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Healthcare Facilities

Year-End 2014

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Overview

Healthcare companies outperformed the broader market during 2014, and the sector is poised for strong gains in 2015. An improving economy and rising consumer spending, coupled with favorable healthcare dynamics, have benefited the sector. Healthcare providers have begun to adapt to new regulations introduced by the Affordable Care Act (ACA), decreasing uncertainty surrounding the law's impact (see "Legislative Update" below). The ACA has brought in a wave of new patients and revenue, a trend that will likely continue as the law is fully implemented.

Low interest rates have constrained the cost of capital for many industry participants, presenting an opportunity for acquisitions by facilities-based healthcare providers.

Transaction activity remains healthy, as industry participants aim to vertically integrate multiple steps of the patient experience, from doctors' offices to specialists to hospitals. Integration has allowed healthcare facility companies to capture revenue from multiple sources, buoying industry performance while reducing costs.

The sector does face some headwinds. Legislative reform still presents healthcare facilities with the challenge of adapting to a new reimbursement regime as new payment models seek to emphasize results rather than (number of) procedures. Many employers are switching to high-deductible plans for employees in order to comply with the ACA and cut costs. This has led many employees to further scrutinize costs, potentially putting pressure on industry margins. Other factors that pose risks to the sector include a decreasing supply of doctors and healthcare professionals, and cuts to Federal outlays to Medicare and Medicaid.

Overall, current valuation trends and expectations are positive for healthcare facilities, with growth in both revenue and profitability expected in 2015. Though challenges exist, expectations for the sector remain optimistic following strong performance in the second half of 2014.

Legislative Update

An upcoming U.S. Supreme Court case, *King v. Burwell* (U.S. Supreme Court, No. 14-114), could pose challenges to the ACA and its ability to enroll individuals in insurance plans. The plaintiffs argue that the language of the law only allows for subsidies on state-run exchanges. They argue the particular language was chosen to push states to create their own exchanges, and that the law's current implementation (with the Internal Revenue Service providing subsidies on state-run and federal exchanges) exceeds the law's authority granted to it by Congress.

The defendant (the Secretary of Health and Human Services) argues that the law's language was simply a term of art, and was meant to include the federal exchange. The law's architects have said subsidies were meant to be distributed through both federal and state exchanges, and the current arrangement is appropriate under the current law.

If the challenge is successful, individuals who received coverage through federal exchanges could potentially lose their tax credits, making plans unaffordable for many. An article in the *New England Journal of Medicine* estimates the ruling could affect over 4.5 million people across 34 states that did not create their own state-run exchanges. The Rand Corporation, a global policy think tank, estimated individual market enrollment would decline by an estimated 9.6 million people if the Supreme Court rules subsidies issued through the federal exchanges are illegal under the ACA (and if the states do not set up their own exchanges). A decision is expected in the summer of 2015. [1, 2, 3, 4]

Industry Perspectives

Increasing Consolidation and Vertical Integration Among Large Healthcare Firms

"Our combination with Gentiva is a critically important strategic milestone for Kindred, improving our ability to provide seamless transitions of care as we advance [our] strategy and firmly [establish] Kindred as the nation's largest provider of home health and hospice services....In early January, we also completed the acquisition of Centerre, a highly respected rehabilitation hospital provider with eleven hospitals and some of Kindred's key integrated care markets….These strategic steps reflect our commitment to help patients at every stage of their recovery from hospitals at home and deepen our presence and capabilities in our integrated care markets."

Paul Diaz
CEO, Kindred Healthcare (KND: NYSE)
on fourth quarter 2014 performance [5]

Home Health and Hospice are Attractive Sub-Sectors

"The [certificates of need] laws in Alabama have made it extremely difficult for us to continue investing in inpatient rehabilitation hospitals....We've identified markets where we could invest capital today with projects that would create numerous jobs and tax benefits for the state, but because of the [CON] laws and the contention it would bring, it would take years to see those projects through…. The demand of home health and hospice will not abate anytime soon and we've noticed demographic tail winds that make [home health] an attractive industry for us to continue to grow."

Jay Grinney
CEO, HealthSouth (NYSE:HLS)
on acquiring Encompass Home Health [6]

ACA Implementation Presents Opportunities

"I would like to talk about industry dynamics, specifically utilization, reimbursement and regulation. To start with in utilization, we continued to see signs of modest increase in utilization. We are encouraged by the progress on exchange enrollment as the result of the Affordable Care Act. During the fourth quarter, we continued to see stability in test volumes on what we are calling a same provider basis."

Steve Rusckowski
CEO, Quest Diagnostics (NYSE: DGX)
on fourth quarter 2014 performance [7]

ACA Implementation Presents Challenges

"...We entered 2015 better positioned to address the needs of our hospital partners. It's becoming clear that the challenges of health care reform are getting more and more real, whether it's through the implementation of the Affordable Care Act; the focus on the institute of health care improvements; [improve] the patient experience; improve the health of populations and provide cost-effective care [or] CMS's intent to move more Medicare and Medicaid reimbursement towards value-based structures."

Dr. Roger Medel
CEO, MEDNAX (NYSE: MD)
on fourth quarter 2014 performance [8]

Shift from Hospitals to Outpatient Facilities

"Our outpatient centers continue to attract consumers who want quality care at a lower cost, as well as potential partners looking to leverage our development and operational capabilities. As healthcare delivery evolves and consumers shop for more affordable solutions, Tenet is strategically positioned to capture the benefits of this fundamental shift. We see many opportunities to continue this growth, both within and apart from our acute care hospital markets."

Trevor Fetter
President & CEO, Tenet Healthcare (NYSE: THC)
on fourth quarter 2014 performance [9]

Patient Outcomes and Services are Priorities

"Recognizing that we will increasingly be measured and reimbursed based on the quality and value of our services, improvement in patient outcome and patient service will be our top priority in 2015."

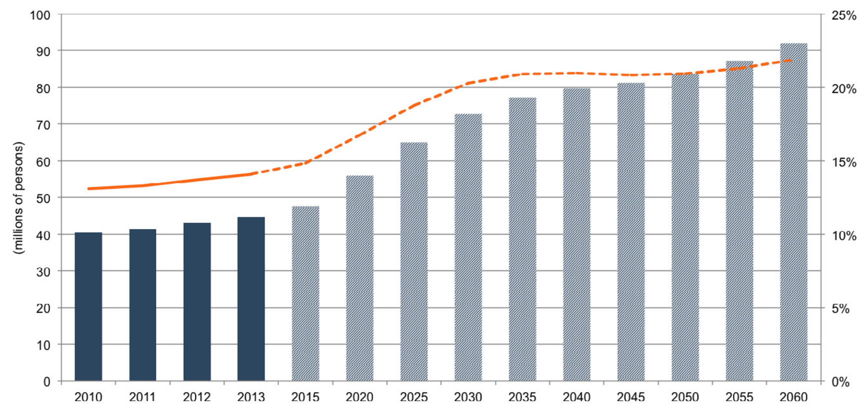
Milton Johnson
CEO, HCA Holdings (NYSE: HCA)
on fourth quarter 2014 performance [10]

Macroeconomic Trends

Demographic Trends I

Aging populations are a major driving force behind spending on healthcare, with the elderly (aged 65 and older) accounting for the largest percentage of healthcare expenditure in the U.S among age groups. Elderly residents are expected to account for 15% of the population in 2015 and grow to 20% by 2030, continuing to increase overall healthcare demand.[13]

U.S. Resident Population 65 Years and Older

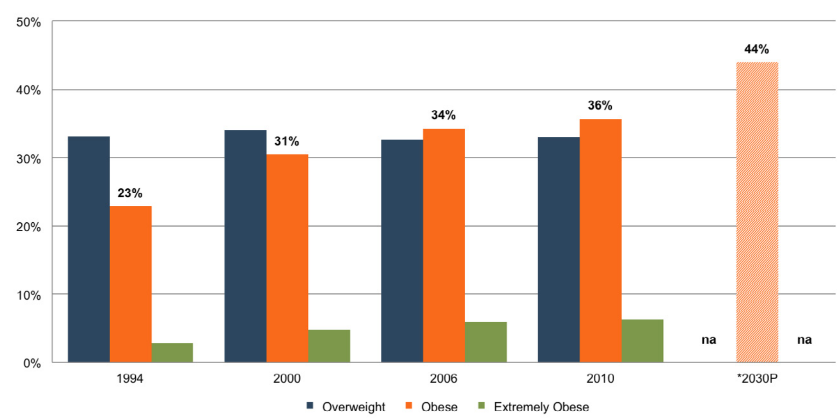


Source: U.S. Census Bureau
Mercer Capital Analysis

Demographic Trends II

In addition to the greying population, the prevalence of unmet medical needs and increasing incidence of lifestyle diseases are likely to drive continued growth in the demand for healthcare services. According to OECD estimates, currently 70% of U.S. adults are overweight or obese, the second highest rate among high-income countries. Some data show obesity rate increases are slowing, however, and some forecasts are even predicting a downturn in the percentage of overweight individuals in the U.S. over the next several years.[14, 15]

