Medical Technologies & Diagnostics

2Q16 HME Sleep and Oxygen Survey

REPORT HIGHLIGHTS: We worked with HME News to survey 87 home medical equipment dealers (HMEs) about the sleep and oxygen markets. Respondents expect their sleep volume growth to increase over the next 12 months though their forecasted growth rates are below our prior survey. CPAP price declines have worsened likely as a result of reimbursement cuts. Ratings for RMD’s flow generators have decreased while ratings for Respironics’ have increased and the two received equal ratings. RMD appears likely to lose flow generator and mask market share over the next 12 months. POC use by respondents is expected to grow rapidly over the next 12 months. We think that the survey is positive for INGN and negative for RMD.

- **Sleep patient volume growth is expected to increase.** Respondents saw their sleep patient volume grow by 3.6% in the last 12 months (LTM) and expect their sleep patient volume to grow by 6.0% in the next 12 months (NTM). However, these growth rates are below our prior survey results of 6.6% and 7.9%, respectively.

- **Flow generator and mask price declines have begun to worsen.** Respondents indicated that flow generator prices declined by 3.2% over the LTM (vs. a 2.1% decline in our prior survey), while mask prices declined by 2.4% over the LTM (vs. a 1.4% decline in prior survey). Pricing has begun to worsen after improving in our prior two surveys. We think this is the result of the latest Medicare reimbursement cuts and we expect pricing to worsen in 2H16 as additional cuts occur.

- **Ratings for RMD and Respironics flow generators have converged.** Ratings for RMD’s flow generators have decreased while ratings for Respironics’ have increased and the two received equal ratings at 5.8 out of 7.0. This probably isn’t too surprising since RMD launched its DreamStation platform in late 2015. And while RMD’s masks remain the highest rated, its lead over its competitors continues to narrow.

- **RMD looks likely to lose flow generator and mask market share.** Over the NTM, respondents expect RMD’s share of their flow generator purchases to decrease by 1.4% and its share of their mask purchases to decrease by 1.9%. Respondents expect Respironics’ share of their flow generator purchases to decrease by 2.0% and its share of their mask purchases to increase by 0.4%. And respondents expect other smaller companies’ share of their flow generator purchases to increase by 3.7% and their share of their mask purchases to increase by 2.1%.

- **Portable oxygen concentrator (POC) use should continue to increase.** POCs are expected to increase from 22.4% of the oxygen market to 26.8% over the next 12 months which implies 20% growth. Applied Home’s OxyGo (a private label Inogen G3) was the highest rated POC at 5.8 out of 7.0, followed by Respironics’ SimplyGo Mini at 5.3, and Inogen’s G3 at 5.1. The biggest factors limiting the use of more POCs remain the initial investment required and reliability concerns.

Companies Mentioned in Report:
- Inogen, Inc. (INGN: $46.22, PT: $58.00)
- ResMed Inc. (RMD: $60.52, PT: NA)

Relevant disclosures begin on page 14 of this report.
Survey Introduction

Needham & Company and HME News worked together to survey US home medical equipment providers (HMEs) about the sleep and oxygen equipment markets. Among the ~9,000 HME professionals that we sent the survey to, 87 responded to one or more of the survey questions for a total participation rate of around 1%. 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). The survey replies were received between 5/26/16 and 6/10/16.

Survey Results

Respondents expect slower sleep patient volume growth

In our earlier surveys, we asked HMEs about their sleep revenue growth. However, we switched to asking about patient volume growth instead starting with our 4Q13 survey, since revenue growth is affected by reimbursement changes and since we think that patient volume growth is more important for ResMed. As a result of this change, the responses to this question are not directly comparable to our prior surveys, although we have added these results to our time series chart in Figure 3.

On average, respondents reported 3.6% sleep patient volume growth in the last 12 months which is down from the 6.6% growth reported in our 4Q15 survey. And respondents expect 6.0% growth in the next 12 months which is also a decline from the 7.9% growth expected in our 4Q15 survey. Of the respondents, 24% saw a decline in their sleep patient volume in the last 12 months and 16% expect a decline in the next 12 months.

![Figure 1: Sleep patient volume growth (LTM)](source: Needham & Company 2Q16 HME Survey)

![Figure 2: Sleep patient volume growth (NTM)](source: Needham & Company 2Q16 HME Survey)
A majority of respondents is exposed to either the Round Two Re-Compete or National Expansion of Medicare competitive bidding

While only 25% of respondents reported that they have contracts for CPAP products in the Medicare Round Two re-compete, 51% of respondents reported that they are located in an area covered by Medicare’s National Expansion.

