



Equity Research Q2 2009 HME Sleep Survey

May 14, 2009

Sector Rating: Respiratory, Market Weight

Company Name	Stock Rating	Price 05/14/09	FY EPS 2009E	FY EPS 2010E	FY P/E 2009	FY P/E 2010
Respiratory						
ResMed Inc. (RMD)	2V	\$38.39	\$1.93	\$2.18	19.9x	17.6x

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

- **Sleep Market Growth May Slow Slightly.** We partnered with *HME Business* magazine to conduct our 6th biannual survey of home medical equipment dealers (HMEs). The survey included responses from 183 HMEs received from 4/29/09-5/13/09. HMEs expect sleep revenue to grow by 9% (down from 10% in our prior survey) in the next 12 months after growing at 7% (down from 8% in our prior survey) in the last 12 months. Since this is a bit below our prior 2009 U.S. sleep market estimate of 10-12% growth, we are lowering our estimate to 8-10% growth.
- **Economy Is A Modest Headwind For Sleep Market.** On average, the HMEs expect the economy to slow their sleep business growth by 1.4%. More specifically, 53% of HMEs have seen a decline in "out-of-pocket" CPAP purchases, 42% have seen patients replacing masks less frequently, and 32% have seen a decline in sleep center referrals. A majority (59%) of HMEs have reduced inventories to conserve cash though only a minority (26%) have had to pay higher interest rates on loans.
- **RMD's Share Gains Likely To Continue In Near Term.** RMD's S8 II was rated 5.9 (up from 5.7 in our prior survey) on a scale from 1 (very poor) to 7 (very good) while Respirationics' M Series was rated 5.5 (down from 5.8 in our prior survey). RMD's Swift LT was rated 5.9 (up from 5.8 in our prior survey) while Respirationics' OptiLife was rated 4.9 (down from 5.2 in our prior survey). RMD looks likely to gain share in both flow generators (38% expect to increase purchases, 13% to decrease) and masks (43% expect to increase purchases, 11% to decrease). Respondents use bi-level flow generators in 12% of patients (with RMD's VPAP rated 5.8 vs. Respirationics' Bi-PAP rated 5.7) and compliance tracking in 66% of patients (with RMD's ResTraxx rated 5.4 vs. Respirationics' Encore rated 5.5).
- **Reimbursement Issues May Pressure RMD.** Many HMEs (44%) have already begun to implement changes to lower costs ahead of competitive bidding. HMEs appear most likely to negotiate lower prices with existing suppliers (52% likely or very likely) and to move Medicare patients to lower cost CPAPs with their existing suppliers (42% likely or very likely). And 90% (up from 81% in our prior survey) of HMEs expect private insurers to cut reimbursement based on Medicare's cut; this represents potential downside of up to \$0.35 to our \$2.31 CY 2010 EPS estimate.
- **Survey Is A Mixed Bag For RMD In Our View; Maintain Our Market Perform Rating.** On one hand, the U.S. sleep market appears reasonably stable with minimal economic impact and RMD looks likely to continue to gain market share. On the other hand, HMEs are taking steps to address the coming reimbursement pressures and private insurers may follow Medicare's reimbursement cuts. With RMD shares trading in line with small-cap GARP peers, we maintain our Market Perform rating.

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, 183 responded to one or more of the survey questions for a total participation rate of about 4%. 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 183 respondents, 140 (or 77%) completed the entire survey. The surveys replies were received between 4/29/09 and 5/13/09.

Survey Says...

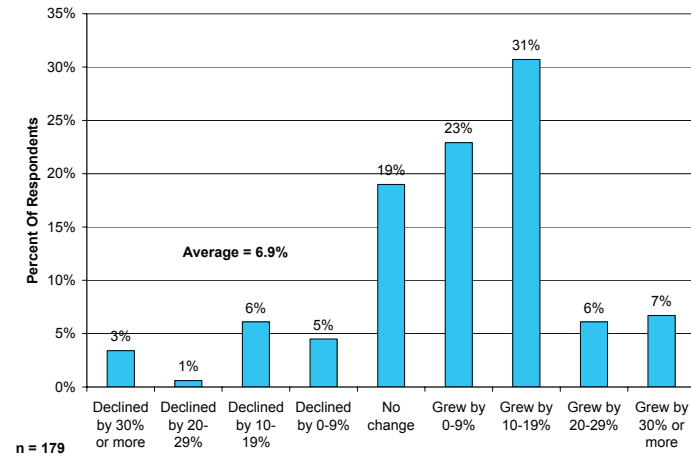
Sleep Therapy Questions

...HME Expectations For Sleep Revenue Growth Have Stabilized At 10%

On average, HMEs report 6.9% growth in the past 12 months and expect 9.4% growth in the next 12 months. The retrospective growth was down 120 bps from 8.1% in our Q4 2008 survey while the forward outlook was down 30 bps from 9.7% in our Q4 2008 survey. Of the respondents, 15% saw a decline in their sleep revenue in the past 12 months (vs. 15% in our prior survey) and 10% expect a decline in the next 12 months (vs. 7% in our prior survey). These growth rates are below our estimate of low-teens (10-12%) domestic growth and as a result we are lowering our 2009 domestic growth estimate to 8-10%.

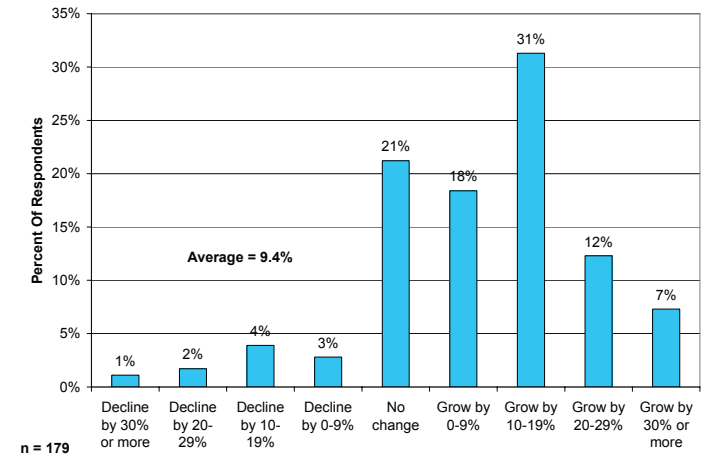
This our sixth HME survey and in each survey expectations of market growth have declined (5 times) or been flat (1 time). This is consistent with our belief that the domestic sleep market has been steadily slowing due to greater penetration (which we estimate is around 35-40%) and slower expansion at sleep labs ahead of home testing.