US Adult Obesity Rates



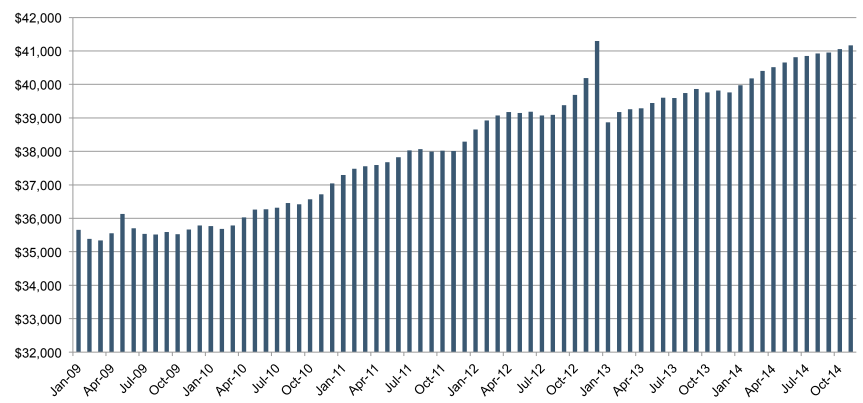
Source: Centers for Disease Control and Prevention; Trust for America's Health, Robert Wood Johnson Foundation
Mercer Capital Analysis

Macroeconomic Trends (cont.)

Disposable Income

Per capita disposable income contracted in the most recent recession, but has grown steadily since 2009. Disposable income increased from approximately $39,000 in the January 2013 to just over $41,000 in November 2014.[11] As disposable income rises, individuals are better able to afford out-of-pocket expenses and healthcare demand can be expected to increase.

US Personal Disposable Income per Capita

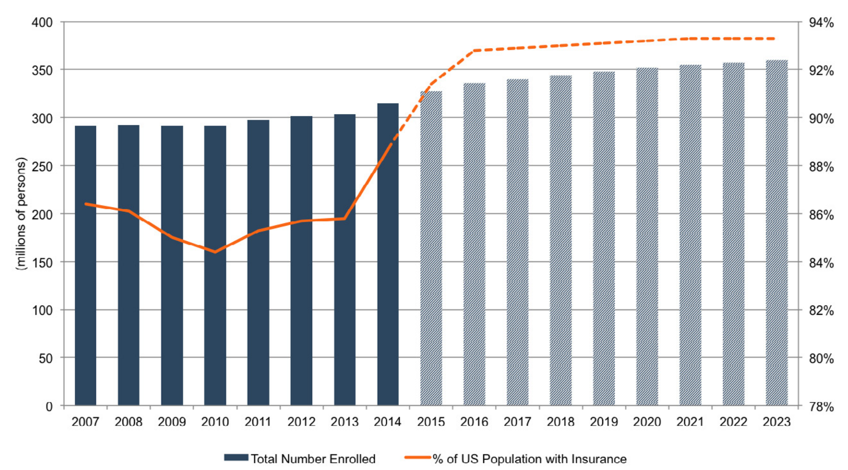


Source: Bureau of Economic Analysis
Mercer Capital Analysis

Health Insurance Coverage

The Affordable Care Act (ACA) was passed, in part, to address the number of Americans without health insurance. People covered by insurance are more likely to use healthcare services. According to current projections, the Center for Medicare and Medicaid Services (CMS) estimates the percentage of Americans enrolled in a health insurance plan will grow from 84% in 2010 to 93% by 2016.[12]

Health Insurance Enrollment Totals



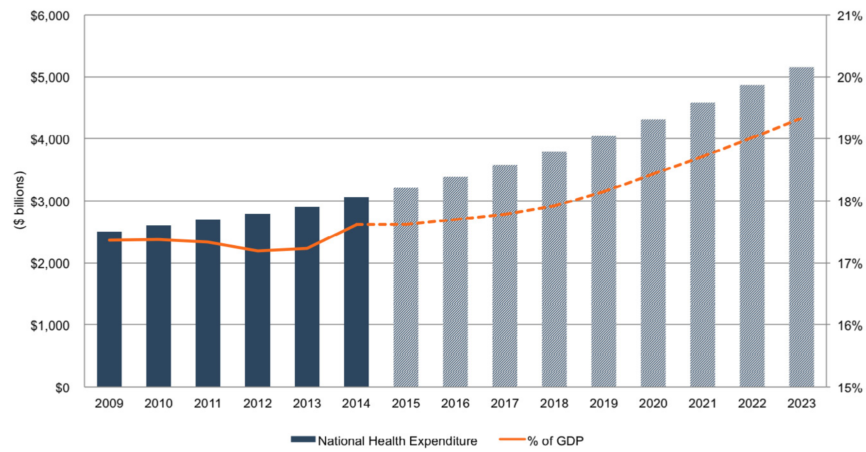
Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group
/Mercer Capital Analysis

Industry Trends

US Healthcare Expenditure I

Due to income levels and demographic shifts, total expenditure is expected to grow from approximately $3 trillion in 2014 to over $5 trillion by 2023. As a percentage of GDP, total healthcare expenditure is expected to grow from 18% in 2014 to almost 20% by 2023. [16]

US Healthcare Spending, Total and % of GDP

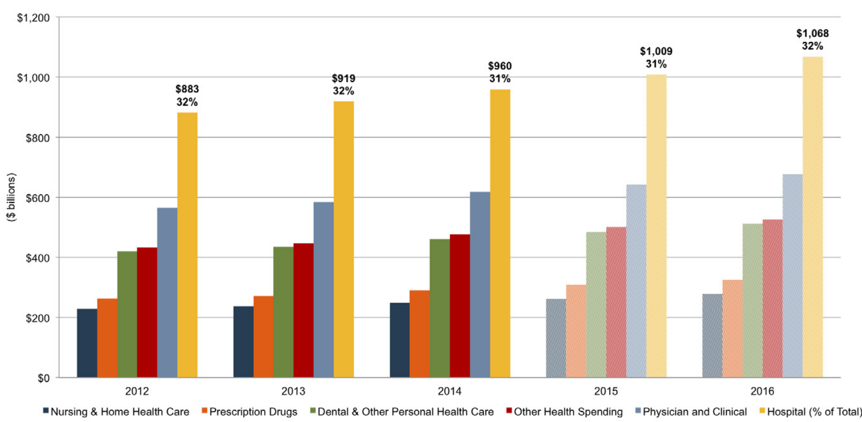


Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group
Mercer Capital Analysis

US Healthcare Expenditure II

Hospitals account for nearly one-third of healthcare expenditure in the U.S, totaling $960 billion according to 2014 estimates. Following hospitals are expenses related to physician and clinical services ($619 billion) and other non-personal health spending ($477 billion). An increase in overall health expenditure presents an opportunity for healthcare facilities.[17]

US Healthcare Expenditure by Sub-Segment



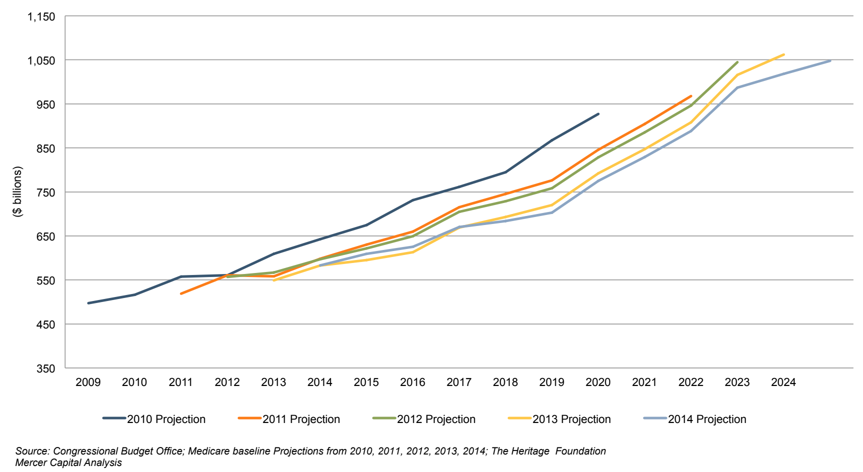
Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group
Mercer Capital Analysis

Industry Trends (cont.)

