DUFF & PHELPS

Industry Insights July 2011

Healthcare Services: Revenue Cycle Management

Observations from the first half of 2011

Industry fundamentals continue to be attractive for HCIT investment.

As discussed in previous reports, the legislation enacted over the past two years has created attractive industry conditions for HCIT firms. The American Recovery and Reinvestment Act of 2009 (ARRA) provides for $19 billion of stimulus funding for healthcare providers that demonstrate meaningful use of a certified EHR, and the Patient Protection and Affordable Care Act (PPACA) of 2010, if fully implemented, could add 30 million lives to the insured patient population. PPACA's wider insurance coverage bodes well for RCM providers, which often generate revenues on a per-transaction basis. While RCM providers do not directly qualify for ARRA stimulus, incentives to upgrade HCIT platforms may result in RCM products bundled with the entire HCIT system in an end-to-end solution.

Irrespective of legislation, demographic trends and projected healthcare expenditures favor continued investment in HCIT. Healthcare is already one of the most data-intensive industries in existence. With healthcare spending expected to continue to outpace inflation and the demographically inevitable aging of the U.S. population, investment in IT infrastructure and services must grow significantly in order to handle the associated increase in data capture, analysis and storage.

Finally, providers continue to face a challenging environment. Reimbursement is under pressure, deadlines for compliance with major unfunded government mandates like ICD-10 are fast approaching and, still, one-third of hospitals are operating at a loss. RCM offers healthcare providers a solution to increase revenue capture, often with minimal upfront implementation costs.

Certified EHR adoption and the quest for meaningful use is a clear priority in the budgets of healthcare providers.

Stage 1 of meaningful use, which sets the baseline for electronic data capture and information sharing, is now underway and in early 2011 the first federal stimulus checks

Inside

Observations from the first half of 2011

were issued to providers that demonstrated Stage 1 compliance. However, the threshold for Stage 1 compliance is relatively low.

The rollout of Stage 2 – the phase in which an expanded amount of patient information will be recorded and used to measure improvements in patient care – is where HCIT providers are expected to be tested in terms of product upgrades and timing. Current regulations require healthcare providers to reach Stage 2 compliance no later than two years after attesting to Stage 1 compliance, meaning that 2013 is slated for the initial adoption of the second stage. With final rules for Stage 2 standards expected to be released in June 2012, the current timeline requires HCIT providers to incorporate new guidelines and functionality into commercial products by October 2012.

Many industry participants believe that this time window is unreasonable and unfairly penalizes early EHR adopters. HIMSS EHR Association has already called for a longer implementation period, expressing concerns that vendors may not have sufficient time to upgrade products. The American Hospital Association has raised concerns that the looming ICD-10 deadline in October 2013 could further complicate implementation.

There are several important implications for RCM providers. First, stand-alone RCMs may need to adopt pricing models that reduce financial barriers to adoption. Low upfront and implementation costs, such as gain share models, may be appealing to healthcare providers that may be hard pressed to finance two major IT implementations simultaneously. Second, RCMs become attractive targets for HCIT/EHR companies. Meaningful use will result in an unprecedented healthcare IT overhaul, just as HCIT systems are becoming more integrated as end-to-end solutions. As the industry consolidates, single-point solutions will become dated. Incorporating RCM offerings into the HCIT/EHR suite is a natural fit.

RCM is the second most important system in a healthcare providers' technology infrastructure, and the line between clinical and financial systems becomes blurred with the shift to electronic records, computer-assisted-coding and automated billing processes. Interoperability of clinical systems and financial systems across participants in the healthcare community becomes a key feature. The ability to glean analytics from EHR/RCM platforms becomes crucial to lowering costs and improving quality.

> "With claims processing errors alone costing $17 billion per year and rising, we think RCM is an integral part of any HCIT system intended to reduce costs and improve quality."

