Zacks Small-Cap Research

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Northstar Healthcare Inc. (T.NHC - TSE)

T.NHC: Pre-announces robust 2Q revenues. Reiterate Outperform rating & raise target.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	01/20/2014
Current Price (07/17/14)	$1.15
Six- Month Target Price	**$2.30**

OUTLOOK

Northstar Healthcare, Inc. holds interests in and operates four ambulatory surgical centers (ASCs) in Houston, Dallas and Scottsdale. The company just pre-announced above expectation revenues for the second quarter, primarily as a result of the implementation of management's growth strategy, which includes integrated Direct-to-Consumer marketing programs. Also, the two MRI Centers that were acquired early this year are now coming on line and are expected to bolster the top-line during the second half. In addition, an eminent bariatric surgeon has joined the ASC that was opened in Scottsdale. We reiterate our Outperform rating.

SUMMARY DATA

52-Week High	**1.64**
52-Week Low	**0.40**
One-Year Return (%)	**88.52**
Beta	**-0.41**
Average Daily Volume (shrs.)	**26,646**
Shares Outstanding (million)	**43.4**
Market Capitalization ($ mil.)	**49.9**
Short Interest Ratio (days)	**1.9**
Institutional Ownership (%)	**25**
Insider Ownership (%)	**35**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**25.1**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**38.3**
P/E using 2014 Estimate	**12.8**
P/E using 2015 Estimate	**8.2**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Growth**
Industry	**Medical Care**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	3.2 A	5.1 A	6.1 A	6.5 A	20.9 A
2013	4.1 A	5.9 A	7.6 A	13.5 A	31.1 A
2014	12.1 A	15.1 E	19.6 E	26.3 E	73.2 E
2015					85.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.02 A	$0.01 A	$0.03 A	$0.01 A	$0.03 A
2013	-$0.02 A	-$0.02 A	-$0.01 A	$0.08 A	$0.04 A
2014	-$0.02 A	$0.01 E	$0.02 E	$0.08 E	$0.09 E
2015					$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years % **17**

Quarterly EPS may not equal annual EPS total due to rounding.

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KEY POINTS

- Northstar Healthcare is a Canadian healthcare company that develops, acquires, owns and manages Ambulatory Surgical Centers (ASCs) in the United States. Currently, the company holds equity interests in four ASCs (two in Houston, one in Dallas and one in Scottsdale), along with two MRI (Magnetic Resonance Imaging) and one Urgent Care Centers in the metropolitan Houston area.
- Management's **growth strategy** entails generating organic growth through physician referrals and targeted direct-to-consumer marketing campaigns, augmented by acquisitions.
- Northstar has developed an enhanced **Direct-to-Consumer marketing program** model designed to educate and motivate prospective patients to contact the company's ASCs. The company launched its first direct-to-consumer marketing programs during 2013, which helped contribute to the 49% increase in net patient revenues.
- The company's **acquisition strategy** entails building a complementary network of ASCs and other healthcare facilities in metropolitan of the United States. Currently, Northstar has operations in the Houston, Dallas and Scottsdale markets and is targeting to replicate the ASC network-building process in other metropolitan areas.
- The domestic ASC industry is highly fragmented. With an estimated 5,900 ASCs, only about 1,300 are managed by multi-facility chains, and the largest chain controls only 239 centers.
- The **turnaround and subsequent consistent sequential quarterly growth of net patient revenues** beginning in 2013 was largely driven by the company's Direct-to-Consumer marketing effort aka **Integrated Marketing Services**. To date, the strategy has been accretive since the operating margin (including corporate expenses which include the higher marketing expenses) is expanding.
- Management aspires to list NHC to a U.S. exchange, such as NASDAQ or NYSE.
- We reiterate our Outperform rating and raise the target to $2.30.

RECENT NEWS

Pre-announcement of second quarter revenues

On July 14, 2014, Northstar Healthcare pre-announced consolidated revenue for the second quarter of 2014. Management estimates that second quarter revenue will be $15.1 million. Though management stated that the revenue was within its expectations, the top-line **was well above our projection**. Management anticipates that annual revenues will be approximately $74 million.

Financial results for first quarter 2014

On March 14, 2014, Northstar Healthcare (NHC.TO) reported financial results for the first quarter ending March 31, 2014. For the first quarter, **net patient service revenue increased 194%** to $12.12 million compared to $4.12 million in the first quarter of 2013, primarily due to increases in case and procedure volume. Net patient service revenue was **significantly above our expectations**, especially since Northstar Healthcare's net patient revenues are seasonal with the first quarter usually being substantially weaker than the fourth quarter due to the fact that health insurance deductibles reset at the beginning of each new calendar year, motivating potential patients to delay procedures in the first few months of the year.

The comparative operating statistics provided by the company indicated that **total cases improved 43.6%** to 1,499 and increased in all specialties except gastro-intestinal. **Procedure volume increased 17.3%** to 4,630. The number of general surgery cases and procedures increased significantly as a percentage of total cases and procedures, respectively. General surgery rose to 30.4% of total cases and 16.5% of total procedures in the first quarter in contrast to comprising 6.9% of both total cases and total

procedures in the first quarter of 2013. **Payer mix improved** with 96.4% of net patient service revenue derived from private payors (insurance and other), up from 86.2% in the comparable quarter last year. The percentage attributable to Medicare reimbursements declined from 4.5% to 0.8%.

Northstar Healthcare Inc.							
Number of Cases	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**1Q-2014**
Pain Management	4,855	3,074	2,540	2,799	2,884	2,887	621
Orthopedics	2,330	1,871	1,171	858	694	724	169
Podiatry	607	247	21	346	156	286	75
Gastro-intestinal	793	420	5	-	70	269	18
General Surgery	423	393	331	469	353	787	456
GYN	-	-	-	-	-	77	26
Ear, Nose, Throat (E.N.T.)	643	471	265	243	311	466	134
Total	9,651	6,476	4,333	4,715	4,468	5,496	1,499

