



Equity Research

June 4, 2008

Q2 2008 HME Sleep & Wound Care Survey

Sector Rating: Orthopedics, Overweight
Sector Rating: Respiratory, Market Weight

Company Name	Stock Rating	Price 06/04/08	FY EPS		FY P/E	
			2008E	2009E	2008	2009
Orthopedics						
Kinetic Concepts, Inc. (KCI)	1	\$45.30	\$3.53	\$3.85	12.8x	11.8x
Respiratory						
ResMed Inc. (RMD)	2	39.63	1.52	1.82	26.1x	21.8x

Source: Company data and WCM, LLC estimates NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
1 = Outperform, 2 = Market Perform, 3 = Underperform, V = Volatile

- **Our Fourth HME Survey.** We partnered with *HME Business* magazine to conduct our fourth survey of home medical equipment dealers (HMEs). The survey included responses from 194 HMEs received between 5/19/08 and 6/2/08.
- **HME Sleep Growth Shows Gradual Slowing.** On average, respondents expect their sleep revenue to grow by 10% (vs. 11% in our prior survey) in the next 12 months after growing at 9% in the past 12 months (vs. 10% in our prior survey). This is slightly below our estimate of low-teens growth in the U.S. sleep market. HME expectations for sleep growth have declined in each of our past four surveys.
- **HMEs Have Begun To Take Steps To Lower CPAP Costs In Face Of Competitive Bidding.** While competitive bidding is set to begin in just 10 cities on 7/1/08, 56% of HMEs have already begun to implement changes to lower CPAP costs. HMEs indicate that they are most likely to attempt to negotiate lower prices with their existing CPAP suppliers and to move Medicare patients to lower cost CPAPs from existing suppliers. Additionally, 89% of respondents expect private insurance to lower CPAP reimbursement based on Medicare's cuts under bidding.
- **RMD Looks Likely To Gain Share.** RMD's S8 and S8 II were rated 5.6 and 5.9, respectively, on a scale from 1 (very poor) to 7 (very good) while RESP's M Series was rated 5.6. RMD's Swift II and Quattro were rated 5.9 and 5.8, respectively, while RESP's OptiLife and ComfortFull 2 were rated 5.5 and 5.0, respectively. RMD should gain share in both flow generators (39% expect to increase purchases, 17% to decrease) and masks (46% expect to increase purchases, 17% to decrease).
- **Only A Minority Of HMEs Offer Or Plan To Offer Negative Pressure Wound Therapy (NPWT).** Only 12% of respondents currently offer NPWT products though another 15% expect to enter the market in the next 6 months. Nearly all respondents offering or planning to offer NPWT target the home market (84%) while 51% target the extended care market and 27% target the acute care market. HMEs charge an average of \$73/day (\$59/day for the pump and \$14/day for dressings) or 19% less than the estimated average \$90/day KCI charges.
- **Despite Some Positive Signs, We Remain Cautious On RMD.** While RMD does look likely to gain some market share, it faces headwinds from a slowing sleep market, intensifying price pressures, and reimbursement cuts. We continue to believe that RMD's growth will not ramp as quickly or as significantly as investors expect and that the stock remains expensive at 23x our CY 2008 EPS estimate.

Medical Technology/Devices

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Please see page 11 for rating definitions, important disclosures and required analyst certifications.

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Survey Background

Wachovia partnered with the trade magazine *HME Business* to conduct our latest survey of home medical equipment (HME) providers. Among the ~4,000 HME professionals that we sent the survey to, 194 responded to one or more of the survey questions for a total participation rate of about 5%. None of the questions in this survey were mandatory, therefore response rates varied from question to question (we note the response rates for questions on each of the charts). Of the 194 respondents, 136 (or 70%) completed the entire survey. The surveys replies were received between 5/19/08 and 6/2/08.

Survey Says...

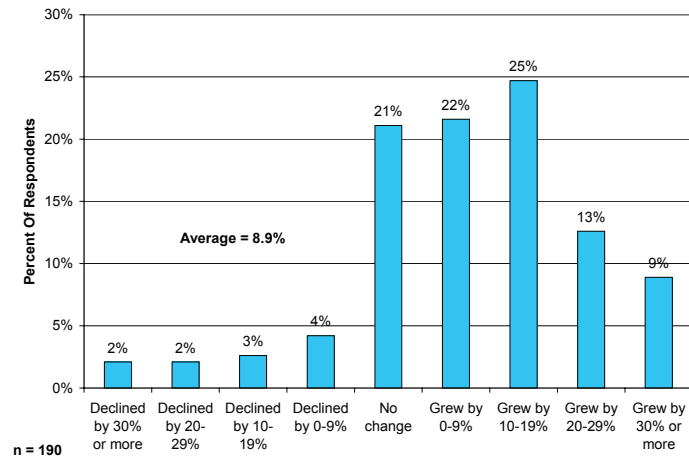
Sleep Therapy Questions

...HME Expectations For Sleep Revenue Growth Have Declined For The Fourth Consecutive Time

This survey marked the fourth decline in HMEs expectations regarding next 12 month sleep revenue growth. On average, HMEs report 8.9% growth in the past 12 months and expect 9.7% growth in the next 12 months. These were both down by about 1% from our Q4 2007 survey. Only 11% saw a decline in their sleep revenue in the past 12 months and only 9% expect a decline in the next 12 months. These growth rates compare with our estimate of low-teens (11-13%) domestic growth.