Figure 1: Sleep Revenue Growth Past 12 Months



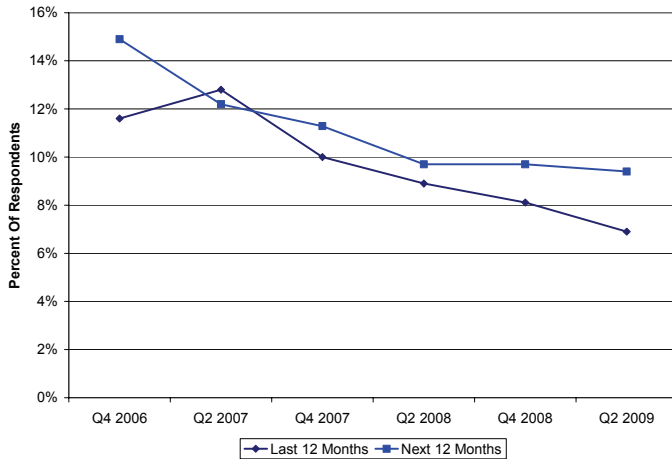
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 2: Sleep Revenue Growth Next 12 Months



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 3: Sleep Revenue Growth (Time Series)

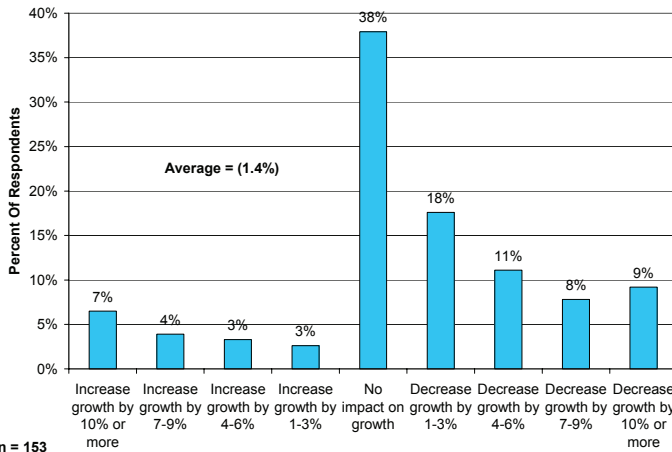


Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

...Recession Is Creating Modest Headwinds For The Sleep Market

Given the current severe recession, we added several new questions on the economy to this survey. On average, the HMEs expect the economy to slow their sleep business growth by 1.4% which is smaller than the 2-4% impact we had expected. More specifically, 53% of HMEs have seen a decline in "out-of-pocket" CPAP purchases, 42% have seen patients replacing masks less frequently, and 32% have seen a decline in sleep center referrals.

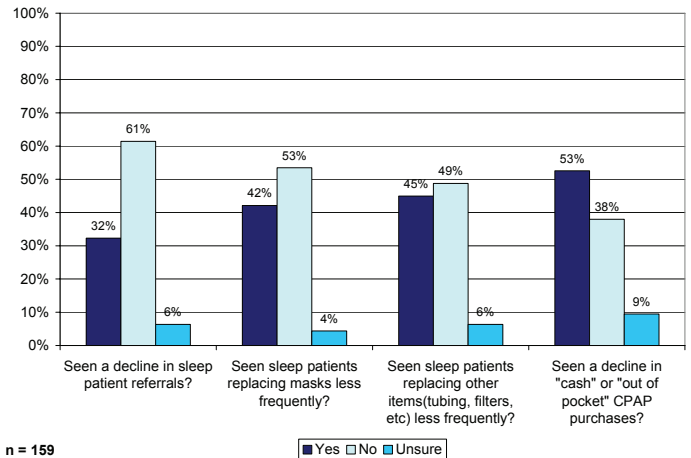
Figure 4: How Much Do You Expect The Economy To Help Or Hurt Your Sleep Business In The Next Year?



n = 153

Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 5: Given The Slowdown In The Economy, Has Your Firm:

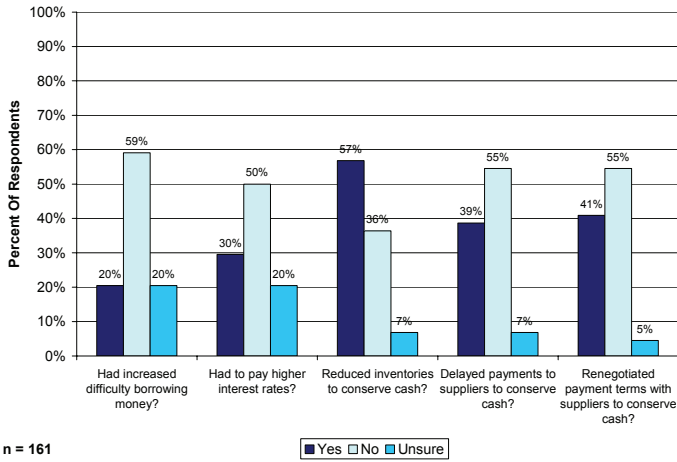


n = 159

Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Finally, we asked questions about the impact of the economy and credit crunch on the HMEs themselves (and not just their customers) since the HMEs are the direct customers of ResMed and other CPAP manufacturers. The HMEs do appear to be reducing their working capital but have generally not seen major difficulties raising capital. For example, HMEs have reduced inventories (57%), renegotiated payment terms with suppliers (41%) and delayed payments to suppliers (39%) to preserve cash. However, only on a minority of HMEs indicated that interest rates had increased (30%) or that borrowing had become more difficult (20%).