Finally, RCMs should continue the evolution of their business models to anticipate the changing relationship between payors and providers under Accountable Care. A good example is Accretive Health's (NYSE:AH) quality and total cost of care (QTCOC) service offering, which enables healthcare providers to effectively manage the health of a defined patient population. QTCOC is essentially a technology-enabled wellness program that aims to allow providers to focus on achieving better outcomes and reducing patient care costs. Under this model, Accretive is paid a base fee plus a share of the cost savings from the defined

Observations from the first half of 2011

patient population, while primary care physicians, hospitals and payors share the remaining savings. QTCOC may provide a glimpse into the future of RCM should Accountable Care Organizations (ACOs) proliferate.

Continued M&A among healthcare providers could further increase the rate of HCIT/RCM vendor consolidation

Providers are undergoing consolidation in response to healthcare reform, reimbursement pressures and challenging financial markets. After down years in 2008 and 2009, U.S. hospital M&A activity rebounded in 2010 – highlighted by Vanguard Health Systems' acquisition of Detroit Medical Center and Cerberus Capital Management's acquisition of Caritas Christi Health Care. 2011 is delivering a strong encore, with announced deal volume increasing 31.5% over the first six months of 2010.

Hospitals nationwide continue to acquire primary care practices to shore up referral networks. Larger hospital networks have voiced their preferences to integrate technology systems, such as billings and collections, to their incumbent platform. Therefore, with each hospital or physician practice acquisition, the number of unique HCIT/RCM solutions continues to shrink. These trends only intensify under proposed new care structures like ACOs.

2011 YTD M&A Activity

In a previous RCM report, we stated our expectation that RCM deal activity would crescendo in 2011 and 2012. We reaffirm this expectation. The wave of RCM M&A continued through the first six months of 2011, as transaction volume increased by 24.4% over the comparable six months in 2010. (Broader U.S. M&A activity grew by 13.3% during the same period). RCM transactions were driven by both financial sponsors continuing to make platform and add-on investments, as well as strategic acquirers using acquisitions to increase product and service offerings and customer reach. 2013 will be a critical year for both meaningful use EHR and ICD-10 deadlines and as a result, we expect to see strong deal activity over the next two years. However, we also believe that deals cut by sellers in 2011 and 2012 will be deals of strength and opportunity whereas the tactical advantage may shift to buyers as time passes and 2013 transactions may become deals of necessity.

Private equity firms continued to make platform investments

Our conversations with private equity firms and observations of deal activity indicate that there is continued demand for new platform investments in the RCM sector.

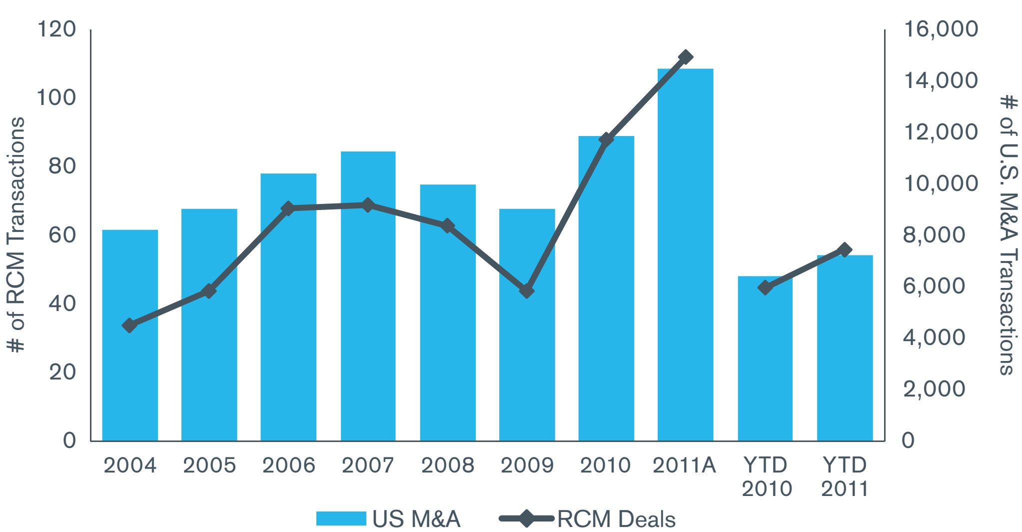
In January 2011, San Francisco-based Serent Capital acquired Cardon Healthcare Network, an independent third-party Medicaid eligibility business for hospitals based in The Woodlands, Texas. The acquisition of Cardon was the result of Serent's focused search for a platform investment in the RCM sector.

