Zacks Small-Cap Research

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University General Health System, Inc. (UGHS –OTC)

UGHS: Zacks reaffirms recently raised price target of $0.90.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/27/2012
Current Price (11/30/12)	$0.40
Six- Month Target Price	**$0.90**

OUTLOOK

University General Health System is a multi-specialty health care provider that owns and operates a regional healthcare network comprised of a core hospital and several complementary healthcare facilities in the metropolitan Houston market. In the last three weeks, the company has reported a positive revenue surprise and announced another acquisition in the Houston area. The revenue surprise was generated by better-than-expected execution of the physician-centric model at both the core hospital and the newly acquired HOPDs. We reaffirm our Outperform rating and recently raised price target of $0.90.

SUMMARY DATA

52-Week High	**$0.49**
52-Week Low	**$0.18**
One-Year Return (%)	**60.00**
Beta	**-0.46**
Average Daily Volume (shrs.)	**182,566**
Shares Outstanding (million)	**325.7**
Market Capitalization ($ mil.)	**$130.3**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**2**
Insider Ownership (%)	**46.4**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2012 Estimate	**19.8**
P/E using 2013 Estimate	**11.1**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small - Growth**
Industry	**Medical Care**
Zacks Rank in Industry	**7 of 17**

ZACKS ESTIMATES

Revenue
(in thousands of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	N/A	N/A	N/A	N/A	56.1 A
2011	15.4 A	17.9 A	20.7 A	18.5 A	72.5 A
2012	19.1 A	29.1 A	36.0 A	37.5 E	121.7 E
2013					160.2 E

Earnings per Share
(EPS is operating earnings before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	N/A	N/A	N/A	N/A	-$0.01 A
2011	-$0.00 A	-$0.00 A	$0.00 A	-$0.01 A	-$0.01 A
2012	$0.00 A	$0.01 A	$0.01 A	$0.01 E	$0.02 E
2013					$0.04 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Results originally reported under March FY; results re-arranged as Dec. year.

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KEY POINTS

- University General Health System is a multi-specialty health care provider that owns and operates a general acute care hospital, eight hospital outpatient departments, one ambulatory surgical center and three senior living facilities in the Houston market. The company also owns and utilizes a support services organization that provides billing and other administrative services to health care companies.
- Since March 2011, University General Health System has pursued an aggressive **acquisition strategy**, building an integrated network of ancillary and complementary healthcare services in the Houston area with University General Hospital at its core. Management expects both to continue filling in its health care network in the Houston market and also to replicate the process in other metropolitan areas.
- Through acquisitions and organic growth, total revenues increased 29.2% in 2011 to $72.5 million. Continuing the trend, total revenues during the first nine months of 2012 advanced 55.9% over the comparable period last year to $84.2 million.
- The most recent acquisitions (the three clinics at the Kingwood Diagnostic and Rehabilitation Center, the Robert Horry Center for Sports and Physical Rehabilitation Center and a sleep and imaging center in Baytown) are expected to contribute $12.5 million in incremental revenue and $4.2 million in EBITDA during the first year within the University General system.
- By delivering **concierge, patient-oriented care**, the University General network provides uniquely competitive health-related services.
- The **physician-centric model** encourages the delivery of patient-oriented services while concurrently generating incremental revenues within the company's network. Moreover, management believes physician-centric model incentivizes doctors to minimize costs, which in turn helps University General to maintain cost controls.
- The acquisition of the revenue cycle management firm Autimus provides scalable billing capabilities for further geographical expansion through acquisition.
- Consult our Initiation Report dated August 27, 2012 for full background information on the company.
- We reiterate our Outperform rating and price target of $0.90.

RECENT NEWS

Third quarter results

On November 15, 2012, University General Health System reported financial results for the third quarter ending September 30, 2012. **Total revenues advanced an impressive 74.4%** over the comparable quarter last year to $36.0 million, primarily due to the 15% improvement in the average daily inpatient census at University General Hospital from 40 to 46, which also drove the hospital's average occupancy rate up to 66.7%. In addition, the top-line benefited from the increase in the number of patients from the acquisitions now classified as HOPDs, namely Baytown Endoscopy Center, UGH Diagnostic Imaging and UGH Physical Therapy. Overall, acquisitions this year contributed $5.9 million of incremental revenues to the third quarter. Management attributes the company's robust growth to the successful execution of its physician-centric, integrated health delivery system strategy.

Net patient revenue at University General Hospital increased 71.3% from $18.6 million to $31.9 million despite a significant increase in the provision for bad debt from 1.9% to 9.9% of total net patient revenue as management conservatively elected to reserve a higher rate for bad debt in order mitigate the potential for a year-end adjustment. **Moreover, the company's payer mix improved** as the acquisitions were integrated into the University General system as HOPDs. During the quarter, the percentage of net patient revenue from commercial and managed care providers increased year-over-year from 62.8% to 72.6% while the proportion of revenue from Medicare and Medicaid reimbursements declined from 34.0% to 26.6%.

Revenue from Trinity Senior Living increased 14.3% to $2.0 million as the overall occupancy rate expanded to 94.4% versus 87.0% in the comparable quarter last year. Support Services contributed $703 thousand in revenue.

The operating margin expanded 2,023 basis points to 32.5% as operating income increased 362% to $11.7 million compared to $2.5 million in the third quarter of 2011. **The company achieved significant operating leverage** as management executed on the cost containment strategy which was initially implemented during the fourth quarter of 2011. As revenues advanced 74.4%, operating expenses increased only 34.2%. Notably, salaries, wages and benefits declined to 29.0% of total revenues versus 40% in the comparable quarter of 2011. As a result, **EBITDA expanded dramatically by 205%** to $14.1 million versus $4.6 million in the third quarter of 2011, and the EBITDA margin increased 1,682 basis points to 39.3%. Below the operating line, the company recorded a noncash charge of $5.7 million related to derivatives due to the company's stock appreciating 91% from $0.22 to $0.42 during the quarter. Net income attributable to common shareholders, which was impacted by the Convertible Preferred C stock dividend for the first time, was $1.96 million or $0.01 per share compared with $1.05 million or $0.00 per share in the comparable quarter last year.