Medicare Spending

The CBO lowered its projections for Medicare funding in 2014, consistent with trends over the last few years as the U.S. government looks to rein in government outlays. The Congressional Budget Office (CBO) projects actual spending per Medicare beneficiary after accounting for inflation will grow an average annual rate of approximately 1% through 2025, slower than the 4% real growth realized from 1985 to 2007. [18] Overall, the CBO estimates Medicare will remain around 13% to 15% of federal spending and 3% of GDP through 2023.[19, 20]

CBO Medicare Spending Baseline Projections



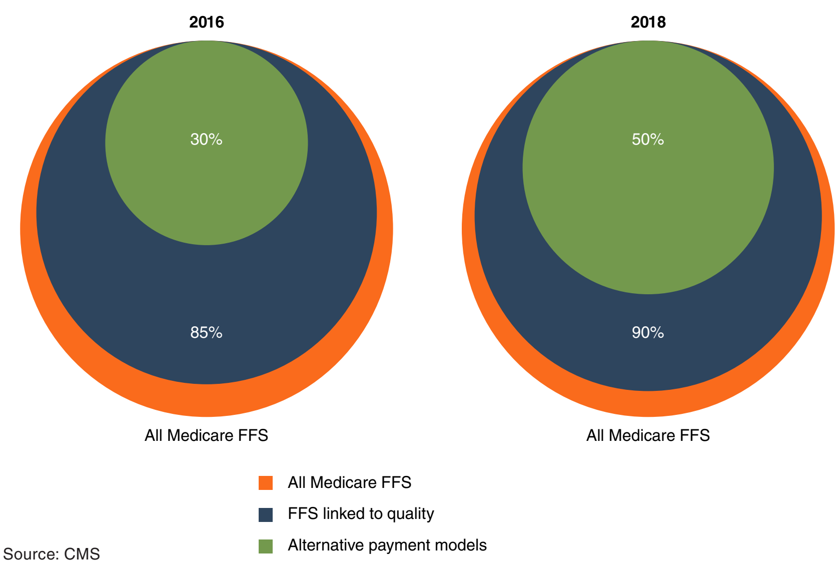
Source: Congressional Budget Office; Medicare baseline Projections from 2010, 2011, 2012, 2013, 2014; The Heritage Foundation Mercer Capital Analysis

Fee-For-Service vs. Value-Based Care

Commercial and government payors continue to push value-based payment models for healthcare providers. The ACA mandated that the CMS begin applying a value modifier under the Medicare Physician Fee Schedule (MPFS) by 2015. According to the CMS, at the end of 2014, value-based payments represented approximately 20% of Medicare fee-for-service (FFS) payments to healthcare providers. The government's goal is to have 85% and 90% of all Medicare FFS payments tied to quality or value by 2016 and 2018, respectively, along with 30% and 50% of Medicare payments tied to alternative payment models by the end of 2016 and 2018, respectively. Healthcare facilities are likely to see slowing revenue growth due to reduced procedure volume and new reporting and regulatory requirements. [22, 23]

Fee-For-Service Vs. Value-Based Care

Target percentage of Medicare FFS payments linked to quality and alternative payment models in 2016 and 2018



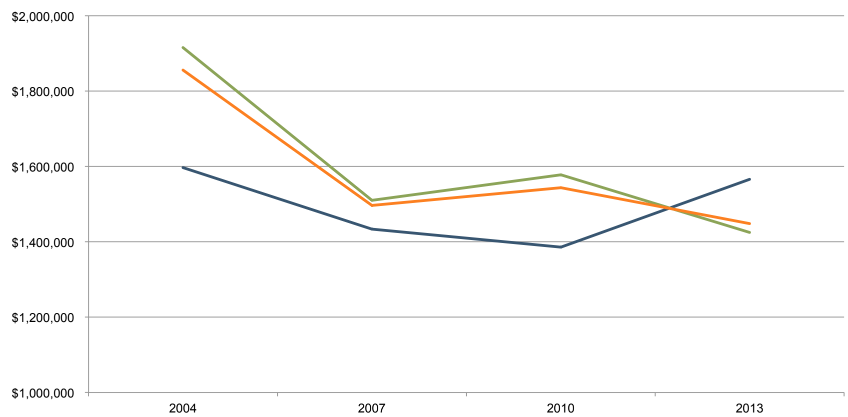
Source: CMS

Industry Trends (cont.)

Physician Revenue Generation

Between 2004 and 2013, average revenue generated by physicians for their respective hospitals dropped by almost 22%. Medicare reimbursement cuts and an evolving payment model (from fee-for-service to value-based) are driving the decline in revenues. This loss of revenue per physician is one of many factors that has led to an uptick in consolidation among hospitals and medical groups over the last decade.[24]

Average Net Revenue Generated by Physicians for Hospitals

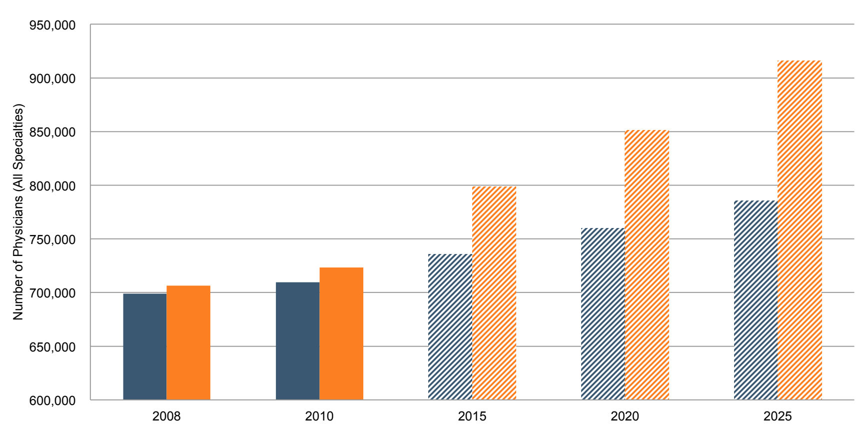


Source: Merit Hawkins Revenue Survey
Mercer Capital Analysis

Physician Shortages

According to the Association of American Medical Colleges (AAMC), the U.S. will have a shortage of approximately 90,000 doctors by 2020. An aging population and an increase in insured individuals are driving demand upward for health professionals, but supply has been slow to follow. Increasing wages could reverse the trend, but would negatively affect healthcare facility margins.[25]

Physician Supply and Demand in the US

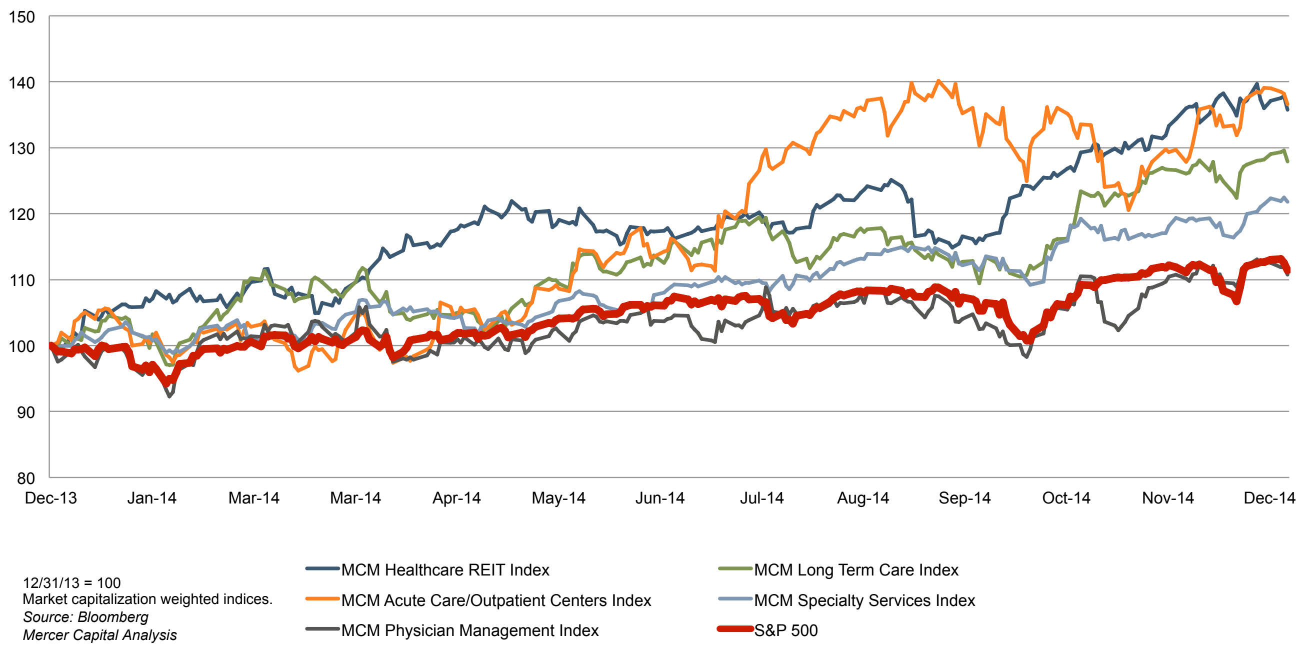


Source: AAMC Report
Mercer Capital Analysis

Valuation Trends

The S&P 500 index gained 11.4% in 2014, compared to 30% in 2013.[26] Healthcare facilities continued their strong performance, beating the broader market through 2014 year-end. The sector was lifted by favorable demographics and positive industry fundamentals, and the sector is expected to perform well into 2015.[27]