Waud Capital Partners, through its Optimum Outcomes portfolio company, acquired Revenue Cycle Solutions (RCS) from Austin Ventures in May 2011, another RCM-specific search by a private equity group. RCS, based in Westchester, IL, is a patient account resolution business serving hospitals and hospital-based physician groups. Waud Capital, which also owns Adreima, a Phoenix-based Medicaid eligibility business, has indicated that it is actively seeking add-on investments for both of its RCM businesses.

> "... deals cut by sellers in 2011 and 2012 will be deals of strength and opportunity, whereas the tactical advantage may shift to buyers as time passes and 2013 transactions may become deals of necessity."

Other examples of platform investments include Norwest Equity Partners' acquisition of Surgical Information Systems, a surgery management software provider to hospitals and SFW Capital Partners acquisition of MD Buyline, an information and analytics for healthcare services companies.

M&A Activity (January 2004 - June 2011)



Source: Capital IQ

2011 YTD M&A Activity

Private equity add-ons continue to build RCM players with broader serving offerings

In January 2011, Advantedge Healthcare Solutions, a Founders Equity portfolio company, acquired AMSplus from MedQuist Holdings. AMSplus is a web-based technology platform that provides billing and practice management services in the New England area. The acquisition expands Advantedge's billing and practice management suite and strengthens the company's position in New England. MedQuist divested this asset to focus on its core clinical documentation solutions.

Private-equity backed Avadyne Health (formerly H&R Accounts) acquired Revenue Cycle Partners (RCP) from Sage Capital. Sage originally acquired RCP in July 2008. RCP provides self-pay account management and third-party insurance follow-up, which complements Avadyne's technology-enabled collections business.

The Coding Source (TCS), a Parthenon Capital Partners portfolio company, acquired Social Service Coordinators (SSC) in January 2011 and Austin Provider Solutions (APS) in February 2011. SSC provides eligibility-based RCM services to health plans, while APS provides healthcare analytics through a SaaS platform. The acquisitions of SSC and APS by TCS came within six months after it acquired Sinaiko Healthcare Consulting in August 2010. Parthenon sold Intermedix Corporation to Thomas H. Lee Partners last year, after acquiring that business in January 2006 and executing a successful acquisition-led growth strategy.

Marlin Equity's MDeverywhere, a web-based physician revenue cycle management provider, added practice management consulting and credentialing services to its product offering with its acquisition of Advanced Health Management Services in May 2011. Marlin had been selectively seeking complementary acquisitions since its acquisition of MDeverywhere in March 2009.

