployed workers do not consume healthcare. As unemployment rises, demand for healthcare services may fall, possibly impacting recovery values.

INDUSTRY TRENDS

HEALTHCARE SERVICES AND COMMODITIES PRICING

Prices of healthcare services and commodities posted year-over-year growth below economy-wide averages, while the producer price index for healthcare-related commodities and services barely budged. According to the latest data from the Bureau of Labor Statistics (“BLS”), hospitals and related services again beat the overall index, but all other categories had modest growth. Residential mental health facilities registered similar growth on the producer price index side, but most other segments showed little movement, with diagnostic laboratories actually posting a decline.



REFERENCE SHEET

Consumer Price Index for Healthcare Commodities and Services – April 2011

Category	Unadjusted Indexes		Unadjusted % Change to April 2011 From		Seasonally Adjusted % Change From		
	March 2011	April 2011	April 2010	March 2011	January to February	February to March	March to April
All consumer items	223.5	224.9	3.2	0.6	0.5	0.5	0.4
Medical care	397.7	398.8	2.9	0.3	0.4	0.2	0.4
Medical care commodities	322.7	324.2	3.1	0.5	0.7	0.5	0.5
Medical care services	420.9	421.7	2.8	0.2	0.4	0.1	0.3
Professional services	334.7	335.0	2.4	0.1	0.5	0.2	0.1
Hospitals and related services	634.4	637.2	5.4	0.4	0.5	0.2	0.6

Note: Indexes on a December 1997 equals 100 base. Source: www.bls.gov

Producer Price Indexes for Healthcare Commodities and Services – April 2011

Industry	Index Base	Index			% Change to April 2011 From	
		December 2010	March 2011	April 2011	April 2010	March 2011
Selected healthcare industries	12/06	111.5	112.1	112.2	1.6	0.1
Offices of physicians	12/96	130.6	131.2	131.1	1.6	-0.1
Medical and diagnostic laboratories	12/03	108.2	107.9	108.0	-0.2	0.1
Home healthcare services	12/96	129.9	129.7	129.7	0.3	0.0
Blood and organ banks	6/06	113.0	112.9	112.9	0.4	0.0
Hospitals	12/92	174.4	175.3	175.6	1.5	0.2
Nursing care facilities	12/03	127.2	128.4	128.6	2.6	0.2
Residential mental health facilities	12/03	134.5	134.7	135.0	4.9	0.2

Source: www.bls.gov