Mercer Capital Healthcare Facility Select Indices: One Year Performance



12/31/13 = 100
Market capitalization weighted indices.
Source: Bloomberg
Mercer Capital Analysis

Acute Care / Outpatient facilities and Healthcare REITs had the strongest performance among healthcare facilities sectors, seeing over 35% gains in 2014. Other facility sub-sectors also saw strong returns, recording 10% to 28% gains over the year.

Indices	Value at Year-End 2014 12/31/13 = 100
MCM Acute Care/Outpatient Centers Index	136.6
MCM Healthcare REIT Index	135.7
MCM Long Term Care Index	127.9
MCM Healthcare Distribution Index	126.3
MCM Specialty Services Index	121.8
S&P 500	111.4
MCM Physician Management Index	110.8

Source: Bloomberg, Mercer Capital Analysis

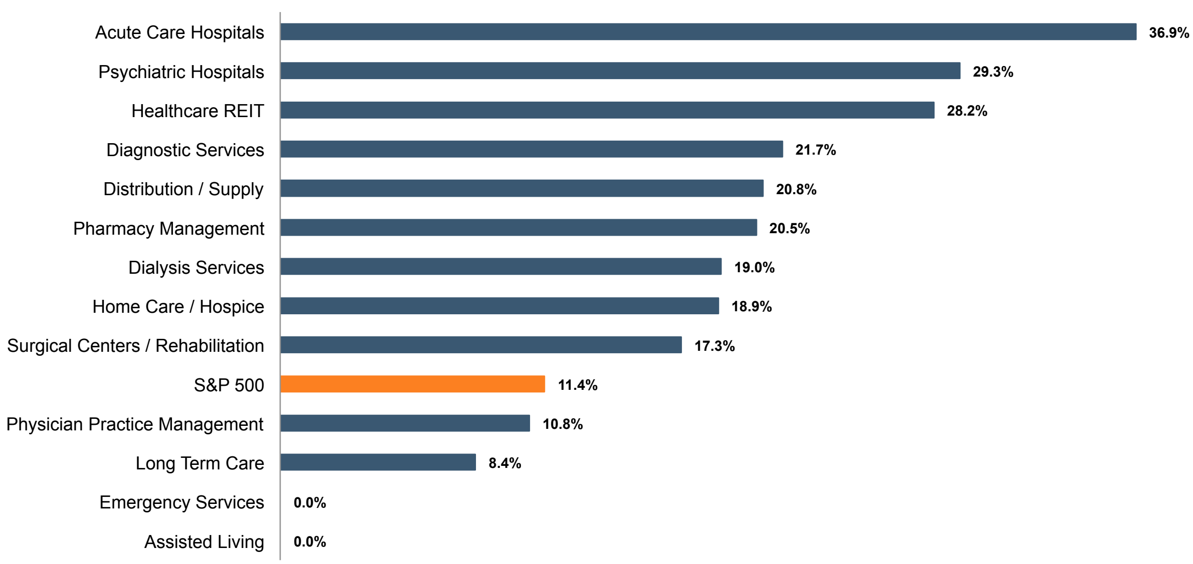
Valuation Trends (cont.)

Stock Price Performance by Market Sectors

Sector	Number of Companies	Median % Change: 3 month	Median % Change: 1 year	LTM Multiples: EV / Revenue	LTM Multiples: EV / EBITDA	Forward Multiples: EV / Revenue	Forward Multiples: EV / EBITDA
Acute Care Hospitals	5	16.2%	36.9%	1.40x	9.7x	1.17x	7.8x
Assisted Living	5	0.0%	0.0%	2.01x	17.9x	2.57x	13.2x
Diagnostic Services	4	9.8%	21.7%	1.76x	8.7x	1.55x	8.5x
Dialysis Services	2	14.9%	19.0%	2.01x	10.5x	1.86x	9.9x
Distribution / Supply	5	17.8%	20.8%	0.35x	14.5x	0.31x	11.0x
Emergency Services	3	18.9%	0.0%	2.42x	9.7x	1.55x	8.4x
Healthcare REIT	7	10.6%	28.2%	13.51x	18.4x	10.40x	15.8x
Home Care / Hospice	6	21.9%	18.9%	0.88x	11.8x	0.78x	9.4x
Long Term Care	4	18.2%	8.4%	0.74x	8.4x	0.67x	3.4x
Pharmacy Management	5	22.1%	20.5%	0.76x	11.7x	0.75x	11.0x
Physician Practice Management	4	8.7%	10.8%	1.87x	14.2x	1.62x	12.2x
Psychiatric Hospitals	3	-0.4%	29.3%	0.48x	10.1x	0.37x	5.7x
Surgical Centers / Rehabilitation	4	11.5%	17.3%	2.42x	9.9x	2.14x	8.8x
All / Median	**57**	**14.9%**	**19.0%**	**1.76x**	**10.5x**	**1.55x**	**9.4x**

Source: Capital IQ, Mercer Capital Analysis

Median Stock Price % Change, 1 Year

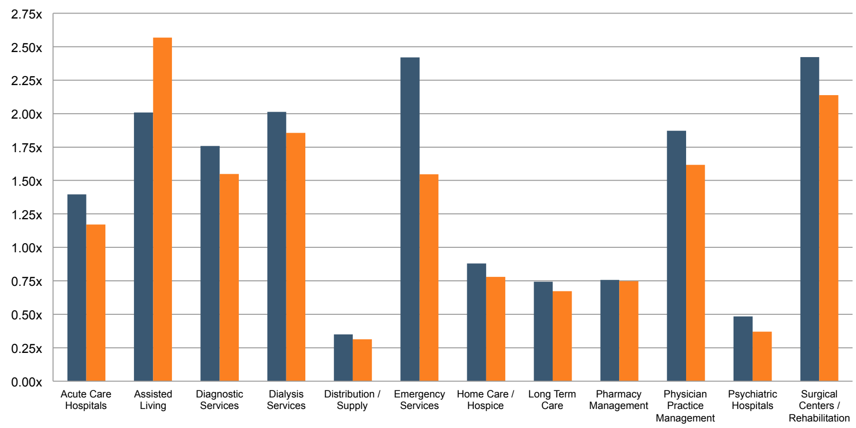


Source: Capital IQ
Mercer Capital Analysis

Valuation Trends (cont.)

EV / Revenue Multiples

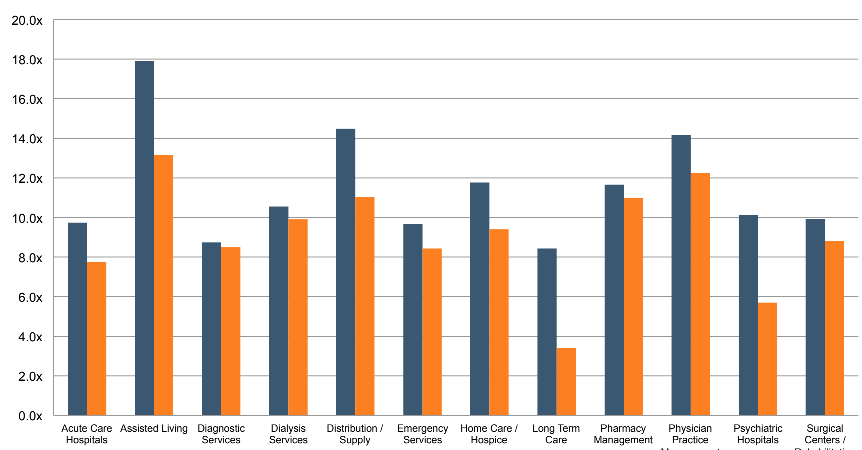
Excluding healthcare REITs, sub-sectors with the highest revenue multiples in 2014 were emergency services centers (2.42x), surgical and rehabilitation centers (2.42x), and dialysis service providers (2.01x). Forward multiples imply growth in estimated revenues for most sectors during 2015.



