M&A UPDATE

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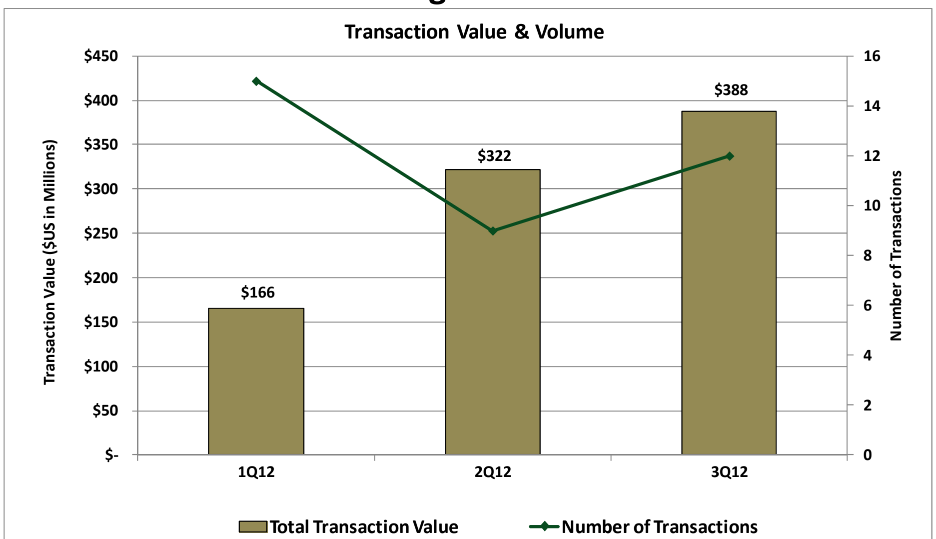
IPO, CFPB and Credit Issuer Changes Will Make Their Mark on M&A

On August 10th, Performant Financial Corp. (Nasdaq: PFMT) completed the first ARM IPO in years. The company went public at $10.60 per share, has since peaked at $12.18 per share, and as of November 9th was trading at $9.66 per share, a 9% discount to the IPO price. This IPO is important to ARM/RCM industry M&A, as it may encourage additional public offerings. If the firm performs well, it should also stimulate interest in the industry among institutional investors who prefer to invest in firms that have an IPO as a potential exit strategy. With increased interest among buyers, and lucrative public offerings as a viable exit alternative, valuations paid to sellers may also rise. Industry participants and potential investors will no doubt be watching carefully.

Another major transaction in the quarter was the private equity acquisition of **Jefferson Capital Systems** from **CompuCredit** (Nasdaq: CCRT). At a deal value of $130.5 million, this represents about one-third of the recent quarter's total transaction value, and shows the continued interest of institutional investors. Considerable activity has also occurred lately among technology and other vendors to the industry (as non-ARM/RCM firms, though, they are not included in our statistics), with approximately 10 such transactions completed thus far in 2012. Investors clearly believe that the growth of the industry will also drive growth in complementary businesses.

Figure 1



Source: Greenberg Advisors

With the U.S. Presidential election behind us, there is considerable concern, particularly among debt buyers and buyers/collectors of financial paper, regarding the anticipated changes resulting from the Consumer Financial Protection Bureau's (CFPB) activities. We expect this regulatory environment, along with changes in recovery policies being implemented by credit issuers, to create a substantial uptick in industry transactions.

These trends may reverse themselves in the long-term, however, as issuers gain a clearer sense of the actual risks, or due to normal business cyclicality or other reasons. In the short-term, we expect a variety of resultant strategic M&A activity, for example:

- Credit issuers' restrictions of "downstream" sales of paper by firms which purchase directly from them will prompt some buyers to acquire servicers to gain in-house capacity to service accounts.
- Reselling restrictions will leave decreased volumes available for secondary debt buyers, prompting many to assess their alternatives, including growth via M&A or the sale of their owned portfolio and/or platform.
- M&A among servicers seeking to gain scale, in order to handle larger volumes that will be available to selected players if issuers continue to reduce their number of approved vendors.
- To diversify away from financial collections, companies will seek acquisitions or partnerships to attain access to or expand within other client segments or services.
- Increasing compliance costs will prompt some to consider their exit alternatives.

For the ARM/RCM industry as a whole, 3Q 2012 reflected an increase in ARM transaction value to $388 million, up sharply from the 1st and 2nd quarters **(Figure 1)**. Activity also picked up, as 12 transactions were completed, compared to 9 in 2Q 2012.