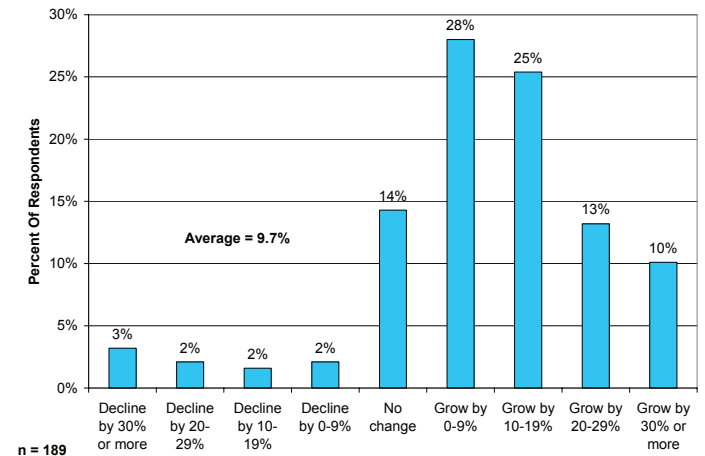
HME growth expectations have declined in each survey we have conducted falling from 15% in Q4 2006 to 10% in our current survey. This is consistent with our belief that the domestic sleep market has slowed due to greater penetration (which we estimate is around 35%), slower expansion at sleep labs ahead of home testing, and a slowing mix shift towards higher-end flow generators.

Figure 1: Sleep Revenue Growth Past 12 Months



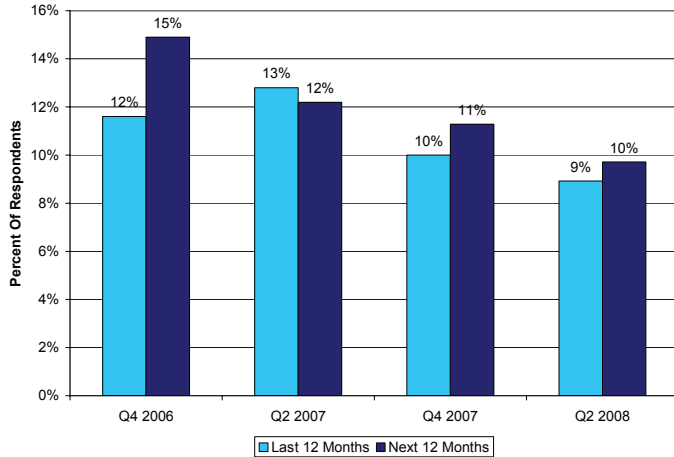
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 2: Sleep Revenue Growth Next 12 Months



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 3: Sleep Revenue Growth (Time Series)



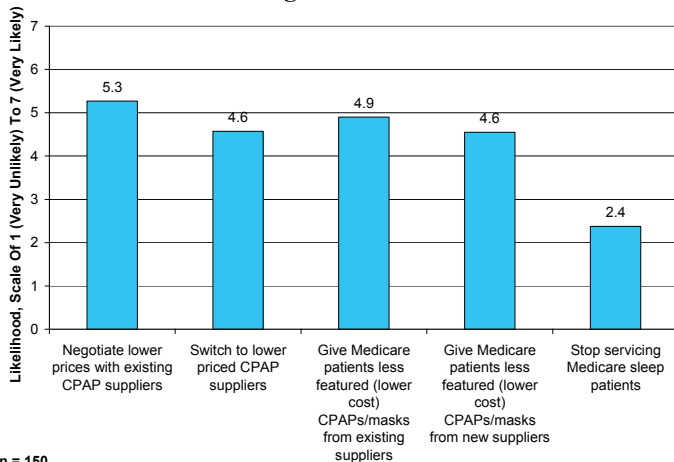
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

... HMEs Are Already Taking Steps To Rein In CPAP Costs Ahead Of Competitive Bidding

We suspected that the slowdown in the domestic sleep market may have been due in part to HMEs preparing to deal with competitive bidding. We asked questions to determine how the HMEs intended to handle competitive bidding and whether or not they had begun to take any steps in this direction. Based on our questions, the HMEs appear more likely to stick with their existing suppliers but to negotiate lower prices and move Medicare patients to lower-end devices. The HMEs look somewhat less likely to move to lower priced suppliers or to move patients to lower-end devices from new suppliers. And the HMEs appear very unlikely to stop servicing Medicare patients.

Many HMEs (56% of respondents) indicated that they have already begun to implement some of these strategies. Not surprisingly, this includes 12% of respondents in the initial 10 cities covered by competitive bidding. But it also includes 44% of respondents in cities that are not yet covered by competitive bidding. We think that this may be driving a mix shift away from higher-end units which might be a factor in the domestic sleep market slowdown. Given that competitive bidding will be rolled out over the next few years, we think that the domestic market may remain under pressure for some time.

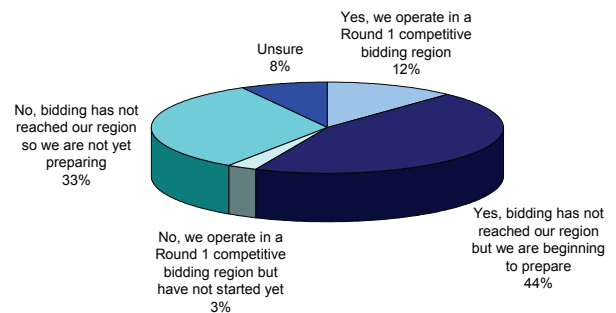
Figure 4: Given Competitive Bidding, How Likely Is Your Firm To Do The Following?



n = 150

Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 5: Has Your Firm Begun To Implement Any Of These Changes Yet?



n = 150

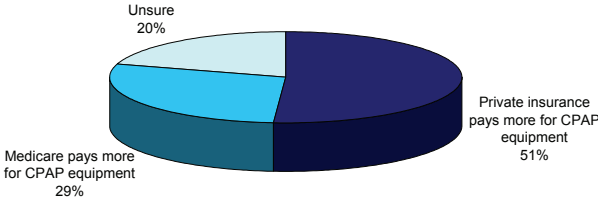
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

... There Is A Sizeable Risk That Medicare Reimbursement Cuts Under Competitive Bidding Spill Over To Private Insurers

We have been operating under the assumption that the declines in Medicare CPAP reimbursement that result from competitive bidding will not be followed by private insurers. The CPAP industry has stated that private insurance pays significantly less than Medicare and that competitive bidding dynamics already exist. Medicare only makes up 20% of the payer mix for CPAP therapy with most of the rest made up by private insurance. With the reimbursement cuts limited to Medicare, only about 10% of ResMed’s revenue is exposed. However, if there is spill over to private insurers, up to another 40% of ResMed’s revenue would potentially be exposed. We asked questions in the survey to attempt to test this assumption.