LTM = LTM EV / LTM Revenue
Forward = NTM EV / NTM Revenue
Source: Capital IQ
Mercer Capital Analysis

EV / EBITDA Multiples

Excluding REITs, the sub-sectors with the highest EBITDA multiples in 2014 were assisted living (17.9x), distribution/supply (14.5x), and physician practice management firms (14.2x). Similar to forward revenue, forward EBITDA is expected to increase across healthcare facility sectors in 2015.



LTM = LTM EV / LTM Revenue
Forward = NTM EV / NTM Revenue
Source: Capital IQ
Mercer Capital Analysis

Mergers & Acquisitions

Trends

Hospitals and healthcare facilities are adapting to changes sweeping through the industry, as new policies and market forces are driving consolidation. Transaction activity remains high as providers combine and consolidate to remain competitive and achieve greater economies of scale. Major factors currently driving transactions include: [28, 29]

- **Reduced reimbursement rates.** Reimbursement issues are causing heavy financial stress on healthcare facilities, as payment models move from fee-for-service towards value-based and bundle payments. Stagnant reimbursement from Medicare, Medicaid, and other commercial payors are also hurting industry revenue, driving an uptick in consolidating M&A activity.

- **Volume challenges.** Patients have been gravitating towards lower cost outpatient facilities, lowering the number of patients in inpatient facilities. Higher deductibles and growing copays have resulted in larger out-of-pocket expenses for consumers, leading patients to delay certain medical treatments. This has led to greater uncertainty in patient volume in a number of healthcare facility sub-sectors.

- **Integrated healthcare services.** In order to maintain margins and profitability, healthcare facilities are looking to expand their footprint into a number of sub-sectors. Larger healthcare facilities are absorbing smaller groups in divergent sectors in order to provide a continuum of care to patients, diversify their services, and control costs.

- **Scale advantages.** Larger and more integrated healthcare facilities have greater leverage and bargaining power when dealing with third-party payors, which has prompted smaller facilities to consolidate with bigger healthcare groups. Considerable capital expenditures will be needed to upgrade older facilities due to increasing healthcare demand, and large medical facility groups are better equipped to take on improvement projects due to their advantageous capital positions.

Select Healthcare Facilities Transactions

- **Laboratory Corp of America Holdings** (NYSEL: LH) announced on November 3, 2014 enters into a definitive agreement to acquire **Covance, Inc.** (NYSE: CVD). The deal will bring together LabCorp, the second largest diagnostic services and laboratory testing provider in the U.S., with Covance, a contract research organization providing drug development and animal testing services. Diagnostic service providers have been hurt by reimbursement changes, as payors decrease rates for certain diagnostic tests and procedures, and fewer tests are being ordered. In the face of the slump in LabCorp's testing volume, the deal will allow the company to expand into the fast-growing contract clinical trial market. LabCorp is also expected to benefit from Covance's international presence. [30]

  Under the terms of the deal, Covance shareholders would receive $75.76 in cash and 0.2886 LabCorp shares for each Covance share. The agreed price represents a premium of more than 30% over Covance's closing stock price on October 31, 2014. The terms imply an enterprise value of $5.7 billion for Covance, representing multiples of approximately 13.6x LTM EBITDA and 2.26x LTM revenue. [31]

- **Omega Healthcare, Inc.** (NYSE: OHI) announced on October 31, 2014 the acquisition of the outstanding shares of **Aviv REIT, Inc.** (NYSE: AVIV). The deal will bring together two healthcare-focused REITS, and according to Omega CEO Taylor Pickett, "The combination of Omega and Aviv creates the premier pure-play skilled nursing facility REIT which [will] be well-positioned to continue as the leading consolidator in the large, highly fragmented [skilled nursing facility] industry." The deal looks to take advantage of the rising demand for long-term care and assisted-living facilities by an aging U.S. population. [32, 33]

  Under the terms of the agreement, Aviv shareholders will receive 0.90 Omega shares for each share of Aviv common stock. Based on the closing stock price for Omega on October 30th, 2014, this price represents a 16% premium over Aviv's closing stock price. As of February 2015, the terms imply an

Select Healthcare Facilities Transactions (cont.)

enterprise value of $2.7 billion for Aviv, representing multiples of approximately 19.4x LTM EBITDA and 16.13x LTM revenue.[34]

- **Kindred Healthcare, Inc.** (NYSE: KND) and **Gentiva Health Services, Inc.** (NASDAQ: GTIV) reached an agreement on October 9, 2014 to merge into the largest provider of long-term, acute-care hospitals, inpatient rehabilitation facilities, and hospice and home health services in the U.S. Kindred issued a press release in early February 2015 announcing the completion of the deal. According to Kindred's then CEO Paul J. Diaz, "Kindred is positioned to deliver patient-centered, coordinated care – from hospital to home – through an integrated model that improves quality, clinical outcomes and patient satisfaction in a cost-effective manner." The deal was consummated after a lengthy period of courtship, with Gentiva rejecting a number of offers from Kindred. [35, 36]

  The transaction terms included $14.50 in cash and 0.27 Kindred shares for each Gentiva share. The offer represented a 17% premium to Gentiva's closing price as of the closing date. According to *The Wall Street Journal*, the offer represented a 50% increase from Kindred's earlier offer of $13.00 a share. The deal implied an enterprise value of $1.8 billion for Gentiva, or multiples of approximately 11.6x LTM EBITDA and 0.91x LTM revenue. [37, 38]

- **Acadia Healthcare Company, Inc.** (NASDAQ: ACHC) announced on October 29, 2014 it would acquire **CRC Health Group, Inc.** Acadia operates over 70 behavioral healthcare facilities across 24 states. CRC Health is a privately held substance-abuse and behavioral disorders treatment provider, operating approximately 120 facilities in 30 states. The deal will allow Acadia to continue expanding its in-patient mental health and substance abuse treatment facilities, along with achieving greater geographic expansion. [39, 40]

  The total consideration was approximately $1.2 billion. In a recent investment presentation, Acadia disclosed pricing multiples were approximately 10.2x 2014 EBITDA and 9.0x post-synergy EBITDA, based on 2014 LTM EBITDA of $115 million and synergies of $15 million. The purchase price represented 2.61x LTM revenue paid on CRC's 2014 expected revenue of $450 million. [41]

- **Extendicare, Inc.** (EXE: TO), a Canadian post-acute and long-term senior care service provider, entered into a definitive agreement on November 7, 2014 to sell substantially all of its U.S. operations to a group of investors including **Formation Capital, LLC,** a healthcare-focused private investment firm, and an affiliate of **Safanad, Inc.,** a global investment firm. Extendicare's U.S. operations included 141 owned and operated senior care centers, four centers operated under lease arrangements, ten centers operated under managed contracts, and 21 centers leased to a third-party operator. "After an extensive strategic review process, and months of negotiating and deal structuring, we are pleased to have reached an agreement to sell our U.S. business. The purchase price reflects an attractive EBITDA multiple and will crystallize value for Extendicare shareholders," said Tim Lukenda, President and Chief Executive Officer of Extendicare. [42, 43]

  The deal implies an enterprise value of $870 million for Extendicare's U.S. holdings, representing multiples of 10.4x adjusted EBITDA and 0.75x LTM revenue. [44]

- Hospital, rehabilitation facility and home-health operator **HealthSouth Corporation** (NYSE: HLS) announced it had entered into a stock purchase agreement with **EHHI Holdings, Inc.,** owner of Encompass Home Health and Hospice (the fifth largest provider of Medicare-focused home health services in the U.S), on November 23, 2014. Encompass has over 135 locations across 13 states. The deal allows HealthSouth to expand into the home health sector, a move HealthSouth's CEO Jay Grinney said the Company has sought for a number of years. [45, 46]

  The transaction price was approximately $750 million, and the terms imply multiples of 10.0x forward adjusted EBITDA, 10.7x LTM EBITDA, and 2.11x LTM revenue. [47, 48]

- **Catamaran Corporation** (NASDAQ: CTRX), a pharmacy benefit management (PBM) service provider, announced on October 8, 2014 that it had entered into an agreement to acquire **Salveo Specialty Pharmacy, Inc.**, an independent specialty pharmacy company. Salveo manages approximately $400 million in annual drug spend, and the deal will allow Catamaran to continue expanding specialty pharmacy capabilities through its wholly-owned subsidiary, BriovaRx. [49]