Figure 6: Given The Recent Credit Market Turmoil, Has Your Firm:



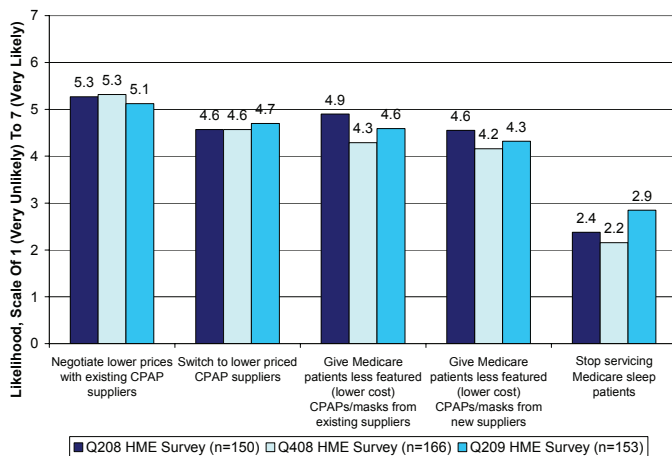
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

... HMEs Are Taking Steps To Rein In CPAP Costs Ahead Of Medicare's Competitive Bidding Program

We suspected that the slowdown in the domestic sleep market may have been due in part to HMEs preparing to deal with competitive bidding (and this year's 9.5% reimbursement cut). We asked questions to determine how the HMEs intend to deal with 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 (potentially driving a negative mix shift). 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.

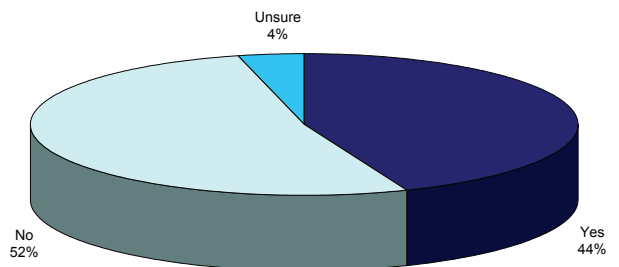
Many HMEs (44% of respondents) indicated that they have already begun to implement some of these strategies. Given that competitive bidding will be rolled out over the next few years, we think that the domestic market may remain under pressure for some time.

Figure 7: When And If Medicare's Competitive Bidding Program Is Implemented In Your Area, How Likely Is Your Firm To Do The Following: (Time Series):



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 8: Has Your Firm Begun To Implement Any Of These Changes Yet?



n = 153

Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

...There Is A Risk That Medicare's Reimbursement Cuts Spill Over To Private Insurers

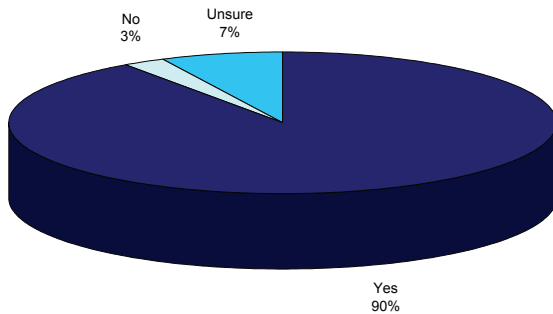
We have been operating under the assumption that the declines in Medicare CPAP reimbursement that result from competitive bidding will not be followed by private insurers (and this assumption is factored into our current estimates). ResMed management has noted that private insurance pays significantly less than Medicare and that competitive bidding dynamics already exist. Medicare only makes up around 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 were spill over to private insurers, up to 50% of ResMed's revenue would be exposed. We asked a question in our surveys to attempt to test this assumption. In our latest survey, 90% of respondents indicated that they expect private insurers to lower their reimbursement as a result of Medicare's cuts under competitive bidding. These results appear to indicate that there is potential for at least some private insurers to cut reimbursement leading to greater than currently assumed exposure for ResMed. In the worst case scenario with all private insurers following Medicare's cuts in lock-step (which is admittedly unlikely), we estimate that ResMed's EPS could be reduced by up to \$0.08 more than we have modeled in calendar 2010, up to \$0.35 more than we have modeled in calendar 2011, and up to \$0.42 more than we have modeled in calendar 2011 (see table below).

Potential EPS Impact Of Medicare Competitive Bidding

ResMed (RMD)	Best Case: Medicare Only			Worst Case: Medicare + Private Pay		
	CY 2010E	CY 2011E	CY 2012E	CY 2010E	CY 2011E	CY 2012E
Incremental Revenue Exposure	1.0%	4.6%	5.5%	5.0%	22.8%	27.4%
Incremental Price Erosion	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Revenue % Reduction	(0.3%)	(1.4%)	(1.6%)	(1.5%)	(6.8%)	(8.2%)
Margin Impact	(0.2%)	(0.8%)	(1.0%)	(0.8%)	(3.9%)	(4.8%)
EPS Impact	(\$0.02)	(\$0.09)	(\$0.11)	(\$0.10)	(\$0.44)	(\$0.53)

Source: Company reports and Wachovia Capital Markets, LLC estimates

Figure 9: Do You Believe That Other Insurers Will Follow Medicare's Cuts To CPAP Reimbursement From Competitive Bidding With Cuts Of Their Own?



n = 155

Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

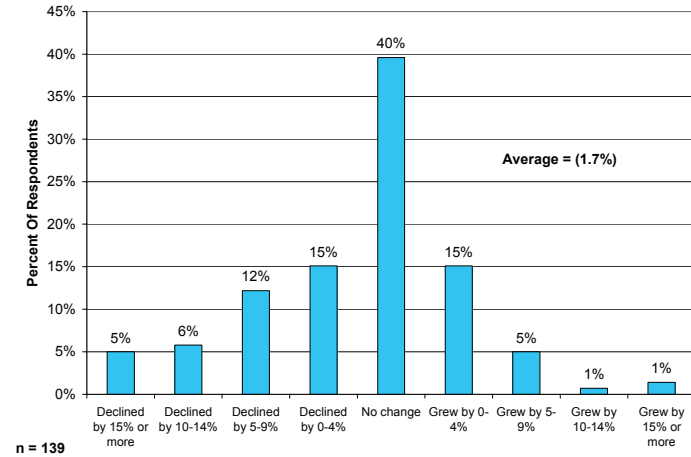
...Price Declines Have Decreased On Flow Generators But Increased On Masks

HMEs report that the average prices that they pay for flow generators and masks declined by averages of 1.7% and 1.5%, respectively, over the past 12 months. The flow generator price declines have eased some since our last survey (1.7% vs. 2.5% in our prior survey) while mask price declines have intensified some since our last survey (1.5% vs. -0.1% in our prior survey).