Northstar Healthcare Inc.							
Percentage of Cases	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**1Q-2014**
Pain Management	50.3%	47.5%	58.6%	59.4%	64.5%	52.5%	41.4%
Orthopedics	24.1%	28.9%	27.0%	18.2%	15.5%	13.2%	11.3%
Podiatry	6.3%	3.8%	0.5%	7.3%	3.5%	5.2%	5.0%
Gastro-intestinal	8.2%	6.5%	0.1%	-	1.6%	4.9%	1.2%
General Surgery	4.4%	6.1%	7.6%	9.9%	7.9%	14.3%	30.4%
GYN	-	-	-	-	-	1.4%	1.7%
Ear, Nose, Throat (E.N.T.)	6.7%	7.3%	6.1%	5.2%	7.0%	8.5%	8.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Northstar Healthcare Inc.							
Procedures	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**1Q-2014**
Pain Management	28,576	14,942	10,704	11,098	9,838	11,928	2,564
Orthopedics	5,996	4,623	2,756	2,191	2,737	2,417	444
Podiatry	2,490	1,140	56	1,686	703	1,566	354
Gastro-intestinal	956	651	7	-	97	400	23
General Surgery	966	823	719	1,081	1,190	1,689	764
GYN	-	-	-	-	-	98	33
Ear, Nose, Throat (E.N.T.)	3,337	1,998	980	917	1,014	1,620	448
Total	42,321	24,177	15,222	16,973	15,579	19,718	4,630

Northstar Healthcare Inc.							
Percentage of Cases	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**1Q-2014**
Pain Management	67.5%	61.8%	70.3%	65.4%	63.1%	60.5%	55.4%
Orthopedics	14.2%	19.1%	18.1%	12.9%	17.6%	12.3%	9.6%
Podiatry	5.9%	4.7%	0.4%	9.9%	4.5%	7.9%	7.6%
Gastro-intestinal	2.3%	2.7%	0.0%	-	0.6%	2.0%	0.5%
General Surgery	2.3%	3.4%	4.7%	6.4%	7.6%	8.6%	16.5%
GYN	-	-	-	-	-	0.5%	0.7%
Ear, Nose, Throat (E.N.T.)	7.9%	8.3%	6.4%	5.4%	6.5%	8.2%	9.7%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Operating salaries and benefits increased 89.2% to $1.92 million, primarily due to increased staffing at the Microsurgery Institute – Dallas location and the opening of the Northstar Healthcare Surgery Center – Scottsdale facility. Higher case volume drove medical supply expense higher by 128% to $1.56 million. Operating general and administrative expense increased 385% to $5.91 million, primarily due to higher marketing expense and also from increased physician contracting and revenue cycle expenses. During the quarter, management invested in **two marketing campaigns in Dallas** (for NueStep podiatry procedures and bariatric weight-loss surgery) that are anticipated to drive growth of cases in the second and third quarters. Corporate costs increased 31.9% primarily as a result of legal fees incurred related to acquisitions and litigation. Net income loss attributable to common shareholders was $800 thousand ($0.02 per diluted share) versus $705 thousand ($0.02 per diluted share) in the comparable quarter last year. Diluted weighted average shares outstanding increased 14.2% sequentially from 37,827,235 during the fourth quarter to 43,190,620, primarily due to the private placement of Units in December 2013.

Northstar Healthcare Inc.							
	2008	2009	2010	2011	2012	2013	1Q-2014
Private insurance and other private pay	91.4%	87.1%	82.5%	86.5%	91.0%	95.8%	96.4%
Workers compensation	4.9%	8.1%	12.4%	8.6%	5.3%	2.4%	2.8%
Medicare	1.5%	2.7%	5.1%	4.9%	3.7%	1.8%	0.8%
Other	2.2%	2.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Cash flow provided by operating activities increased to $2.3 million versus $0.2 million during the first quarter of 2013. Working capital declined from $8.7 million at the end of 2013 to $7.6 million on March 31, 2014. On the company's consolidated balance sheet, $1.6 million in long-term debt (specifically promissory notes to banks) appeared from the acquisition of medical equipment by two of the company's subsidiaries. The medical equipment serves as collateral against the debt and Northstar is not liable under the promissory notes.

Strategy for 2014 and Beyond

For 2014, management's primary focus is to increase net patient revenues and EBITDA through scaling direct-to-consumer marketing programs in the Houston, Dallas and Scottsdale markets, along with completing selective acquisitions. During the first quarter, the NueStep podiatry direct-to-consumer marketing campaign was launched in Dallas, and an advertising program for bariatric weight-loss surgery was underwritten, also in Dallas. With stronger seasonality, in addition to the MRI and Urgent Care Centers in the Houston area coming on line in the third quarter, management is confident that revenues will continue to increase in the second half.

In addition, Northstar will present at several national surgical center meetings in order to identify potential new partnerships for surgical centers elsewhere in the U.S. Longer-term, management anticipates entering two new markets in 2015 (possibly San Antonio) and four additional markets in 2016.

Bariatric Surgeon Joins Northstar Healthcare

On July 10th, Dr. Terry Simpson joined Northstar Healthcare at the Scottsdale location. Dr. Simpson is a very experienced bariatric surgeon having performed weight loss and laparoscopic surgery for over 20 years, starting with laparoscopic bariatric surgery in 1994, adding gastric sleeves in 2001 and Lap-Band surgery in 2003. His experience and skills led to his appointment as a proctor for Allergan, the company that offered the Lap-Band gastric banding system until 2013, at which time Allergan sold its obesity intervention business to Apollo Endosurgery. The Lap-Band is a laparoscopically implanted system that restricts the stomach's capacity by an adjustable gastric band. By reducing the amount of food consumed and the resultant change in diet, patients can better achieve their goals of weight loss and a healthier life. Dr. Simpson has authored three books about weight loss surgery.

OVERVIEW

Northstar Healthcare Inc. (NHC: TSE, NRTSF:) is a Canadian healthcare company that develops, acquires, owns and manages Ambulatory Surgical Centers (ASCs) in the United States, thus far focusing on the Dallas and Houston metropolitan markets and most recently Scottsdale. Founded in 2007, Northstar attained partnership interests in two ASCs: The Palladium for Surgery in Houston (through the Palladium Partnership) and the Kirby Surgery Center in Houston (through the Kirby Partnership aka Medical Ambulatory Surgical Suites, LP). The company also provided management services for three River Oaks Pain Management facilities in Humble, Baytown and the Galleria. In early 2011, Northstar Healthcare acquired partnership interests in the Palladium for Surgery in Dallas and in December 2013, formed Northstar Healthcare Surgery Center - Scottsdale. In general, the company's ASCs offer certain

clinical specialties, including pain management, orthopedic surgery, podiatry surgery and ENT (ear, nose and throat) surgery. The company's facilities include:

- **Northstar Healthcare Surgery Center - Houston** Operations began in December 2003 with specialties in pain management, ENT (ear, nose and throat), podiatry and orthopedics. Formerly operating as Palladium for Surgery – Houston and Houston Microsurgery Institute, Northstar acquired ownership interests from all the physician limited partners through various transactions, until in October 2013, Northstar took over all existing operations. Located within four miles of the Texas Medical Center in Houston, the facility has 3 surgical suites, 2 treatment rooms (suitable for colonoscopy and interventional pain procedures), 7 pre-op beds and 8 post-op beds. The facility now also offers general surgery, gastrointestinal and chiropractic services. Northstar directly **owns 100%** of Northstar Healthcare Surgery Center - Houston.