  Catamaran paid a purchase price of $260 million in cash. The deal represents a multiple of 13.0x LTM EBITDA. [50]

Transactions Summary

Buyer / Acquirer	Target / Seller	Announce Date	Close Date	Implied Enterprise Value	Implied Enterprise Value / Revenue	Implied Enterprise Value / EBITDA
Laboratory Corp. of America Holdings	Covance, Inc.	11/2/2014	NA	$5,677.4	2.26x	13.6x
Omega Healthcare Investors, Inc.	Aviv REIT, Inc.	10/30/2014	NA	$2,736.5	16.13x	19.4x
Kindred Healthcare, Inc.	Gentiva Health Services, Inc.	10/9/2014	NA	$1,791.7	0.91x	11.6x
Acadia Healthcare Company, Inc.	CRC Health Group, Inc.	10/29/2014	NA	$1,207.7	NA	NA
Formation Capital, LLC; Safanad, Inc.	Extendicare Holdings, Inc.	11/7/2014	NA	$870.0	0.75x	10.4x
Healthsouth Corp.	Encompass Home Health, Inc.	11/23/2014	12/31/2014	$750.0	2.11x	10.7x
Providence Service Corp.	Community Care Health Network, Inc.	9/17/2014	10/23/2014	$400.0	2.14x	9.2x
Catamaran Corporation	Salveo Specialty Pharmacy, Inc.	10/8/2014	1/2/2015	$260.0	NA	13.0x
Kindred Healthcare, Inc.	Centerre Healthcare Corporation	11/11/2014	1/2/2015	$195.0	1.38x	11.7x
Griffin-American Healthcare REIT III, Inc.	Southlake TX Hospital	11/18/2014	NA	$128.0	NA	NA
Laboratory Corp. of America Holdings	LipoScience, Inc.	9/24/2014	11/20/2014	$58.3	1.28x	NA
HCP, Inc.; Brookdale Senior Living Inc.	Freedom Village of Bradenton, LLC	9/2/2014	9/2/2014	$53.0	NA	NA
Medequities Realty Trust, Inc.	1125 Sir Francis Drake Boulevard Operating Company, LLC	8/1/2014	8/1/2014	$51.0	NA	NA
Acadia Healthcare Company, Inc.	McCallum Place Eating Disorder Centers	9/3/2014	9/3/2014	$43.4	NA	NA
Sentio Healthcare Properties, Inc	St. Andrews Village	5/22/2014	8/13/2014	$42.5	NA	NA
Juniper Communities, LLC	Coldren Associates (nka:Juniper Village at Brookline)	7/9/2014	7/9/2014	$35.5	NA	NA

$ in millions
Source: Capital IQ, Mercer Capital Analysis (only deals with implied enterprise value exceeding $10M shown)
See "Selected Healthcare Facilities Transactions" for more discussion on certain transactions and multiples.

Transactions Summary (cont.)

Buyer / Acquirer	Target / Seller	Announce Date	Close Date	Implied Enterprise Value	Implied Enterprise Value / Revenue	Implied Enterprise Value / EBITDA
Acadia Healthcare Company, Inc.	Belmont Center For Comprehensive Treatment	12/4/2014	NA	$35.0	NA	NA
Interpace Diagnostics, LLC	RedPath Integrated Pathology, Inc.	10/31/2014	10/31/2014	$34.8	NA	NA
Medical Properties Trust, Inc.	Sherman/Grayson Health Services, LLC	10/31/2014	10/31/2014	$32.5	NA	NA
Investment 360 LLC	Deer Meadows Retirement Community	7/25/2014	NA	$30.3	NA	NA
Neogenomics, Inc.	Path Logic, Inc.	7/8/2014	7/8/2014	$29.1	3.02x	NA
Medical Properties Trust, Inc.	Fairmont General Hospital, Inc. (nka:Fairmont Regional Medical Center)	9/19/2014	9/19/2014	$25.0	NA	NA
AMN Healthcare Services, Inc.	Avantas, LLC	12/22/2014	12/22/2014	$25.0	NA	NA
Legacy Healthcare Services, Inc.	Manorcare Of Highland Park (nka:Warren Barr North Shore)	7/1/2014	7/1/2014	$19.0	NA	NA
Surgical Care Affiliates, Inc.	Surgical Specialty Hospital of Arizona, LLC	7/18/2014	NA	$17.0	NA	NA
2000 E. Commercial Blvd, LLC	Ft. Lauderdale Health & Rehabilitation Center, Inc.	10/6/2014	10/6/2014	$15.7	NA	NA
Legend Senior Living, LLC	Meadowview of Greeley, LLC	7/8/2014	7/8/2014	$15.3	NA	NA
American Addiction Centers, Inc.	Recovery First, Inc.	12/15/2014	NA	$13.1	NA	NA
Origins Behavioral Healthcare, LLC	Hanley Center, Inc.	12/19/2014	12/19/2014	$11.5	NA	NA
Summit Healthcare REIT, Inc.	Gateway, Inc.	9/24/2014	12/31/2014	$11.3	NA	NA
Kettering Adventist HealthCare, Inc.	Tributaries Land Co.	9/4/2014	9/4/2014	$10.6	NA	NA
LHC Group, Inc.	Life Care Home Health, Inc.	7/15/2014	NA	$10.0	0.35x	NA

$ in millions
Source: Capital IQ, Mercer Capital Analysis (only deals with implied enterprise value exceeding $10M shown)
See "Selected Healthcare Facilities Transactions" for more discussion on certain transactions and multiples.

Public Company Pricing

Acute Care Hospitals

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Community Health Systems, Inc.	CYH	$53.9	18.8%	37.3%	$6,269.9	$23,900.9	$18,639.0	$2,737.0	1.40x	10.5x	1.17x	7.6x
HCA Holdings, Inc.	HCA	$73.4	30.2%	53.8%	$31,819.2	$61,291.2	$36,918.0	$7,385.0	1.70x	8.5x	1.59x	8.2x
Lifepoint Hospitals Inc.	LPNT	$71.9	15.8%	36.1%	$3,255.6	$5,325.5	$4,483.1	$577.0	1.28x	9.7x	1.05x	7.7x
Tenet Healthcare Corp.	THC	$50.7	7.9%	20.3%	$4,979.8	$16,859.8	$16,615.0	$1,952.0	1.05x	9.6x	0.93x	7.8x
Universal Health Services Inc.	UHS	$111.3	16.2%	36.9%	$11,011.4	$14,723.1	$8,065.3	$1,475.1	1.90x	10.6x	1.62x	9.4x
Median			**16.2%**	**36.9%**					**1.40x**	**9.7x**	**1.17x**	**7.8x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Assisted Living

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
AdCare Health Systems Inc.	ADK	$4.0	-6.3%	-6.7%	$75.7	$221.2	$227.3	$12.4	0.97x	17.9x	2.82x	13.2x
Brookdale Senior Living Inc.	BKD	$36.7	10.0%	34.9%	$6,725.6	$12,903.1	$3,343.5	$605.1	4.40x	24.7x	2.57x	14.1x
Capital Senior Living Corp.	CSU	$24.9	4.5%	3.8%	$724.7	$1,363.2	$380.1	$63.7	3.71x	23.9x	3.33x	16.5x
Five Star Quality Care Inc.	FVE	$4.2	-17.2%	-24.4%	$201.9	$239.0	$1,109.0	$14.9	0.22x	11.7x	0.18x	6.5x
Skarbiec Holding S.A.	SKH	$32.5	0.0%	0.0%	$221.7	$206.8	$91.1	$25.1	2.01x	5.7x	0.00x	0.0x
Median			**0.0%**	**0.0%**					**2.01x**	**17.9x**	**2.57x**	**13.2x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Quick References

Enterprise Value	Market Capitalization + Total Debt + Preferred Equity + Minority Interest - Cash and Short Term Investments
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
LTM	Last Twelve Months
Forward	Next Twelve Month Estimates

Public Company Pricing (cont.)

