



Healthcare

Focus



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Strong Activity Through Q3 2007

Healthcare services M&A continued with an active second and third quarter 2007. Private equity groups are driving a significant portion of this activity. Year-to-date 2007, there have been 566 deals announced and closed, versus 660 in all of 2006. Key drivers to this deal volume include a healthy economy, strong investment from private equity groups, and continued abundance of capital.

A number of large deals closed in the period of June to September 2007, with much of the activity in the provider space. In late June, TPG completed its acquisition of the outpatient division of HealthSouth for approximately \$945 million. In early July, The Carlyle Group completed its \$6 billion acquisition of Manor Care, a provider short-term acute and long-term care services. In addition, Symbion, a leading operator of short-term ambulatory surgery centers, was acquired by Crestview Advisors for approximately \$486 million. Other companies acquired include AmeriPath, Triad Hospitals, and MedQuest. Also notable, the home healthcare and sleep diagnostics sectors showed heavy activity, closing 27 and nine deals, respectively.

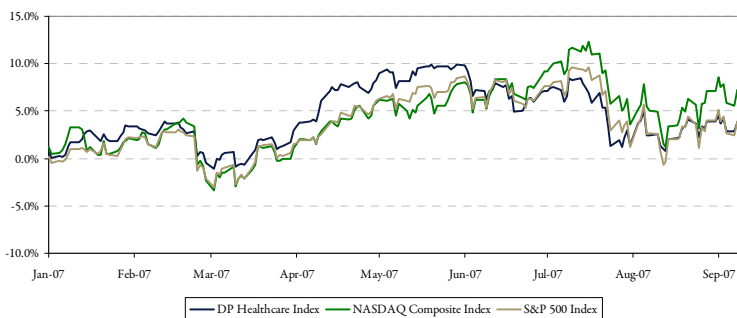
Several regulatory events occurred in the 3rd quarter. On August 6, the merger of Evanston Northwestern Healthcare (ENH) and Highland Park Hospital was deemed unlawful; if this ruling stands, it will have significant implications to similar hospital mergers, past and future. A second case involved a ruling that allowed Provena Covenant Medical Center to restore its property tax exemption, thereby accelerating the debate over charity care and tax exemption. CMS issued a Final Rule that sets Ambulatory Surgery Center (ASC) Medicare reimbursement rate to 65% of the hospital outpatient rate, and the U.S. House of Representatives passed legislation that may prohibit physician ownership in hospitals.

In our sector spotlight we take a brief look at the outpatient rehabilitation care segment. There has been a significant amount of M&A activity in 2007, including the sale of both HealthSouth's and Stryker's rehabilitation care divisions. We also take a look at some recent regulatory issues that have arisen relating to reimbursement.

We expect a strong remainder of 2007. The recent turbulence in the debt market appears to be settling down. The middle market has been resilient to these events and continues to thrive. We expect vigorous activity in the ASC and diagnostic imaging sectors.

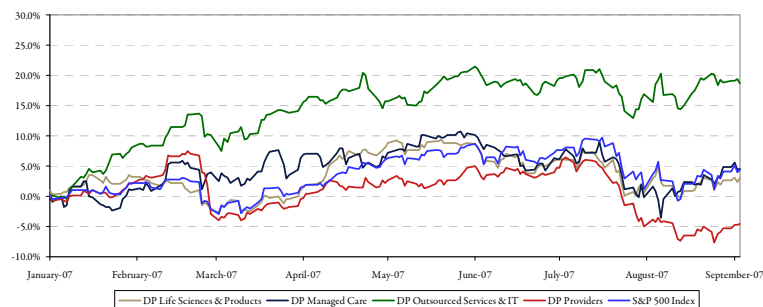
Healthcare Public Market Trends

Industry YTD Return



Source: CapitalIQ

Sector YTD Return



Source: CapitalIQ



HEALTHCARE INDUSTRY DEVELOPMENTS

Recent Transactions & Regulatory Changes

Selected Transactions Q2-Q3 2007 *

On September 5, 2007, **Skilled Healthcare Group** acquired the assets of ten skilled nursing facilities and a hospice company from **Laurel Healthcare Providers LLC** for **\$51.5 million**.

