



Q2 2014 M&A Update Hospital & Health Facilities

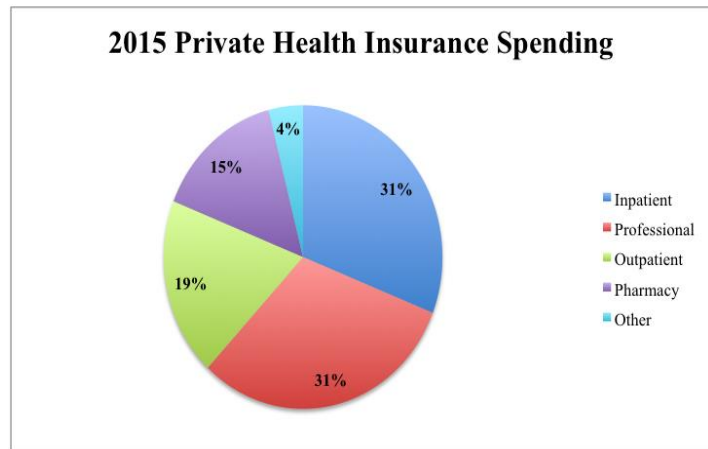
Hospital Merger and Acquisition First Quarter 2014 Recap

Hospital consolidation is an increasing trend that is the focus of growing scrutiny from researchers and policymakers. In the first quarter of 2014, 23 mergers and acquisitions occurred, compared to 21 transactions in the first quarter of 2013—a 9.5% increase. Of the 23 transactions, 20 involved acquisition of not-for-profit organizations—15 by other not-for-profit organizations and 5 by for-profit organizations.

Hospital Consolidation: Economies of Scale or Price Manipulation

For the \$2.8 trillion healthcare industry, analysts project that medical costs will rise 6.8 % in 2015, up slightly from 6.5% for 2014. This medical cost trend is the projected percentage increase in per capita costs of medical services that affect commercial insurers and large, self-insured businesses. The graph below shows how 2015 private health insurance spending is expected to break down by medical category.

Due to these rising costs, the health care industry is accustomed to deals. In our communities, consolidation of physicians with hospitals is standard fare. Hospitals are integrating with long-term care providers and merging with peers to achieve scale in regional systems. At a national level though, our industry lags banking, investment banking, airlines and discount retailing where a few global players dominate activity. Relative to these, health care remains a highly fragmented industry in the United States: 4,000 biotech companies, 6,000 medical device manufacturers, and 5,200 hospitals with more than a third independent/nonsystem-affiliated; 397 insurance operators; and 880,000 physicians— 70% of whom are in small, independent practice settings.



Due to this high fragmentation, analysts believe that hospital and healthcare providers is one of the top two subsectors that will see the most M&A deals. They say that the two major drivers for these mergers are access to capital for independent hospitals and the quest for economies of scale. One of the reasons why standalone hospitals feel the need to consolidate is the new reimbursement system that favors clinical integration. The gain of economies and efficiencies of scale through consolidation helps hospitals cope with rising compliance costs and decreasing reimbursements from government programs. Providers will become more profitable if measures are taken to increase efficiency. Increasingly, hospitals and health systems are considering consolidation with other hospitals. Due to pressure from the Affordable Care Act (ACA) and other related regulations, these companies now have to find ways to run more efficiently cope with shifts in reimbursement policies and replace depleting inpatient revenues. Hospital systems also have to find growth areas by creating more diversified and far-reaching service platforms including expanding their capabilities in outpatient services. Also on the rise are M&A deals involving retail clinics. Due to the out-of-pocket patient pay because of high deductibles, the demand for these clinics is expected to increase along with the number of insured patients seeking more economical healthcare options. Hospitals are also expected to respond to current rising urgent care demand.



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On July 3, 2014, the Centers for Medicare & Medicaid Services (CMS) issued a proposed rule that would update payment policies and payment rates for services furnished under the Medicare Physician Fee Schedule (PFS) on or after January 1, 2015. The proposed rule was published in the Federal Register (www.federalregister.gov/) on July 11, 2014. CMS will accept comments on the proposed rule until September 2, 2014. Historically, Medicare pays physicians and other practitioners for care management services as part of face-to-face visits, but last year CMS finalized a separate payment for managing the care of Medicare patients with two or more chronic conditions beginning CY 2015. The main goal of the new proposed rule on PFS rates is to allow for greater price transparency and public input prior to rates being set. The main proposed changes are:

- Acute care hospitals that submit quality data report and are meaningful user of Electronic Health Records (EHRs) will receive 1.3% increase in Medicare operating rates.
- Calculation of payments will be adjusted due to cuts under the Patient Protection & ACA
- Medicare disproportionate share hospitals (DSH) payments will be reduced 75% by 2019, and DSH payments will be reduced 1.1% in fiscal year 2015.
- The 2-midnight rule seeks to treat & bill out patients for outpatient services if patient stay is less than 2 nights
- Hospital value-based purchasing program seeks to take back 1.5% of Medicare payments and be dispersed to hospitals based on how well they performed healthcare quality measures.
- The hospital readmissions reduction program penalizes 3 % of payments to hospitals for heart attack, heart failure, and pneumonia 30-day readmission rates for Medicare patients.