- **Northstar Healthcare Surgery Center - Dallas**. Originally opened in 2005, this facility provides healthcare services of pain management, ENT, podiatry, orthopedics and general surgery as an outpatient ambulatory surgery center. The ASC formerly operated as Microsurgery Institute of Dallas (MSID), which leased medical equipment from Palladium for Surgery – Dallas (PFSD). In October 2013, Northstar syndicated a private placement for certain physicians to become partners of the operation. The center was folded into a new entity, NHC ASC – Dallas, in which Northstar Healthcare currently holds a **35% interest**.

- **Kirby Surgical Center** - Houston - Opened in June 2004, Northstar acquired a 65.5% interest in Medical Ambulatory Surgical Suites, LP (the Kirby Surgical Center) in 2007. The facility is located less than four miles from the Texas Medical Center in Houston. Through three subsequent transactions, the company sold 40.5% of its interests to physician limited partners, effectively decreasing the company's ownership **interest** to **25.0%**. Physicians at the Center provide care in the specialties of ENT, orthopedic surgery, general surgery, interventional spine care, sports medicine and pain management.

- **Northstar Healthcare Surgery Center** - Scottsdale – Formed in December 2013, this ASC operates utilizing the assets from a former Brown Hand Center outpatient surgery center that were acquired through a business combination. The Scottsdale facility opened during the first quarter of 2014. Northstar directly **owns 100%** of Northstar Healthcare Surgery Center - Scottsdale.

Northstar Healthcare also owns and operates the newly opened **Northstar Urgent Care & Imaging Center** in Spring, Texas (in the metropolitan Houston area) and the **Northstar Imaging Center** in Houston. All told, Northstar holds partnership interests in ASCs that operate 18 operating/procedure rooms with over 150 surgeons on staff.

Northstar Healthcare was founded by current CEO, Dr. Donald Kramer, M.D., in May 2007 and was capitalized through an initial public offering (IPO) that same month. Approximately $138.7 of the $139.7 million in net proceeds were utilized to purchase a 70% indirect partnership interest in the Palladium Partnership (a limited partnership of physicians performing surgeries at the Palladium for Surgery – Houston facility) and a 60% interest in the Medical Ambulatory Surgical Suites, LP (aka Kirby Partnership consisting of a similar limited partnership of physicians performing procedures at the Kirby Surgical Center in Houston).

Dr. Donald Kramer has founded many healthcare enterprises including Omniplus Healthcare in 1995, Access Mediquip in 1996 and Palladium for Surgery-Houston in 2003. Access Mediquip was acquired by Water Street Capital in 2011 for $80 million. Northstar Healthcare acquired a 70% interest of the Palladium for Surgery-Houston in May 2007 (Dr. Kramer retained approximately 18% of the partnership after the transaction). Northstar Healthcare also acquired Dr. Kramer's 95% ownership interest of Palladium for Surgery – Dallas in January 2011.

Management's **growth strategy** entails generating organic growth through physician referrals and targeted direct-to-consumer marketing campaigns, augmented by acquisitions. Northstar Healthcare's **business model** revolves around establishing **strategic partnerships** with the physicians associated with Ambulatory Surgical Centers in order to drive organic growth (cases and procedures) through increasing patient flow. At the Northstar Healthcare Surgery Center - Dallas and the Kirby Surgical Center, physician-partners are incentivized through equity ownership. At the Northstar Healthcare Surgery Centers in Houston and Scottsdale, physicians are motivated through non-equity contract relationships. By aligning the economic interests of physicians with the company's organic growth strategy, not only is case volume growth bolstered through physician referrals, but also surgeons can be more easily recruited into the Northstar ASC system of facilities.

To generate incremental patient flow through the company's facilities, Northstar embarked upon a program of marketing campaigns to drive case volume. By educating and motivating potential patients to contact the physicians at the ASCs, the marketing campaigns augment the traditional source of net patient revenue (physician referrals). Initially, the company developed the **integrated marketing campaign** to educate and motivate prospective patients to contact the company's ASCs. The first campaign was launched in the Dallas and Houston markets during the fall of 2011. Building upon that platform, the company developed the enhanced **Direct-to-Consumer marketing** program, augmenting the campaigns with dedicated websites, listings on local online directories, social media pages, YouTube videos and paid search-engine keywords. Northstar Healthcare launched its first direct-to-consumer marketing programs during 2013, which helped contribute to the 49% increase in net patient revenues.

Northstar Healthcare's **acquisition strategy** entails building a network of ASCs and other complementary healthcare facilities in metropolitan areas of the United States. Management is focused on replicating the ASC network-building process thus far employed in the Houston market, where the healthcare facilities act as a platform for scalable growth through in-network physician referrals and lead generation from Direct-to-Consumer marketing campaigns. Potential acquisition candidates may be in-network local hospitals, ASCs, Urgent Care Centers, MRI facilities or other complementary healthcare service offices in order to leverage the effect of current marketing programs or out-of-network operations that establish platforms in new geographic locations.

The company has made several recent acquisitions. On December 12, 2013, Northstar announced that the company was the **winning bidder** to acquire the **former Brown Hand Center outpatient surgery facility** in an upscale neighborhood of Phoenix, Arizona. The surgery center has four operating rooms and 27,000 square feet of floor space. The winning bid was $460,000. The bankruptcy court has delayed the closing of the sale, and to date, no material revenue has been generated by the Phoenix center. On January 21, 2014, Northstar Healthcare acquired the ownership interests in **two imaging centers** and **one urgent care clinic** in the **Houston area**. The total purchase price was $1.4 million comprised of $0.9 million in cash and 431,711 shares of NHC common stock. Through the purchase of Spring Northwest Management, LLC (Katy, TX), Spring Northwest Operating, LLC (Katy, TX) and Willowbrook Imaging, LLC (Houston, TX), Northstar Healthcare's revenue generation platform will be augmented with additional revenue streams derived from the 19 physician partners in these facilities.