Acquisitions

On October 30, 2012, University General announced the acquisition of **a sleep and imaging center** in Baytown from Jacinto Medical Group for an undisclosed amount. The acquisition complements and deepens the University General's footprint in Baytown, and management expects the center to generate revenues of over $5 million annually while generating $1.6 million in adjusted EBITDA. In addition, the transaction strengthens University General's relationship with the Jacinto Medical Group, a multi-specialty healthcare provider with fifteen physicians that co-manages the UGH Baytown Endoscopy Center.

On August 27, 2012, University General announced the acquisition of the **Robert Horry Center for Sports and Physical Rehabilitation Center** for an undisclosed amount of cash. Located in southwest Houston, the physical therapy clinic expands the number of HOPDs owned and operated by University General Hospital to three. The President and Founder of the Robert Horry Center for Sports and Physical Rehabilitation is Robert Horry, who over 16 years played for the Houston Rockets, Los Angeles Lakers, Phoenix Suns and San Antonio Spurs, winning NBA championships with three different teams. Operating as a HOPD, management expects that the center will generate at least $1.0 million in annual net patient revenues.

On August 1, 2012, University General announced the acquisition of **three clinics operating in Kingwood Diagnostic and Rehabilitation Center**, which is a medical office building located in Kingwood, a northern suburb of Houston. The diagnostic imaging, physical therapy and sleep clinics were acquired from Management Affiliates of Northeast Houston, LLC for an undisclosed combination of stock, cash and assumed debt. Under the company's branding strategy, the clinics have been renamed the UGH Kingwood Diagnostic and Rehabilitation Center and will operate as hospital outpatient departments (HOPDs) of University General Hospital. Management expects that the three clinics will generate at least $6.5 million in annual net patient revenues and produce annual EBITDA of $2.6 million in the first year under University General Health System.

New Contract for Support Services

On September 9, 2012 University General announced that its Sybaris Group subsidiary had been selected as the official catering company for the Athletics Department of Rice University.

Financings

On September 28, 2012, University General closed a $15.0 million line of credit and a $4.0 million term note with MidCap Financial, LLC, a Delaware limited liability company. University General accessed the

entire $4 million term note and $12.3 million of the $15.0 million line of credit, significantly reducing interest expense and strengthening the company's balance sheet.

The proceeds were utilized to repay $9.0 million of 6.5% borrowings from Amegy Bank, $2.125 million for the equipment lease with Regions Bank and $1.0 million of the 18% note purchase agreement from Sigma Opportunity Fund, LLC. With the line of credit's rate being only 2.0% above LIBOR and the term note's rate being 2.5% above LIBOR, University General is expected to save approximately $800,000 in interest expense annually. Also, $3.61 million was paid to the IRS curtailing the incurrence of additional interest and penalties and eliminating all of University General's remaining payroll tax delinquencies.

By attaining this financing on such quite favorable terms attests to the favorable acceptance of management's strategic plan of building, owning and operating regional health care networks in multiple, major metropolitan areas. The financing also provides the company with additional liquidity that will enable the accelerated execution of management's aggressive acquisition strategy. As a result, University General is expected to expand its revenue base and level of profitability.

On August 30, 2012, University General refinanced the mortgage notes of Trinity Hills and Trinity Shores senior living facilities. Both were refinanced with their existing lenders for an additional 18 months.

OVERVIEW

Based in Houston, Texas, University General Health System, Inc. (UGHS: OTC) is a health care facilities company. The company's primary business unit is University General Hospital, a general acute care hospital in Houston, which was opened in 2006. Initially, the hospital was owned and operated by a Texas Limited Partnership (University General Hospital, LP) with a Delaware Limited Partnership (University Hospital Systems, LLP) acting as the general partner. University General Health System, Inc. became a publicly-traded company in March 2011 through a reverse merger with Seabridge Freight Corp. whereby the former partners (approximately 90 physicians) received approximately 100 million shares of stock.

Strategic Growth Plan

Long-term, management's strategic growth plan entails the creation and operation of regional health care networks developed around general acute-care host hospitals in other metropolitan areas, replicating the process employed in Houston. Each network is anticipated to be built through the acquisition of a host hospital and ancillary healthcare facilities within a radius such that they can operate under the hospital's licenses as Hospital Outpatient Departments (HOPDs). Each locally concentrated system is expected to consist of a core hospital with free-standing HOPDs (such as procedure facilities, diagnostic imaging centers, physical therapy clinics, among others) and Ambulatory Surgical Centers (ASCs). By consolidating providers into HOPDs, the University General network benefits from higher reimbursement rates. In addition, the company's physician-centric model allows the network to capture incremental revenues for procedures referred within the system.

The Implementation of the Acquisition Strategy in Houston

After completing the reverse merger in March 2011, management embarked on an **aggressive acquisition campaign** designed to create a regional health care network around a core hospital (University General Hospital) **in the Houston area**. During 2011, the company acquired three senior living facilities (**Trinity**), a support services organization that provides billing and other administrative services (**Autimis**) and a luxury hospitality service provider and facility management company (**Sybaris**). As a result, two new business segments were formed: Senior Living and Support Services. In addition, the company acquired 51% of the support services company that manages the six senior living facilities (**TrinityCare**) and 15% of Mainland Surgery Center.

Thus far in 2012, University General has announced five acquisitions: **Baytown Endoscopy Center, 1960 Digital Imaging** (a diagnostic imaging and physical therapy center), **three clinics** (diagnostic imaging, physical therapy and sleep) located at the Kingwood Diagnostic and Rehabilitation Center, the **Robert Horry Center for Sports and Physical Rehabilitation Center** and **a sleep and imaging center** located in Baytown. University General Health System is expected to continue acquiring ancillary healthcare facilities in the Houston area in order to help fill out in its health care network, including free-standing emergency rooms, ambulatory surgical centers, diagnostic imaging centers, physician practices, post-acute skilled nursing facilities (SNFs) and other complementary facilities. In addition, it is possible that additional host hospitals may be acquired.