The manufacturers cite 5-15% annual price declines, however, with ResMed typically at the lower end of this range and Respirationics typically at the higher end. How do we explain this differential? We think that the

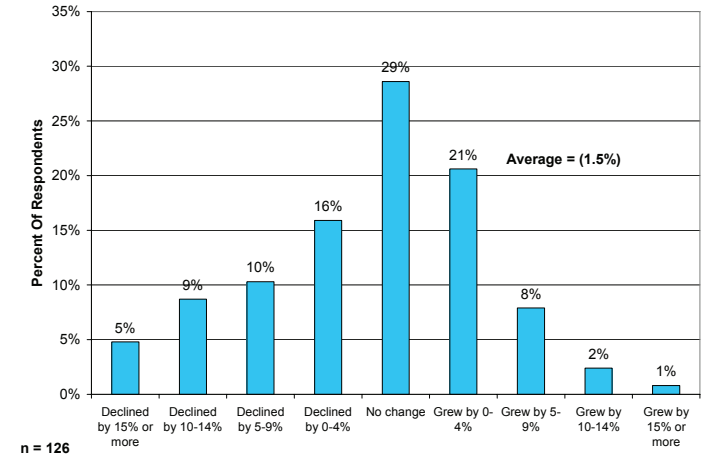
manufacturers refer to pure pricing while the HMEs refer to average selling prices which account for the effect of mix shifts as well as pricing. While these mix shifts continue to be positive, we think that reimbursement pressures may slow mix shifts over the next few years.

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



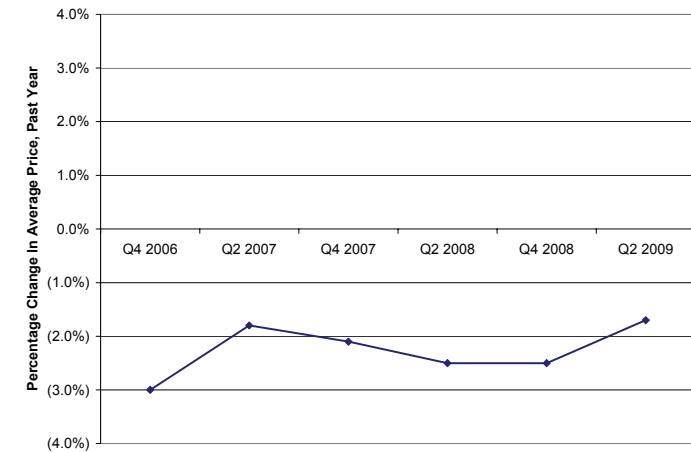
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 11: By What % Has The Average Price You Pay For A Mask Changed In Past 12 Months?



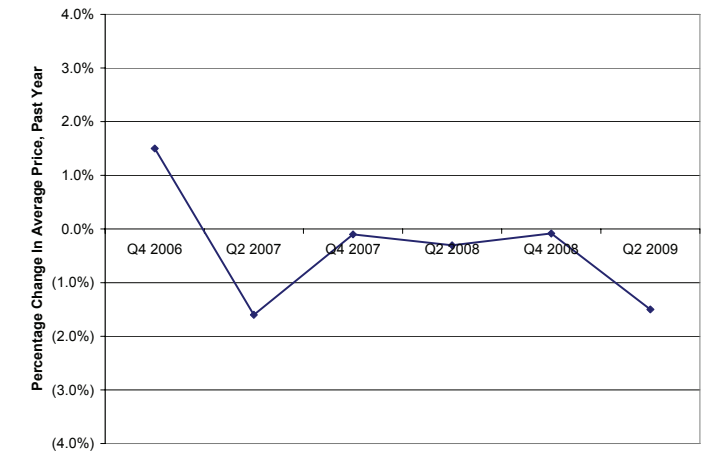
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 12: Change In Average Flow Generator Prices (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 13: Change In Average Mask Prices (Time Series)