On August 23, 2007, **Crestview Partners LLC** acquired **Symbion Incorporated**, an owner and operator of 59 short-stay surgical facilities in 23 states, for **\$486 million (1.9x revenues; 12.7x EBITDA)**.

On August 21, 2007, **Walgreen Company** acquired **Option Care Incorporated**, a provider of specialty pharmacy and home infusion services, for **\$678 million (1.0x revenues; 15.1x EBITDA)**.

On August 13, 2007, **Novant Health** agreed to acquire **MQ Associates Incorporated**, an operator and provider of diagnostic imaging sites and services with a network of 90 centers in 13 states, for **\$403 million**.

On August 8, 2007, a consortium of private equity investors including **Goldman Sachs Urban Investment Group**, **Haas Wheat & Partners**, and **Pharos Capital Group** acquired **Nursefinders Incorporated**, a provider of healthcare staffing services, from **Gryphon Investors** for **\$250 million**.

On August 1, 2007, **WellPoint Incorporated** acquired **American Imaging Management**, a provider of diagnostic imaging benefit management services, for **\$300 million (1.5x revenues)**.

On July 31, 2007, **Air Methods Corporation** entered into an agreement to acquire **FSS Airholdings Incorporated**, a provider of medical air transportation services, for **\$25.0 million (0.2x revenues)**.

On July 25, 2007, **Community Health Systems** acquired **Triad Hospitals**, an owner and operator of hospitals and ASCs with over 65 facilities in 17 states, for **\$4.8 billion (1.1x revenues; 9.3x EBITDA)**.

On July 2, 2007, **The Carlyle Group LLC** entered into an agreement to acquire **Manor Care Incorporated**, a provider of short-term post-acute services and long-term care services with a network of 551 facilities, for **\$6.0 billion (1.6x revenues; 13.0x EBITDA)**.

On June 29, 2007, **TPG** acquired **HealthSouth Corporation's Surgery Division**, a network of 139 outpatient surgery centers and 3 surgical hospitals, for **\$945 million (12.5x revenues; 10.7x EBITDA)**.

On May 31, 2007, **Quest Diagnostics** acquired **AmeriPath Incorporated**, the leading pathology services provider, from **Welsh, Anderson & Stowe** for **\$1.2 billion (2.6x revenues; 16.7x EBITDA)**.

*Source: CapitalIQ, MergerStat & Dresner Partners estimates

Regulatory Changes

Evanston Northwestern Healthcare ("ENH") Antitrust Ruling. On August 6, 2007, the Federal Trade Commission (FTC) upheld its 2005 decision by an Administrative Law Judge declaring the **merger of ENH and Highland Park Hospital ("HPH")** in 2000 as **unlawful** under Section 7 of the Clayton Act. The 2005 decision was the culmination of a series of allegations by managed care organizations of anticompetitive behavior by ENH. Although the FTC has not ordered the divestiture of HPH, the decision could have serious implications for similar hospital mergers, past and contemplated.

Prohibition on Physician Ownership of Hospitals. On August 1, 2007, the US House of Representatives, as part of legislation that would **reauthorize the State Children's Health Insurance Program (SCHIP)**, approved legislation that would prohibit new physician ownership of hospitals and impose restrictions on existing physician-owned hospitals. The new legislation would impose **additional requirements** on these hospitals for them to continue to **qualify for the Stark Whole Hospital Exception**: physician ownership must be limited to 40%; no new expansion; and strict ownership disclosure requirements. It is unclear whether it will pass, but it shows continuing legislation pressure in the industry.

Provena Property Tax Exemption. On July 20, 2007, **Provena Covenant Medical Center** in Champaign, Illinois **won a lawsuit to restore its property tax exemption**, which it lost in 2003 after Champaign County alleged that Provena was deficient in its level of charity care. In September 2006 the Illinois Department of Revenue upheld this allegation, making Illinois the first state to revoke the tax exemption of a not-for-profit hospital. This ruling is a victory for the not-for-profit hospital sector and can be considered a landmark event in the **accelerating debate over charity care and tax exemption**.

