

M&A UPDATE

Strategic Deals Drive 1st Quarter M&A

Issue Highlights

1Q 2012

- \$1.53 billion in ARM transaction value for LTM ended March 31, 2012
- Strategic buyers account for 80% of transactions
- 4 deals in healthcare vertical, including 2 in RCM
- Fewer deals involving firms only engaged in traditional collections
- Pricing multiples of EBITDA are steady

With the 1st quarter of 2012 complete, our numbers show 10 completed ARM M&A transactions accounting for \$125 million in deal value. This comes after a typically busy 4th quarter of 2011, in which \$445 million was transacted in 12 ARM deals. Deal activity on an LTM (last twelve months) basis continues at a steady and impressive pace, with over \$1.5 billion transacted as of March 31, 2012 (**Figure 1**). Firms servicing the U.S. Department of Education continue to see strong demand, as demonstrated by the acquisition of **Enterprise Recovery Systems** by **Audax Group**-backed **United Recovery Systems (URS)**. Healthcare is another active sector, where 4 of the 10 firms acquired in the quarter focus, and where 2 of those 4 offer Revenue Cycle Management (RCM) services. In addition, 3 transactions involved U.K.-based firms, including publicly traded **Portfolio Recovery Associates' (PRAA)** acquisition of **Mackenzie Hall Holdings**, one of the largest deals in the quarter, which provides PRAA entry into the U.K. market.

Strategics Got it Done in Q1. We've noted in the past that deal sizes logically tend to be higher when financial buyers are active (**Figure 2**). The strategic-dominated activity this quarter speaks to this point, as the average deal size of \$12.5 million was the smallest it's been since 1Q10, and strategic buyers completed 8 of the 10 transactions. Some of these strategic buyers, however, include private equity-backed companies, which often seek smaller tuck-in deals after acquiring a platform and therefore have similar economic incentives as "pure" strategic firms. A good example is the Audax Group-backed acquisition noted above, which from a strategic perspective gives access to the U.S. Department of Education collection contract. Although not a small deal by most standards, it was possible only because Audax already owned an ARM platform company in URS. Another example is the merger between **Serent Capital**-backed **Cardon Healthcare Network** and **Outreach Services**, one of the quarter's RCM transactions.

Beyond Collection Agencies. As mentioned above, RCM firms remain in demand, as they are at the crossroads of the trend among healthcare providers to outsource non-core services, in tandem with favorable, and highly publicized macroeconomic factors regarding the healthcare industry. We've seen many ARM firms expand their services beyond traditional early-stage and 3rd party collection services, and RCM M&A activity is reflective of this trend. In fact, in 1Q12 only 60% of the M&A transactions involved a seller engaged in traditional collections, a fairly steep decline from past years (**Figure 3**). Many of the fastest growing firms in the ARM "universe" include firms that offer other outsourced revenue and receivable enhancement services, such as BPO and RCM.

Pricing Multiples Steady. Pricing multiples are an equally important barometer of the ARM market. The median Price/EBITDA multiple in 4Q11 was 6.0x, the highest since 2008, and in 1Q12 it was 6.0x again (**Figure 4**). This is clear evidence that investor interest remains strong, especially for well-performing, compliant firms in desirable sectors, providing in-demand services. This is also a sign that deal activity should rise throughout the year.

We continue to expand our relationships with new capital providers eager to lend to or invest in ARM/RCM firms, debt purchasers, and related specialty finance and BPO firms around the world. These include a wide array of specialized lenders, strategic investors, and financial investors, many of which go well beyond the "typical" names you may have heard of. Please contact us if you would like to discuss the opportunities we're seeing in the marketplace.

