

LIBERATOR MEDICAL HOLDINGS, INC. (OTC BB: LBMH)

August 26, 2009

Industry: Medical Supplies

Fiscal Year Ends September 30

FYE Sept (US \$)	2008A	2009E	2010E	2011E
Revenue	9.3M	25.6M	42.8M	69.1M
Operating Profit	(0.8)M	2.5M	6.5M	15.3M
Net Income	(1.3)M	1.5M	3.6M	9.3M
EPS	(0.04)	0.03	0.07	0.17
P/E	n/a	41.7	14.3	5.9

Closing Price \$1.34 (08/25/09)
 52-Week High \$1.34
 52-Week Low \$0.31
 Shares Outstanding 32.3 million shares
 Market Cap \$40.71 million
 Share Volume (3 mo) 33,371 shares



Investment Conclusion

Liberator Medical Holdings, Inc. (OTC BB: LBMH) provides investors with the opportunity to establish an early position in the expanding direct-to-consumer medical supplies products space. Due to changes in reimbursement of certain categories, the direct-to-consumer medical supplies market will continue to grow. These Medicare changes have allowed LBMH's experienced management team to capitalize on new product segments with recurring revenue, low customer attrition and high margins.

Similar to the highly successful direct-to-consumer diabetes model created by LBMH founder, Chairman and CEO Mark Libratore (founder of Liberty Medical Supplies, Inc.), LBMH is fast becoming a leading supplier in the direct-to-consumer medical supply space. With gross margins over 60%, a 10 to 1 or more return on advertising dollars and proven leadership, we believe LBMH is poised to achieve impressive sales and earnings growth. We are initiating coverage LBMH with a BUY recommendation and a \$2.75 price target.

See the last page of this report for important Disclosure Information.

AVALON S.T.E.P. ANALYSIS

Story Line

Liberator Medical Holdings, Inc. (LBMH) offers an attractive opportunity to invest in the direct-to-consumer medical supply space, with an emphasis on the rapidly growing urological, mastectomy and ostomy categories. In the past 18 months, the Company has grown its annual revenue run rate from approximately \$3 million to \$28 million. The Company has been profitable for the last four consecutive quarters.

LBMH has a first mover advantage in urology and mastectomy, process expertise and intimate knowledge of the reimbursement system, which provide potential barriers to entry. The company was founded by CEO Mark Libratore, who founded and grew direct-to-consumer diabetes supplier Liberty Medical into a \$100 million business. Liberty was sold to PolyMedica in 1996. In 2007, MedcoHealth Solutions (NYSE: MHS) acquired PolyMedica for \$1.5 billion, largely on the strength of its Liberty unit.

LBMH has a proven business model with high margins and returns on advertising dollars. Investors have the opportunity to invest in a leading distributor of direct-to-consumer medical supplies. An aging U.S. population will lead to increases in the First Research, Inc. estimated \$55 billion home healthcare market. The home healthcare industry includes medical and skilled nursing services; medical equipment, supplies, and medication services; therapeutic; and psychosocial services. Currently, 18,000 companies operate within this highly fragmented industry with the largest 50 companies accounting for less than 25% of the market. The number of distributors is likely to consolidate and contract as a new Medicare regulation requiring accreditation and bonding takes effect October 1, 2009.

The senior management of LBMH has done this before. With a recurring revenue stream, high margins and low customer attrition, LBMH offers investors with a favorable risk/reward investment.

Time Line

Given the current market size as well as present and future market growth, LBMH should continue to capture a significant number of patients each quarter. We believe LBMH can attain annual revenue of approximately \$69 million in FY 2011.

Earnings Line

On August 3rd, 2009, LBMH reported fiscal Q3 earnings per share of \$0.02 on revenue of approximately \$7.0 million compared to EPS of \$(0.01) on revenue of approximately \$2.4 million in Q3 2008. Cash flow from operations in the first nine months increased to nearly \$699 thousand from approximately (\$1.5 million) in the year ago period.