During 2013, Northstar Healthcare raised net proceeds of approximately $4.09 million through a private placement of 5,862,500 Units and about $168,000 from the exercise of stock options. Working capital improved from $7.11 million at the end of 2012 to $8.69 million on December 31, 2013.

Northstar Healthcare' net patient revenues are seasonal with the fourth quarter being substantially stronger than the first quarter. Since health insurance deductibles reset at the beginning of each new calendar year, potential patients tend to delay procedures in the first few months of the year.

SUMMARY OF CORPORATE HISTORY

Northstar has a complex history that includes difficulties in connection with a rapidly changing reimbursement environment in the first two years of its existence, which were exacerbated by a conflict with a major insurer. As a result of these difficulties, the share price dropped dramatically, from an all-time high of $18.30 in 2007 to as low as $0.10 in late 2012. In November 2013, the company's share price rebounded to above $1.00, primarily due to a rebound in the company's net patient revenues and EPS driven by syndication/re- syndication of partnerships to motivate physician partners, consumer-centric marketing campaigns and selective acquisitions. While the company's recovery is still in an early stage, management has taken some positive and innovative steps to initiate the turnaround. For a comprehensive review of the company's history and turnaround, see our report dated April 11, 2014.

Historical Timeline

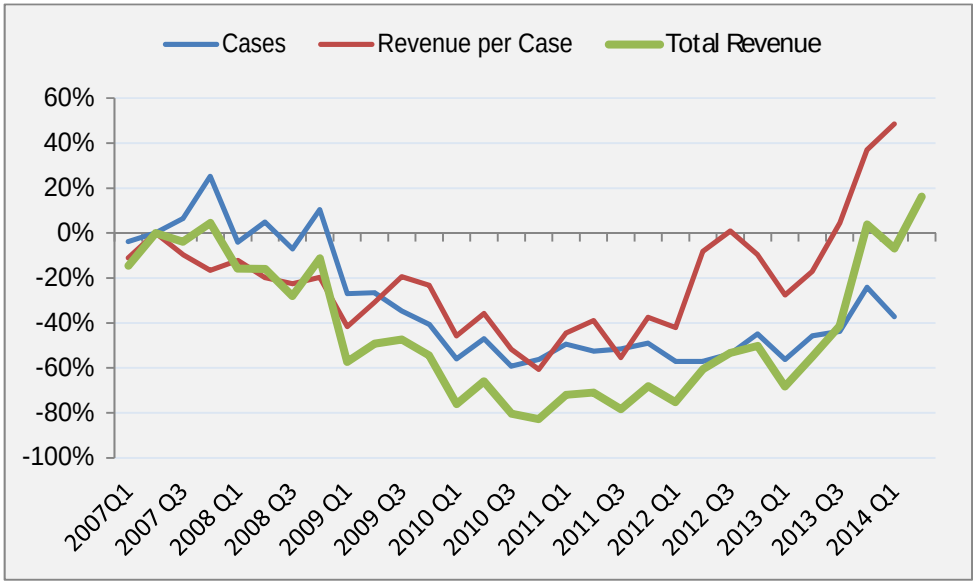
- March 16, 2007 — Northstar Healthcare incorporated in British Columbia
- May 17, 2007 — Northstar Healthcare completes IPO of 12,087,698 shares at $12.25
- May-June 2007 — Acquire 70% interest in **The Palladium for Surgery – Houston** and 60% interest in the **Kirby Surgery Center** in Houston for $138.7 million
- June 5, 2007 — Overallotment of IPO exercised for 1,813,154 shares
- September 2008 — Stephen Linehan appointed CEO
- February 2009 — Dr. Kramer makes tender offer for Northstar Healthcare
- October 27, 2010 — Dr. Kramer & Donna Alexander rejoined Northstar as CEO and COO
- November 1, 2010 — MSIH begins utilizing Palladium Partnership's facility
- January 1, 2011 — Acquire **The Palladium for Surgery - Dallas** (PFSD) for $2.2 million
- Spring 2011 — Launch first **integrated marketing campaign** (colonoscopy)
- September 2011 — Launch NueStep podiatry integrated marketing campaign
- 2013 — Launch **Direct-to-Consumer marketing programs** for Curaspine and NueStep in Houston
- December 2013 — Form **Northstar Healthcare Surgery Center – Scottsdale**
- December 12, 2013 — Win bid for former Brown Hand Center outpatient surgery facility in Phoenix
- January 21, 2014 — Acquire 2 imaging centers & 1 urgent care clinic in **Houston** area

In October 2010 Dr. Donald Kramer, MD re-assumed the CEO position and began to focus on turning around the company's fortunes. At the time, not only was the business environment challenging, but also the ASC industry was being pressured by reimbursement and physician recruitment issues. The reimbursement environment was much more difficult and competition among ASCs grew more intense as the market had matured. As a result, physician recruitment became more challenging as the ratio of eligible physicians to ASCs has fallen.

Under Dr. Kramer's leadership, the company has since pursued a pragmatic and empirical strategy of syndication and re- syndication of partnerships to motivate physician partners, consumer-centric marketing campaigns and selective acquisitions. To the extent that these advances prove sustainable and replicable, Northstar Healthcare represents a potential turnaround and potential growth opportunity for investors.

Initial turnaround initiatives focused on re-syndication of partnerships and the acquisition of the Palladium for Surgery - Dallas. On November 1, 2010, the company announced the long-awaited re-syndication of the Palladium for Surgery ASC. Northstar purchased 18% of Dr. Kramer's 27.5% interest in the Palladium Partnership, raising the company's total stake to 92%. The Palladium Partnership ceased operations, and the newly created partnership of the Microsurgery Institute of Houston leased the Palladium for Surgery – Houston facility for a 25.7% equity share. The attempt to incentivize productivity among the physician partners did not fully achieve the expected results; therefore, ultimately, Northstar bought out the MSIH partners and raised its stake to 97.5%.