The pros for hospital M&A argues that consolidation allows for increased collaboration and clinical integration to improve clinical care coordination and outcomes by reducing excess capacity. According to Martin Gaynor, PhD and director of the bureau of economics for the Federal Trade Commission (FTC), says there is “*little evidence that consolidation achieves these goals.*” He went on to quote and cite previous research that has found hospital consolidations increased prices by up to 50% and other studies that found more hospital competition was associated with the provision of higher-quality care. Dr. Gaynor goes on to say that the main concern of the FTC is to monitor the market barriers to entry because as alternatives and competition start to disappear so does innovation, which ultimately protects consumers.¹

Despite Dr. Gaynor’s cited research, the Center for Healthcare Economics and Policy completed a study in early 2014 that found that the overwhelming majority of hospital M&A actually created a more competitive marketplace.² According to the report, there was no statistical correlation to show that hospital consolidation resulted in pricing power and overall higher prices. The conflicting research is evidence that the hospital industry is still divided on M&A. However, the facts that the industry cannot hide from is that the under the ACA another \$320 billion to the already \$113 billion in hospital payment cuts is coming, and historically hospital prices have risen faster than inflation. Although recently through regulation change price growth has been slowing, but hospital M&A has continued at its blistering pace.

¹ Rich Daly, “Hospital Consolidation Trend to Continue”, *Healthcare Financial Management Association* © 2014, June 16, 2014, accessed July 11, 2014, <http://www.hfma.org/Content.aspx?id=23307>

² Margaret E. Guerin-Calvert and Jen A. Maki, PhD, “Hospital Realignment Mergers Offer Significant Patient and Community Benefits”, *Center for Healthcare Economics and Policy*, January 23, 2014, PDF



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Selected Hospital Transactions in Q2 2014

07/12/2014 – **Community Health Systems**, based in Franklin, Tenn., signed a letter of intent to buy **Natchez (Miss.) Regional Medical Center**.

07/02/2014 – **Siskin Hospital** completes acquisition of 109 beds at **St. Barnabas. Siskin Hospital** and will also add long-term care services at **St. Barnabas**. Both facilities are located in Chattanooga, TN.

07/02/2014 – Lynchburg, Va.-based **Centra Health** has taken full ownership of **Bedford (Va.) Memorial Hospital** for \$12 million.

06/30/2014 – **Virginia Commonwealth University Health System** in Richmond and **Community Memorial Healthcenter** in South Hill, Va., signed a preliminary merger deal.

06/27/2014 – **Fresenius Medical Care AG & Co. KGaA** acquired **Sound Inpatient Physicians, Inc.** and **MedSpring Urgent Care**.

06/23/2014 – **Beaumont Health System** will acquire **Oakwood Healthcare, Inc.** (Oakwood) and **Botsford Health Care Continuum** to create post-merger 8 hospitals with 3,337 beds, 153 outpatient sites, 5,000 physicians, 33,093 employees, 3,500 volunteers, and combined revenues of about \$3.8 billion.

06/16/2014 – **Kindred Healthcare, Inc.** signs NDA to acquire **Gentiva Health Services, Inc.** for all-cash at \$17.25 a share. As of July 29, **Kindred** reiterated commitment to acquisition subject to due diligence.

05/30/2014 – **Catholic Health Initiatives** acquires **Memorial Health System of East Texas** effective June 1, 2014.

05/15/2014 – **IPC The Hospitalist Company, Inc.**, the US-based provider of hospital medicine and related facility-based services, has acquired

RG Psychological Services, P.C., the US-based company engaged in providing mental health services.

05/15/2014 – **Northwestern Memorial Healthcare** has signed a definitive agreement to merge with **CDH-Delnor Health System, Inc.**, the US-based company headquartered in Winfield, Illinois, is an owner and operator of hospitals.

05/06/2014 – **American Anesthesiology, Inc.**, the US-based provider of anesthesiology services, and subsidiary of **MEDNAX, Inc.**, has acquired **Anesthesia and Pain Management Group, LLC**, the US-based company engaged in providing physician services that includes anesthesia providers, ambulatory services and pain management services for outpatient procedures.