Price Line

Our initial price target of \$2.75 is based on LBMH achieving a price-to-sales multiple of 3.3x our FY 2010 estimate of \$42.8 million, a 50% premium to the multiple for which PolyMedica was acquired for in 2007. We believe the 50% premium appropriate considering LBMH's high margins, niche expertise and high customer retention. Potential for upside to our revenue and earnings estimates exists driven by additional customers and future products sold into LBMH's existing customer channel.

Background & Business Model

LBMH was founded in 1999 by Mark Libratoro, founder and former CEO of diabetes supplies provider Liberty Medical Supply, Inc. Libratoro and Liberty pioneered the direct-to-consumer diabetes supplies market. In 1996, Libratoro sold Liberty to then publicly traded PolyMedica Corporation and stayed on as President of Liberty and Senior Vice President of PolyMedica. From 1996 until his departure from PolyMedica in 1999, Libratoro and his team grew Liberty from \$11 million in annual revenues to \$100 million.

In the last 18 months, LBMH has increased its annualized revenue run rate from approximately \$3 million to approximately \$28 million. In FY10 we expect annual revenue to exceed \$42.8 million.

LBMH operates within five primary business lines: urological, mastectomy, ostomy, diabetes and diabetes education. The Company sells and ships medical supplies from many of these lines quarterly providing LBMH with a steady recurring revenue stream. Within urology, the company sells intermittent, indwelling and external catheters for both men and women. Mastectomy supplies include forms and bras; ostomy supplies include colostomy, ileostomy and urostomy supplies; and diabetes supplies include blood sugar testing supplies such as monitors and test strips.

The company's one time advertising expense provides LBMH with an annuity like income. Customers acquired from one advertising occurrence often last for years.

A recent change in Medicare reimbursement of intermittent catheters within urology has left LBMH poised to capture a relatively new and growing medical supply market.

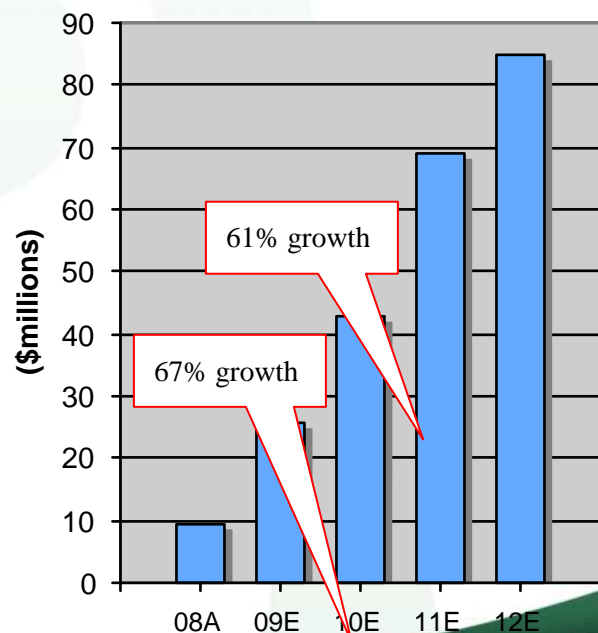
Capitalizing on management's experience at Liberty, LBMH has set out to recreate the successful model developed at Liberty within the diabetes market in a number of other growing chronic illness and disease categories.

Large and Growing Market

LBMH targets Medicare eligible seniors and payer eligible patients with chronic illnesses. According to First Research, the number of Americans over the age of 65 will nearly double from 34 million in 2000 to 62 million in 2025. Currently, there are 90 million Americans with chronic diseases and all disease states and the consumption of their related durable medical supplies is expected to grow.

For example, within the urological market, disposable catheters were estimated to be a \$600 million market in 2007, according to Rand Health. A Medicare ruling in April 2008 changing reimbursement expanded the market. The 2008 Medicare ruling raised the number of reimbursable catheters to up to 200 per month. The previous allowance was for 4 per month. Millennium Research Group updated its US Markets for Urological Devices 2008 report reflecting the 2008 rule change and now expects the US intermittent catheter market will attain a 40%+ compound annual growth rate (CAGR) between 2008 and 2012.