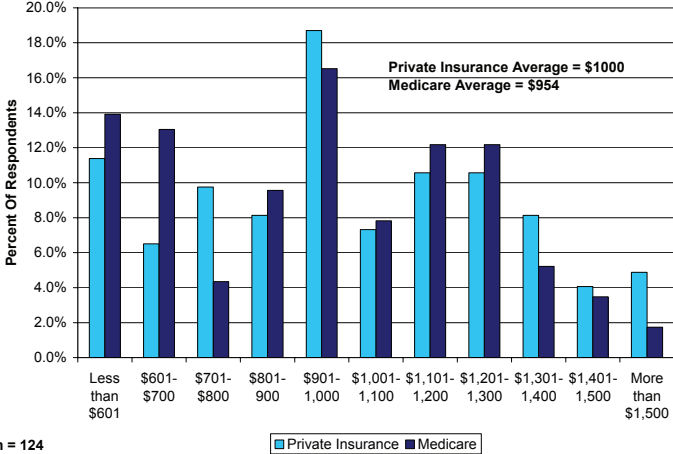
Most HMEs (51%) indicated that private insurance pays more for CPAP equipment while only 29% indicated that Medicare pays more (the remaining 20% were unsure). On average, the HMEs report being paid \$1,000 by private insurance and \$954 by Medicare for setting up a new patient on CPAP. And importantly, 89% of respondents indicated that they expect private insurers to lower their reimbursement as a result of Medicare’s cuts under competitive bidding. These results run counter to our assumption and seem to indicate that there is potential for at least some private insurers to cut reimbursement leading to greater exposure for ResMed.

Figure 6: Do You Receive Higher Reimbursement For Sleep Patients With Private Insurance Or Medicare?



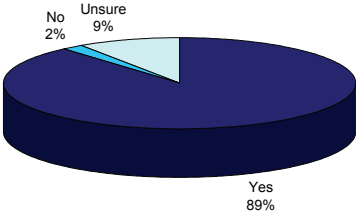
n = 147
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 7: How Much Do You Get Paid For Setting Up A New Patient On CPAP By Private Insurance And Medicare?



n = 124
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 8: Do You Believe That Private Insurers Will Use Medicare's Bidding To Lower Their CPAP Reimbursement?

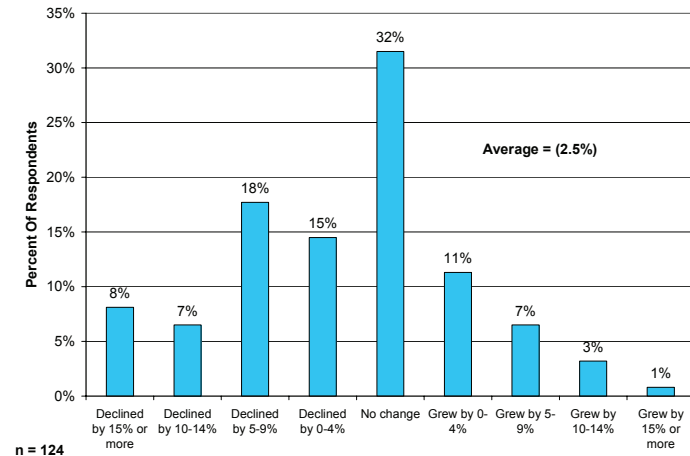


n = 149
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

...Prices Declines On Flow Generators And Masks Have Accelerated Since Our Prior Survey

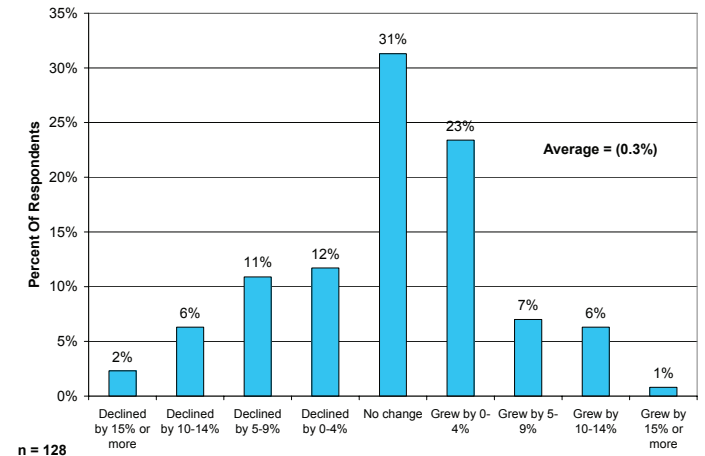
HMEs report that the average prices that they pay for flow generators and masks declined by averages of 2.5% and 0.3%, respectively, over the past 12 months. These are both slightly more severe than the price declines indicated in our prior survey (2.1% for flow generators and 0.1% for masks) indicating that average selling prices (ASPs) declines have worsened. The manufacturers cite 5-15% annual price declines, however. How do we explain this differential? We think that the manufacturers refer to pure pricing while the HMEs refer to average selling prices which account for the effect of mix shifts as well as pricing. While these mix shifts continue to be positive, we think that reimbursement pressures have slowed the mix shift and may continue to do so for the next few years.

Figure 9: By What % Has The Average Price You Pay For A Flow Generator Changed In Past 12 Months?