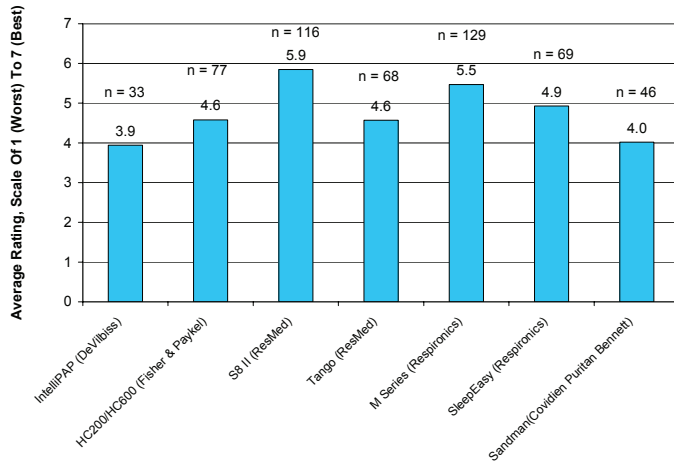


Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

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

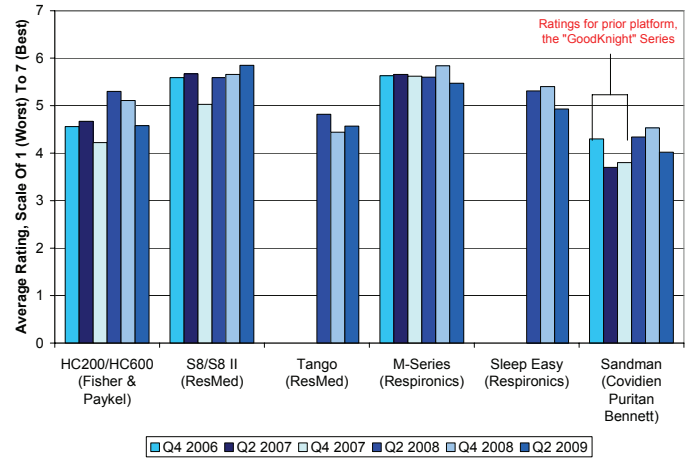
ResMed's newest flow generator, the S8 II was rated slightly higher than in our Q4 2008 survey at 5.9 out of 7.0 (vs. 5.7 in our prior survey). In contrast, Respironics' M-Series was rated slightly lower than in our Q4 2008 survey at 5.5 out of 7.0 (vs. 5.8 in our prior survey). We think this is a sign that ResMed has gained the upper hand in flow generators and that the HMEs have begun to recognize the improvements that ResMed has made with its Easy-Breathe motor system. Fisher & Paykel's HC200/HC600 was rated 4.6, down from 5.1 in our prior survey, while Covidien's Sandman was rated 4.0, down from 4.5 in our prior survey. We also had the HMEs rate the newer low-end flow generators from ResMed and Respironics. The HMEs gave ResMed's Tango a 4.6 and Respironics' Sleep Easy a 4.9.

Figure 14: Flow Generator Platform Ratings



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

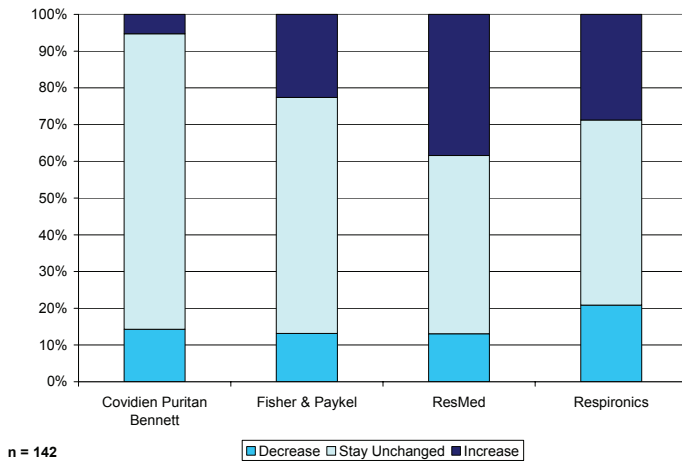
Figure 15: Flow Generator Platform Ratings (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

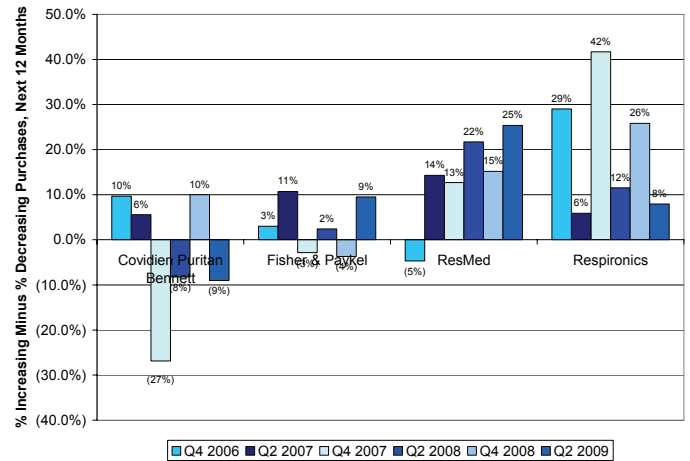
Consistent with the ratings, the HMEs indicated that they intend to increase their purchases of ResMed's flow generators by more than any other companies' flow generators (38% of respondents expect to increase ResMed's flow generator purchases vs. 13% that expect to decrease purchases). Respironics' still appears to have a strong trajectory (29% expect to increase purchases, 21% to decrease) while Fisher & Paykel looks likely to hold flow generator market share and Covidien (COV) looks likely to continue to lose flow generator market share despite its improved product line-up.

Figure 16: In Next 12 Months Will Your Flow Generator Purchases Decrease, Increase, Or Stay Unchanged...



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 17: Difference In % Of Respondents Increasing Vs. Decreasing Purchases (Time Series)



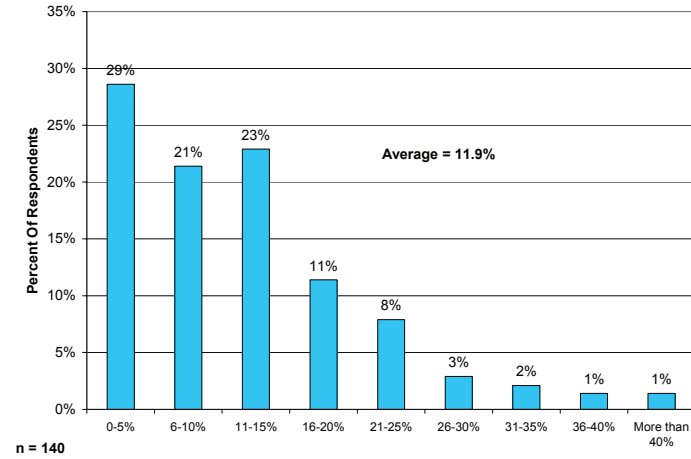
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

...Bi-Level Flow Generators Represent A Small Portion Of CPAP Market And ResMed Appears To Have A Slight Edge Over Respironics

To gauge the size of the bi-level segment of the CPAP market, we asked the HMEs what portion of the patients use bi-level flow generators. According to our respondents, bi-levels make up around 12% on average. Assuming the bi-levels cost an average of 2.5x more than a standard flow generator, these high-end units make up 30% of the market on a dollar basis. Until recently, Respironics had the upper hand in the bi-level segment since it sold bi-level units on its compact M Series platform while ResMed only had bi-level units on its bulky S7 platform. In the past year, however, ResMed rolled out new versions of its bi-level units on its smaller S8 platform and appears to have closed the gap with Respironics' offerings. Market share

