

Outsourced Clinical Services

Coverage Report

“Market Intelligence for Industry Players”

Q1 2012



Capstone Partners
Investment Banking Advisors

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MARKET OVERVIEW

Outsourced clinical services are defined as specialty medical services that are delivered in the setting of a hospital, outpatient surgery center, or skilled nursing facility by clinicians or medical specialists who are not employees of the hospital or facility. Such services are outsourced, and provided by corporations that operate independently from the facility. The outsourced positions generally involve physicians, physician assistants, nurse practitioners, or medical technicians. Outsourced clinical services cover a broad range of specialties such as anesthesiology, radiology and teleradiology, emergency department services, allied health staffing, respiratory and rehabilitation therapy, intraoperative neurological monitoring (IONM), hospitalists and other services.

M&A ACTIVITY

The outsourced clinical services industry is experiencing vibrant M&A activity, with at least 30 transactions recorded in the industry in 2011. Activity in the sector is being fueled by large corporations desiring to consolidate the industry as well as private equity groups looking to deploy cash in a sector that is less dependent on economic conditions and is benefitting from favorable demographic trends.

The outsourced clinical services sector is highly fragmented, with most of the providers being local or regional operators. Consolidators are making acquisitions with the belief that expertise and scale results in a competitive advantage in providing these highly technical and complex services. This theory is especially relevant when it comes to the operational tasks of staffing, billing and reimbursement management. With complex reimbursement protocols and a large number of underinsured and uninsured patients, the process can be very difficult and time consuming, even for the most sophisticated providers. As a result, there is a shift toward national firms that are able to leverage recruiting, billing and technology over a larger customer base, and thereby offer a more compelling value proposition.

Because many local providers have been operating in their respective markets for years, it can be difficult for national providers to unseat them from existing contracts and relationships. While national providers are able to effectively compete for newly created outsourcing agreements, acquisitions remain the fastest, and in some cases the only, viable method of penetrating entrenched markets. By acquiring a reputable local firm, a suitor can secure an established base of key contracts, enabling them to extend their geographic presence and expand their customer base as well as add the clinical staff that has the reputation, relationships and local knowledge critical to success.

Moreover, M&A activity in the space has been fueled by buyers who are looking to acquire new specialties and/or additional services that can be cross-sold to their existing clients. Aiding in this initiative is the fact that hospitals are increasingly seeking more comprehensive services from fewer vendors in order to drive cost savings and operational benefits. Specifically, the administration and execution of contracts is simpler when fewer but larger outsourced providers are involved.

The Outsourced Clinical Services market is experiencing robust M&A activity, a result of industry consolidation, strong market fundamentals, and attractive industry growth.

In searching for acquisition targets, we find that buyers are looking for companies that demonstrate the following attributes:

- ▶ A reputation for clinical excellence. Those that are well regarded for their expertise in performing highly complex and complicated procedures are in high demand
- ▶ A highly educated and skilled staff of professionals combined with high clinician retention rates
- ▶ A significant recruiting infrastructure in place, complemented by a strong in-house training program
- ▶ Long-standing relationships with leading customers, including exclusive and multi-year contracts backed by high contract renewal rates
- ▶ A track record of consistent year-over-year revenue and case load growth, attractive EBITDA margins and limited exposure to Medicaid reimbursements

MARKET FUNDAMENTALS ATTRACT BUYERS

A combination of strong market growth supported by enduring fundamentals is attracting buyers and investors to the outsourced clinical services sector. While the range of services is varied, they all benefit from similar demographic trends and market needs, namely the aging of the population and pressure for hospitals to cut costs and improve patient outcomes.

Demographic Trends Support Growth: Demographics are a key factor driving the healthcare sector and are expected to continue to positively impact the demand for outsourced clinical services. The Baby Boom generation totals some 75 million and boomers are starting to enter a time in their lives when they require more medical services. At the same time, technological advances are allowing people to extend their lives, albeit with more medical care. As a result, people – even those afflicted with chronic or terminal diseases – are living longer. In the United States, those aged 65 or older represented 13% of the population in 2010; that figure is expected to reach 20% in 2050, according to the Census Bureau. Put another way, the number of US residents aged 65 and older will more than double from about 40 million today to an estimated 88.5 million by 2050. The aging U.S. population and the corresponding increase in the incidence of chronic disease, combined with continued advancements in medical devices and surgical treatments, are expected to fuel demand for healthcare services.