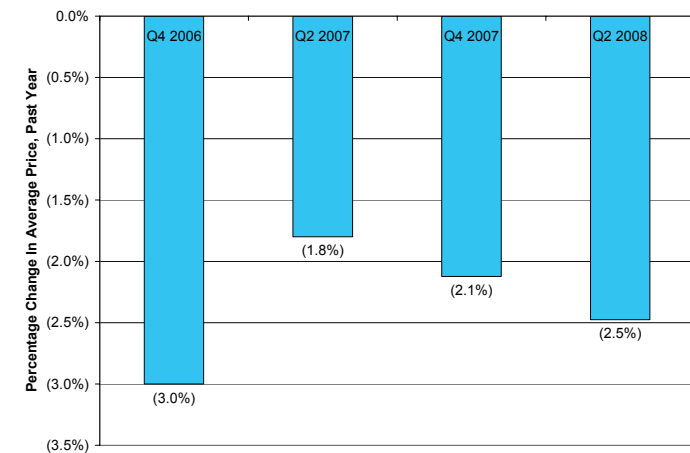
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 10: By What % Has The Average Price You Pay For A Mask Changed In Past 12 Months?



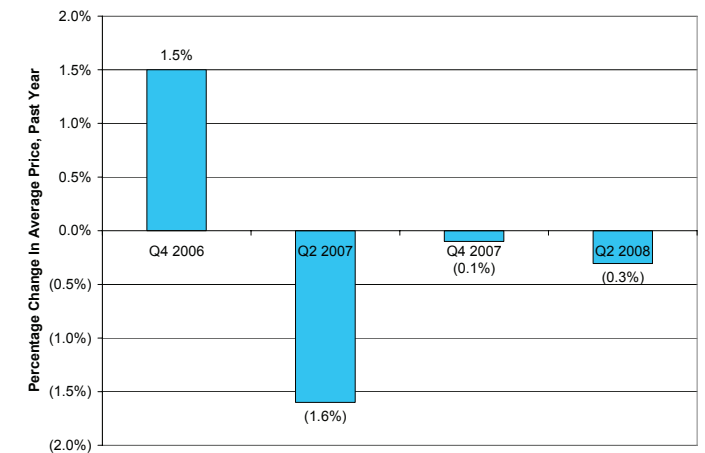
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 11: Change In Average Flow Generator Prices (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 12: Change In Average Mask Prices (Time Series)

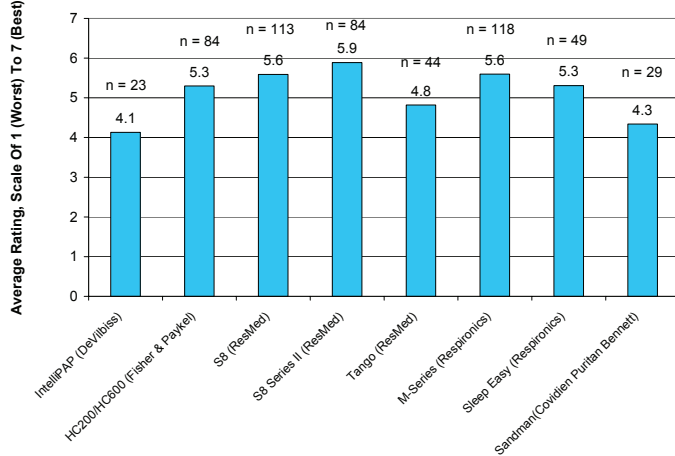


Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

...ResMed's Flow Generators Were Rated Highest And ResMed Looks Likely To Gain Flow Generator Market Share

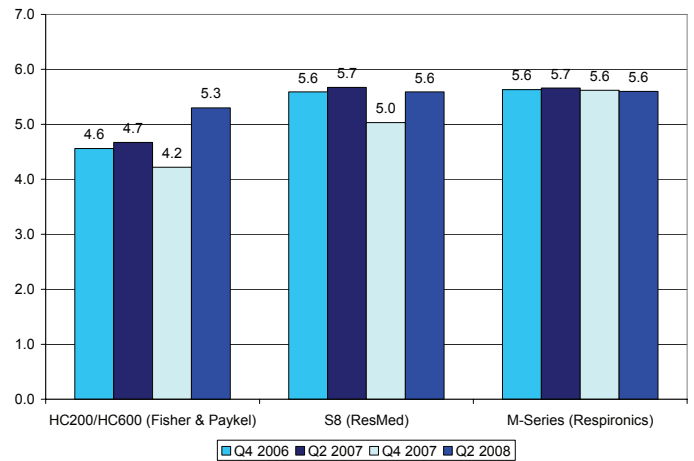
ResMed's S8 flow generator platform bounced back and was rated a 5.6 out of 7.0 versus 5.0 in our prior survey. We think the decline in our Q4 2007 survey may have been due to ResMed's recall of the S8 which was initiated in Q2 2007 (just after our Q2 2007 survey was conducted). ResMed's new S8 II received the highest rating at 5.9; ResMed is in the very early stages of launching this product so our next survey may give a better indication of how this product is being received. Respirationics' M Series was rated identically to the S8 (5.6) and in line with prior surveys while Fisher & Paykel's HC200/HC600 was rated 5.3, well ahead of our prior surveys. We also had the HMEs rate the newer low-end flow generators from ResMed and Respirationics. The HMEs gave ResMed's Tango a 4.8 and Respirationics Sleep Easy a 5.3.