Revenue Growth Through 2012



The FDA has approved intermittent catheters for single use only. Under the prior Medicare rule, patients were forced to wash and reuse their catheters. As a result patients were at higher risk for urinary tract infections. A UTI hospitalization costs Medicare or a private insurer \$5,000 or more per incident. The 2008 change in reimbursement will likely reduce UTI hospitalizations. We estimate between 500,000 and 1 million patients use intermittent catheters in the United States.

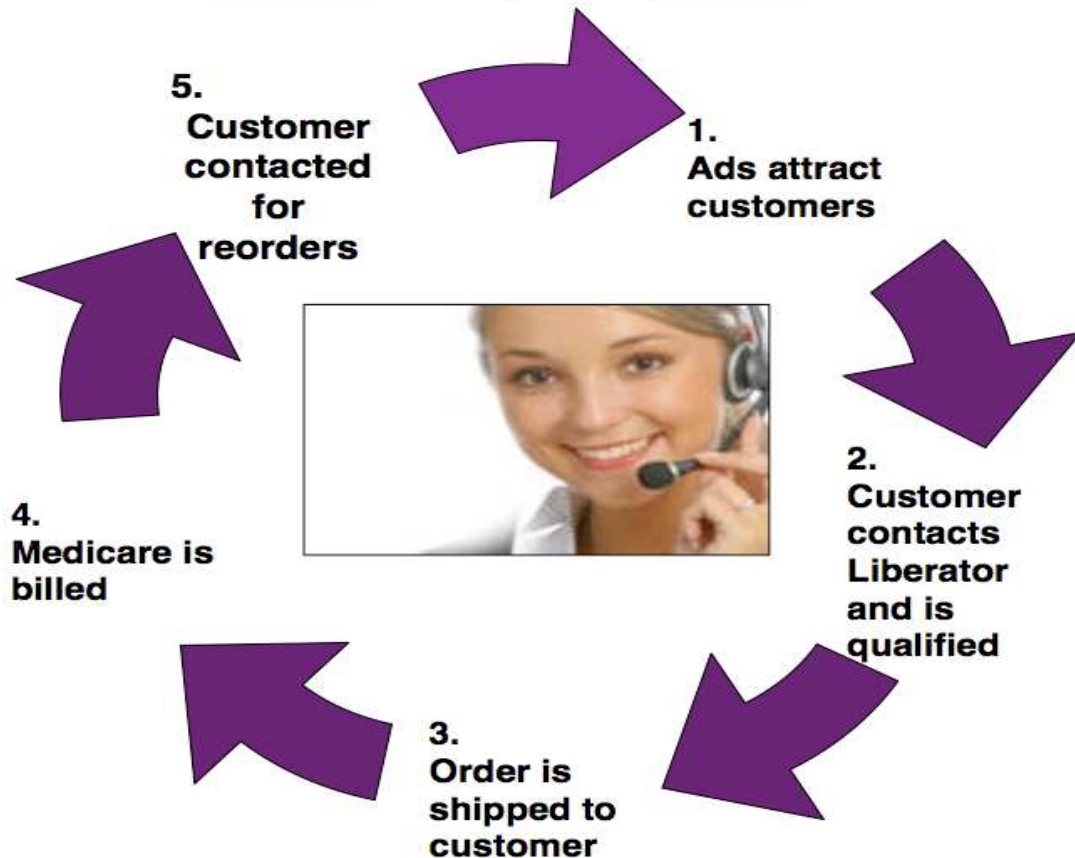
The home health care medical supplies market is highly fragmented. Most patients are served by single “Mom and Pop” operations. The estimated \$55 billion home healthcare market is made up of approximately 18,000 companies. The largest 50 companies make up less than 25% of sales.

LBMH has grown into one of the largest supplier of home healthcare durable medical supplies directly to

consumers. The aging U.S. population and inevitable increase in chronic diseases will increase durable medical supplies consumption. By educating consumers, LBMH is able to capture recurring revenue streams, low customer attrition and high operating margins.