Diagnostic Imaging

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Alliance Healthcare Services, Inc.	AIQ	$21.0	-22.3%	-15.2%	$221.7	$732.7	$436.4	$121.7	1.68x	5.6x	0.00x	0.0x
Quest Diagnostics Inc.	DGX	$67.1	14.3%	25.3%	$9,692.5	$13,443.5	$7,435.0	$1,409.0	1.84x	9.5x	1.78x	9.0x
Laboratory Corp. of America Holdings	LH	$107.9	5.4%	18.1%	$9,117.6	$11,575.0	$6,011.6	$1,167.6	1.95x	10.0x	1.81x	9.4x
RadNet, Inc.	RDNT	$8.5	28.8%	411.4%	$364.8	$980.4	$717.6	$114.9	1.38x	8.0x	1.32x	8.0x
Median			**9.8%**	**21.7%**					**1.76x**	**8.7x**	**1.55x**	**8.5x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Dialysis Services

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
DaVita HealthCare Partners Inc.	DVA	$75.7	4.7%	19.5%	$16,276.5	$24,047.0	$12,780.7	$2,399.8	1.92x	9.9x	1.81x	9.7x
Fresenius Medical Care AG & Co. KGAA	FME	$61.3	25.1%	18.5%	$18,594.4	$26,138.7	$16,134.3	$2,928.4	2.11x	11.2x	1.91x	10.1x
Median			**14.9%**	**19.0%**					**2.01x**	**10.5x**	**1.86x**	**9.9x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Distribution / Supply

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
AmerisourceBergen Corporation	ABC	$90.2	24.1%	28.2%	$19,717.3	$19,904.4	$123,981.4	$1,407.1	0.17x	14.5x	0.16x	10.6x
Cardinal Health, Inc.	CAH	$80.7	17.8%	20.8%	$26,718.6	$28,256.6	$93,928.0	$2,441.0	0.31x	11.8x	0.30x	10.3x
Henry Schein, Inc.	HSIC	$136.2	14.7%	19.2%	$11,465.9	$12,767.0	$10,371.4	$867.4	1.25x	14.9x	1.18x	14.0x
McKesson Corporation	MCK	$207.6	11.5%	28.6%	$48,134.1	$56,497.1	$173,870.0	$3,921.0	0.35x	15.9x	0.31x	11.0x
Patterson Companies, Inc.	PDCO	$48.1	21.7%	16.7%	$4,828.3	$5,211.5	$4,347.6	$417.5	1.20x	12.5x	1.17x	11.9x
Median			**17.8%**	**20.8%**					**0.35x**	**14.5x**	**0.31x**	**11.0x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Public Company Pricing (cont.)

Emergency Services

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Adeptus Health Inc.	ADPT	$37.4	47.4%	0.0%	$368.2	$511.1	$210.7	$9.3	2.93x	73.7x	1.55x	12.0x
Air Methods Corp.	AIRM	$44.0	-14.8%	-24.4%	$1,726.2	$2,380.1	$1,004.8	$264.5	2.42x	9.7x	2.25x	8.4x
InfuSystem Holdings, Inc.	INFU	$3.2	18.9%	47.2%	$70.2	$96.2	$60.7	$16.1	1.58x	5.8x	1.34x	8.3x
Median			**18.9%**	**0.0%**					**2.42x**	**9.7x**	**1.55x**	**8.4x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Home Care / Hospice

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Addus HomeCare Corporation	ADUS	$24.3	8.0%	8.1%	$264.1	$253.9	$312.9	$22.9	0.85x	12.2x	0.76x	9.7x
Almost Family Inc.	AFAM	$29.0	31.1%	-10.5%	$274.3	$325.1	$495.8	$27.7	0.70x	14.9x	0.65x	9.0x
Amedisys Inc.	AMED	$29.4	75.3%	100.6%	$979.7	$1,087.8	$1,188.3	$66.3	0.91x	20.0x	0.89x	11.7x
Chemed Corp.	CHE	$105.7	12.8%	37.9%	$1,797.4	$1,952.4	$1,456.3	$196.8	1.37x	10.6x	1.30x	9.0x
Gentiva Health Services Inc.	GTIV	$0.0	0.0%	0.0%	$0.0	$0.0	$1,969.7	$154.3	0.00x	0.0x	0.00x	0.0x
LHC Group, Inc.	LHCG	$31.2	45.9%	29.7%	$554.9	$629.0	$717.9	$59.7	0.91x	11.3x	0.80x	10.0x
Median			**21.9%**	**18.9%**					**0.88x**	**11.8x**	**0.78x**	**9.4x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Long Term Care

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Diversicare Healthcare Services Inc.	DVCR	$9.5	24.7%	103.7%	$58.2	$105.1	$344.2	$20.3	0.30x	6.6x	0.00x	0.0x
The Ensign Group, Inc.	ENSG	$44.4	42.8%	0.3%	$997.8	$955.8	$1,027.4	$99.4	0.97x	8.7x	0.84x	8.8x
Kindred Healthcare Inc.	KND	$18.2	-21.3%	-7.9%	$1,265.6	$2,628.5	$5,027.6	$342.8	0.52x	9.0x	0.51x	6.8x
National Healthcare Corp.	NHC	$62.8	11.6%	16.6%	$885.6	$917.9	$871.7	$104.6	1.07x	8.2x	0.96x	0.0x
Median			**18.2%**	**8.4%**					**0.74x**	**8.4x**	**0.67x**	**3.4x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Public Company Pricing (cont.)

Pharmacy Management

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
CVS Health Corporation	CVS	$96.3	27.8%	34.6%	$111,045.4	$122,896.4	$139,367.0	$10,724.0	0.91x	11.6x	0.84x	11.0x
Catamaran Corporation	CCT	$60.1	27.6%	19.2%	$12,474.0	$13,076.1	$21,581.9	$845.7	0.57x	14.5x	0.49x	12.8x
Express Scripts Holding Company	ESRX	$84.7	22.1%	20.5%	$62,140.2	$76,003.4	$100,887.1	$6,689.1	0.76x	11.7x	0.75x	10.8x
Omnicare Inc.	OCR	$72.9	9.6%	20.8%	$7,138.7	$9,067.7	$6,417.6	$741.7	1.43x	12.4x	1.37x	12.1x
PharMerica Corporation	PMC	$20.7	-27.6%	-3.7%	$677.7	$1,031.5	$1,894.5	$123.3	0.57x	8.9x	0.53x	7.4x
Median			**22.1%**	**20.5%**					**0.76x**	**11.7x**	**0.75x**	**11.0x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Physician Practice Management

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
MEDNAX, Inc.	MD	$66.1	13.7%	23.8%	$6,638.5	$6,849.0	$2,438.9	$559.0	2.91x	12.7x	2.62x	11.7x
Envision Healthcare Holdings, Inc.	EVHC	$34.7	-3.4%	-2.3%	$6,366.5	$8,172.7	$4,397.6	$551.1	1.93x	15.7x	1.67x	12.8x
IPC Healthcare, Inc.	IPCM	$45.9	3.8%	-22.7%	$790.3	$834.8	$694.0	$72.6	1.23x	11.7x	1.12x	10.8x
Team Health Holdings, Inc.	TMH	$57.5	15.2%	26.3%	$4,090.9	$4,795.7	$2,819.6	$291.8	1.81x	17.0x	1.56x	14.0x
Median			**8.7%**	**10.8%**					**1.87x**	**14.2x**	**1.62x**	**12.2x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Psychiatric Hospitals

Company Name	Ticker	Price at 12/31/14	% Change 3-month	% Change 1 year	Market Cap	Enterprise Value (EV)	LTM Rev.	LTM EBITDA	LTM Multiples EV / Rev.	LTM Multiples EV / EBITDA	Forward Multiples EV / Rev.	Forward Multiples EV / EBITDA
Acadia Healthcare Company, Inc.	ACHC	$61.2	34.5%	29.3%	$3,667.6	$4,654.8	$1,004.6	$205.4	5.17x	25.9x	3.27x	14.4x
Magellan Health, Inc.	MGLN	$60.0	-3.6%	0.2%	$1,638.1	$1,528.8	$3,760.1	$220.3	0.40x	7.8x	0.36x	5.7x
Providence Service Corp.	PRSC	$36.4	-0.4%	41.7%	$577.7	$632.4	$1,481.2	$73.1	0.48x	10.1x	0.37x	5.6x
Median			**-0.4%**	**29.3%**					**0.48x**	**10.1x**	**0.37x**	**5.7x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Public Company Pricing (cont.)