Timeline

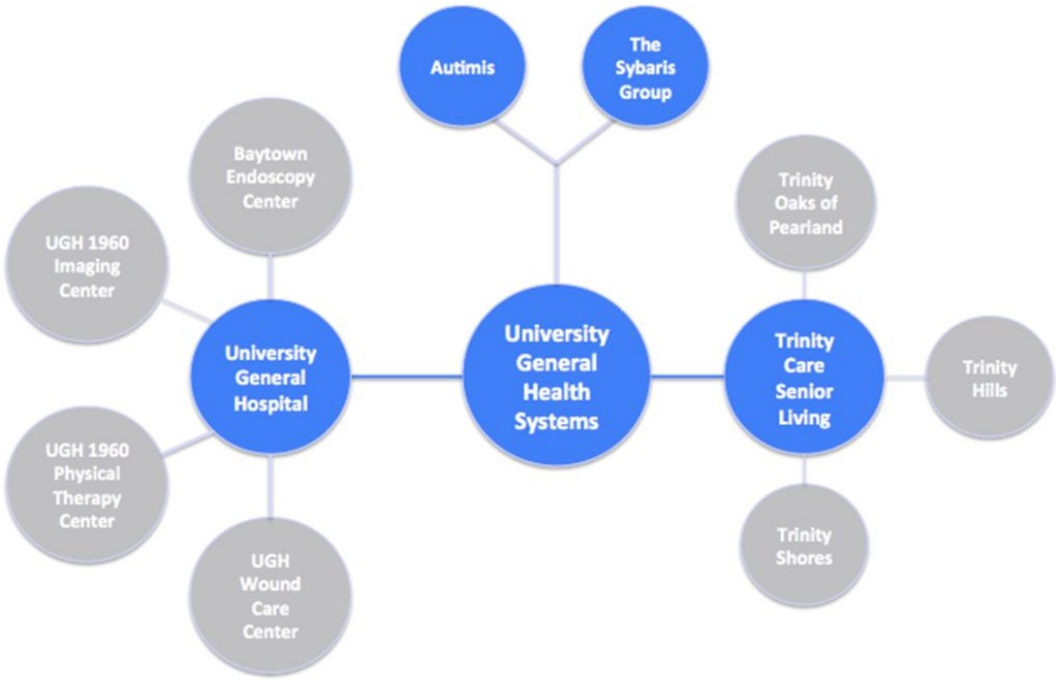
• August 2005	University General Hospital LP founded
• September 27, 2006	University General Hospital opens
• May 2010	Opened hyberbaric wound care center as HOPD
• March 28, 2011	UGHS becomes public company in reverse merger with SeaBridge Freight
• April 25, 2011	Opened Kingwood Neighborhood Emergency Center as HOPD
• May 1, 2011	Acquired 15% of Mainland Surgery Center as ASC
• June 30, 2011	Acquired Trinity Oaks, Trinity Shores and Trinity Hills senior care facilities
• June 30, 2011	Acquired 51% of TrinityCare Senior Living, LLC
• June 30, 2011	Acquired Autimis, LLC and Autimis Medical Billing, LLC
• December 31, 2011	Acquired The Sybaris Group, LLC
• February 10, 2012	Kingwood Neighborhood Emergency Center exits UGHS network
• April 13, 2012	Acquired Baytown Endoscopy Center as HOPD
• June 1, 2012	Acquired 1960 Digital Imaging (now UGH Diagnostic Imaging) as HOPD
• August 1, 2012	Acquired three clinics at the Kingwood Diagnostic and Rehabilitation Center
• August 27, 2012	Acquired Robert Horry Center for Sports and Physical Rehabilitation Center
• October 30,2012	Acquired a sleep and imaging center in Baytown as HOPD

University General Health System operates **three business units**: Hospital, Senior Living and Support Services.

- ***Hospital*** (94.2% of revenues in 2011) Located in Houston, the Hospital unit is comprised of a 69-bed general acute care hospital, the company's corporate offices and several Hospital Outpatient Departments (HOPDs), including a hyberbaric wound care center, UGH Diagnostic Imaging, UGH Physical Therapy, Baytown Endoscopy Center, three clinics at Kingwood Diagnostic and Rehabilitation Center, the Robert Horry Center for Sports and Physical Rehabilitation Center, a sleep and imaging center in Baytown and an Ambulatory Surgical Center (ASC) known as Mainland Surgery Center.
- ***Senior Living*** (4.9%) Owning three senior living communities in Texas (Trinity Oaks in Pearland, Trinity Shores in Port Lavaca and Trinity Hills in Knoxville), the Senior Living unit offers housing and assistance to elderly and mid-acuity frail residents. All three senior living facilities were acquired in June 2011. Also, University General purchased a 51% controlling interest in Trinity Care Senior Living, the support services company that manages the facilities. In total, UGHS operates six senior living facilities.
- ***Support Services and Other*** (0.8%) Composed of the Autimus and Sybaris acquisitions, Support Services provides revenue management, food, hospitality and facility services to University General Hospital and other healthcare companies. Acquired in June 2012, Autimus provides billing and coding services while Sybaris, which was acquired in December 2012, offers food, hospitality and facility management services.

HOSPITAL FACILITIES SEGMENT (HOUSTON)

The Hospital segment of University General Health System is composed of a regional health care network serving the Houston market, which consists of an acute-care hospital (University General Hospital), an ambulatory surgical center (Mainland Surgery Center) and several HOPDs (see below). The Hospital segment represented **91.1% of UGHS's revenues** during the first nine months of 2012.



University General Hospital, the company's initial healthcare facility, opened on September 27, 2006. Located at 7501 Fannin Street in Houston, the facility is a 69-bed general acute-care hospital with six intensive care unit beds and 11 intermediate care unit beds. The hospital provides a wide range of patient care, including 24-7 emergency services, inpatient surgery, outpatient surgery, heart catheterization procedures, pain management, physical therapy, sleep study, diagnostic imaging and respiratory therapy, among others. Also, University General Hospital offers concierge care, delivering amenities that a patient would have at home or at an upscale hotel. Some of these amenities include private rooms with hardwood floors, flat screen televisions, internet access and meals served on china.