Proprietary Business Processes

LBMH’s management team has developed primary business processes over the years to attract service and retain medical supplies customers. The company has also learned how to successfully navigate the Medicare and private payer reimbursement and coding procedures. Customer service and information gathering are essential elements of LBMH’s business. LBMH employees are trained not only in how to deal with the consumer, but how to communicate with patients’ physicians to handle the paperwork, regulations and gather the information necessary for Medicare and private payer reimbursement.



Customers are contacted quarterly to determine whether or not they need additional supplies. At times, customers qualify for higher levels of reimbursement. Doctors are then re-contacted by the company to obtain new prescriptions.

LBMH builds an extensive file on each patient in order to meet patient needs and ensure the highest degree of Medicare and insurance reimbursement. This excessive documentation helps the company meet any audit by outside payers.

Return on Advertising

Since LBMH sells directly to the consumer, it markets itself extensively utilizing television commercials, print and internet advertising.

LBMH generates \$10 in revenue in the short term and \$20 in the long term for every \$1 that it spends on advertising.

That compares with approximately \$10-\$12 in long-term revenue historically achieved at Liberty.

The higher return at LBMH is achieved by the longer-term relationship the company is able to establish with its customers.

Diabetes is a more mature market and customers tend to jump from supplier to supplier, leaving for a free meter or other marketing gimmicks.

Urology, ostomy and mastectomy patients tend to stick with their supplier longer. Their medical conditions are often more complex and personal, so when they find a supplier that makes their lives easier, they aren't quick to change.

There have not been any real promotional pushes by the smaller competitors outside of diabetes to lure customers away from LBMH.

Promotions could increase, however, we don't expect trauma victims, patients with neurogenic bladder or cancer will forego the convenience of LBMH's service for a promotional gadget.

Suppliers

LBMH has over 200 suppliers and sells products from all of the major suppliers and brands including Mentor, American Breast Care, Coloplast, C.R. Bard (NYSE: BCR), Nearly Me and Rochester Medical (NASDAQ: ROCM).

Competition

Outside of diabetes, competition consists primarily of specialty drug stores, Byram Healthcare, Edgepark Medical Supplies, United Ostomy, and many small independent dealers and stores.

In the diabetes space, LBMH competes with Liberty, the industry leader and Chronic Care Solutions among other much smaller diabetes supply companies.

Barriers to Entry

LBMH mostly competes with small specialty drug stores and dealers. The number of competitors will likely shrink due to new Medicare requirements.

It will be increasingly difficult for small competitors to compete in this space. Some will exit rather than post a \$50,000 bond per location as is now required of suppliers of durable medical equipment, prosthetics, orthotics and supplies (DMEPOS) by Medicare.

DMEPOS suppliers must be accredited and post the \$50,000 bond by October 1, 2009, or lose the ability to bill Medicare. It's estimated 50,000 DME companies will not meet the deadline. LBMH is already accredited and has posted the \$50,000 bond.

Outside of diabetes, we believe it will be difficult for even a larger company to match LBMH's experience with all of the various disease states and Medicare ICD-9 codes.

LBMH is becoming the brand associated with medical supplies relating to chronic illnesses outside of the diabetes market. Just like Liberty is front of mind in the diabetes space, LBMH has become *the* brand associated with direct-to-consumer catheters.

As a testament to its brand and in addition to its acquisition of customers via its advertising campaign, physicians and likely payers are referring patients directly to LBMH.

Experienced Management Team

Libratore, CFO Bob Davis and COO John Leger all spent a considerable amount of time building Liberty Medical into a \$100 million business.

Davis served as CFO of Liberty from 1994 -1999 while Leger was Senior VP of Operations from 1991 – 2004.

Libratore founded Liberty in 1989. He sold it in 1996 to PolyMedica for approximately \$9 million. At the time, Liberty had roughly 17,000 customers and \$13 million in revenue.