Figure 13: Flow Generator Platform Ratings



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

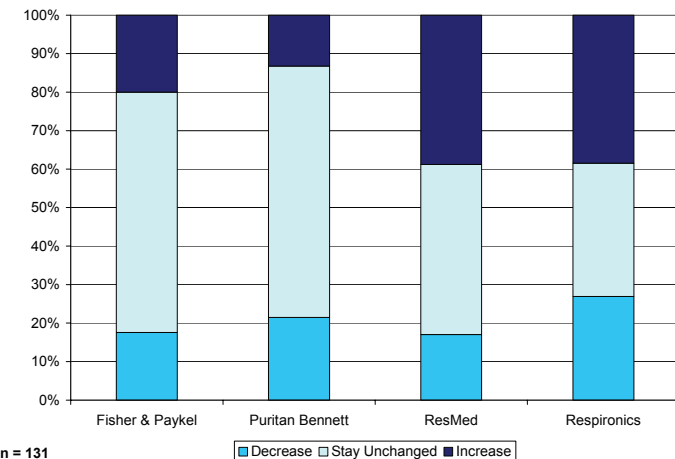
Figure 14: Flow Generator Platform Ratings (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

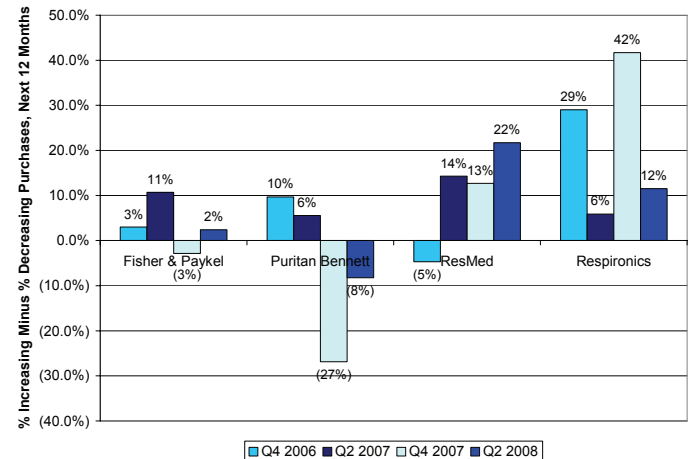
Consistent with the ratings, the HMEs indicated that they intend to increase their purchases of ResMed flow generators by more than any other companies' flow generators (39% of respondents expect to increase ResMed flow generator purchases vs. 17% that expect to decrease purchases). Respirationics and Fisher & Paykel look likely to hold market share while Covidien's (COV) Puritan Bennett division look most likely to lose market share.

Figure 15: In Next 12 Months Will Your Flow Generator Purchases Decrease, Increase, Or Stay Unchanged...



n = 131
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 16: Difference In % Of Respondents Increasing Vs. Decreasing Purchases (Time Series)



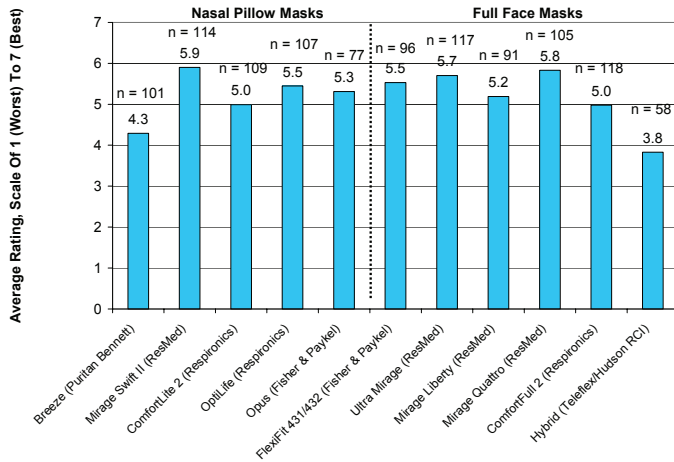
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Q2 2008 HME Sleep & Wound Care Survey

...ResMed's Masks Were Rated Highest And ResMed And Respironics Look Likely To Continue To Gain Mask Market Share

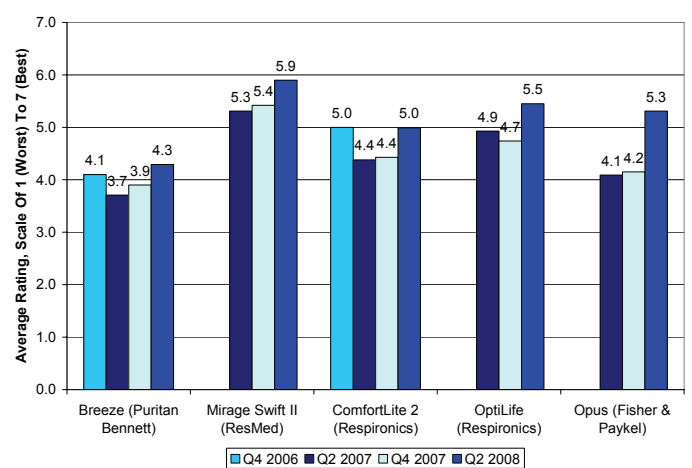
ResMed continues to have the best masks according to our survey. In the nasal pillow category, ResMed's Swift II was the highest rated at 5.9 (out of 7.0) followed by Respironics' OptiLife (5.5) and Fisher & Paykel's Opus (5.3). These results are largely consistent with our prior HME surveys though nearly all the masks were rated more highly in this survey. In the full face mask category, ResMed's Quattro was the highest rated at 5.8 followed by ResMed's Ultra Mirage (5.7) and Fisher & Paykel's FlexiFit 431/432 (5.5).

Figure 17: Mask Ratings



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

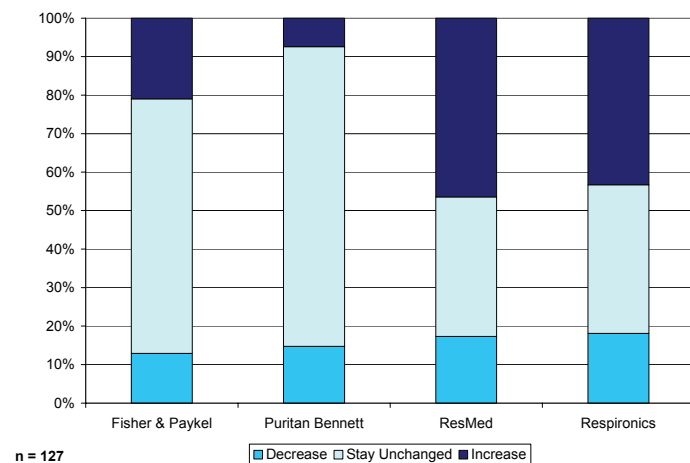
Figure 18: Mask Ratings (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