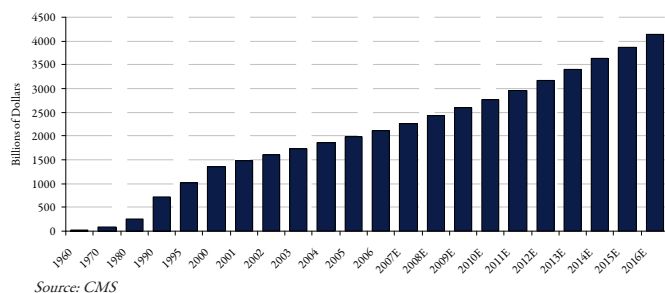
ASC Final Rule. On July 16, 2007, **CMS** issued a Final Rule addressing the ASC payment rate: the final **ASC rate will be 65% of the hospital outpatient rate** and will be phased in over a four-year period (as opposed to the two-year period contemplated by the August 8, 2006 Proposed Rule) beginning January 1, 2008. In addition to setting the payment rate, the Final Rule contained additional provisions:

- Approximately **800 new procedures** that previously were deemed unsafe to be performed in ASCs have been **added**.
- Annual rate increases are now **directly linked to HOPD increases**,
- Procedures which previously could not be performed in ASCs due to prohibition under Stark; this will **increase the amount of related ancillary services** that can be separately billable.
- Additions of approved procedures with heavy device and implant costs; this may make procedures that previously were not profitable in ASCs to be **now viable in ASCs**.

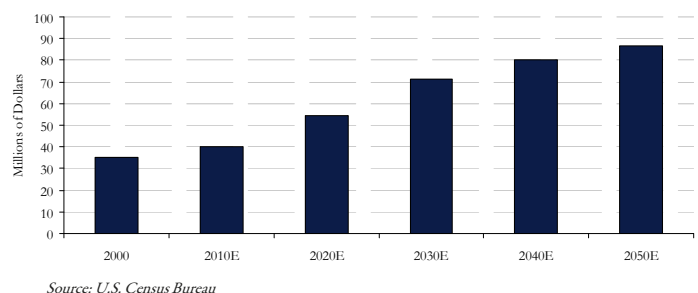
Stark III. On August 27, 2007, **CMS** released its highly anticipated Stark III rules. The new rules extend the provisions of the current Stark II structure and provide for stricter enforcement, particularly in the diagnostic imaging area. The regulation will become effective in 90 days, in early December. The third phase of the regulation was put in place as response to public comments on Stark II. The Phase III final rule interpreted various statutory exceptions to the prohibition in order to reduce the regulatory burden on the health-care industry.

Healthcare Industry Metrics

U.S. Healthcare Expenditures



U.S. Population 65 & Older



HEALTHCARE SECTOR SPOTLIGHT

Outpatient Rehabilitation Care

Opportunities

Rehabilitation care is a growth sector in healthcare. The sector is expected to thrive based on several macro trends, including healthcare spending, an aging population, and longer life expectancy.

The industry is highly fragmented, both inpatient and outpatient, with no single company having a significant market share. The combination of the industry structure and the positive macro outlook provides for an environment prime for consolidation.

There has been significant M&A activity in the past year. In January 2007, **Select Medical acquired HealthSouth's outpatient rehabilitation division for \$245 million**. In April 2007, **Kindred Healthcare acquired 22 inpatient rehab facilities from Ventas for \$171.5 million**. In June 2007, **Water Street Healthcare Partners acquired Stryker's outpatient rehabilitation division, Physiotherapy Associates, for \$150 million**. In addition, on June 28, 2007, the parent companies of both **Physiotherapy Associates** and **Benchmark Medical** agreed to merge the

outpatient rehabilitation clinic operators. **Water Street Healthcare Partners** and **Wind Point Partners** who own **Physiotherapy** and **Benchmark** respectively, will be the majority owners.