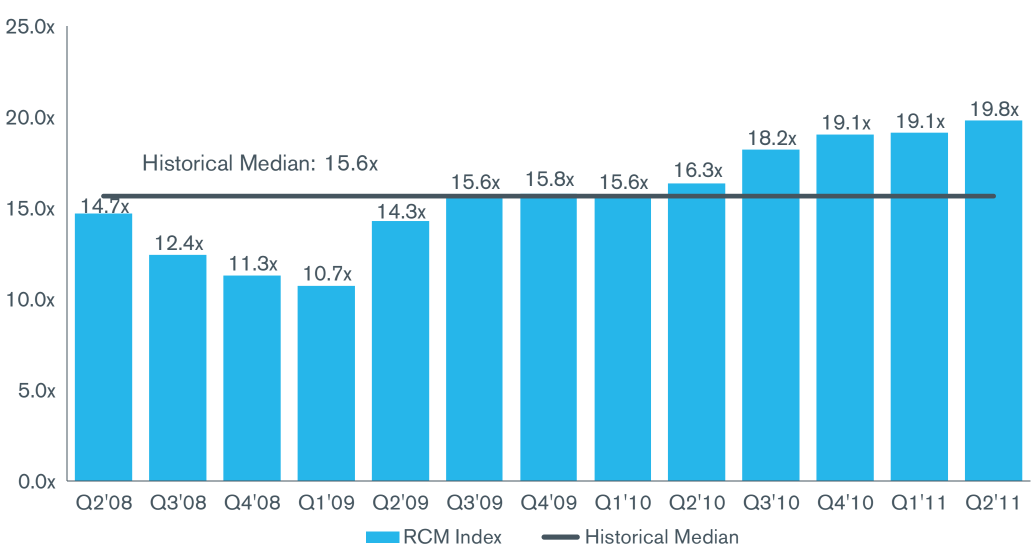
Strategic buyers continue to make moves

Strategic deal activity reflected many deals of strength and opportunity, as existing RCM businesses looked to bolster their suite of services. At the risk of over-generalizing, we believe that sellers of RCM businesses are in a in strong position to negotiate favorable valuation and contract terms in the current RCM M&A wave.

Automatic Data Processing acquired AdvancedMD Software, Inc. from Francisco Partners in February 2011. AdvancedMD is a cloud-based provider of practice management EHR and RCM solutions. The exit was a success for Francisco, which had originally acquired the business in January 2008.

In February 2011, Craineware acquired ClaimTrust, a web-based provider of RCM solutions designed to reduce denials from RAC audits. For the U.K.-based Crainware, the acquisition provides another offering in its suite that includes business intelligence, RCM, supply management and consulting.

RCM Index Average Enterprise Value to EBITDA Multiples (Q2 2008 to Q2 2011)



*Multiples calculated based on the average daily LTM EBITDA multiple for the preceding twelve months.
Source: Capital IQ

2011 YTD M&A Activity

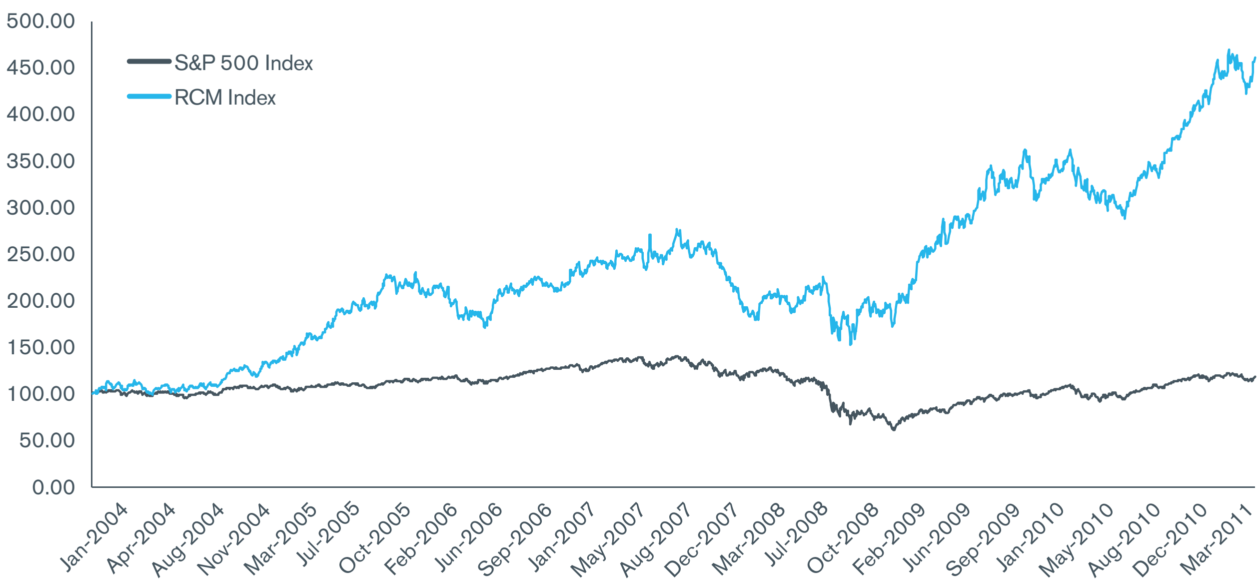
The acquisition also follows our "arms race" analogy from prior reports, as firms build out their RCM offerings to combat government mandates such as ICD-10 and RACs, which stand to reduce revenue and increase cost and complexity for providers.