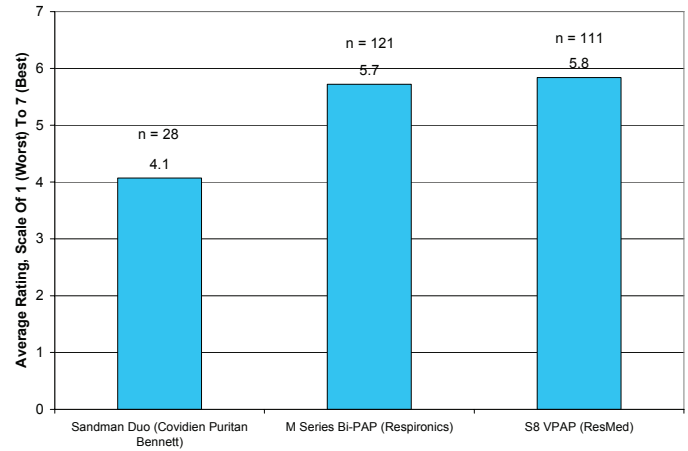
gains in the bi-level segment have been an important driver of ResMed's recent revenue growth and margin expansion. Our survey supports ResMed's claims and ResMed's new VPAP bi-level line-up was rated slightly higher than Respirationics (5.8 vs. 5.7).

Figure 18: In What Portion Of Your Patients Do You Use A Bi-Level Flow Generator?



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 19: Bi-Level Flow Generator Platform Ratings

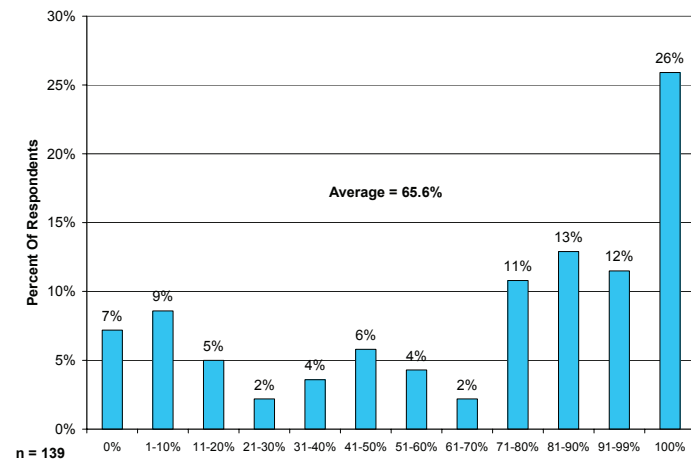


Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

...Flow Generators With Compliance Tracking Are Used In A Majority Of Patients And ResMed's and Respirationics' Compliance Tracking Systems Are Neck-In-Neck

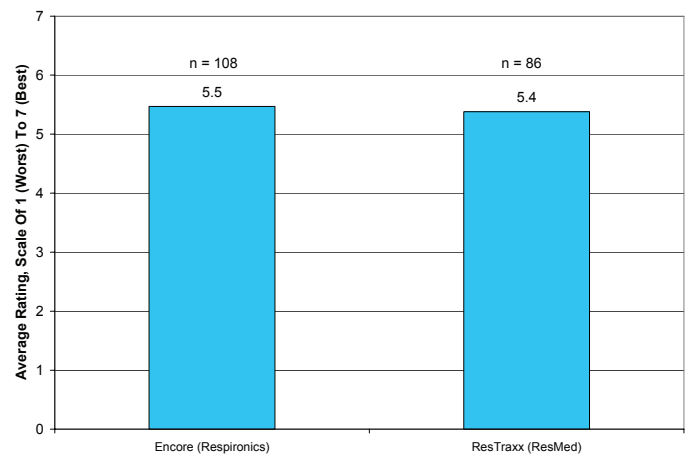
Medicare recently added a requirement for a data report showing that patients use CPAP for at least 4 hours per night for 70% of nights during a consecutive 30 day trial period. According to ResMed, this is driving an increased interest in compliance tracking technologies and ResMed believes that its ResTraxx—a "piggy-back" device introduced a few years ago that allows wireless compliance tracking—is well-suited for this task. Unlike Respirationics' Encore compliance tracking system, which uses a dial-up modem, ResMed's ResTraxx uses cell-phone signals to transmit the data minimizing the burden on the patient.

Figure 20: In What Portion Of Patients Do You Use Compliance Tracking Technologies?



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 21: Compliance Tracking System Ratings



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Since this is a potential driver for ResMed, we asked the HMEs about their use of compliance tracking technologies and the results showed that the HMEs use compliance tracking for an average of 66% of their patients. We suspect that this may be because many private insurers (around 80% of the payer mix) already

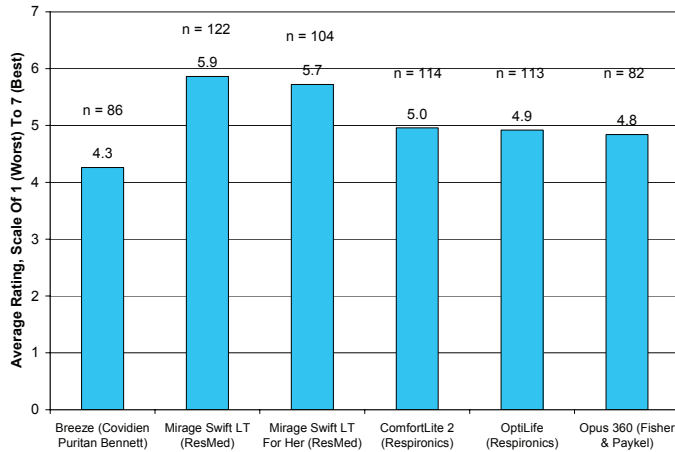
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require this. Compliance tracking technologies come in numerous forms (data storage cards, etc) so this answer doesn't imply that the higher-end internet-based systems like ResTraxx or Encore are used in anywhere close to the full 66% of patients. We also asked the HMEs to rate these two systems; Encore was rated slightly higher at 5.5 versus ResTraxx at 5.4.