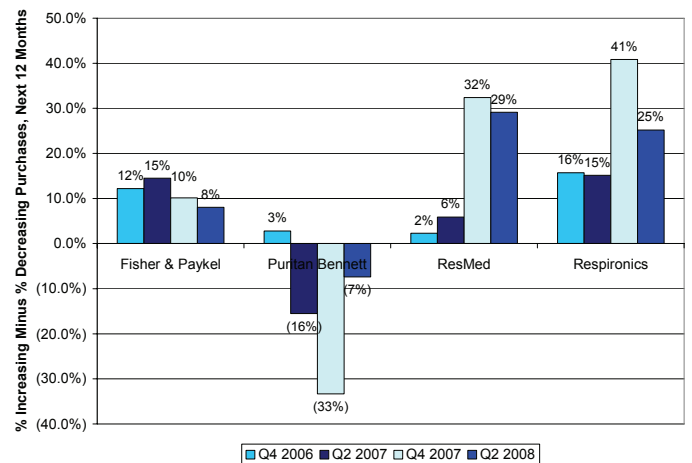
Consistent with the ratings, the HMEs indicated that they intend to increase their purchases of both Respironics and ResMed masks by more than any other companies' masks (46% of respondents expect to increase ResMed mask purchases vs. 17% that expect to decrease purchases; 43% of respondents expect to increase Respironics mask purchases vs. 18% that expect to decrease purchases). Fisher & Paykel looks likely to hold market share while Covidien's (COV) Puritan Bennett division look likely to lose market share.

Figure 19: In Next 12 Months Will Your Mask Purchases Decrease, Increase, Or Stay Unchanged...



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 20: Difference In % Of Respondents Increasing Vs. Decreasing Purchases (Time Series)

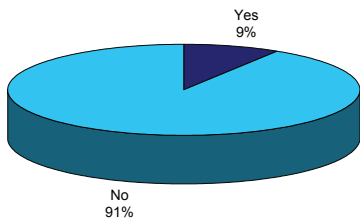


Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

...Only A Small Number Of HMEs Currently Administer Home Sleep Apnea Tests Though More Plan To Start Over Next 12 Months

Only 9% of respondents currently offer patients home testing for sleep apnea. However, another 42% of respondents plan to begin offering home testing over the next 12 months with the bulk starting in 6 months or more. This supports our view that home testing while home testing could be a significant driver, it is not likely to kick in until 2009 at the earliest.

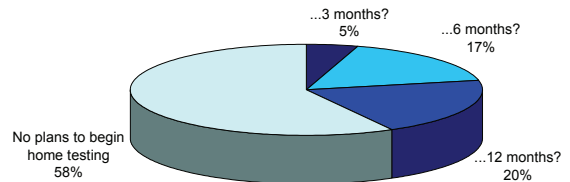
Figure 21: Does Your Firm Currently Administer Home Tests For Sleep Apnea?



n = 136

Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 22: Does Your Firm Plan To Begin Administering Home Tests For Sleep Apnea In The Next...



n = 124

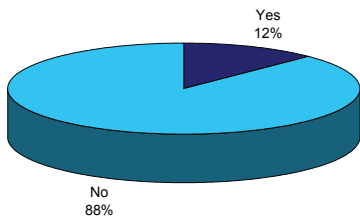
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Negative Pressure Wound Therapy (NPWT) Questions

...A Minority Of HMEs Participate Offer Negative Pressure Wound Therapy (NPWT) But More Plan To Offer It In The Next 6 Months

Most HMEs in our survey are not participating in the NPWT market (only 12% currently offer NPWT products) but more plan to enter in the next 6 months (15% expect to begin offering NPWT products). These numbers are consistent with our prior survey (in which 15% currently offered NPWT product and 13% expected to begin offering NPWT products).

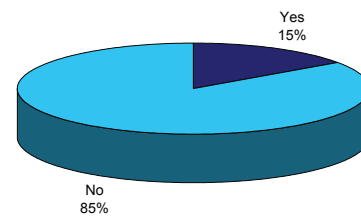
Figure 23: Do You Currently Offer NPWT?



n = 193

Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 24: Do You Plan To Begin Offering NPWT In Next 6 Months?



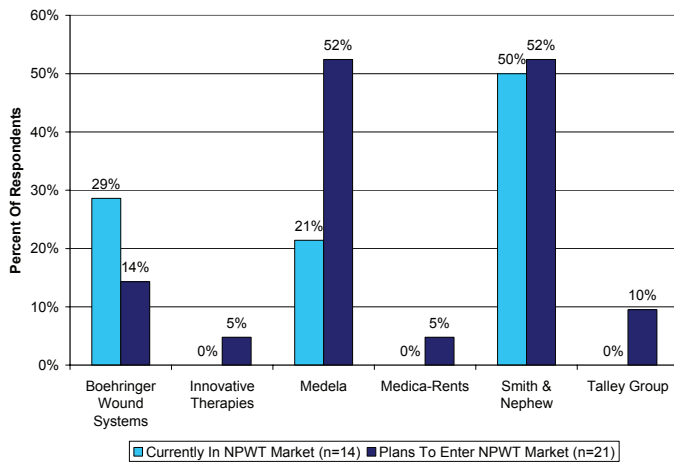
n = 169

Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

...Smith & Nephew, Boehringer Wound Systems, And Medela Are Most Common Suppliers Of NPWT; HMEs Are Focused Primarily On Home Setting But Some Sell Into Extended And Acute Settings As Well