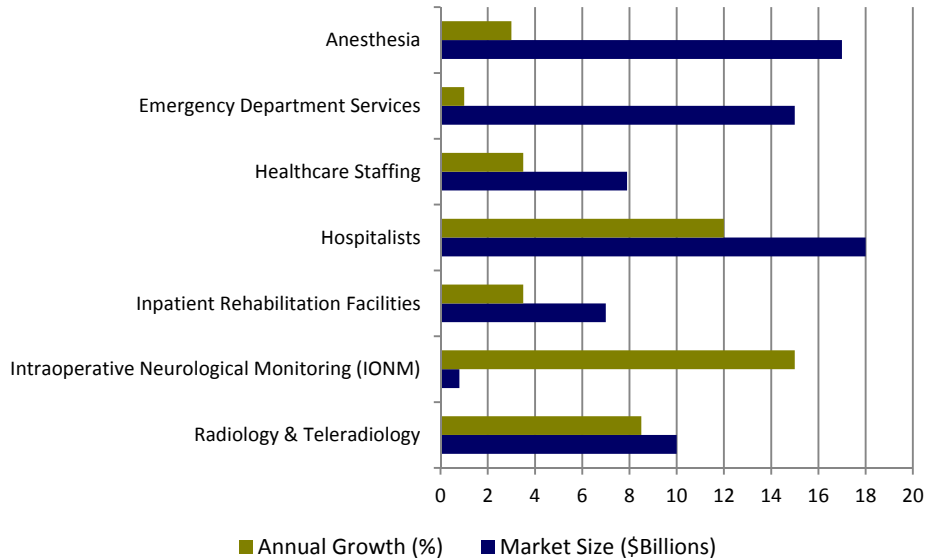
Hospitals Seek Improvements: While patient numbers are expected to rise, hospitals are increasingly outsourcing specialized clinical services as care becomes more complex and the potential for patient injury more prevalent. In addition, hospitals are enjoying significant cost savings and efficiencies by outsourcing these services. Lacking the internal resources, professional expertise or time to develop and manage a staff of specialists, hospitals are increasingly relying on third-party firms to provide outsourced specialist services. The benefits to hospitals include:

- ▶ Better patient outcomes resulting in shorter hospital stays, lower rehabilitation costs and the avoidance of possible medical malpractice suits
- ▶ Lower operating costs and improved efficiencies
- ▶ Reduced capital outlays
- ▶ Access to professional clinical staff 24x7, 365 days a year, which allows greater flexibility to meet varying demand and to manage staffing needs related to vacation coverage and weekend, emergency, or-time-sensitive cases

INDUSTRY SIZE AND GROWTH FUELS BUYER DEMAND

M&A activity is also strong in this space due to the market size and growth of outsourced clinical services. Many of the individual specialties have a market size of \$10 billion or more, and several of the specialties are growing at high single- or double-digit rates, as shown in the following graph and market commentary.

Outsourced Clinical Services: Market Size and Growth



Source: Capstone Research

Anesthesia: This market is driven by the number of surgical procedures performed which is influenced by patients over age 65. About half of the anesthesia market is outsourced, primarily to local anesthesiology groups.

Emergency Department (ED) Services: Outsourced by about 65% of hospitals, this department is often a hospital’s most unprofitable unit. But, EDs are critical, acting as the “front door” to the facility for the majority of profitable patient admissions.

Healthcare Staffing: Hospitals are increasingly using healthcare staffing companies to serve as Managed Services Providers (MSP), or gatekeepers, for all outsourced clinical staff.

Hospitalists: Relatively new, this specialty has quickly earned a reputation for efficiently treating hospitalized patients, increasing asset utilization and improving patient satisfaction. Hospitalists are utilized in about 60% of hospitals.

Inpatient Rehabilitation Facilities (IRFS): 80% of all IRFs are specialized units within hospitals. The majority (over 80%) of hospitals self-operate their IRF units; 20% (mostly smaller facilities) choose to outsource the services to a provider.

Intra-Operative Neurological Monitoring: This specialty is growing but only 50% of spine procedures undergo IONM today.

Radiology: A shortage of radiologists and the increasing technological requirements of radiology has led to outsourcing and utilization of teleradiology services (remote interpretation of images over the Internet).

While this industry is enjoying healthy growth and prospects for the future remain attractive, it is not without risk, primarily related to the near-term economic headwinds and changes in government reimbursement programs.