Surgical Centers / Rehabilitation

			% Change				LTM		LTM Multiples		Forward Multiples	
Company Name	Ticker	Price at 12/31/14	3-month	1 year	Market Cap	Enterprise Value (EV)	Rev.	EBITDA	EV / Rev.	EV / EBITDA	EV / Rev.	EV / EBITDA
AmSurg Corp.	AMSG	$54.7	20.1%	19.2%	$2,633.9	$5,434.5	$1,621.9	$478.1	4.05x	12.7x	2.33x	8.5x
HEALTHSOUTH Corp.	HLS	$38.5	7.2%	15.4%	$3,375.0	$5,001.2	$2,374.3	$582.7	2.14x	8.4x	1.95x	8.0x
Surgical Care Affiliates, Inc.	SCAI	$33.7	15.7%	-3.4%	$1,297.5	$2,252.7	$850.7	$221.4	2.71x	10.4x	2.45x	12.9x
Select Medical Holdings Corporation	SEM	$14.4	-7.7%	24.0%	$1,885.3	$3,479.4	$3,020.4	$352.8	1.16x	9.5x	1.11x	9.1x
Median			**11.5%**	**17.3%**					**2.42x**	**9.9x**	**2.14x**	**8.8x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

Healthcare REIT

			% Change				LTM		LTM Multiples		Forward Multiples	
Company Name	Ticker	Price at 12/31/14	3-month	1 year	Market Cap	Enterprise Value (EV)	Rev.	EBITDA	EV / Rev.	EV / EBITDA	EV / Rev.	EV / EBITDA
Aviv REIT, Inc.	AVIV	$34.5	22.4%	45.5%	$1,629.3	$2,602.2	$182.4	$150.4	15.34x	18.4x	11.88x	13.3x
Health Care REIT, Inc.	HCN	$75.7	20.7%	41.3%	$24,795.1	$35,471.7	$3,305.9	$1,717.4	10.98x	20.2x	9.97x	18.2x
HCP, Inc.	HCP	$44.0	6.4%	21.2%	$20,221.3	$29,624.4	$2,266.3	$1,781.4	13.51x	16.2x	13.09x	15.7x
Healthcare Realty Trust Incorporated	HR	$27.3	7.5%	28.2%	$2,682.2	$4,083.9	$370.6	$219.8	11.03x	18.9x	10.40x	17.6x
LTC Properties Inc.	LTC	$43.2	10.6%	22.0%	$1,505.8	$1,839.2	$118.4	$106.5	15.83x	17.9x	14.72x	16.6x
Omega Healthcare Investors Inc.	OHI	$39.1	6.0%	31.1%	$4,978.6	$7,279.5	$504.8	$467.2	15.02x	16.1x	17.84x	12.1x
Ventas, Inc.	VTR	$71.7	11.9%	25.2%	$21,182.2	$31,824.2	$3,071.3	$1,663.1	10.60x	19.3x	9.30x	15.8x
Median			**10.6%**	**28.2%**					**13.51x**	**18.4x**	**11.88x**	**15.8x**

$ in millions, except per share pricing
Source: Capital IQ, Mercer Capital Analysis

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Fairness Opinions

Evaluating a Buyer's Shares from the Seller's Perspective

M&A activity in the U.S. (and globally) has accelerated in 2014 after years of gradual improvement following the financial crisis. According to Dealogic, M&A volume where the target was a U.S. company totaled $1.4 trillion YTD through November 10, the highest YTD volume on record and up 43% from the same period last year. Excluding cross-border acquisitions, domestic-only M&A was $1.1 trillion, which represented the second highest YTD volume since 1999 and up 27% from last year. Healthcare and telecommunications were the first and second most targeted sectors.

The improvement has taken a long time even though corporate cash is high, financing costs are very low and organic revenue growth in most industries has been sluggish. Aside from improving confidence, another key foundation for increased M&A activity fell into place in 2013 when equity markets staged a strong rally as the S&P 500 rose 30% (32% with dividends) and the Russell 2000 increased 37% (39%). The absence of a meaningful pullback in 2014 and a 12% advance in the S&P 500 and 2% in the Russell 2000 have further supported activity.

The rally in equities, like low borrowing rates, has reduced the cost to finance acquisitions because the majority of stocks experienced multiple expansion rather than material growth in EPS. It is easier for a buyer to issue shares to finance an acquisition if the shares trade at rich valuation than issuing "cheap" shares. As of November 24, the S&P 500's P/E based upon trailing earnings (as reported) was 20.0x compared to 18.2x at year-end 2013, 17.0x at year-end 2012 and 14.9x at year-end 2011. The long-term average P/E since 1871 is 15.5x (Source: http://www.multpl.com).

High multiple stocks can be viewed as strong acquisition currencies for acquisitive companies because fewer shares have to be issued to achieve a targeted dollar value. As such, it is no surprise that the extended rally in equities has supported deal activity this year. However, high multiple stocks may represent an under-appreciated risk to sellers who receive the shares as consideration. Accepting the buyer's stock raises a number of questions, most which fall into the genre of: what are the investment merits of the buyer's shares? The answer may not be as obvious as it seems, even when the buyer's shares are actively traded.

Our experience is that some, if not most, members of a board weighing an acquisition proposal do not have the background to thoroughly evaluate the buyer's shares. Even when financial advisors are involved there still may not be a thorough vetting of the buyer's shares because there is too much focus on "price" instead of, or in addition to, "value."

A fairness opinion is more than a three or four page letter that opines as to the fairness from a financial point of a contemplated transaction; it should be backed by a robust analysis of all of the relevant factors considered in rendering the opinion, including an evaluation of the shares to be issued to the selling company's shareholders. The intent is not to express an opinion about where the shares may trade in the future, but rather to evaluate the investment merits of the shares before and after a transaction is consummated.

Key questions to ask about the buyer's shares include the following:

- **Liquidity of the Shares.** What is the capacity to sell the shares issued in the merger? SEC registration and even NASDAQ and NYSE listings do not guarantee that large blocks can be liquidated efficiently. Generally, the higher the institutional ownership, the better the liquidity. Also, liquidity may improve with an acquisition if the number of shares outstanding and shareholders increase sufficiently.

- **Profitability and Revenue Trends.** The analysis should consider the buyer's historical growth and projected growth in revenues, and operating earnings, (usually EBITDA or EBITDA less capital expenditures) in addition to EPS. Issues to be vetted include customer concentrations, the source of growth, the source of any margin pressure and the like. The quality of earnings and a comparison of core vs. reported earnings over a multi-year period should be evaluated.

- **Pro Forma Impact.** The analysis should consider the impact of a proposed transaction on revenues, EBITDA, margins, EPS and capital structure. The per share accretion and dilution analysis of such metrics as earnings, EBITDA and dividends should consider both the buyer's and seller's perspectives.

- **Dividends.** In a yield starved world, dividend paying stocks have greater attraction than in past years. Sellers should not be overly swayed by the pick-up in dividends from swapping into the buyer's shares; however, multiple studies have demonstrated that a sizable portion of an investor's return comes from dividends over long periods of time. If the dividend yield is notably above the peer average, the seller should ask why? Is it payout related, or are the shares depressed? Worse would be if the market expected a dividend cut. These same questions should also be asked in the context of the prospects for further increases.

- **Capital Structure.** Does the acquirer operate with an appropriate capital structure given industry norms, cyclicality of the business and investment needs to sustain operations? Will the proposed acquisition result in an over-leveraged company, which in turn may lead to pressure on the buyer's shares and/or a rating downgrade if the buyer has rated debt?

- **Balance Sheet Flexibility.** Related to the capital structure should be a detailed review of the buyer's balance sheet that examines such areas as liquidity, access to bank credit, and the carrying value of assets such as deferred tax assets.

- **Ability to Raise Cash to Close.** What is the source of funds for the buyer to fund the cash portion of consideration? If the buyer has to go to market to issue equity and/or debt, what is the contingency plan if unfavorable market conditions preclude floating an issue?

- **Consensus Analyst Estimates.** If the buyer is publicly traded and has analyst coverage, consideration should be given to Street expectations vs. what the diligence process determines. If Street expectations are too high, then the shares may be vulnerable once investors reassess their earnings and growth expectations.

- **Valuation.** Like profitability, valuation of the buyer's shares should be judged relative to its history and a peer group presently as well as relative to a peer group through time to examine how investors' views of the shares may have evolved through market and profit cycles.

- **Share Performance.** Sellers should understand the source of the buyer's shares performance over several multi-year holding periods. For example, if the shares have significantly outperformed an index over a given holding period, is it because earnings growth accelerated? Or, is it because the shares were depressed at the beginning of the measurement period? Likewise, underperformance may signal disappointing earnings, or it may reflect a starting point valuation that was unusually high.

- **Strategic Position.** Assuming an acquisition is material for the buyer, directors of the selling board should consider the strategic position of the buyer, asking such questions about the attractiveness of the pro forma company to other acquirers.

- **Contingent Liabilities.** Contingent liabilities are a standard item on the due diligence punch list for a buyer. Sellers should evaluate contingent liabilities too.

The list does not encompass every question that should be asked as part of the fairness analysis, but it does illustrate that a liquid market for a buyer's shares does not necessarily answer questions about value, growth potential and risk profile.

We at Mercer Capital have extensive experience in valuing and evaluating the shares (and debt) of financial and non-financial service companies garnered from over three decades of business. Feel free to contact us to discuss your situation in confidence.

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