As we approach the halfway pole in 2012, the Medical Services Industry has lost a bit of steam from an investment standpoint. Just three months ago, this sector was in the top 10 of the *Value Line* industry rankings, but now it has retreated several spots. Make no mistake, however, this field is still an above-average selection, it is just that the investment community is growing tired of the promises that reform was supposed to have already brought. That, coupled with some earnings misses, as the companies in the pages to follow make alterations to their business models to get in line with new regulations, has caused some to take a pass on this segment in search of greener pastures elsewhere.

In the last couple of weeks, the overall market has been on a downward trajectory, and many entities in this space have felt that negativity. Still, smoother seas are likely ahead and the potential inherent in many shares available in the medical services area is undeniable.

Labs Continue To Flourish

For starters, unemployment has eased considerably from its peak level, and though recent data in this department have been unsettling, more and more people are returning to the workforce. In that vein, drugs-of-abuse testing is back on its feet at both members of the laboratory duopoly, *Laboratory Corporation of America* and *Quest Diagnostics*.

Moreover, new laws in the laboratory business are forcing smaller competition to either close up shop or sell to the larger players. A consolidation trend that will probably end up with the duopoly being even stronger is clearly in full swing at present. *Quest* made its initial big splash with the $2 billion purchase of AmeriPath, and now, under new leadership, will probably be targeting bolt-ons to bolster its line of offerings. *LabCorp*. has done smaller pacts but in mass amounts. Most recently, it bought MEDTOX for $240 million. This company is a large name in the toxicology space and should fit well under the buyer's umbrella, as it adds breadth to operations. Both companies are pumping out handsome earnings and generating ample cash flow. With that, we see no end in sight to the recent shopping spree.

HMOs Are Retreating

The bottom line in the Health Maintenance Organization (HMO) sector these days is that employer groups are doing everything in their power to cut costs. Add to this the fact that spending limits (floors) are being put in place for each individual plan, and the moving parts become confusing.

Utilization rates, which have remained low for several linked quarters now, and had been aiding HMOs during this adjustment phase may be on the rise. *Aetna* has already begun to see upticks in these figures, and the other major players in the field, like *WellPoint* and *UnitedHealth Group*, have to assume the same is forthcoming for them. This fundamental will undoubtedly be the wild card in what is already a cloudy year for Earnings Predictability among healthcare providers.

INDUSTRY TIMELINESS: 14 (of 98)

Hospitals Poised To Recover

We remain high on hospital operators due to the underlying belief that if every American is indeed to have medical coverage, then hospitals' bad-debt expense should fall dramatically. President Obama stated that as his goal when his reform plan was initially unveiled, and this industry's profitability, already in an upswing from an operations standpoint, should spike if the uninsured are removed from the equation.

Health Management Associates is an example of a company that navigated choppy waters, fought off bankruptcy and takeover whispers, and got its act together. Unfortunately, now there are a couple of legal overhangs weighing on this stock, but we think the potential here is immense. *Universal Health Services* also has a bright future, but its lofty position in the downtrodden Las Vegas area causes trepidation in the investment community. We believe over time the slow-but-steady economic advancement we are currently seeing will alleviate this ailment.

Conclusion

The Medical Services Industry's future is very much up in the air at this juncture. But, if the planned reform goes into full swing, the benefits will be tremendous. On that note, there are a number of timely stocks in this arena. Too, numerous issues offer strong 3- to 5-year appreciation aspirations.

As always, we suggest that interested parties read through each of the forthcoming pages before selecting the investment that best suits their profile.

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%***