Hospital Outpatient Departments

Integral parts of University General's regional health care network are the company's Hospital Outpatient Departments (HOPDs), namely:

- University General Hospital - Baytown Endoscopy Center
- University General Hospital - Hyberbaric Wound Care Center located at the hospital
- UGH Diagnostic Imaging and UGH Physical Therapy (previously known as 1960 Digital Imaging)
- KW Physical Therapy, UGH KW Imaging and UGH KW Sleep Center operating in the Kingwood Diagnostic and Rehabilitation Center
- UGH Robert Horry Center for Sports and Physical Rehabilitation Center
- A sleep and imaging center located in Baytown

An important aspect of University General's **accretive acquisition model** is the pricing benefit inherent to the migration a medical clinic from the status of an ASC to a HOPD. Procedures performed at hospitals and HOPDs are under a higher reimbursement payment structure for various reasons. For

example, hospitals are held to more rigorous standards of safety and quality of care, in addition to having higher overhead costs. Therefore, hospital reimbursement rates by third-party payors and Medicare and Medicaid are generally 30% to 75% higher. Legally, a hospital can only pay "fair market value" for a physician's interest in an ASC, and according to the definition by the IRS, the assessment of fair market value may not consider an anticipated higher payment structure. Given the disparity in reimbursement rates and the transaction valuation of HOPDs and ASCs, it is attractive for hospitals to acquire clinics and ASCs at fair market value. For the physician owners of the clinics, the benefits of joining an integrated delivery model far exceed the reduction of a portion of the autonomy of an independent practice. Also, under the umbrella of a hospital network, both University General and the physicians of the acquired clinics benefit from greater, hospital-based reimbursement rates by third-party payors and Medicare and Medicaid under the HOPD payment system.

SENIOR LIVING SEGMENT

The **Senior Living segment** is comprised of the Trinity assets, which were acquired on June 30, 2011. Due to the Trinity assets being acquired mid-year, year-end segment figures for 2011 are misleading; however, during the first nine months of 2012, the Senior Living segment represented **7.0% of UGHS's revenues**. This business unit derives revenues principally from resident fees, which reflect costs charged for housing, support services and assisted living care. Senior Living residents typically sign resident agreements for one-year renewable terms. The business also generates revenue from entrance fees, community fees and management fees. Despite the difficult economic backdrop, the Senior Living segment recorded an overall occupancy rate above 94.4% in the third quarter ending September 30, 2012. Management has indicated that the TrinityCare concept may be expanded to facilities in Pearland, Texas; Covington, LA; Shreveport, LA; Seymour, TN; Crossville, TN and Cookeville, TN.

University General acquired three senior living communities in an acquisition completed on June 30, 2011 for 23,395,895 shares and certain assumed liabilities. These facilities are: 1) **Trinity Oaks** of Pearland and 2) **Trinity Shores** of Port Lavaca in Texas, and 3) **Trinity Hills** of Knoxville, Tennessee. Trinity Oaks is an 80-unit senior living community, which has been in operation since 2001. Trinity Shores is a 63-unit senior living community that has been in operation since 2007, and Trinity Hills is an 87-unit senior living community that has also been in operation since 2007. Also, University General acquired a 51% stake in **TrinityCare Senior Living**, which develops and manages senior living communities. TrinityCare manages the three Trinity senior living communities acquired by University General, and three additional facilities in Georgia (assisted living community and two memory care greenhouses). Management intends to continue developing new facilities both nationally and potentially internationally.

SUPPORT SERVICES AND OTHER SEGMENT

The **Support Services segment** is primarily composed of The Sybaris Group, Autimis and Autimis Medical Billing, all three having been acquired in 2011. Since Sybaris was acquired on December 31st, year-end segment figures are misleading; however, during the first nine months of 2012, the Support Services segment accounted for **1.9% of UGHS's revenues**.

University General strengthened its back office services capabilities through acquisitions in 2011. **Autimis** and **Autimis Medical Billing** were acquired on June 30, 201. These two companies are focused health care billing, coding and revenue cycle management. Both of the Autimis companies serve the healthcare industry including hospitals, ambulatory surgery centers, laboratories and emergency rooms. Autimis has been providing billing, coding and other revenue management services to University General since September 2009. Autimis will continue to provide these services to University General and generate incremental revenue through service agreements with third party healthcare providers. Autimis results are included in the company's Support Services business segment.

University General acquired **Sybaris Group** on December 31, 2011. Sybaris provides luxury hospitality and facility management services. In addition to providing food, housekeeping, parking valet and information technology services to University General, Sybaris provides these services and others (such as plant operations & maintenance, executive & conference event planning, etc.) to a total of twelve clients in Houston. Sybaris has about 100 employees and generated revenues of about $5.5 million and estimated earnings of $500,000 in 2011. The company financed the Sybaris acquisition with 5.0 million shares of its common stock. The company expects that the addition of Sybaris will enable University General to leverage its concierge concept and operating infrastructure as it expands. For example, recently, the Sybaris Group was selected as the official catering company for the Athletics Department of Rice University. Sybaris is also included in the company's Support Services operating segment.

PHYSICIAN-CENTRIC MODEL

As a result of the acquisitions in the Houston area, University General Health System has developed a health care network with multiple healthcare-related revenue streams and the synergies related to a **physician referral network**. Fostering a physician-centric system, there are approximately 550 physicians with hospital privileges at the University General Hospital, including approximately 90 physicians have an equity interest in UGHS. Obviously, share ownership aligns the interests of the hospital with that of the doctors who feed the hospital with patients through the referral system. In addition, a collaborative culture in the operating rooms, patient floors and ancillary service units encourages physicians without equity ownership to take an active role in hospital operations. In turn, the hospital provides opportunities to benefit from collaborating with UGHS, such as working with large primary care groups to improve their operating performance in their clinics.

CONCIERGE CARE

Concierge medicine has grown significantly since it was first introduced in 1996. According to the AAPP (American Academy of Private Physicians), there are an estimated 3,500 concierge physicians across the nation, up 46% from about 2,400 physicians roughly a year and a half ago. The AAPP also estimates that concierge doctors serve almost a million patients nationwide.

Many concierge practices are "hybrid" ones that provide both concierge and normal healthcare services to patients. Patients who opt in for concierge services generally pay additional fees in exchange for the extra benefits, which often include luxury amenities for in-hospital stays and sometimes priority treatment and healthcare services that are not traditionally covered by insurance. The additional fees for the concierge service can range from $60 to $30,000 annually, depending on the service level the patient requires. The OIG (Office of Inspector General of the U.S. Department of Health and Human Services) has made it clear that physician practices offering concierge services must provide additional services "beyond what is already covered by Medicare" in order to request additional fees.