... ResMed's Masks Were Rated Highest And ResMed Looks Likely To Gain Mask Market Share

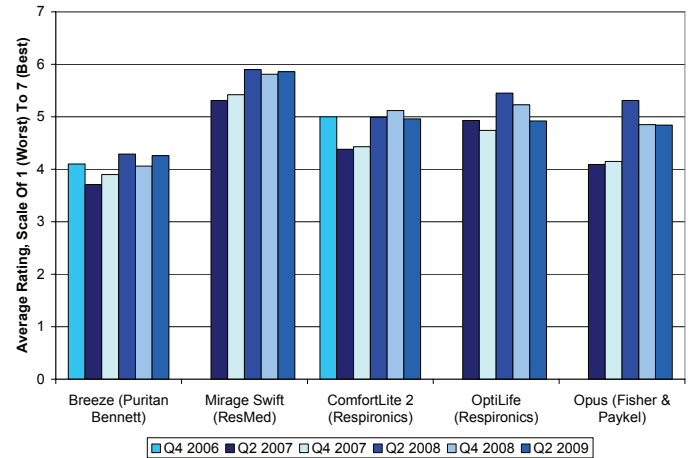
ResMed continues to have the best masks according to our survey. In the nasal pillow category, ResMed's Swift LT and Swift LT For Her were the highest rated at 5.9 and 5.7 (out of 7.0), respectively, followed by Respirationics' OptiLife (4.9) and ComfortLite 2 (5.0), Fisher & Paykel's Opus (4.8), and Covidien's Breeze (4.3).

Figure 22: Nasal Pillow Mask Ratings



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

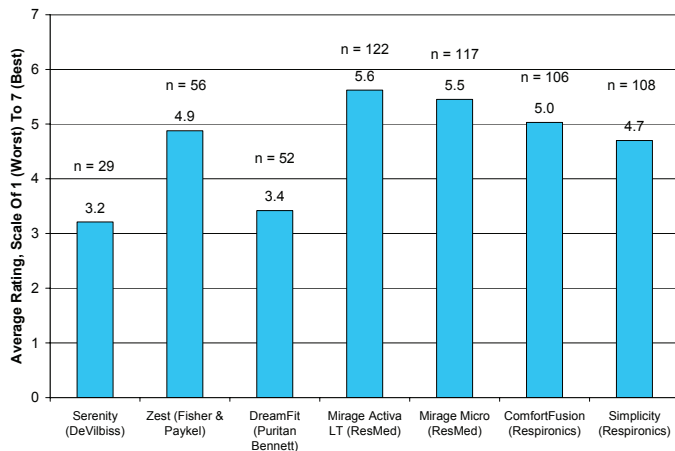
Figure 23: Nasal Pillow Mask Ratings (Time Series)



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

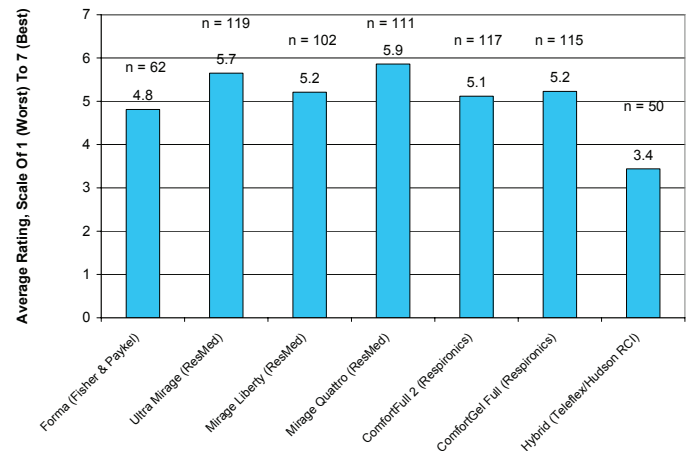
In the nasal mask category, ResMed's Mirage Activa LT and Mirage Micro were the highest rated at 5.6 and 5.5 (out of 7.0), respectively, followed by Respirationics' ComfortFusion (5.0) and Simplicity (4.7), Fisher & Paykel's Zest (4.9), Covidien's DreamFit (3.4), and DeVilbiss's Serenity (3.2). And in the full face mask category, ResMed's Mirage Quattro, Ultra Mirage, and Mirage Liberty were the highest rated at 5.9, 5.7, and 5.2 (out of 7.0), respectively, followed by Respirationics' ComfortGel Full (5.2) and ComfortFull 2 (5.1), Fisher & Paykel's Forma (4.8), and Teleflex's Hybrid (3.4).

Figure 24: Nasal Mask Ratings



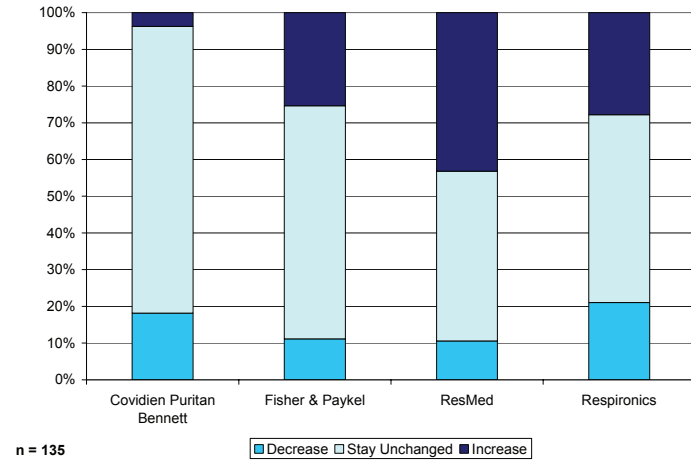
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 25: Full Face Mask Ratings