Changes in Revenue, Revenue per Case, and Total Revenue Relative to 2Q 2007



In January 2011, Northstar Healthcare acquired the Palladium for Surgery – Dallas (PFSD) by purchasing the 95% interest held by Dr. Kramer and a related party's 5% interest for $2.2 million, which based on an independent third-party valuation. The facility expanded the company's number of surgical suites, treatment rooms, active surgeons and physician limited partners by 30-to-50%. Details of the facilities pre-acquisition revenues and earnings have not been disclosed. PFSD initially leased its ASC and medical equipment to the Microsurgery Institute of Dallas, LLC in exchange for a 25% ownership interest in MSID. In August 2012, the company re-syndicated MSID (MSID) by buying out its partners and closing a private placement of a 50% share to a private physician group. In conjunction with the re-syndication, Northstar ASC Management Inc. was created to provide management services to the partnership. In December 2012, the company sold additional stakes to 3 new physician partners, decreasing its ownership share to 36.5%.

Business Model with Value-Added Integrated Marketing Campaigns

In 2011, Northstar Healthcare began implementing several initiatives designed to strengthen the company's position by providing not only capital, facilities and business expertise, but also patient flow via direct-to-consumer marketing campaigns. Northstar identified a target audience of highly symptomatic patients suffering from nerve entrapment and developed an **integrated marketing campaign** to educate and motivate prospective patients to communicate with the company's facilities. The campaign was launched in the Dallas and Houston markets during the fall of 2011.

Specifically, each integrated marketing campaign is designed to provide patients with knowledge of the awareness of the disease, the recognition of symptoms, the availability of treatment options and the option of a dialogue with treatment professionals. Once a patient commits to obtaining more information, the company's **call centers** and patient relationship experts actively engage with potential patients to help establish an understanding of the company's healthcare services and to motivate them to schedule appointments at one of the company's facilities. The marketing program employed a **mix of traditional media** (television, print and radio) along with toll-free numbers. In addition, local general practitioner referrals are encouraged with the use of a referral coordinator, fax referral and a patient referral card.

The NueStep Podiatry Integrated Marketing Campaign – Initiated during September 2011 in Dallas and Houston, the NueStep podiatry integrated marketing campaign focuses on foot and ankle pain caused by nerve entrapment, which is treated by a procedure available exclusively at Northstar. Marketing objectives include education on nerve entrapment, recognition of symptoms, education on the availability of advanced procedures to decompress entrapped nerves, and empowering patients to have productive

discussions with treatment professionals. In order to ensure a high conversion of inquiries to procedures, the company hired a full-time podiatrist and staff to directly handle prospect calls and manage the program. The campaign is comprised of all marketing modalities, including a website at nuestep.com that was set up in October 2011.

In early 2012, the company began implementing the integrated marketing approach at the Palladium for Surgery - Houston facility. The partners of the Microsurgery Institute Houston were bought out by the company to provide the company with freedom to operate the facility directly and to obtain the full financial benefits of 100% ownership.

During 2012, Northstar Healthcare developed an innovative **Direct-to-Consumer Marketing Campaign** building upon integrated marketing platform developed in 2011.The Direct-to-Consumer marketing program consists of an **on-line presence** with a dedicated websites, listings on local **online directories** (such as Yelp, Yahoo Local Directory, Google Local Directory and Yellowpages.com), **social media** pages (Facebook and Twitter), informative YouTube videos and paid search-engine keywords (google, MSN and Yahoo). In January 2013, Northstar hired a chief marketing officer (and later an external medical marketing consulting firm) and began a series of therapeutic area focused direct-to-consumer campaigns that are designed to achieve critical patient educational objectives and drive brand awareness.



The Houston Colonoscopy Center Direct-to-Consumer Marketing Campaign – A colonoscopy marketing campaign was launched in the spring of 2013 to increase the awareness on importance of colonoscopies and to better educate patients about the importance of colon cancer screening, along with informing them of screening guidelines. The program is bolstered by an on-line presence with a website (houstoncoloncenter.com). The colonoscopy campaign was performed in close coordination with a second campaign on hemorrhoid treatment.

CuraSpine Direct-to-Consumer Marketing Campaign – The online presence of CuraSpine at curaspineprocedure.com was launched in August 2013. CuraSpine is a minimally invasive, rapid recovery protocol for treating herniated disks, spinal stenosis, degenerative disks, facet disease, and arthritis among other maladies.

Bariatric Campaign Direct-to-Consumer Marketing Campaign – Based on the successes in Houston, Northstar initiated a similar marketing program promoting bariatric and spine surgery at the Dallas facility. Weight loss surgery (aka bariatric surgery) includes a variety of procedures designed to help obese patients lose weight. Once patients lose a lot of weight, they usually want plastic/reconstructive surgery to help remove the excess of skin or body contouring to enhance their achievements.

The marketing-enhanced, direct-to-consumer business model not only generates an on-going revenue stream, but also creates an opportunity for the company to motivate physicians and other partners to enter into partnerships for the delivery of ASC services.