University General Health System strives to provide patient-centric health care not only by promoting the active involvement of patients and their families in the design and delivery of medical treatments, but also by providing quality patient care in a soothing and restful environment with concierge service. Studies have shown that the concierge environment calms the anxiety surrounding most hospital stays.

At University General Hospital, concierge services are delivered at no additional cost to the patient. By providing concierge-level healthcare that is not associated with a fee, University General possesses a competitive advantage over local competing hospitals for elective medical procedures and diagnostic services.

The interior design of University General Hospital, including the patients' rooms, reflects the up-scale ambiance of a luxury hotel. Upon arriving, patients and guests are greeted by a parking attendant and are provided complimentary valet parking. The lobby features a baby grand piano and soothing waterfall. Marble floors enhance public areas. The hospital's interior design creates a comforting environment for the time spent while recovering from an illness or a medical procedure. The rooms are private with hard-wood paneling and are equipped with flat screen televisions. Wireless internet access is complimentary. Meals, which are nutritionally-balanced and designed for high-quality taste and satisfaction, are served on fine china. The ambiance, accoutrements and food service are designed to make one's hospital stay as pleasant as possible.

The Sybaris Group, acquired by UGHS, provides the hospitality and facility management services for University General Hospital. Sybaris supplies the housekeeping and valet parking, in addition to the food and nutrition services. The environmental housekeeping services include the cleaning, disinfecting and/or sanitizing of both public areas and rooms. Since Sybaris is capable of delivering a five-star culinary experience at executive & conference events, the menus at University General Hospital include meals that are well-planned, nutritional, healthy and tasty. Also, staff concierge providers can aid family members in arranging transportation to and from the hospital and with hotel, airline and restaurant reservations. The University General concierge can even assist with ordering flowers, renting cars and providing information on and transportation to local cultural sites and activities. Management believes that by providing concierge healthcare through an environment that brings comfort to patients and families, University General should be the hospital of choice in Houston.

VALUATION

Valuation methodologies for large-cap hospital companies usually entail the use the price-to-revenues, price-to-EBITDA and/or P/E metrics in comparison to the industry mean and median as well as relative to the company's historic valuation range. Though the risks associated with newer, smaller companies, such as University General, are greater than that for more established companies with longer track records, in our view, so are the growth prospects. Therefore, due to University General's size and potential for significant growth, we believe that the large-cap hospital universe is not an appropriate valuation benchmark. Also, University General Health System has not yet established 5-year historic valuation ranges by which the company's industry position, growth profile and financial stability have been assessed by investors.

The industry of Specialty Providers of Hospital-Related Services, however, does appear to be an appropriate valuation benchmark. The significantly higher multiples relative to larger hospital companies reflect the fundamental trend towards HOPDs and the increased utilization of ASCs. In addition, the higher multiples better reflect the growth potential of these smaller companies.

The appropriate valuation methodologies for University General are based on price-to-sales (P/S) and enterprise value-to-EBITDA (EV/EBITDA) due the character of the company's enterprise, namely a small-capitalization company with a revenue profile that should experience rapid growth both through internal growth as the company's hospital network is better utilized and through the execution of management's aggressive acquisition strategy. The growing revenue stream has already manifested itself into positive earnings in the second and third quarters of 2012. Based on historical norms for similar specialty providers of hospital-related services companies, we expect UGHS to trade in an EV/EBITDA valuation range between 9.4 and 6.0, and specifically, our target is based on UGHS attaining the first quartile valuation benchmark of an 8.4 EV-to-EBITDA ratio due to the positive news flow of the successful implementation of management's growth strategies. **Our share price target is $0.90**, in which we utilize annualized EBITDA from operations derived from the most recent quarter's results due to the company's rapid EBITDA growth rate. Interestingly, the large-cap hospital universe is currently trading very tightly around its valuation mean and median (approximately 6.2 EV/EBITDA), which should provide a floor valuation for smaller growth companies related to the large-cap hospital facilities industry.

Industry Comparables	Pr Chg YTD	P/E CFY	EPS Gr 5Yr Est	Price/ Book	Price/ Sales	Price/ CF	EV/ EBITDA
UNIVERSITY GENERAL	42.9	19.8	13.5	N/M	1.3	22.4	8.7
S&P 500	12.6	14.0	10.8	3.8	2.4	11.9	N/A
LARGE CAP HOSPITALS							
Industry Mean	7.0	14.3	12.6	1.8	0.7	8.7	6.2
Industry Median	7.0	12.2	11.9	1.8	0.4	4.5	6.3
COMMUNITY HEALTH SYS.	68.9	8.3	12.3	1.0	0.2	2.8	6.4
HCA HOLDINGS	44.1	8.7	11.5	N/A	0.4	4.7	6.3
HEALTH MGT. ASSC.	9.5	9.9	11.5	2.2	0.3	4.1	5.9
LIFEPOINT HOSPITALS	-4.4	11.7	9.5	0.8	0.5	4.5	6.2
TENET HEALTH	41.1	14.6	10.2	2.5	0.3	4.2	6.6
UNIVL HEALTH SVCS.	15.3	10.9	11.5	1.6	0.6	6.3	6.5
VANGUARD HEALTH	4.3	12.7	13.0	2.6	0.1	2.3	5.8
SPECIALTY PROVIDERS							
Industry Mean	90.4	12.0	12.2	2.0	2.5	9.6	7.8
Industry Median	11.1	12.9	12.0	1.3	0.9	8.7	8.2
AMSURG CORP.	8.0	14.0	11.7	1.1	1.0	11.1	4.1
MEDNAX INC.	9.6	16.4	13.9	2.0	2.2	15.9	9.4
PSYCHEMEDICS CORP.	28.0	16.6	11.4	5.4	2.4	15.8	9.8
US PHYSICAL THERAPY	36.2	17.8	15.0	2.3	1.3	14.7	7.5
VCA ANTECH INC.	4.4	15.0	12.4	1.5	1.1	9.0	8.2

Also, valuation based on the price-to-sales metric confirms and reinforces the $0.90 price target. We expect UGHS to trade in a P/S valuation range between 2.2 and 1.0, which is also based on historical valuations of similar companies. The first quartile valuation benchmark is 2.0 price-to-sales or $0.95 per share utilizing annualized revenues from operations from the most recent quarter's results. Price-to-sales valuation also incorporates a company's ability to increase revenues and gain market share. Given management's stated business plan of becoming a creator, owner and operator of regional health care networks in multiple metropolitan areas, University General is expected to expand its revenue base significantly.