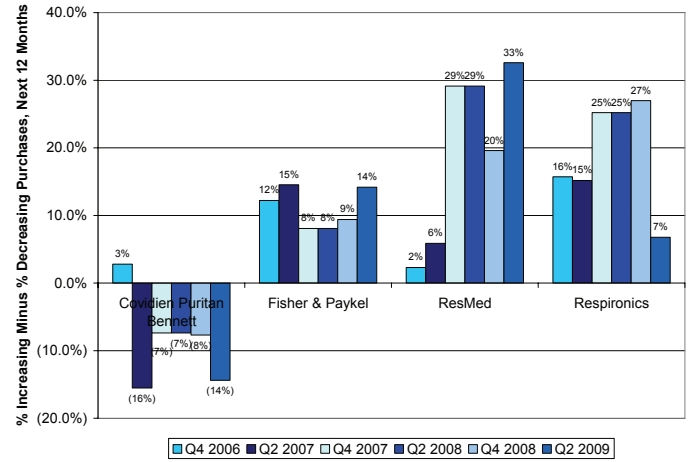
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 26: In Next 12 Months Will Your Mask Purchases Decrease, Increase, Or Stay Unchanged...



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 27: Difference In % Of Respondents Increasing Vs. Decreasing Purchases (Time Series)

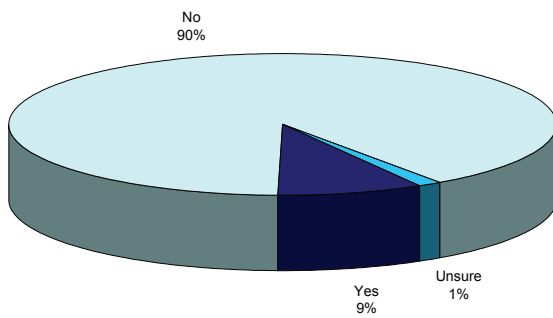


Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

...Few HMEs Currently Administer Home Sleep Apnea Tests Though More Plan To Start

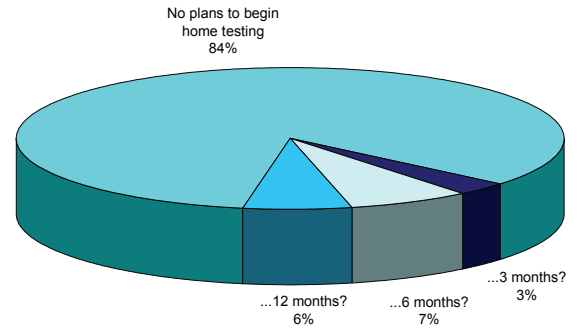
Only 9% of respondents currently offer patients home testing for sleep apnea. Another 16% of respondents plan to begin offering home testing over the next 12 months (consistent with our prior survey) with the bulk starting in 6 months or more. This supports our view that while home testing could be a significant driver for ResMed and the sleep market, few HMEs have taken the plunge to begin offering home testing possibly due to restrictions by payers.

Figure 28: Does Your Firm Currently Administer Home Tests For Sleep Apnea?



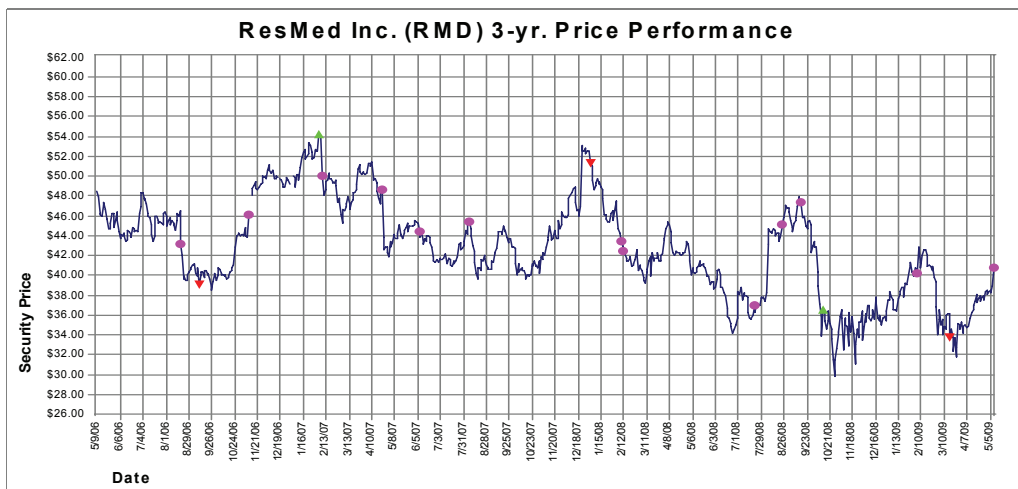
Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Figure 29: Does Your Firm Plan To Begin Administering Home Tests For Sleep Apnea In The Next...



Source: Wachovia Capital Markets, LLC Q2 2009 HME Survey

Required Disclosures



	Date	Publication Price (\$)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price (\$)
	5/9/2006		Matson			
	5/9/2006	NA	1	49.00	52.00	48.50
▼	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
●	7/21/2008	37.00	2	36.00	39.00	37.00
●	8/25/2008	45.17	2	43.00	47.00	45.17
●	9/16/2008	47.40	2	44.00	48.00	47.40
▲	10/13/2008	33.90	1	40.00	44.00	36.54
●	2/5/2009	40.19	1	42.00	46.00	40.19
▼	3/17/2009	36.08	2	34.00	38.00	33.68
●	5/8/2009	38.99	2	38.00	42.00	40.75

Source: Wachovia Capital Markets, LLC estimates and Reuters data

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

Additional Information Available Upon Request

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2 = Market Perform: The stock appears appropriately valued, and we believe the stock's total return will be in line with the market over the next 12 months. HOLD

3 = Underperform: The stock appears overvalued, and we believe the stock's total return will be below the market over the next 12 months. SELL

SECTOR RATING

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U = Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

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V = A stock is defined as volatile if the stock price has fluctuated by +/-20% or greater in at least 8 of the past 24 months or if the analyst expects significant volatility. All IPO stocks are automatically rated volatile within the first 24 months of trading.

As of: May 14, 2009

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