With PolyMedica's resources to help increase marketing spend, Liberty hit \$100 million in sales three years later.

In 2007, MHS acquired PolyMedica for \$1.5 billion. At the time, PolyMedica was generating \$675 million in revenue, 70% of which was attributed to its diabetes business.

Similar to Liberty, we believe LBMH will be attractive to a large pharmacy services company like MedcoHealth Solutions (NYSE: MHS) or CVS Caremark (NYSE: CVS) wanting to enter the lucrative direct-to-consumer chronic illness device space existing outside of diabetes without having to build the necessary infrastructure from scratch.

Purchasing LBMH would provide the acquirer with a turnkey operation that would otherwise take years to develop.

A purchase price of 3.3x sales, a 50% premium to the valuation at which MedcoHealth Solutions (NYSE: MHS) acquired PolyMedica, is reasonable considering many of LBMH's clients are more profitable than a diabetes patient. Outside of the diabetes space, LBMH should be able to achieve higher growth potential.

Additionally, LBMH's extensive patient files would be valuable to a pharmacy services provider as many of these patients are chronically ill. The data could be mined and monetized by the patients' drug spending.

The Future

We anticipate a significant increase to revenue and earnings in FY 2010 and 2011 as a result of continued marketing efforts and a boost in advertising spend in 2011.

There are no apples-to-apples comparisons for calculating future trading multiples. LBMH is the only publicly traded direct-to-consumer distributor of durable medical supplies and devices. LBMH's closest comparable is Liberty Medical, which is now part of the much larger MHS.

Our 12 month price target of \$2.75 represents a price-to-sales multiple of 3.3, which is 50% higher than the multiple for which PolyMedica was acquired. We believe the higher multiple is justified considering PolyMedica was a more mature company in a slower stage of growth.

Further share price appreciation is possible going into 2011 as the Company continues to ramp sales and earnings.

Capital Structure

As of June 30, 2009, LBMH had roughly \$3.5 million in cash and equivalents. The company had approximately \$6.6 million in outstanding debt consisting of convertible notes. LBMH also had a shareholder loan of approximately \$1.7 million from CEO, Mark Libratore.

May 2008 Convertible Note

LBMH closed a \$3.5 million gross private placement on May 22, 2008. The private placement consisted of a convertible note and warrants. The convertible note has a conversion price of \$0.80 per share. The note is senior, unsecured and accrues interest at 3% per annum paid semiannually. The note matures on May 22, 2010. The institutional investor and placement agent were also issued 4.375 million five year warrants with an exercise price of \$1.00 per share. LBMH used the proceeds to fund its direct-to-consumer advertising campaign

October 2008 Convertible Note

LBMH closed a \$2.5 million gross private placement consisting of convertible notes and warrants on October 17, 2008. The note is convertible into common shares at an initial conversion price of \$0.75. The note matures October 17, 2010 and accrues interest at a rate of 3% per annum paid semi-annually. The institutional investor and placement agent were also issued approximately 1.4 million 3-year warrants with an exercise price of \$1.25 per share.

The proceeds remain available for future growth. Nearly all of the growth over the past 12 months has been generated by cash flow from operations.

Librator's Holdings

Since inception, Mark Librator has invested approximately \$3.2 million in LBMH. He currently owns approximately 48% of LBMH's outstanding shares representing nearly all of his net worth. Librator subordinated his \$1.7 million shareholder loan to the institutional investor's convertible notes.

Other Senior Management

LBMH has a strong management team that has worked together previously to build and sell a successful sales and service focused company. Besides CEO and sole LBMH Director, Mark Librator, LBMH's CFO and COO both have extensive execution experience.