05/01/2014 – **Port Huron Hospital** and **McLaren Health Care** in Flint, MI, signed a definitive acquisition agreement, making Port Huron Hospital the 12th hospital within the McLaren system.

05/01/2014 – **Alameda Health System** services are expanded as **Alameda Hospital** officially joins **Alameda Health System**.

05/01/2014 – **Pyramid Healthcare, Inc.**, the US-based drug and alcohol rehabilitation center, that provides behavioral healthcare services for men and women, and a portfolio company of **Clearview Capital, LLC**, the US-based private equity firm, has acquired **Onward Behavioral Health Inc.**, the US-based company engaged in offering outpatient substance abuse treatment services for children, adolescents, and adults.

04/29/2014 – **Northwestern Memorial Healthcare** acquires **Cadence Health**, which forms an integrated academic healthcare delivery system spanning more than 60 sites of



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care across Chicago and its suburbs, including four hospitals, and more than 4,000 physicians and 17,600 employees.

04/29/2014 – **The University of Wisconsin Health** in Madison and **SwedishAmerican Health System** in Rockford, Ill., approved a letter of intent to merge.

04/29/2014 – **Mount St. Mary's Hospital and Health Center**, a 175-bed hospital in Lewiston, N.Y., agreed to become a full member of **Catholic Health**.

04/07/2014 – **Grays Harbor Community Hospital** in Aberdeen, Wash., collected more

than 3,000 signatures in the hope of becoming a public-owned hospital.

04/01/2014 – The bankrupt 207-bed **Fairmont General Hospital** in WV, as its initial buyer, chose **Alecto Healthcare Services**, a private firm based in Los Angeles, CA. The deal is still pending approval from the bankruptcy court, and there will also be an auction for further bidding.

04/01/2014 – **Catholic Health Initiatives** acquires **Mercy Hot Springs Mercy Hospital** Hot Springs (Ark.) is officially part of Englewood, Colo.-based Catholic Health Initiatives, as CHI and Chesterfield, Mo.-based Mercy signed a definitive acquisition agreement.



Q2 2014 M&A Update Hospital & Health Facilities

SELECTED PUBLICLY TRADED HOSPITALS

Company Name	Ticker Symbol	Price	Change prior Qtr	52wk High	52wk Low	Mkt Cap	EPS	P/E	EV (\$M)	LTM Revenue (\$M)	EBITDA (\$M)	EV/Rev	EV/EBITDA
Chindex International Inc.	CHDX	23.69	24.2%	23.99	14.62	419.6	\$ (0.56)	N/A	421	183	13	2.3x	33.2x
Community Health Systems, Inc.	CYH	45.37	15.8%	49.87	34.55	5,270.0	\$ (0.52)	N/A	21,600	13,920	1,710	1.6x	12.6x
HCA Holdings, Inc.	HCA	56.38	7.4%	58.55	35.2	25,410.0	\$ 3.39	16.6	52,920	34,570	6,610	1.5x	8.0x
Kindred Healthcare Inc.	KND	23.1	-1.4%	26.81	12.5	1,490.0	\$ (3.13)	N/A	2,810	4,920	296	0.6x	9.5x
Lifepoint Hospitals Inc.	LPNT	62.1	13.8%	66.02	43.97	2,810.0	\$ 2.78	22.3	4,630	3,750	490	1.2x	9.5x
Tenet Healthcare Corp.	THC	46.94	9.6%	50.25	36.87	4,680.0	\$ (0.78)	N/A	15,670	12,640	1,460	1.2x	10.7x
Universal Health Services Inc.	UHS	95.76	16.7%	98.89	63.51	9,530.0	\$ 5.31	18.0	12,600	7,370	1,390	1.7x	9.1x
Average*			12.3%					19.0				1.4x	10.3x

*EV to Rev & EV to EBITDA average multiples exclude highest & lowest outliers

SELECTED PUBLICLY TRADED HEALTHCARE REITs

Company Name	Ticker Symbol	Price	Change prior Qtr	52wk High	52wk Low	Mkt Cap	EPS	P/E	EV (\$M)	LTM Revenue (\$M)	EBITDA (\$M)	EV/Rev	EV/EBITDA
Medical Properties Trust Inc.	MPW	13.24	3.5%	15.5	11.47	2,250.0	\$ 0.49	27.0	3,590	261	200	13.7x	18.0x
Health Care REIT, Inc.	HCN	62.67	5.2%	68.79	52.42	19,120.0	\$ 0.25	250.7	29,340	3,050	1,660	9.6x	17.7x
Physicians Realty Trust	DOC	14.39	3.4%	14.63	11	492.3	\$ (0.21)	N/A	458	21	9	21.4x	50.1x
HCP, Inc.	HCP	41.38	6.7%	47.45	35.5	18,860.0	\$ 2.19	18.9	27,630	2,120	1,730	13.0x	16.0x
Omega Healthcare Investors Inc.	OHI	36.86	10.0%	38.33	27.37	4,630.0	\$ 1.57	23.5	6,860	438	408	15.7x	16.8x
Universal Health Realty Income Trust	UHT	43.38	2.7%	47.63	38.36	561.3	\$ 1.06	40.9	777	57	40	13.7x	19.6x
Ventas, Inc.	VTR	64.1	5.8%	72.32	54.89	18,840.0	\$ 1.57	40.8	28,300	2,870	1,580	9.9x	17.9x
Average*			5.3%					67.0				13.2x	18.0x