RISKS

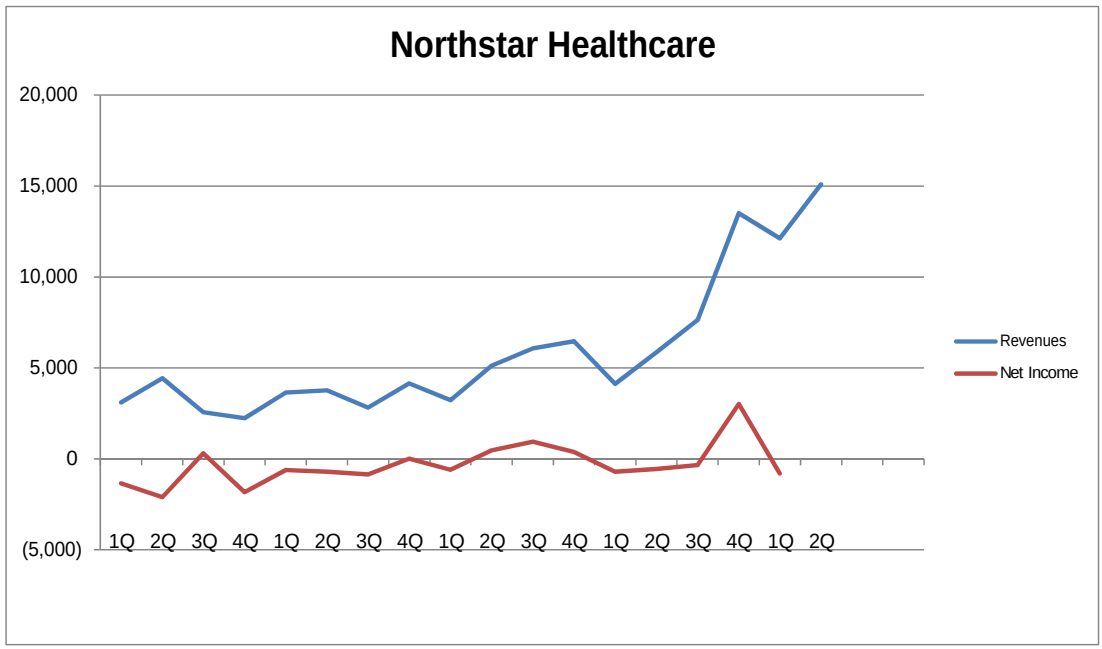
- CEO Dr. Donald Kramer holds considerable control over Northstar Healthcare and its strategy as a result of Dr. Kramer holding a $2.1 million 6.25% promissory note related to the company's purchase of his 95% interest of Palladium for Surgery - Dallas in January 2011. The relationship is further extended by Northstar having entered into a management and cost sharing agreement (for support the company's marketing campaigns) with Northstar Pain Management P.A., which is owned by Dr. Kramer. Also, Dr. Kramer owns 17,144,482 shares of Healthcare Ventures, Ltd., which holds significant interests in Northstar Healthcare Subco LLC and Northstar Healthcare Acquisitions LLC.
- Steve Linehan, the former CEO of Northstar Healthcare, filed suit against the company in the District Court of Harris County, Texas, claiming damages of $1.1 million related to his employment agreement. Northstar denies the claims and has filed a countersuit for fraudulent inducement into that employment agreement. Considering all the relevant facts and circumstances, Northstar Healthcare believes that it is doubtful that a material payment will be paid, and therefore, no provision has been made for this claim. The case is currently scheduled for trial in April 2014.
- The privately-held ASCs that were combined to form Northstar Healthcare in 2007 followed a business model based on aggressive billing practices. The dramatic revenue decline that occurred shortly after the company's IPO, to a significant extent, can be attributed to payer pushback against those practices.
- Physician recruitment and maintenance remains a key variable for success. In 2008, the company's difficulties with payors at the Palladium for Surgery Houston were largely associated with financial terms offered to non-partner physicians to induce them to perform surgery at the facility.

VALUATION

Valuation methodologies for health care services 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. The industry of Specialty Providers of Healthcare Services appears to be the appropriate valuation benchmark. The relatively higher multiples relative to the stock indices reflect the profitability and strong revenue profiles of specialty healthcare-related companies, such as ASCs, and the better growth potential of these relatively smaller companies.

The appropriate valuation methodologies for Northstar Healthcare 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 Direct-to-Consumer marketing program is rolled out and through the execution of management's acquisition strategy. The growing revenue stream has already manifested itself into the positive earnings reported for the last two calendar years.

Based on current valuation of similar specialty providers of healthcare services companies, we expect NHC to trade in a P/S valuation range between 2.8 and 1.3, which is also based on current valuations of similar companies. The first quartile valuation benchmark is 2.4 price-to-sales or $2.67 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. Given management's stated business plan of becoming a creator, owner and operator of health care networks in multiple metropolitan areas, Northstar Healthcare is expected to expand its revenue base significantly.



Valuation based on the EV/EBITDA metric mollifies the price target. Comparable companies trade in an EV/EBITDA valuation range between 11.8 and 6.8. The first quartile valuation benchmark is a 10.6 EV-to-EBITDA ratio or $1.61 per share. This tempering of the target appears consistent since the profitability aspect of management's growth strategy has not yet been consistently confirmed by financial results. Utilizing both first quartile P/S and EV-to-EBITDA (EV/EBITDA) values, **our share price target is $2.30.**

Industry Comparables	**Pr Chg YTD**	**P/E CFY**	**EPS Gr 5Yr Est**	**Price/ Book**	**Price/ Sales**	**Price/ CF**	**EV/ EBITDA**
NORTHSTAR HEALTHCARE	4.5	12.8	17.0	5.1	1.0	14.3	7.6
Industry Mean	45.9	26.2	12.3	2.6	3.3	15.1	9.8
Industry Median	10.0	19.6	10.5	2.1	1.2	12.2	11.0
S&P 500	7.2	16.9	10.8	4.8	3.3	14.8	N/A
AMSURG CORP.	3.7	19.2	10.9	1.4	1.4	14.7	6.8
SURGICAL CARE AFFILIATES	-14.0	31.5	N/A	2.7	1.4	12.9	8.2
MEDNAX INC.	8.7	18.4	14.3	2.5	2.6	18.3	11.8
PSYCHEMEDICS CORP.	-2.9	15.1	11.4	6.1	2.8	16.2	11.7
US PHYSICAL THERAPY	-2.1	21.6	20.0	2.7	1.6	17.7	9.9
UNIVERSAL HEALTH SVCS.	19.3	18.9	10.3	2.8	1.3	12.1	9.2
VCA INC.	15.4	19.8	12.4	2.4	1.8	13.9	11.0

We are optimistic about Northstar as a turnaround story. The company has experienced a dramatic increase in revenues over the last several quarters that appear to arise from its Direct-to-Consumer Marketing campaigns, the development of innovative new methods for recruiting physicians, and positioning itself as a provider rather than a seeker of patient streams through its branding efforts.

BALANCE SHEET & PROJECTED INCOME STATEMENT

Northstar Healthcare Inc.