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Figure 1

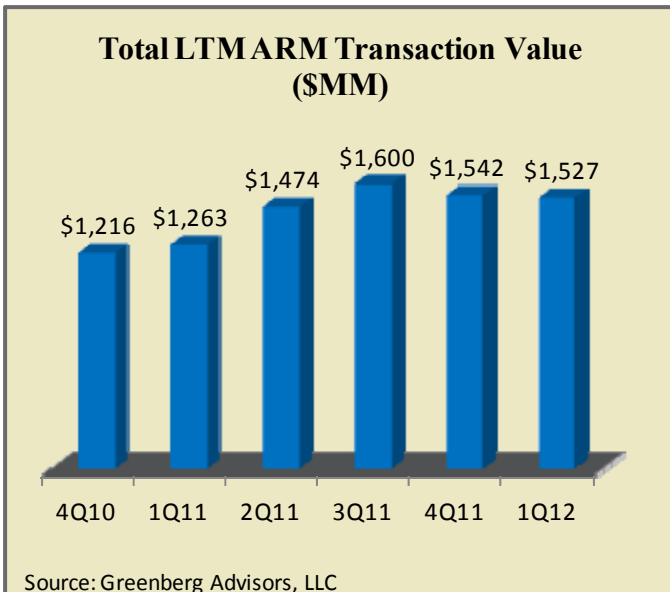


Figure 2

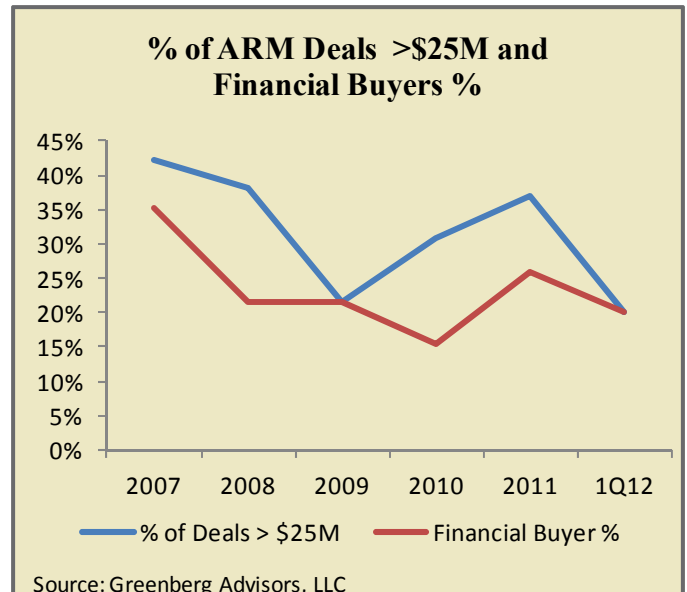


Figure 3

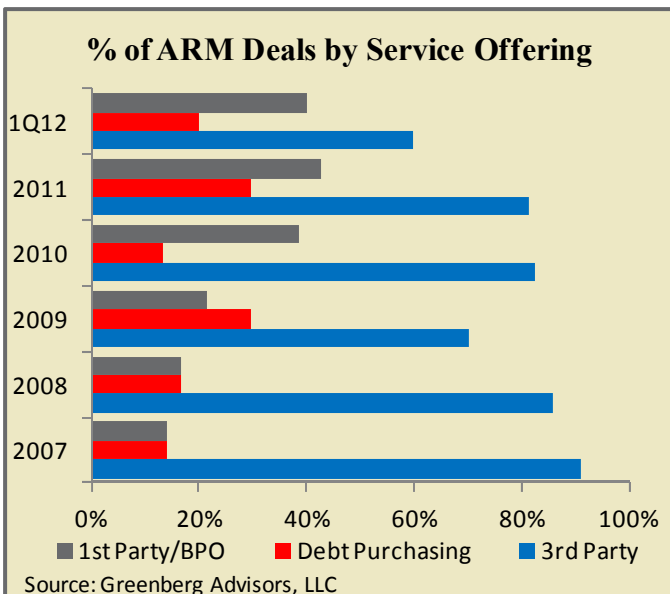
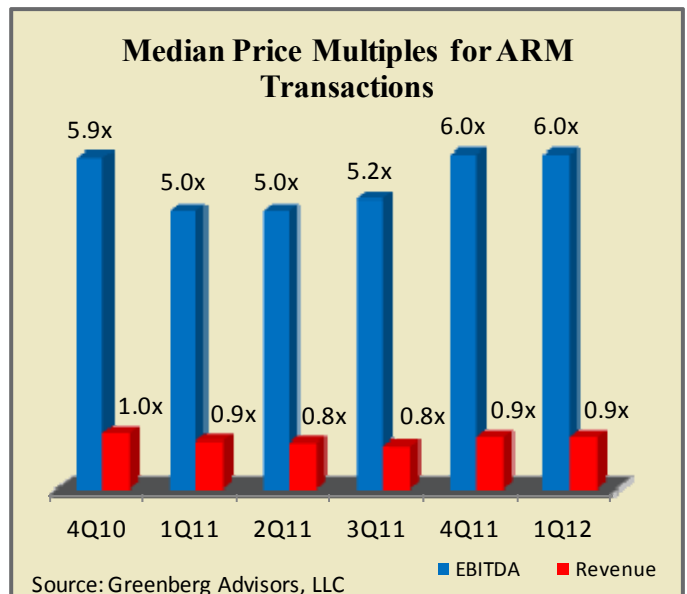


Figure 4



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