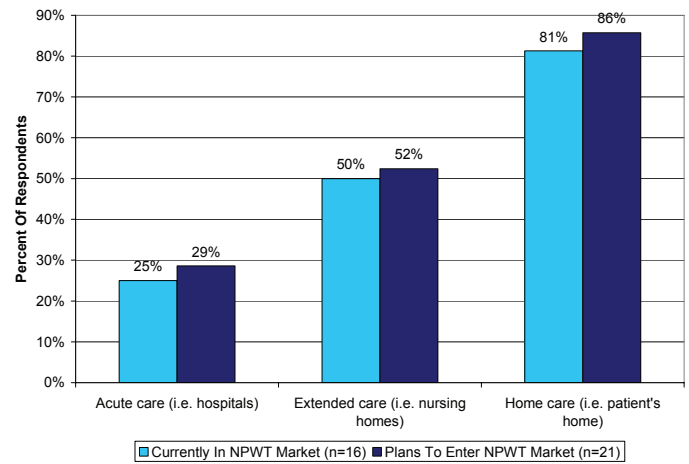
Most HMEs that offer or plan to offer NPWT are purchasing products from Smith & Nephew, Boehringer Wound Systems, and Medela. And while, not surprisingly, the HMEs are mainly focused on offering NPWT in the home care setting (84%), some are offering NPWT in the extended care (51%) and even acute care (27%) settings. We note that while CMS data shows that HMEs have struggled to collect Medicare payments for home-based NPWT (rejection rates are >75%), payments in the other care settings are from the facilities not insurers which may make it easier to collect payments.

Figure 25: From Which Supplier Do You Purchase NPWT Pumps?



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 26: In Which Care Settings Do You Offer NPWT?

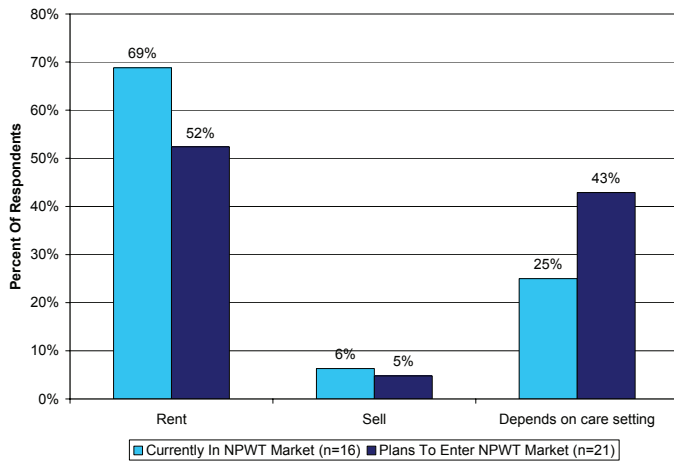


Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

...HMEs Offer NPWT Pumps Mainly Through Rentals With Rental Rates Below KCI's

We asked HMEs about their sales model for NPWT to determine if they were renting or selling the pumps. The majority of HMEs rent the pumps although some said that the sales model depends on the care setting. While we think it makes more sense economically for HMEs to rent pumps, it is possible that more cost sensitive customers may prefer to purchase rather than rent the pumps.

Figure 27: Sales Model For HMEs Offering Or Planning To Offer NPWT Products

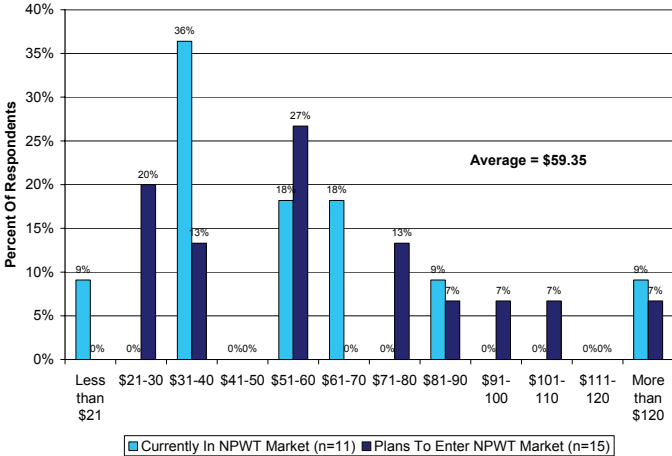


Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Medical Technology/Devices

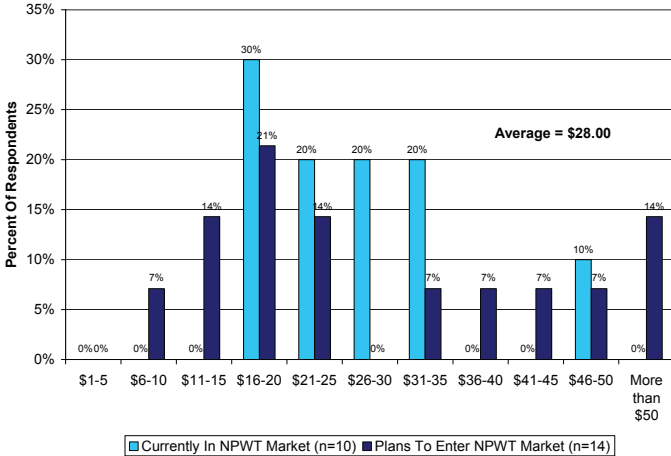
We asked the HMEs about the rental rates that they charge (or intend to charge) for NPWT pumps. While the sample size was small (26 total responses) and there was a wide range of responses, the average was \$59 per day (down slightly from \$63 in our prior survey). We also asked the HMEs about their pricing on dressings. On average, the HMEs charge \$28 per dressing (which is typically changed every two days). So the average cost for keeping a patient on NPWT works out to \$73 per day. We believe that this is about 19% below the rates that KCI charges (which we estimate are an average of \$90 per day).

Figure 28: What Is Your Daily NPWT Rental Rate?