Robert Davis, CFO, has a Masters degree in Accounting from University of Houston and holds a CPA certificate from the State of Texas. Bob has held numerous financial executive-level positions including: controller for a manufacturer of jet engine parts, TurboCombustor Corp.; Data Development Inc. and Caribbean Computer Corp. He also served as CFO and Manager of Financial Planning for Liberty Medical Supply, Inc. from 1995 to 1999. He has been the Controller and Chief Financial Officer of Liberator Medical Supply, Inc. since its organization

John Leger, COO, joined Liberator in April 2006. John was the Senior VP of Operations at Liberty Medical Supply from December 1991 through January 2004. He was responsible for diabetic call center operations, customer services, repeat

customer sales, document acquisition and management, claims processing to Medicare, mail services, shipping, receiving, and purchasing. John worked closely with Mark Librator and stayed on with the company through its growth to over 650,000 active customers. Due to an agreement not to compete with Liberty during a severance agreement period, John made his expertise available as an independent consultant until he joined Closer Healthcare, Inc. as a VP of Operations in 2005. Closer is a mail order provider of diabetes testing supplies and primarily serviced customers in national clinical trials as well as the managed care sector. He spent a year with Closer prior to joining Liberator Medical.

Appendix: Capital Table

Fully Diluted Share Count

The following table details currently outstanding shares and common stock equivalents, including warrants and share incentive options.

Common stock, net of treasury stock	32,306,711
Convertible debt	9,081,333
Options and warrants	15,299,102
Fully diluted	56,687,146

Appendix: Earnings Model

	FY 2008 A	FY 2009 E	FY 2010 E	FY 2011 E
Sales	<u>\$9,550,106</u>	<u>\$25,600,224</u>	<u>\$42,834,597</u>	<u>\$69,054,895</u>
Cost of Sales	3,439,427	9,298,073	16,241,030	25,658,473
Gross Profit	<u>6,110,679</u>	<u>16,302,150</u>	<u>26,593,568</u>	<u>43,396,422</u>
General & Administrative Expenses				
Payroll taxes & Benefits	2,684,870	5,435,143	6,250,415	7,187,977
Administrative	2,501,854	3,298,192	5,600,000	8,120,000
Advertising	469,710	1,996,891	3,000,000	4,500,000
Depreciation	213,431	364,074	500,000	700,000
Bad debts	1,041,887	2,671,605	4,711,806	7,596,038
Total General & Administrative Expenses	<u>6,911,752</u>	<u>13,765,905</u>	<u>20,062,220</u>	<u>28,104,015</u>
Gain/Loss from Operations	<u>(801,073)</u>	<u>2,536,245</u>	<u>6,531,347</u>	<u>15,292,406</u>
Other Income/Expense				
Interest Expense	(520,015)	(1,082,407)	(1,080,000)	(1,080,000)
Interest Income	12,186	19,767	16,000	24,000
Total Other Income/Expense	<u>(507,829)</u>	<u>(1,062,640)</u>	<u>(1,064,000)</u>	<u>(1,056,000)</u>
Gain/Loss Before Income taxes	<u>(1,308,902)</u>	<u>1,473,605</u>	<u>5,467,347</u>	<u>14,236,406</u>
Provision for income taxes-\$6MM NOL (35% tax rate)	0	14,400	1,913,572	4,982,742
Net income (loss)	<u>(\$1,308,902)</u>	<u>\$1,459,205</u>	<u>\$3,553,776</u>	<u>\$9,253,664</u>
Weighted Average Basic Shares Outstanding	31,767,839	32,500,000	37,000,000	44,000,000
EPS	<u>(\$0.04)</u>	<u>\$0.04</u>	<u>\$0.10</u>	<u>\$0.21</u>
Diluted Shares outstanding	31,767,839	42,000,000	52,000,000	56,000,000
Diluted EPS	<u>(\$0.04)</u>	<u>\$0.03</u>	<u>\$0.07</u>	<u>\$0.17</u>

Liberator Medical Holdings, Inc. and Subsidiaries Condensed and Consolidated Balance Sheets