Recent price declines are moderating

Respondents indicated that the three major manufacturers reduced prices modestly in the last three months. Fisher & Paykel’s average prices declined by 0.4% while the average declines were 1.1% for ResMed and 1.8% for Respironics. These declines are smaller than our prior survey and a continuation of a trend of decreasing recent declines in our recent surveys. This data seems to conflict with our other pricing questions (discussed below) which indicates that prices are beginning to worsen. Given the significant reimbursement cuts occurring in 2H16, we still expect pricing to worsen this year.
Figure 6  By how much have the following companies’ CPAP prices changed in the past 3 months (in response to competitive bidding)?

Source: Needham & Company 2Q16 HME Survey

Fisher & Paykel looks like a relative share loser while smaller companies look like relative share winners in the wake of bidding

In response to competitive bidding, respondents expect to reduce their purchases of CPAP products from Fisher & Paykel the most, followed by ResMed, Respironics, and then other smaller companies the least. We think this indicates that ResMed is at risk of losing some market share due to the continued roll-out of competitive bidding.

Figure 8  How do you expect reimbursement declines to affect your purchases of CPAP products from the following companies over the next 12 months?

Source: Needham & Company 2Q16 HME Survey

Respondents’ preferred approach to dealing with reimbursement declines is to negotiate lower prices with their existing CPAP manufacturers

Respondents indicated that negotiating lower prices with their existing CPAP manufacturers remains the most important approach to dealing with declining reimbursement. This was followed by switching to lower priced manufacturers, giving Medicare patients lower cost products from existing manufacturers, and then giving Medicare patients lower cost products from new manufacturers.
ResMed may be at risk of losing some Brightree customers

A majority of respondents (61%) indicated that they are Brightree customers. Since some Brightree customers have expressed concern about the access to their data that the software system could provide to ResMed, we asked them about their views of the deal. More respondents (43%) have a negative view of the deal than those that have a positive view (18%). And more respondents (19%) indicated that they are less likely to use Brightree because of the deal than those that are more likely to use Brightree because of the deal (7%). As a result, we think that ResMed is at risk of losing some Brightree customers.

Use of auto-setting flow generators and bi-level flow generators looks likely to decrease modestly

Auto-setting flow generators were being used for about 49% of patients in the last 12 months and this looks likely to decrease to 48% of patients in the next 12 months. Auto-setting flow generators sell for a premium to standard flow generators so this could drive an unfavorable mix shift.
Bi-level flow generators were being used for 17% of patients in the last 12 months and this looks likely to decrease to 14% of patients in the next 12 months. Bi-level flow generators sell for a premium to standard flow generators so this could drive an unfavorable mix shift.

**Flow generator price declines have begun to worsen again**

Respondents indicated that flow generator prices declined by 3.2% in the last 12 months versus a 2.1% decline in our 4Q15 survey. This represents a reversal from the recent improvements in our last two surveys and could be a sign that the latest competitive bidding reimbursement cuts are beginning to hurt prices. With additional reimbursement cuts occurring in 2H16, we think that pricing could continue to get worse.
ResMed looks likely to lose flow generator market share in the next 12 months

ResMed’s flow generator market share may decline by 1.4% over the next 12 months. Respondents indicated that ResMed’s flow generators currently make up 40.5% of their purchases and expect this to decline to 39.1% in the next 12 months. Fisher & Paykel’s flow generator market share may decline by 0.3% and Respironics’ market share may decline by 2.0% over the next 12 months. The other smaller manufacturers’ market share may increase by 3.7% over the next 12 months.

Respironics DreamStation was rated the same as ResMed’s AirSense 10

Respironics DreamStation flow generator platform was rated at 5.8 out of 7.0, in line with Respironics’ DreamStation flow generator platform at 5.8 but above Fisher & Paykel’s Icon flow generator platform at 4.7. We think this is concerning since ResMed’s AirSense 10 platform had been rated significantly higher than Respironics in our last three surveys and this coincided with significant market share gains on ResMed’s part. We think that this means that Respironics’ DreamStation platform has begun to level the playing field and that flow generator market share trends could stabilize or even reverse.
ResMed’s compliance tracking hardware and software received the highest ratings

We asked the HMEs to rate the compliance tracking approaches taken by ResMed’s AirSense 10 (built-in cellular capability) and Respironics’ DreamStation (modular cellular or Wi-Fi capability). Respondents preferred ResMed’s approach, rating it 6.1 out of 7.0 compared with Respironics’ approach, which was rated 5.7. We also asked the HMEs to rate ResMed’s and Respironics’ compliance monitoring software. The ratings were closer here with ResMed’s AirView receiving a 5.8 out of 7.0 and Respironics EncoreAnywhere receiving a 5.6.