The healthcare reform bill signed by President Obama on March 23, 2010 provides for significant reforms to the US healthcare system, including provisions to limit Medicare reimbursements. These initiatives could result in reduced medical procedures, which would in turn impact the volume and price levels of outsourced clinical services. Additionally, given the budgetary woes of many states, Medicaid funding could be at risk, which would likely result in lower reimbursement rates for providers. Recently, several states dramatically reduced Medicaid payment rates to hospitals and senior care/skilled nursing operators and Medicare reduced reimbursements to senior care providers by 11.1% effective October 1, 2011. Thus far, physician reimbursement rates have fared better. As long as healthcare reform remains in the spotlight, the full effect of changes in government reimbursements will continue to be an area of concern for the industry.

M&A TRENDS

Recent transactions in this industry reveal the following notable trends:

Acquirers are Large and Active: Most of the buyers in this industry are sizable players, including several publicly held corporations or subsidiaries of public companies. In addition, buyers tend to be very active, acquiring several companies each year, a strong signal of a roll-up/consolidation trend in the industry as players look to quickly gain scale, capabilities and relationships.

Buyers Emphasize Synergy: Nearly all of the transactions have had a strong synergistic theme. Some of the acquisitions were made in the same clinical specialty, with a focus on expanding the buyer's geographic footprint, as evidenced by the several acquisitions recently completed by American Anesthesiology, Inc. Other transactions supported a differentiation theme, whereby buyers are rolling up varied specialties that can be offered to the same customer base. Team Health Holdings and EmCare are two such buyers looking to build a diversified suite of outsourced clinical specialties. Furthermore, a number of large skilled nursing providers have focused on expanding from their traditional core service (which is highly impacted by changes in Medicaid and Medicare reimbursement rates) by acquiring companies offering hospice, rehabilitation therapy (facilities and outsourced services) and home health services.

Industry Attracts Outside Buyers: Interestingly, there have been a handful of buyers from outside the industry, such as NuVasive, a medical device manufacturer that acquired an IONM services provider. General staffing firms have also been active in the industry, attracted by the unique and long-term opportunities within the healthcare sector.

Private Equity Plays Important Role: Many of the buyers in this industry either currently enjoy, or previously had, private equity group backing. It is not surprising that private equity groups are interested in investing in this space, given its strong fundamentals and attractive consolidation and growth opportunities.