Experian plc (LSE:EXPN), the global information services company, acquired Medical Present Value, Inc. (MPV) from Rho Ventures and Centerpoint Ventures for $185 million in June 2011. MPV is a subscription-based RCM provider that offers data, analytics and software that assists physicians in establishing patient eligibility, settling patient out-of-pocket expenses and improving collections. The acquisition is the second in three years for Experian in the HCIT sector – the company also acquired SearchAmerica, an eligibility verification business in 2008. Experian estimates MPV's 2012 revenues to be $45 million and earnings before interest and taxes (EBIT) to be in excess of $10 million.

In May, Emdeon (NYSE:EM) bought Equiclaim, a leading provider of post payment audit and recovery services for payers, for $41 million. EquiClaim was one of the first subcontractors for CMS's Recovery Audit Contractors (RAC) program and offers Emdeon a market-tested payment integrity solution. George Lazenby, chief executive officer of Emdeon stated that "[Emdeon] anticipates the need for [payment integrity solutions] to increase as complexities in medical billing and coding rise with the pending conversion from ICD-9 to ICD-10." The acquisition is further evidence of Emdeon's evolution from an EDI clearinghouse into a healthcare informatics and RCM business. See our 2010 RCM report for a full case study on Emdeon.

The TriZetto Group acquired Gateway EDI, a competitor to Emdeon's EDI business, creating a new technology platform that is expected enhance connectivity to between payers and providers. TriZetto systems serve almost half of the insured U.S. population, resulting in real-time access to payment information for customers of the combined entity. Timothy Fogerty, Gateway EDI's chief executive officer indicated that the combination should better support "promising new models [of healthcare delivery] such as accountable care organizations and patient-centered medical home." TriZetto's CEO labeled the combination as an "industry game-changer [that would] shape the future of healthcare." Gateway EDI was a portfolio company of ABRY Partners.

RCM Index vs. S&P 500
(January 1, 2004 – June 30, 2011)



Source: Capital IQ

Selected Publicly Traded RCM Companies

Selected Publicly Traded RCM Companies 2011

Given that RCM processes often blend with other healthcare IT solutions, we have compiled an index of eight revenue cycle management companies and six healthcare IT / BPO providers ("RCM Index").

Valuations remained strong as of mid-year 2011, with most firms in the RCM index trading in the upper quartile of their 52-week highs. Average RCM Index EBITDA multiples continued their consecutive quarters streak of flat/positive gains since Q1 2009. The average quarterly EBITDA multiple of 19.8x during Q2 2011 was the highest level in over three years.

Year to date through June 30, 2011, the RCM index was up 19.0%, while the S&P 500 increased 3.8%. Since 2004, the RCM index increased by 360.8%, while the S&P 500 increased 19.1%.