RISKS

- Operating in a state with one of the nation's higher levels of uninsured inhabitants (an estimated 27.6% of the population), Texas could impact the company's uncompensated costs over time. However, this risk is partially mitigated by University General's focus on providing concierge medical services in an upscale setting, along with its lower than industry average exposure to Medicare and Medicaid reimbursements.
- CEO Dr. Hassan Chahadeh holds super-voting power through his ownership of 3,000 shares of super-voting Series B preferred stock. Though the preferred stock has no economic value, the voting power is equal to the number of votes of all outstanding shares of capital stock plus one additional vote; therefore, Dr. Chahadeh controls a majority of voting rights on all matters that require shareholder approval. Dr. Chahadeh is a practicing physician himself. Having received a degree in medicine from Damascus University in Syria, Dr. Chahadeh also studied general surgery and anesthesiology at Baylor College of Medicine in Houston. He has been involved with University General Hospital since it's inception as a founder and managing general partner.

- University General has been or is involved in a number of legal disputes; however, all appear under control and adequately reserved. See Initiation Report for details.
- The disparity of reimbursement levels between different classes of surgical health care facilities (hospitals/HOPDs and ASCs) has sparked proposals to revise the Medicare hospital outpatient prospective payment system (OPPS) and the Medicare ambulatory surgical center (ASC) payment system. On average, Medicare pays 56% of the amount to ASCs that is paid to HOPDs for the same medical services. The discrepancy is a major driving force in the conversion of ASCs to HOPDs. While University General's ASCs likely enjoy similar reimbursement rates to its HOPDs, the level of the company's ASC reimbursements could be at risk if CMS decides to disallow conversions for reimbursement parity.
- The IRS filed tax liens against University General Hospital to collect past due payroll taxes. In August 2011, the hospital entered into an installment agreement with the IRS, under which payments were made until March 2012. As of November 14, 2012, the outstanding balance related to past due payroll taxes was $1,008,303. Management anticipates becoming current through cash flow generated by operations. Also, UGHS became profitable in the second quarter of 2012; therefore, in anticipation of the payment of income tax, the company began recording an Income Tax Payable liability on the balance sheet ($6.1 million as of September 30, 2012).
- In the Houston market, University General Hospital competes with the Texas Medical Center, which is comprised of 15 hospitals, four nursing schools and three medical schools making it the largest medical center in the world. Given that this competing facility is continuing to expand, the demand nursing and other support staff could put upward pressure on labor and other costs that could negatively impact University General's profit margins.

INCOME STATEMENT

University General Hospital System, Inc.