RECENT M&A TRANSACTIONS: OUTSOURCED CLINICAL SERVICES

Date	Target	Target Business Description	Acquiror	Enterprise Value (\$mm)	EV / LTM	
					Revenue	EBITDA
Dec-2011	PCA Hospitalists, Inc.	Provides hospitalist services in South Florida	IPC The Hospitalist Company, Inc. (NasdaqGS:IPCM)	-	-	-
Nov-2011	Austin Anesthesiology Group, L.L.P	Provides anesthesia services to hospitals	American Anesthesiology, Inc. (sub. of Mednax)	-	-	-
Oct-2011	Solvis Medical Group	Provides medical staffing and physical therapy services	Smart-Tek Solutions Inc. (OTCPK:STTN)	0.54	0.2x	-
Oct-2011	Impulse Monitoring, Inc.	Provides intraoperative neurophysiological monitoring (IONM) services to hospitals	NuVasive, Inc. (NasdaqGS:NUVA)	80.0	-	-
Oct-2011	Surgical Monitoring Associates, Inc.	Provides outsourced Intraoperative Neurophysiological Monitoring (IONM) services	SpecialtyCare	-	-	-
Oct-2011	MEA Management, LLC	Offers physician and allied health professional staffing services to hospitals	Team Health Holdings, Inc. (NYSE:TMH)	-	-	-
Oct-2011	Integrity Hospitalists Group, LLP	Provides hospitalist services	Team Health Holdings, Inc. (NYSE:TMH)	-	-	-
Sept-2011	Marshall Emergency Services Associates, PLLC	Operates hospital emergency departments	Atlanta Equity Investors, LLC	-	-	-
Sept-2011	Diagnostic Imaging, Inc.	Provides radiology services to hospitals	Virtual Radiologic Corporation	-	-	-
Sept-2011	Anesthesia Consultants, P.C.	Provides anesthesia and pain management services to hospitals	Team Health Holdings, Inc. (NYSE:TMH)	-	-	-
Sept-2011	Active Diagnostics, Inc.	Provides intraoperative neuromonitoring (IONM) services to hospitals	Specialty Care Services Group, LLC	-	-	-
Sept-2011	Acute Surgical Care Specialists, PLLC	Provides surgical care support services to hospitals	EmCare, Inc.	-	-	-
Aug-2011	Inpatient Management Inc.	Provides hospitalist programs to hospitals	Eagle Hospital Physicians LLC	-	-	-
Aug-2011	Bay Area In-Patient Group, A Medical Corporation	A hospitalist organization that provides inpatient health services	Sound Inpatient Physicians, Inc.	-	-	-
July-2011	Healthcare Partners, Inc.	Operates as a physician and healthcare recruitment company	VISTA Staffing Solutions, Inc.	18.7	-	-
July-2011	American Anesthesiology of Florida	Provides anesthesia services in hospitals and other healthcare facilities	American Anesthesiology, Inc. (sub. of Mednax)	-	-	-
July-2011	Kenwood Hospitalists LLC	Provides hospitalist services	Sound Inpatient Physicians, Inc.	-	-	-
July-2011	North Florida Acute Care Specialists, LLC	Provides hospitalist services	IPC The Hospitalist Company, Inc. (NasdaqGS:IPCM)	-	-	-
July-2011	Primedoc Management Services, Inc.	Operates as a hospitalist and hospital staffing company	Eagle Hospital Physicians LLC	-	-	-
June-2011	RehabCare Group, Inc.	Provides rehabilitation services to hospitals and long-term care facilities	Kindred Healthcare, Inc.	1,288.8	1.0x	7.7x
May-2011	Emergency Medical Services Corporation	Ambulance and physician staffing services	Clayton, Dubilier & Rice, Inc.	3,255.7	1.0x	9.5x
April-2011	Crdenia Corp.	Provides healthcare staffing and recruiting solutions	SeniorBridge Family Companies, Inc.	-	-	-
Mar-2011	Mid-Michigan Hospitalist Group, PC	Provides hospitalist services	IPC The Hospitalist Company, Inc. (NasdaqGS:IPCM)	-	-	-
Feb-2011	PRN Registry, Inc.	Provides healthcare staffing to healthcare facilities	SK3 Group Inc. (OTCPK:SKTO)	-	-	-
Jan-2011	Hospitalist practice in Tampa, Florida	Provides hospitalist services	IPC The Hospitalist Company, Inc. (NasdaqGS:IPCM)	-	-	-
Jan-2011	Inland Hospitalist Medical Group, Inc.	Operates hospitalist programs in Southern California	IPC The Hospitalist Company, Inc. (NasdaqGS:IPCM)	-	-	-
Jan-2011	North Pinellas and Northwood Anesthesia Associates, LLC	Provides anesthesia services	EmCare, Inc.	-	-	-
Jan-2011	Great Lakes Intraoperative Monitoring, LP	Offers neurological intraoperative monitoring services	Impulse Monitoring, Inc.	-	-	-

Mean	928.7	0.7x	8.6x
Median	80.0	1.0x	8.6x

Source: Capital IQ; - = transaction value not disclosed
LTM = last twelve months; EV = enterprise value

CAPSTONE PARTNERS: COMPLETED HEALTH & MEDICAL TRANSACTIONS



has been acquired by





Capstone Partners recently completed a transaction in which it successfully advised Surgical Monitoring Associates®, Inc. (SMA®) on its acquisition by SpecialtyCare.

Surgical Monitoring Associates® is a leading provider of outsourced Intraoperative Neurophysiological Monitoring (IONM) services to leading hospitals and surgical groups throughout the Northeast.

“I am very pleased that we are joining forces with SpecialtyCare, a leader in outsourced clinical and operating room services that shares our focus and commitment to clinical and service excellence both to the patient and surgeon.”

- Dr. Daniel Schwartz, SMA® Founder

 <p><i>has divested assets to</i></p> 	 <p><i>has secured financing from</i></p> 	 <p><i>has divested assets to</i></p> 	 <p><i>has been acquired by</i></p> 	 <p><i>has secured financing from</i></p> 
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ABOUT CAPSTONE PARTNERS

Capstone Partners LLC is a leading national investment banking firm dedicated to serving the corporate finance needs of middle market business owners, investors and creditors. The firm provides merger & acquisition, private placement, corporate restructuring, valuation and financial advisory services. Capstone maintains various industry specialties including in health & medical products and services. The firm also possesses merchant banking capabilities to actively co-invest in transactions.

Additional information about Capstone Partners can be found at www.capstonellc.com.

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