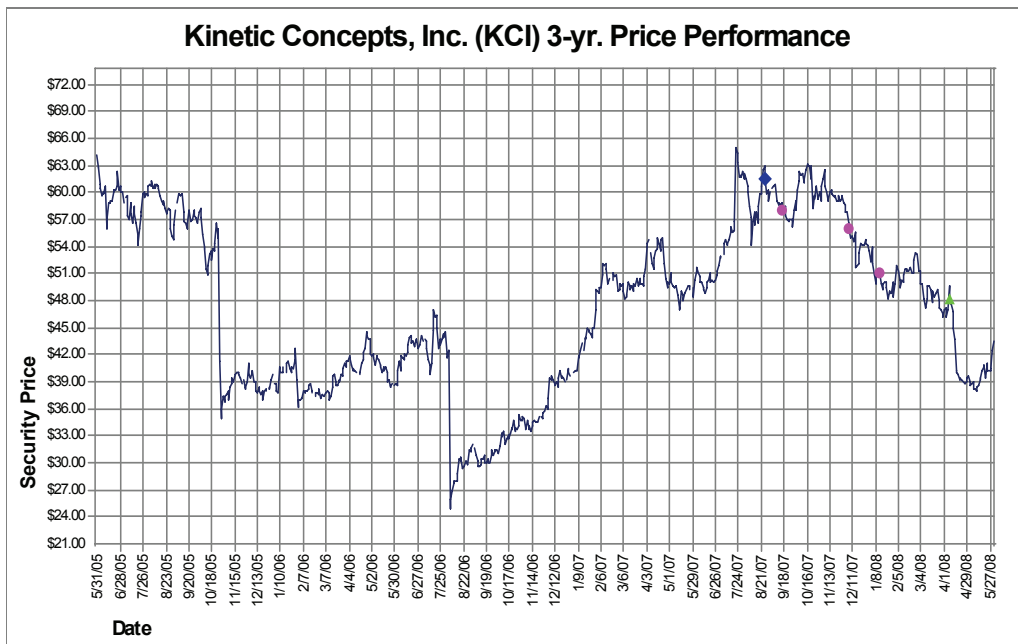
Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Figure 29: How Much Do You Charge Per Dressing?



Source: Wachovia Capital Markets, LLC Q2 2008 HME Survey

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	8/27/2007		Matson			
◆	8/27/2007	61.48	2	62.00	65.00	61.48
●	9/17/2007	58.11	2	60.00	65.00	58.11
●	12/6/2007	56.04	2	57.00	63.00	56.04
●	1/11/2008	51.10	2	52.00	57.00	51.02
▲ ●	4/8/2008	49.57	1	58.00	62.00	48.30

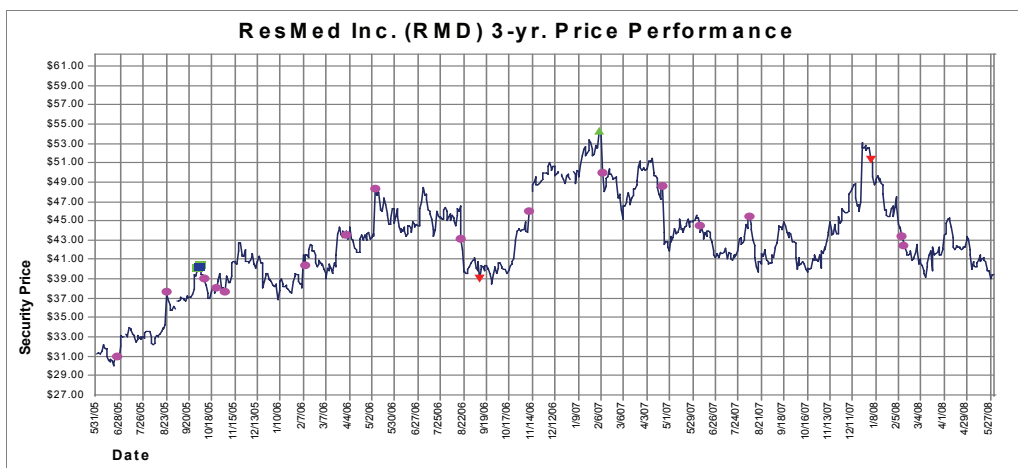
Source: Wachovia Capital Markets, LLC estimates and Reuters data

Symbol Key

- ▼ Rating Downgrade
- ▲ Rating Upgrade
- Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- Analyst Change
- Split Adjustment

Rating Code Key

- 1 Outperform/Buy
- 2 Market Perform/Hold
- 3 Underperform/Sell
- SR Suspended
- NR Not Rated
- NE No Estimate



Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
5/31/2005		Huber			
5/31/2005	NA	1	32.00	33.50	31.24
6/23/2005	NA	1	33.50	35.00	31.00
8/23/2005	NA	1	39.00	40.50	37.68
10/3/2005		2 for 1 stock split.			
10/3/2005		Matson			
10/7/2005	NA	1	78.00	81.00	39.04
10/24/2005	NA	1	39.00	40.50	38.00
11/3/2005	NA	1	42.00	44.00	37.60
2/8/2006	NA	1	46.00	48.00	40.41
3/30/2006	NA	1	48.00	50.00	43.48
5/5/2006	NA	1	49.00	52.00	48.36
8/18/2006	NA	1	52.00	55.00	43.10
9/11/2006	NA	2	40.00	44.00	39.04
11/9/2006	NA	2	42.00	47.00	46.02
2/2/2007	NA	1	61.00	66.00	54.26
2/7/2007	NA	1	60.00	65.00	50.00
4/23/2007	NA	1	50.00	55.00	48.64
6/6/2007	NA	1	52.00	56.00	44.44
8/7/2007	NA	1	50.00	54.00	45.40
1/2/2008	52.53	2	51.00	55.00	51.31
2/8/2008	44.33	2	40.00	45.00	43.36
2/12/2008	42.49	2	38.00	43.00	42.49

Source: Wachovia Capital Markets, LLC estimates and Reuters data

Symbol Key		Rating Code Key	
▼ Rating Downgrade	◆ Initiation, Resumption, Drop or Suspend	1 Outperform/Buy	SR Suspended
▲ Rating Upgrade	■ Analyst Change	2 Market Perform/Hold	NR Not Rated
● Valuation Range Change	□ Split Adjustment	3 Underperform/Sell	NE No Estimate

Additional Information Available Upon Request

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