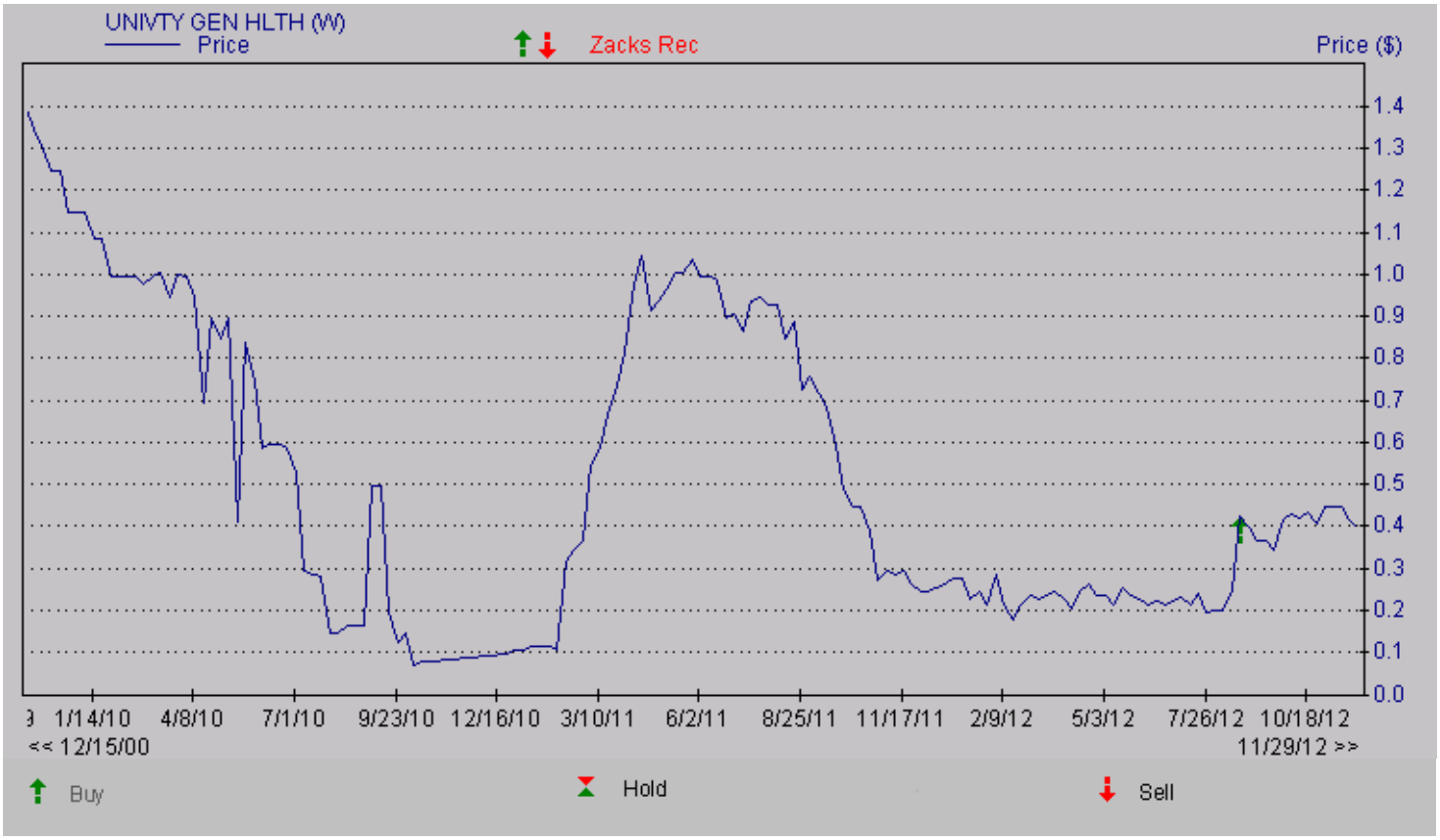
($US)	2010 (Restated)	2011 1Q	2011 2Q	2011 3Q	2011 4Q	2011 Year	2012 1Q	2012 2Q	2012 3Q	2012 4QE	2012E Year	2013E Year
Revenues												
Hospital (net patient revenues)	**55,929,507**	15,443,233	17,884,070	18,597,110	16,378,206	**68,302,619**	16,617,733	26,518,937	31,856,794	33,290,350	**108,283,814**	**146,473,011**
Senior living	**-**	-	-	1,723,571	1,840,943	**3,564,514**	1,868,433	1,908,425	1,969,785	2,009,181	**7,755,824**	**7,910,940**
Support services	**-**	-	-	168,279	297,360	**465,639**	483,700	395,364	702,542	716,593	**2,298,199**	**2,344,163**
Other	**205,042**	5,982	2,971	161,996	3,262	**174,211**	117,189	250,351	1,491,270	1,521,095	**3,379,905**	**3,515,102**
Total Revenues	**56,134,549**	**15,449,215**	**17,887,041**	**20,650,956**	**18,519,771**	**72,506,983**	**19,087,055**	**29,073,077**	**36,020,391**	**37,537,219**	**121,717,742**	**160,243,216**
Operating expenses												
Salaries, wages and benefits	**19,902,304**	6,134,717	6,812,693	8,263,837	7,945,765	**29,157,012**	8,281,991	8,735,661	10,448,799	11,083,852	**38,550,303**	**49,034,037**
Medical supplies	**11,314,219**	3,160,635	3,103,206	3,399,612	3,539,376	**13,202,829**	2,932,125	3,859,736	4,820,777	5,003,607	**16,616,245**	**20,912,155**
Management fees	**2,597,546**	1,389,655	1,303,727	1,412,385	1,240,689	**5,346,456**	0	0	0	0	**0**	**0**
General and administrative expenses	**11,347,868**	3,484,039	4,172,194	4,886,019	5,536,655	**18,078,907**	4,227,502	7,667,311	7,222,741	8,713,207	**27,830,761**	**36,917,776**
Provision for doubtful accounts	**3,439,321**					**1,332,434**						**0**
Gain on extinguishment of liabilities	**(2,781,917)**	(1,303,366)	(160,979)	(1,947,134)	(1,029,970)	**(4,441,449)**	(96,739)	(2,806,787)	(618,353)	0	**(3,521,879)**	**0**
Depreciation and amortization	**6,952,007**	1,762,607	1,757,509	2,104,016	1,712,578	**7,336,710**	1,725,173	1,769,920	2,443,747	2,468,184	**8,407,024**	**9,633,482**
Total operating expenses	**52,771,348**	**14,628,287**	**16,988,350**	**18,118,735**	**18,945,093**	**70,012,899**	**17,070,052**	**19,225,841**	**24,317,711**	**27,268,850**	**87,882,454**	**116,497,450**
Operating income	**3,363,201**	820,928	898,691	2,532,221	(425,322)	**2,494,084**	2,017,003	9,847,236	11,702,680	10,268,368	**33,835,287**	**43,745,765**
EBITDA	**10,315,208**	**2,583,535**	**2,656,200**	**4,636,237**	**1,287,256**	**9,830,794**	**3,742,176**	**11,617,156**	**14,146,427**	**12,736,553**	**42,242,312**	**53,379,247**
Interest income (expense) net	**(4,782,168)**	(1,179,696)	(1,045,427)	(1,349,023)	(1,364,457)	**(4,938,603)**	(1,437,965)	(1,385,335)	(1,363,821)	(1,287,586)	**(5,474,707)**	**(6,069,008)**
Other income	**0**	0	0	0	0	**500,000**	11,583	0	0	0	**11,583**	**11,583**
Derivative (expense)	**0**	**-**	**-**	**-**	**-**	**0**	**-**	(1,262,106)	(508,681)	0	**(1,770,787)**	**0**
Change in fair value of derivatives	**0**	0	0	0	0	**0**	0	916,533	(5,173,513)	0	**(4,256,980)**	**(8,513,960)**
Gain (loss) before income tax	**(1,418,967)**	(358,768)	(146,736)	1,183,198	(1,789,779)	**(1,944,519)**	590,621	8,116,328	4,656,665	8,980,782	**22,344,396**	**29,174,380**
Income tax expense	**300,000**	81,000	81,000	99,000	182,862	**443,862**	99,000	3,407,131	2,271,631	3,502,505	**9,280,267**	**11,378,008**
Gain (loss) before noncontrolling interest	**(1,718,967)**	(439,768)	(227,736)	1,084,198	(1,972,641)	**(2,388,381)**	491,621	4,709,197	2,385,034	5,478,277	**13,064,129**	**17,796,372**
Net income attributable to noncontrolling int.	**0**	0	0	(38,748)	(144,066)	**(182,814)**	(2,183)	30,018	212,131	(27,391)	**212,575**	**289,576**
Net gain (loss) attributable to Company	**(1,718,967)**	(439,768)	(227,736)	1,045,450	(2,116,707)	**(2,571,195)**	489,438	4,739,215	2,597,165	5,450,886	**13,276,704**	**18,085,948**
Dividend - Convertible Preferred C stock									129,547	129,547	**259,094**	**518,188**
Deemed dividend - Conv. Preferred C stock								3,845,034	504,946	504,946	**4,854,926**	**2,019,784**
Net income attrib. to com. shareholders									1,962,672	4,816,393	**6,779,065**	**13,558,129**
Basic and diluted income (loss) per share	**($0.01)**	**($0.00)**	**($0.00)**	**$0.00**	**($0.01)**	**($0.01)**	**$0.00**	**$0.01**	**$0.01**	**$0.01**	**$0.02**	**$0.04**
Diluted weighted average shares out.	123,583,509	174,728,566	253,000,000	276,379,591	279,909,909	254,401,405	283,440,226	326,817,830	364,932,417	366,932,417	335,530,723	375,000,000

BALANCE SHEET

University General Hospital System, Inc.