Risks

Wage Inflation. Labor expense is the largest operating cost component in the rehabilitation industry. Therapists' wages are cyclical in nature and are often related to changes in Medicare reimbursement. It is unlikely that there will be a relief from the current wage pressure until more providers experience a prolonged period of more severe Medicare reimbursement pressure.

Medicare 75% Rule for Inpatient Rehabilitation Facilities (IRFs). The single largest risk facing IRF operators is the "75% rule", which requires that at least 75% of Medicare admissions to IRFs must fall under 13 specified diagnoses. Providers have experienced year-over-year volume declines of 7-10% over the last six quarters as a result of this rule. The phase-in period for the 75% rule is now 50% complete and IRF providers face the growing challenge of compliance over the next two years.

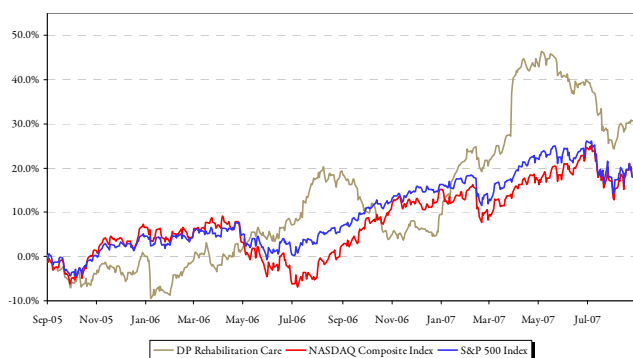
Rehabilitation Care Statistics

Public Company Trading Statistics

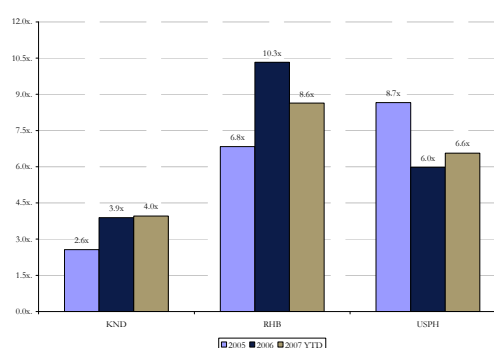
(\$ in millions, except per share data)

Company Name	Stock Price	Market Cap	TEV	LTM Revenue	LTM EBITDA	Enterprise Value to:								
						Revenue		EBITDA		EBIT		Price to:		
						LTM	2007E	LTM	2007E	LTM	2007E	LTM EPS	2007E EPS	
Kindred Healthcare Inc. (NYSE:KND)	\$19.39	792.7	803.4	4,434.0	199.5	0.2x	0.2x	4.0x	3.9x	7.5x	7.5x	16.3x	14.9x	
Rehabcare Group Inc. (NYSE:RHB)	\$16.20	283.2	380.4	730.5	46.7	0.5x	0.5x	8.1x	7.8x	12.8x	12.4x	35.6x	20.5x	
US Physical Therapy Inc. (NasdaqNM:USPH)	\$13.74	159.4	150.6	137.1	24.0	1.1x	1.0x	6.3x	6.0x	7.7x	na	19.5x	18.8x	
						High	1.1x	1.0x	8.1x	7.8x	12.8x	12.4x	35.6x	20.5x
						Low	0.2x	0.2x	4.0x	3.9x	7.5x	7.5x	16.3x	14.9x
						Mean	0.6x	0.6x	6.1x	5.9x	9.3x	9.9x	23.8x	18.1x
						Median	0.5x	0.5x	6.3x	6.0x	7.7x	9.9x	19.5x	18.8x

