Two weeks shy of the second half of 2013, and the Medical Services Industry is rapidly climbing the *Value Line* rankings. When news of the Affordable Care Act hit the market a couple of years back, the sector rose sharply only to fall a year or so later when bears flooded the market with negativity and trepidation about the coming reform. Fast forward to the present day and a more positive sentiment is again taking over. Clearly, some segments of the healthcare field will benefit more than others. Still, each company will get a boost in some way or another. This belief has carried this industry back into the top-third of our rankings.

Many of the entities on the pages ahead will have to deal with an adjustment/transition phase in the coming six months-plus. With that, some earnings comparisons will probably not bowl over the investment community. For the most part, we think this type of flattish period has already been factored into many current quotations. Therefore, there is some downside protection inherent in the prices as we roll toward 2014, a year that should be marked by dramatic changes to the U.S. healthcare system.

As is always the case when dealing with government reimbursements, we continue to caution that payout levels need to be constantly monitored. Some favorable news arose lately when the Centers for Medicare and Medicaid Services (CMS) reversed its course and called for a rise in Medicare Advantage payouts. Unknowns such as this abound in this field, but for the time being, the sector has a clean bill of health.

Labs Have Been Laggards

One negative that has arisen from the waiting before reform sets in is a dramatic dip in utilization at the once-highflying lab duopoly. The two constituents of this market leader are *Laboratory Corporation of America* and *Quest Diagnostics*. Each of these companies has seen its recent results bogged down by significantly lesser volumes showing up for testing. The belief is that patients are eschewing trips to the doctor not deemed vital until next year. Less trips to the doctor result in fewer patients being sent for screening, and the overall number of lab tests is off considerably.

Luckily, we see this pattern as an aberration, and the long-term health of the duopoly looks solid. Both have been adding facilities during the downturn in volume. Several lesser players are exiting the field due to lack of funding or the unknowns that go with government reimbursements. Therefore, the end result is these companies will probably emerge with even greater market share and return to growth mode when the patients begin to resurface. Too, profitability should get a boost from esoteric testing for advanced diseases in the cardiovascular and cancer segments.

Hospital Resurgence

The hospital sector started out 2013 on the right foot with stout earnings comparisons. Regardless, it appears the investment community has taken a shine to this subsector as the one that will benefit most from the Affordable Care Act. That theory makes sense, given the damage that bad-debt expense has done in the past to the likes of *Health Management Associates* and *Tenet Healthcare* among others. The number of Americans with healthcare coverage should swell beginning in 2014. When that phenomenon occurs, those operators that have been upping their bed counts in the last year-plus should post solid gains.

INDUSTRY TIMELINESS: 18 (of 97)

The anticipation of reduced costs stemming from uninsured patients is the main reason why so many of the hospital stocks on the coming pages are much higher in price than they were just three months ago.

HMOs Have Wood To Chop

Health Maintenance Organizations were originally not going to be pleased with the coming reform, but now that view has gone by the wayside for the most part. Yes, results in 2013 will probably not be stellar, as these companies work their way through all the exchanges set up for healthcare coverage. Too, spending floors for each individual account will bring on an adjustment period the likes of which this business has never seen. Not surprisingly, the heavy hitters like *Aetna* and *UnitedHealth Group* are already getting out in front of these concerns.

Elsewhere, the CMS recently announced that it will not be cutting payouts on the Medicare Advantage platform, which will be of the biggest benefits to *Humana*, whose business model would have taken on the most heat if that move went through. Lobbyists and government officials hammered out a deal to raise reimbursements, when all is said and done a huge victory for HMOs. Still, much work is needed by many to get prepared for the winds of change.

Conclusion

There will undoubtedly be some speed bumps in the near term on the Medical Services Industry's path. But the future is bright for a number of stocks in this sector, especially those that lead their subdivisions. Many of the issues have enjoyed sizable price increases over the past three months, which has affected both their Timeliness ranks and 3- to 5-year aspirations.

As we always do at this point, we suggest subscribers thumb through each of the following pages to select the stock that best fits their investment needs.

Erik M. Manning