($US)	2010 Year	2011 1Q	2011 2Q	2011 3Q	2011 Year	2012 1Q	2012 2Q	2012 3Q
ASSETS								
Cash and cash equivalents	2,246,774	86,645	200,003	622,959	538,018	423,894	475,885	5,342,072
Accounts receivable (less all. for doubtful accts)	10,718,443	11,300,768	15,260,711	16,373,762	10,913,361	11,480,073	17,175,814	23,442,899
Inventories	1,708,974	1,857,421	1,994,793	2,070,087	1,908,177	1,897,444	1,878,266	1,493,096
Receivables from related parties	-	-	621,860	476,379	658,764	584,021	1,084,021	0
Prepaid expenses and other assets	52,790	139,857	457,875	592,103	1,275,104	960,576	1,315,319	3,997,465
Total current assets	**14,726,981**	**13,384,691**	**18,535,242**	**20,135,290**	**15,293,424**	**15,346,008**	**21,929,305**	**34,275,532**
Investments in unconsolidated affiliates			115,000	115,000	687,323	687,323	767,323	847,323
Property, equip. & leasehold imp. (net)	53,296,070	51,712,566	63,861,625	78,294,372	66,437,316	76,241,012	66,841,636	67,993,247
Intangible asset	-	-	-	1,200,000	7,649,000	1,110,000	7,198,000	6,282,500
Goodwill	-	-	33,365,278	16,457,447	22,199,874	18,299,310	28,900,818	28,974,185
Other non-current assets, net	1,788,397	1,812,772	908,275	1,933,385	2,234,985	1,964,611	1,883,224	2,304,228
Total assets	**69,811,448**	**66,910,029**	**116,785,420**	**118,135,494**	**114,501,922**	**113,648,264**	**127,520,306**	**140,677,015**
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)								
Accounts payable	13,972,196	12,336,334	15,177,608	12,735,052	11,874,720	10,680,342	10,535,040	10,032,820
Payables to related parties	3,226,630	549,929	2,023,807	2,237,165	2,493,088	2,507,940	2,089,287	2,155,945
Accrued expenses	14,385,115	11,440,205	8,385,719	7,774,265	7,516,940	8,841,149	5,339,916	4,226,512
Accrued acquisition cost	-	-	1,407,546	1,407,546	1,007,380	1,007,380	521,401	521,401
Taxes payable	-	-	3,329,091	4,361,799	4,171,826	4,943,678	5,149,799	3,640,381
Income tax payable	-	-	-	-	-	-	3,840,809	6,112,440
Deferred revenue	-	-	24,375	401,515	314,876	349,322	248,954	264,705
Lines of credit	8,450,000	8,450,000	8,450,000	8,451,025	8,451,025	8,451,025	8,451,025	0
Notes payable, current portion	17,276,041	16,016,165	18,870,115	18,314,509	28,982,331	27,298,071	25,528,386	21,483,002
Notes payable to related parties	-	-	2,780,683	3,461,831	2,798,783	2,754,455	2,164,527	2,170,143
Capital lease obligations	11,204,153	7,580,441	7,849,141	8,340,357	5,943,685	5,976,202	4,633,186	2,491,850
Capital lease obligations to related party	-	-	218,067	235,443	239,409	249,154	253,397	257,713
Derivative liability								10,569,206
Total current liabilities	**68,514,135**	**56,373,074**	**68,516,152**	**67,720,507**	**73,794,063**	**73,058,718**	**68,755,727**	**63,926,118**
Long-term Line of Credit (less current)								12,269,000
Notes payable, less current portion	2,412,366	749,791	14,136,174	12,968,377	8,459,474	7,840,348	13,707,523	21,342,197
Notes payable to related parties (less current)	-	-	2,144,062	2,029,297	1,983,514	1,910,040	0	0
Capital lease obligations (less current)	31,279,277	31,112,801	439,840	50,815	34,893	215,259	331,153	240,945
Capital lease obligations - related party (less current)		-	30,925,148	30,867,634	30,803,450	30,732,509	30,671,750	30,609,920
Total liabilities	**102,205,778**	**88,235,666**	**116,161,376**	**113,636,630**	**115,075,394**	**113,756,874**	**113,466,153**	**128,388,180**
Preferred stock Series B	3	3	3	3	3	3	3	3
Convertible preferred stock Series C	-	-	-	-	-	-	4	3,797,633
Common stock	120,340	253,000	274,896	276,396	283,440	283,440	324,326	325,653
Additional paid-in-capital	13,150,907	26,718,247	46,177,453	47,600,953	49,078,223	48,905,461	58,900,069	55,178,809
Shareholders' receivables	-	(2,130,000)	(2,130,000)	(2,130,000)	(2,219,068)	(2,239,068)	(2,409,069)	(2,429,069)
Accumulated deficit	(45,665,580)	(46,166,887)	(47,479,336)	(46,433,886)	(53,049,030)	(52,393,589)	(47,883,491)	(49,677,189)
Total shareholders' equity (deficit)	(32,394,330)	(21,325,637)	(3,156,984)	(686,534)	(5,906,432)	(5,443,753)	8,931,842	7,195,840
Noncontrolling interest			3,781,028	5,185,398	5,332,960	5,335,143	5,122,311	5,092,995
Total equity (deficit)	(32,394,330)	(21,325,637)	624,044	4,498,864	(573,472)	(108,610)	14,054,153	12,288,835
Total liabilities and shareholders' equity	**69,811,448**	**66,910,029**	**116,785,420**	**118,135,494**	**114,501,922**	**113,648,264**	**127,520,306**	**140,677,015**
Shares outstanding	152,501,259	253,000,000	283,440,226	276,395,895	283,440,226	283,440,226	324,326,655	325,654,031

HISTORICAL ZACKS RECOMMENDATIONS



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