*EV to Rev & EV to EBITDA average multiples exclude highest & lowest outliers

Despite flat year over year first quarter company profits, the Standard & Poor's 500-stock index gained 4.7%, extending its gains for the year to 6.1%. Its six-quarter winning streak marks its best since a 14-quarter run ending in mid-1998, according to S&P Dow Jones Indices. The S&P 500 had to overcome a series of unexpected curve balls, ranging from the frigid winter that froze the economy and temporary talk of a return to Cold War relations between the USA and Russia due to the Ukraine crisis that saw Moscow annex Crimea and White House counter with economic sanctions against Russia. In the second quarter, our Hospital and Healthcare REIT indices outperformed all three major indices with gains of 12.3% and 5.3% respectively as investors and executives remain bullish on the healthcare industry. The hospital index rose in part through the strong performance of **Chindex International Inc.** and **Universal Health Services Inc.**, which increased 24.2% and 16.7%, respectively.

The strong performance of **Chindex International Inc.**, an American provider of primary care and ambulatory health services, shares were due to the announcement that the Company had entered into an amended and restated merger agreement. This agreement is relating to the merger among the Company and the existing buyer consortium comprised of an affiliate of TPG, Fosun Industrial Co., Limited, and Ms. Roberta Lipson, the CEO of the Company, and a merger subsidiary of the Buyer Consortium providing for an increase in the merger consideration from \$19.50 per share in cash to \$24.00 per share in cash. The closing date is expected for the second half of 2014.

Universal Health Services, Inc. is one of the nation's largest hospital companies, operating acute care and behavioral health hospitals and ambulatory centers nationwide. The Company's strong second quarter performance was mostly thanks to its strong first quarter earnings. CFO Steve Filton cited that Medicaid expansion driving down self-pay patients was a positive on earnings and revenue. Under the ACA, the hospital industry accepted big cutbacks in government payments in return for the revenue that would come from tens of millions of patients who would gain insurance. Also, Fitch upgraded the Company's Issuer Default Rating ("IDR") to BB+ from BB thanks in part to the Company's commitment to debt repayment, strengthening cash flows, and revenue diversification.



Lawrence, Evans & Co., LLC provides investment banking, finance, and consulting services for small and middle market healthcare providers and services companies. We are very active on the buy-side, sell-side, capital raising and restructuring of hospitals and healthcare facilities.

SERVICES

<p>▪ Investment Banking & Corporate Finance</p>	<ul style="list-style-type: none"> -Private Company Sales -Division/Subsidiary Divestitures -Distressed Transaction Advisory - Acquisition Advisory Services - Private Market Financings - LBO's and Recapitalizations
<p>▪ Turnaround & Restructuring</p>	<ul style="list-style-type: none"> -Turnaround Management -Debt Restructuring/Refinancing -Orderly Liquidations - Chief Restructuring Officer (CRO) - Bankruptcy Planning/ 363 Sales - Receivership/Trustee
<p>▪ Consulting</p>	<ul style="list-style-type: none"> -Strategic Options Analysis -Valuations & Financial Assessments -Interim CEO/CFO - Strategic Planning - Organizational Reviews - Expert Testimony & Opinions

REPRESENTATIVE TRANSACTIONS

<p>Community Hospital</p> <p>\$15,000,000 Purchase of Accounts Receivables</p> <p> Acted as buy-side exclusive advisor</p>	<p>Community Hospital IN and PA</p> <p>\$9,000,000 Working Capital Financing</p> <p> Acted as advisor</p>	<p>Management Team</p> <p>Acquire an Acute Care Hospital in Texas</p> <p> Acted as advisor</p>
<p>Acute Care Hospital Alabama</p> <p>\$12,000,000 Acquisition Financing</p> <p> Acted as advisor</p>	<p>Community Hospital California</p> <p>\$1,000,000 Working Capital Financing</p> <p> Acted as advisor</p>	<p>Community Hospital Texas</p> <p>\$1,500,000 Working Capital Financing</p> <p> Acted as advisor</p>

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