Revenue Cycle Management Index

Company Information		Market Data				LTM Operating Performance				Multiples	
Company Name	**Ticker**	**Price as of 6/30/11**	**% of 52-Week High**	**Equity Value (mm)**	**Enterprise Value (1) (mm)**	**Revenue (mm)**	**Revenue Growth**	**Gross Margin**	**EBITDA Margin (2)**	**EV (1) / LTM REV**	**EV(1) / LTM EBITDA (2)**
Revenue Cycle Management											
Accretive Health, Inc.	AH	$28.79	93.9%	$2,768.9	$2,650.0	$644.1	23.0%	21.5%	4.4%	4.1x	93.2x
Advisory Board Co.	ABCO	57.88	97.4%	$940.8	$910.4	$290.3	21.3%	47.3%	13.5%	3.1x	23.2x
Allscripts Healthcare Solutions, Inc.	MDRX	19.42	84.0%	3,694.2	3,998.2	1,074.5	0.0%	48.8%	16.1%	3.7x	23.0x
athenahealth, Inc.	ATHN	41.10	81.3%	1,433.2	1,339.3	261.0	29.2%	61.6%	14.9%	5.1x	34.6x
Emdeon Inc.	EM	13.12	78.0%	1,195.6	2,016.2	1,036.4	10.7%	38.5%	22.4%	1.9x	8.7x
HMS Holdings Corp.	HMSY	76.87	90.6%	2,172.2	2,056.0	320.4	31.2%	45.8%	27.2%	6.4x	23.6x
MedAssets, Inc.	MDAS	13.36	53.4%	783.1	1,693.7	428.5	20.5%	74.4%	25.0%	4.0x	15.8x
Merge Healthcare Incorporated	MRGE	5.20	84.0%	438.2	628.9	173.0	142.0%	60.7%	17.8%	3.6x	20.4x
Healthcare IT / BPO											
Cerner Corp.	CERN	61.11	97.1%	10,315.4	9,805.9	1,910.5	11.7%	82.1%	26.4%	5.1x	19.5x
Computer Programs & Systems Inc.	CPSI	63.48	96.2%	702.3	675.9	162.1	25.5%	42.8%	21.7%	4.2x	19.2x
MedQuist Inc.	MEDQ	11.78	84.1%	442.4	670.9	403.3	33.4%	34.3%	21.3%	1.7x	7.8x
Transcend Services, Inc.	TRCR	29.39	98.1%	312.7	281.1	101.4	28.3%	38.8%	21.5%	2.8x	12.9x
Quality Systems Inc.	QSII	87.30	95.3%	2,547.3	2,429.6	353.4	21.1%	63.9%	28.8%	6.9x	23.9x
					Mean	$550.7	28.4%	50.8%	20.1%	4.1x	25.1x
					Median	$353.4	23.0%	47.3%	21.5%	4.0x	20.4x

(1) Calculated as equity value plus preferred stock, less net debt.
(2) EBITDA reduced to account for minority interest expense.
LTM = Latest Twelve Months
EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization
Source: Capital IQ

DUFF & PHELPS

For more information about our industry expertise or to subscribe to *Industry Insights,* visit:

www.duffandphelps.com/subscribe

Business Services
Brooks Dexter
Managing Director
+1 310 689 0075

Brad Hileman
Vice President
+1 310 689 0138

Healthcare
Jim Hesburgh
Managing Director
+1 212 871 5970

Chris Mercier
Managing Director
+1 312 697 4634

About Duff & Phelps

As a leading global provider of financial advisory and investment banking services, Duff & Phelps balances analytical skills, deep market insight and independence to help clients make sound decisions. The firm provides expertise in the areas of valuation, transactions, financial restructuring, alternative assets, disputes and taxation, with more than 1,000 employees serving clients from offices in North America, Europe and Asia. Investment banking services in the United States are provided by Duff & Phelps Securities, LLC. Investment banking services in the United Kingdom and Germany are provided by Duff & Phelps Securities Ltd. Duff & Phelps Securities Ltd. is authorized and regulated by the Financial Services Authority. Investment banking services in France are provided by Duff & Phelps SAS. For more information, visit www.duffandphelps.com. (NYSE: DUF)