Rehabilitation Care Equity Market Performance

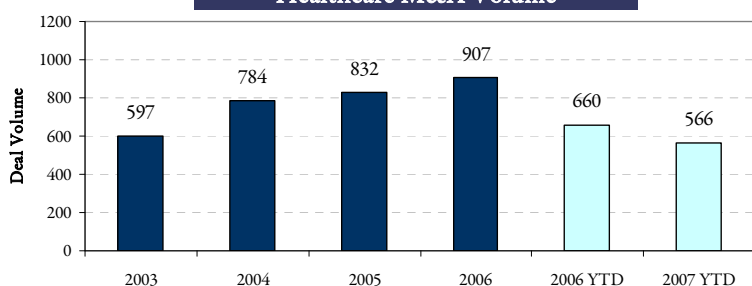


Rehabilitation Care EV / EBITDA Multiples



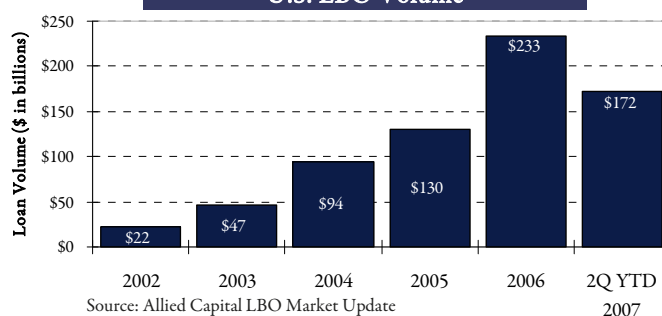
Healthcare Capital Markets

Healthcare M&A Volume



Source: CapitalIQ

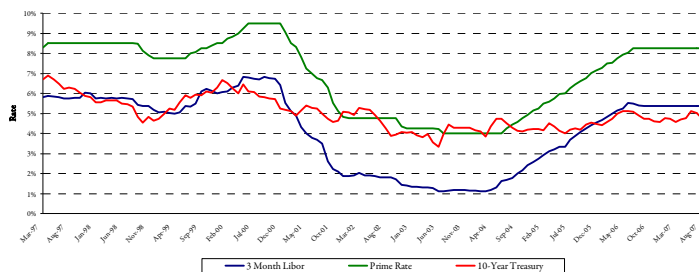
U.S. LBO Volume



Source: Allied Capital LBO Market Update

Capital Markets

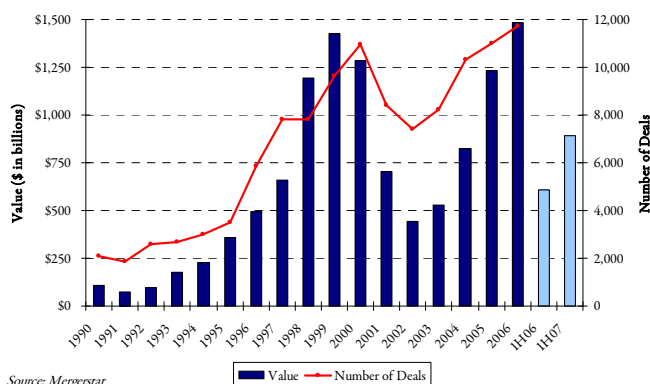
Interest Rates



CPI Index

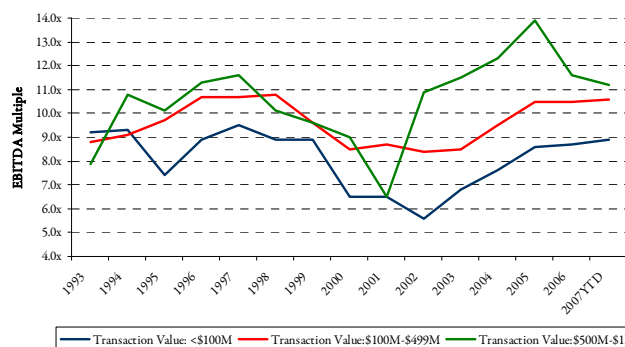


Mergers and Acquisitions



Source: Mergerstat

Average EV/EBITDA Multiples for Middle Market Companies



Note: Data represents median multiples

Source: Mergerstat

Dresner Partners Healthcare Group



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Our role as financial advisor requires independent and objective advice and seasoned execution. Please contact one of our Healthcare Group leaders to discuss how our experience can help you.

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