(in thousands of $US)	2007 12/31/2007	2008 12/31/2008	2009 12/31/2009	2010 12/31/2010	2011 12/31/2011	2012 12/31/2012	2013 12/31/2013	1Q 2014 03/31/2014
ASSETS								
Cash and cash equivalents	4,983	3,733	6,182	4,236	2,505	4,222	5,602	5,938
Accounts receivable	13,861	8,366	3,040	1,747	2,341	4,090	8,281	6,754
Medical supplies	507	575	502	439	488	535	787	870
Income tax receivable	-	-	310	87	-	-	-	-
Prepaid expenses and other assets	668	1,258	667	479	255	287	540	774
Total current assets	**20,019**	**13,932**	**10,701**	**6,988**	**5,589**	**9,134**	**15,210**	**14,336**
Property and equipment - net	5,561	4,658	3,552	2,222	1,875	1,308	4,833	7,355
Foreign currency exchange contract	5,467	-	-	-	-	-	-	-
Intangible assets	9,076	1,658	285	285	1,097	1,097	1,097	1,097
Goodwill	139,443	15,300	1,635	1,635	1,228	1,228	1,228	1,228
Note receivable	-	-	-	-	-	-	150	150
Investment in associate	-	-	-	-	67	37	-	150
Other non-current assets, net	43	35	33	41	67	67	121	237
Total assets	**179,609**	**35,583**	**16,206**	**11,171**	**9,923**	**12,871**	**22,639**	**24,553**
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)								
Accounts payable	1,075	1,185	852	844	576	811	3,018	2,663
Accrued liabilities	2,653	1,395	1,522	873	1,068	1,215	1,720	2,340
Dividends payable	1,402	659	-	-	-	-	-	-
Taxes payable	227	410	-	-	-	-	-	-
Notes payable - current portion	-	-	-	-	-	-	1,693	1,693
Capital lease obligations - current portion	-	-	-	-	-	-	49	50
Other current liabilities	-	-	19	5	125	-	43	-
Total current liabilities	**5,357**	**3,649**	**2,393**	**1,722**	**1,769**	**2,026**	**6,523**	**6,746**
Notes payable, less current portion	-	-	-	-	2,093	1,693	0	0
Long-term debt	-	-	-	-	-	-	-	1,559
Accrued liabilities	-	1,718	-	-	-	-	-	-
Future tax liability	3,991	-	-	-	-	-	-	-
Capital lease obligations (less current)	-	-	-	-	-	0	163	151
Foreign currency exchange contracts	-	4,750	-	-	-	-	-	-
Related party deferred distributions	-	-	2,026	-	-	-	-	-
Class B units	-	-	1,815	-	-	-	-	-
Other liabilities	28,200	3,400	5	0	0	2	0	0
Total liabilities	**37,548**	**13,517**	**6,239**	**1,722**	**3,862**	**3,721**	**6,686**	**8,456**
Non-controlling interests	**9,394**	**7,072**	**4,776**	**3,466**	**3,623**	**4,462**	**4,754**	**6,180**
Common stock	139,718	139,718	139,718	145,412	143,747	144,677	146,704	146,203
Additional paid-in-capital	-	228	812	886	1,004	1,125	4,193	4,212
Accumulated deficit	(7,051)	(124,952)	(135,339)	(140,315)	(142,313)	(141,114)	(139,698)	(140,498)
Total shareholders' equity (deficit)	132,667	14,994	5,191	5,983	2,438	4,688	11,199	9,917
Total equity (deficit)	142,061	22,066	9,967	9,449	6,061	9,150	15,953	16,097
Total liabilities and shareholders' equity	**179,609**	**35,583**	**16,206**	**11,171**	**9,923**	**12,871**	**22,639**	**24,553**
Shares outstanding	13,900,852	13,900,852	13,900,852	33,344,210	33,385,395	36,082,114	42,729,547	43,411,258

Northstar Healthcare Inc.