	<u>June 30,</u> <u>2009</u> (Unaudited)	<u>September 30,</u> <u>2008</u>
Assets		
Current Assets		
Cash	\$3,488,557	\$1,173,018
Accounts receivable, net of allowance for doubtful accounts of \$2,097,825 and \$1,055,606, respectively	3,493,813	2,405,102
Prepaid expenses	46,590	321,182
Inventory, net of allowance for obsolete inventory of \$50,000 and \$50,000, respectively	1,235,058	785,884
Deferred advertising, current portion	1,658,265	769,851
Other	<u>2,953</u>	<u>1,848</u>
Total Current Assets	<u>9,925,236</u>	<u>5,456,885</u>
Property & Equipment		
Property and Equipment, net of accumulated depreciation of \$928,717 and \$714,641, respectively	1,062,112	815,833
Other Assets		
Deferred advertising, net of current portion	1,435,418	660,524
Deferred loan costs	466,337	492,821
Deposits	<u>114,690</u>	<u>100,089</u>
Total Other Assets	<u>2,016,445</u>	<u>1,253,434</u>
Total Assets	<u>\$13,003,793</u>	<u>\$7,526,152</u>
Liabilities & Stockholder's Equity		
Current Liabilities		
Accounts payable	\$2,120,278	\$900,448
Accrued liabilities	431,377	289,848
Stockholder loan	1,664,649	1,664,649
Convertible notes payable, net of unamortized discount of \$406,570 and \$56,833, respectively	3,734,356	772,163
Capital lease obligation, current portion	78,093	50,816
Deferred rent liability, current portion	<u>56,244</u>	<u>48,261</u>
Total Current Liabilities	<u>8,084,997</u>	<u>3,726,185</u>

**Liberator Medical Holdings, Inc. and Subsidiaries Condensed and Consolidated Balance Sheets
 Continued**
Long-Term Liabilities

Convertible notes payable, net of unamortized discount of \$111,773 and \$748,921, respectively	2,406,926	2,788,704
Capital lease obligation, net of current portion	90,772	82,155
Deferred rent liability, net of current portion	<u>172,045</u>	<u>214,215</u>
Total Long-Term Liabilities	<u>2,669,743</u>	<u>3,085,074</u>
Total Liabilities	<u>10,754,740</u>	<u>6,811,259</u>

Stockholder's Equity

Common stock, \$.001 par value, 200,000,000 shares authorized, 32,392,311 and 32,050,366 shares issued at June 30, 2009 and September 30, 2008, respectively	32,392	32,050
Additional paid-in capital	11,617,104	11,177,266
Accumulated deficit	<u>(9,359,865)</u>	<u>(10,494,423)</u>
	2,289,631	714,893
Less: Treasury stock at cost (85,600 shares)	(40,578)	
Total Stockholders' Equity	<u>2,249,053</u>	<u>714,893</u>
Total Liabilities and Stockholders' Equity	<u>\$13,003,793</u>	<u>\$7,526,152</u>

Investment Risks

LBMH is subject to the same risks as other medical supplies distributors and home healthcare companies including, but not limited to: changes in Medicare or private payer reimbursement policies, delays or denials of reimbursement, potential product liability and/or changes in government regulations.

Specific to LBMH, the success of the company is largely dependent on founder and CEO, Mark Libratore and his team. Departure of key management could negatively impact LBMH's business. In order to achieve increased sales, the company may have to raise additional capital to fund marketing initiatives. If LBMH is unable to raise additional capital, its growth or its ability to operate could be severely impacted. LBMH's shares trade on the Bulletin Board Exchange and as a result, trading volume may be limited. LBMH is a penny stock and may be restricted by the SEC's penny stock regulations and NASD's sales practice requirements.

LBMH relies on customer reorders. Some product lines are cash flow negative after the first order and do not become positive until the customer reorders the product. LBMH may have to increase its staff in order to meet our projected marketing and sales goals. The growth in headcount will add to the company's cost structure with no guarantee of sales growth.

The company has sustained significant losses since inception and there is no guarantee LBMH's business will continue to be profitable. LBMH's stock trades on the OTC Bulletin Board and the market and liquidity of the stock is difficult to predict.

For additional Investment Risks, see LBMH's September 30, 2008 10-K and subsequently filed 10-Qs.

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