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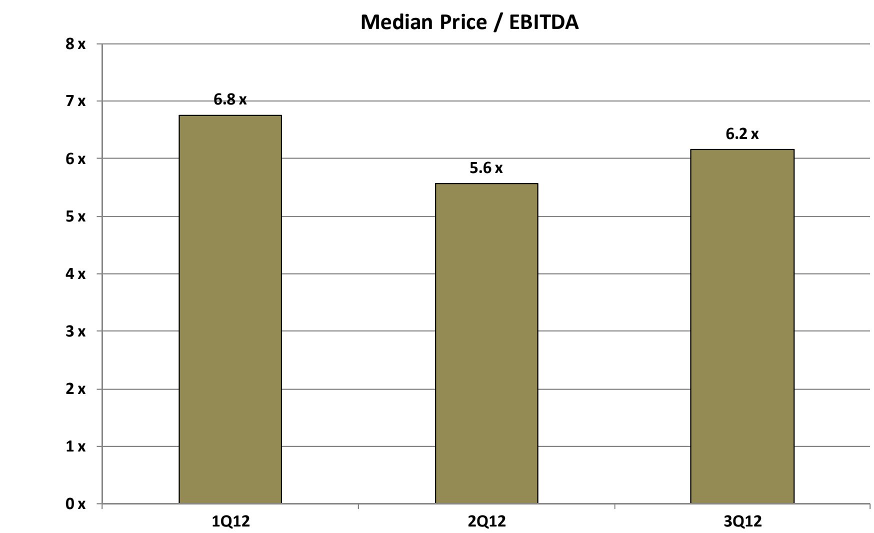
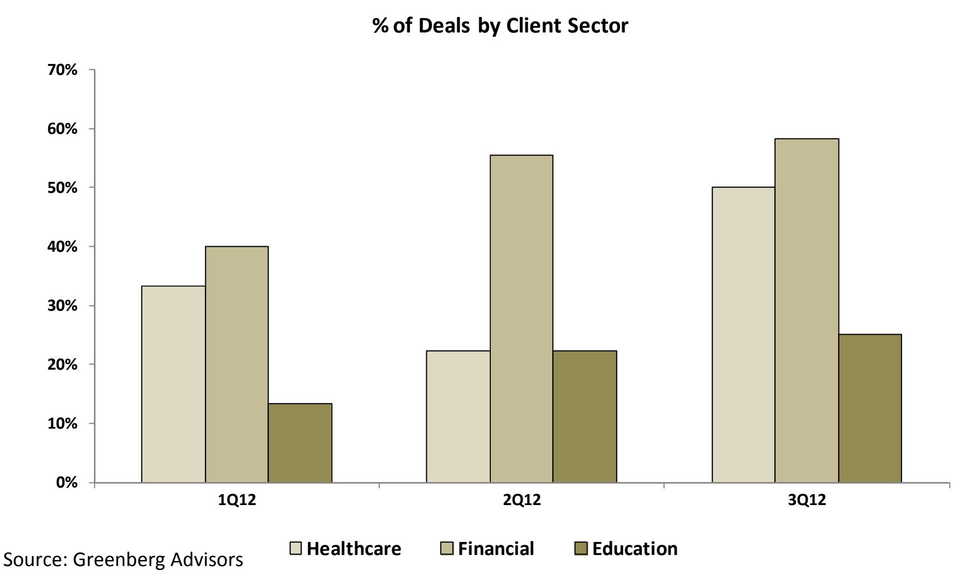


Source: Greenberg Advisors

Figure 2

As for deal pricing, the median Price/ EBITDA multiple increased to 6.2x in 3Q 2012, rising from 5.6x in 2Q 2012 **(Figure 2)**. When comparing the first 3 quarters of 2012 to those of 2011, multiples have been trending higher, and overall, they continue to remain in what would be considered a healthy range for the current M&A environment.



Source: Greenberg Advisors

Figure 3

There continues to be interest in ARM/ RCM firms servicing clients both in and out of the financial segment. For example, 50% of the transactions in 3Q 2012 involved firms which service or purchase healthcare accounts, roughly the same percentage as those servicing or purchasing accounts for financial clients **(Figure 3)**. As well, one out of every four ARM firms sold in 3Q 2012 generated at least some of its revenue from the education sector. This includes Performant Financial Corp. (noted previously), which provides services in all three of these sectors, and is a contractor for the U.S. Department of Education.

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