ResMed’s built-in compliance tracking is an advantage to Respironics’ modular compliance tracking; cellular is the most popular data collection method

A majority of respondents (49%) indicated that ResMed’s built-in cellular compliance tracking capability is an advantage when compared to Respironics’ modular cellular/Wi-Fi compliance tracking. More specifically, 23% of respondents indicated that they plan to purchase more ResMed flow generators because of the built-in cellular capability.
Figure 24  Is ResMed’s built-in cellular compliance tracking an advantage or disadvantage when compared to Respironics’ modular cellular or Wi-Fi compliance tracking?

Respondents indicated that mask prices declined by 2.4% in the last 12 months versus a 1.4% decline in our 4Q15 survey. This represents a reversal from the recent improvements in our last two surveys and could be a sign that the latest competitive bidding reimbursement cuts are beginning to hurt prices. With additional reimbursement cuts occurring in 2H16, we think that pricing could continue to get worse.

Figure 25  Change in mask prices (LTM)

Figure 26  Change in mask prices (time series)

ResMed looks likely to lose mask market share in the next 12 months

ResMed’s mask market share may decline by 1.9% over the next 12 months. Respondents indicated that ResMed’s masks currently make up 44.1% of their purchases and expect this to decline to 42.2% in the next 12 months. Fisher & Paykel’s mask market share may decline by 0.6% and Respironics’ market share may increase by 0.4% over the next 12 months. The other smaller manufacturers’ market share may increase by 2.1% over the next 12 months.
ResMed’s masks remain the highest rated

ResMed’s masks remain the highest rated followed by Respironics in second place and Fisher & Paykel in third place. In standard nasal masks, ResMed’s Mirage FX and AirFit N10 were rated the highest at 5.5 and 5.2 out of 7.0, while Respironics’ Wisp and Fisher & Paykel’s Eson were rated 5.1 and 4.7, respectively.

In nasal pillow masks, ResMed’s AirFit P10 was rated the highest at 5.9 out of 7.0, while Respironics’ DreamWear and Fisher & Paykel’s Opus 360 were rated 5.6 and 4.5, respectively.
And in full face masks, ResMed’s AirFit F10 was rated the highest at 5.8 out of 7.0, while Fisher & Paykel’s Simplus and Respironics’ Amara View and were rated 5.5 and 5.3, respectively.

**Portable oxygen concentrator (POC) use is likely to increase in the next 12 months**

While delivered tanks currently represent 47.7% of the ambulatory oxygen market, HMEs expect these to see the biggest decline, by 6.6% to 41.1% of the market over the next 12 months. Delivered tanks are expected to be replaced by both home-fill systems, which are expected to increase by 2.5% from 29.0% of the market to 31.5% over the next 12 months, and POCs, which are expected to increase by 4.4% from 22.4% to 26.8% over the next 12 months. If this proves accurate, it implies that POC sales to HMEs would increase by 20% over the next 12 months.
Applied Home Healthcare’s OxyGo (private label version of Inogen’s G3) received highest rating

Applied Home’s OxyGo (a private label version of Inogen’s G3) was rated the highest at 5.8 out of 7.0. This was followed by Respironics SimplyGo Mini (5.3), Inogen’s G3 (5.1), and Precision Medical’s EasyPulse (4.7). We think this indicates that the high rating of OxyGo should mean that Inogen can gain share within the HME channel.

Most HMEs offer POCs to at least some patients but concerns about the upfront investment and poor reliability are limiting POC use

Most HMEs (82%) offer POCs to patients willing to pay for them out of their own pocket. Similarly, 78% offer POCs on a rental basis to patients that are traveling. A smaller, but still substantial portion of HMEs indicated that they offer POCs to patients with private insurance (60%), Medicare (56%), and Medicaid (36%). Respondents cited the initial investment (53%), reliability concerns (37%), and concerns about profitability (2%) as the primary factors that limit their use of POCs.
Figure 38  What type of payors does your firm offer POCs to?

Source: Needham & Company 2Q16 HME Survey

Figure 39  What are the biggest factors limiting your firm’s use of portable oxygen concentrators?

Source: Needham & Company 2Q16 HME Survey
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