INDUSTRY TIMELINESS: 7 (of 98)

With 2012 now in full swing, the Medical Services Industry remains near the top of the *Value Line* industry rankings. This year should be one marked by sweeping reform through the vast majority of the sector, as the Obama Administration's plan to ensure that every American has some form of medical coverage enters its next phase. Due to these changes, uncertainty is elevated and rampant among many of the companies in this space, but the overwhelming sentiment is that the new legislation will be a net positive for medical service entities as a whole.

These positive vibes have been echoed by Wall Street. Nearly all of the stocks in this arena are up since our December review. The overall market's good fortune of late has played a role, but so too has brightening earnings guidance.

Hospitals Get Healthier

It was not very long ago that it appeared the number of hospital operators would be dwindling, not because of a consolidation trend, but due to bankruptcies, as these firms were being suffocated by lofty bad-debt totals. Caring for the uninsured was becoming such an expense that it eroded the profits being generated in other areas of business. The most recent recession was nearly the proverbial death knell for companies such as *Health Management Associates* and *Tenet Healthcare*, but now results are on an upswing. Upgrades funded by wisely placed cash flow during the downturn are paying off handsomely. Spruced-up facilities and imaging machinery are reaping wider profits and helping to overcome what has been a dour period for volume. We would be remiss to not point out that *Health Management Associates* has some legal overhangs swirling around it (see the full-page report), but that does not take away from the fact that its actual hospital business has come back to life.

The future for these operators seems to be bright, too. Share net should incline in the coming years, as bad debt shrinks from more people having medical coverage. Our in-house view of slow-but-steady economic advancement should serve to only enhance these gains.

Laboratories Are Timely

Both members of the lab duopoly, *Laboratory Corporation of America* and *Quest Diagnostics*, are back on our recommended list (Timeliness: 2). Each has been aggressive on the acquisition front and bolstered its footprints in their respective areas of expertise. Too, lofty unemployment metrics had slowed their drugs-of-abuse testing numbers. With this figure now retreating to more-historic norms, business may pick up.

More advanced (esoteric) screens for everything from cancer to cardiovascular disease should keep the earnings needle moving in the right direction. Also of note, *Quest* has boosted its dividend considerably. Many pundits often point out this trait when differentiating between choosing which of these two stocks to invest in. Given *LabCorp's* financial strength and solid cash flow generation, we would not be surprised if it initiated a payout of its own in the near future.

Uncertainty Among HMOs

Enrollment figures have left much to be desired of late. Big-name plans like *Aetna* have found it difficult to grow their numbers, as employer groups are dealing with ever-tightening budgets. Because of those constraints, the groups may not always pick the best company to get health insurance from; rather, they look for the cheapest. On top of this, the increased competition in the landscape has stifled premium upticks. And, although it always seems to be the case, the threat of government cutbacks hangs over Medicare and Medicaid reimbursements.

From an investment standpoint, many of these shares are trading at very attractive P/Es, and now could be a most opportune time to strike in this field. Uncertainty and regulation changes have historically led to a round of M&A in this space, and the coming year-plus may be no different.

Conclusion

These are changing times in the Medical Services Industry. Still, there are a number of timely stocks available, and 3- to 5-year appreciation aspirations are wide for many equities within our coverage.

As always, we recommend that subscribers peruse each of the following pages before deciding on where their funds are best placed.

Erik M. Manning

Composite Statistics: Medical Services Industry

2008	2009	2010	2011	2012	2013		15-17
304802	323622	331488	***347500***	***385000***	***423500***	Revenues ($mill)	***517000***
10.6%	10.4%	11.2%	***11.5%***	***12.0%***	***12.2%***	Operating Margin	***14.2%***
5267	5552	5834	***6125***	***6450***	***6775***	Depreciation ($mill)	***7770***
12443	13073	15756	***17250***	***19250***	***21400***	Net Profit ($mill)	***30800***
34.5%	34.9%	34.9%	***35.0%***	***35.0%***	***35.0%***	Income Tax Rate	***35.0%***
4.1%	4.0%	4.8%	***5.0%***	***5.0%***	***5.1%***	Net Profit Margin	***6.0%***
d5174	14758	13963	***16000***	***17500***	***19000***	Working Cap'l ($mill)	***24000***
61372	58367	61528	***58800***	***56000***	***55000***	Long-Term Debt ($mill)	***45100***
80589	95342	102593	***120000***	***137000***	***148000***	Shr. Equity ($mill)	***197500***
10.1%	9.7%	10.7%	***10.5%***	***10.5%***	***11.5%***	Return on Total Cap'l	***13.0%***
15.4%	13.7%	15.4%	***14.5%***	***14.0%***	***14.5%***	Return on Shr. Equity	***15.5%***
15.1%	13.6%	14.8%	***13.5%***	***13.0%***	***14.0%***	Retained to Com Eq	***15.0%***
2%	1%	4%	***5%***	***5%***	***5%***	All Div'ds to Net Prof	***6%***
12.4	9.3	9.0	***12.0***	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	***15.0***
.75	.62	.58	***.75***			Relative P/E Ratio	***1.00***
.2%	.1%	.4%	***.5%***			Avg Ann'l Div'd Yield	***.5%***