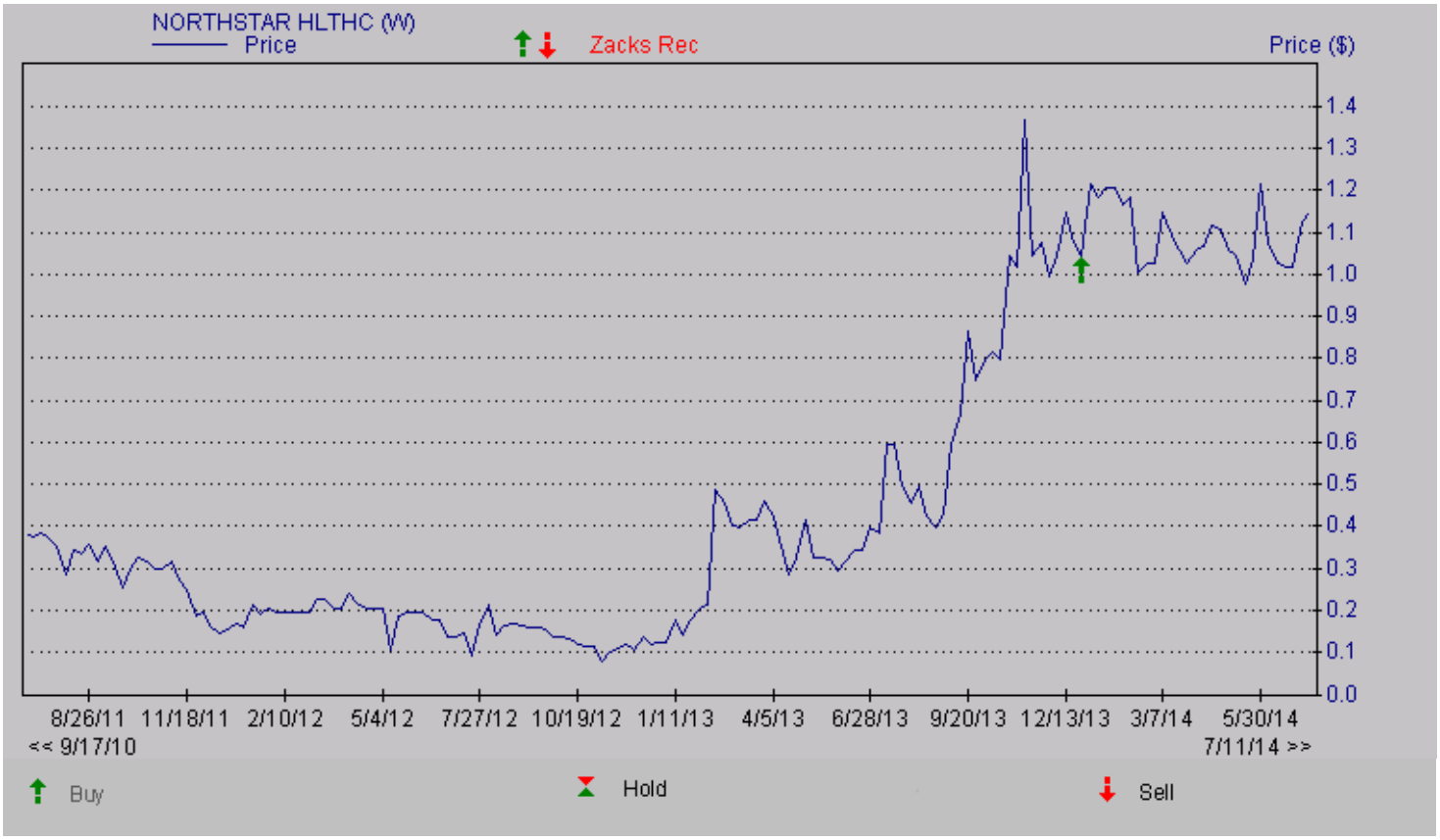
(in thousands of $US)	2007 12/31/2007	2008 12/31/2008	2009 12/31/2009	2010 12/31/2010	2011 12/31/2011	2012 12/31/2012	2013 12/31/2013	2014 E 12/31/2014
Net patient service revenue	**32,919**	**42,779**	**24,924**	**12,329**	**14,380**	**20,897**	**31,128**	**73,119**
Operating expenses								
Salaries and benefits	3,853	6,674	6,334	3,366	3,877	3,832	5,329	10,034
Medical supplies	2,528	4,038	3,206	2,365	2,476	2,391	4,423	8,533
General and administrative expenses	4,136	7,761	10,518	2,821	4,062	4,488	10,648	24,511
Provision for doubtful accounts	-	5,735	1,091	775	912	145	-	50
Depreciation and amortization	1,079	1,783	1,406	1,408	1,047	779	650	1,210
Total operating expenses	**11,596**	**25,991**	**22,555**	**10,735**	**12,374**	**11,635**	**21,050**	**44,339**
Operating income	**21,323**	**16,788**	**2,369**	**1,594**	**2,006**	**9,262**	**10,078**	**28,780**
Salaries and benefits	-	-	-	1,638	1,730	1,600	2,285	3,721
General and administrative	-	-	-	3,361	1,964	1,681	2,228	3,143
Legal expenses	-	-	-	3,420	242	553	808	1,342
Amortization	-	-	-	34	38	71	81	101
Total corporate expenses	**0**	**0**	**0**	**8,453**	**3,974**	**3,905**	**5,402**	**8,308**
Other income (expense)								
Gain (loss) on bargain purchase	-	-	-	-	-	-	2,392	-
Distributions, other liabilities, non-controlling int.	(1,088)	(1,384)	(320)	-	-	-	-	-
Withholding taxes (expense)	(857)	(853)	-	-	-	-	-	-
Chg. In fair value, other liabilities, non-controlling int.	(10,236)	24,800	1,585	-	-	-	-	-
Class B units (distributions & gains)	-	-	-	2,138	-	-	-	-
Goodwill and intangible (impairment)	-	(131,141)	(14,880)	-	-	-	-	-
Gain (loss) on foreign currency	6,003	(8,809)	3,886	50	45	-	-	-
State franchise tax (expense)	(225)	(301)	(94)	(76)	(77)	(119)	(177)	(344)
Other income (expense)	82	72	(234)	286	510	3	1	(370)
Total other (income) expense	**(6,321)**	**(117,616)**	**(10,057)**	**2,398**	**478**	**(116)**	**2,216**	**(714)**
Net Income	**15,002**	**(100,828)**	**(7,688)**	**(4,461)**	**(1,490)**	**5,241**	**6,892**	**19,758**
Current income tax expense (recovery)	227	459	(685)	-	-	-	-	-
Future income tax expense	3,991	(3,991)	0	-	-	-	-	-
Total income tax expense (recovery)	4,218	(3,532)	(685)	0	0	0	0	0
Net income attributable to noncontrolling int.	**7,624**	**6,910**	**3,384**	**515**	**685**	**4,042**	**5,476**	**16,043**
Net gain (loss) attributable to Company	**3,160**	**(104,206)**	**(10,387)**	**(4,976)**	**(2,175)**	**1,199**	**1,416**	**3,716**
Basic income (loss) per share	$0.23	($7.50)	($0.75)	($0.26)	($0.07)	$0.03	$0.04	$0.09
Diluted income (loss) per share	**$0.23**	**($7.50)**	**($0.75)**	**($0.26)**	**($0.07)**	**$0.03**	**$0.04**	**$0.09**
Basic weighted average shares outstanding	13,749,756	13,900,852	13,900,852	18,801,644	33,350,980	35,461,911	36,793,950	43,490,620
Diluted weighted average shares outstanding	13,749,756	13,900,852	13,900,852	18,801,644	33,350,980	35,764,295	37,637,662	43,490,620

Northstar Healthcare Inc.

(in thousands of $US)	2012 12/31/2012	2013 1Q	2013 2Q	2013 3Q	2013 4Q	2013 12/31/2013
Net patient service revenue	**20,897**	**4,121**	**5,862**	**7,640**	**13,505**	**31,128**
Operating expenses						
Salaries and benefits	3,832	1,012	1,142	1,332	1,843	5,329
Medical supplies	2,391	686	724	852	2,161	4,423
General and administrative expenses	4,488	1,217	2,005	2,993	4,433	10,648
Provision for doubtful accounts	145	-	-	-	-	-
Depreciation and amortization	779	156	155	154	185	650
Total operating expenses	**11,635**	**3,071**	**4,026**	**5,331**	**8,622**	**21,050**
Operating income	**9,262**	**1,050**	**1,836**	**2,309**	**4,883**	**10,078**
Salaries and benefits	1,600	520	536	420	809	2,285
General and administrative	1,681	426	470	577	755	2,228
Legal expenses	553	107	174	354	173	808
Amortization	71	19	20	20	22	81
Total corporate expenses	**3,905**	**1,072**	**1,200**	**1,371**	**1,759**	**5,402**
Other income (expense)						
Gain (loss) on bargain purchase	-	-	-	-	2,392	2,392
State franchise tax (expense)	(119)	(17)	(35)	(47)	(78)	(177)
Other income (expense)	3	(13)	(19)	98	(65)	1
Total other (income) expense	**(116)**	**(30)**	**(54)**	**51**	**2,249**	**2,216**
Net Income	**5,241**	**(52)**	**582**	**989**	**5,373**	**6,892**
Total income tax expense (recovery)	0	0	0	0	0	0
Net income attributable to noncontrolling int.	**4,042**	**653**	**1,145**	**1,328**	**2,350**	**5,476**
Net gain (loss) attributable to shareholders	**1,199**	**(705)**	**(563)**	**(339)**	**3,023**	**1,416**
Basic income (loss) per share	$0.03	($0.02)	($0.02)	($0.01)	$0.08	$0.04
Diluted income (loss) per share	**$0.03**	**($0.02)**	**($0.02)**	**($0.01)**	**$0.08**	**$0.04**
Basic weighted average shares outstanding	35,461,911	36,221,965	36,308,965	36,817,590	37,827,235	36,793,950
Diluted weighted average shares outstanding	35,764,295	36,221,965	36,308,965	36,817,590	37,827,235	37,637,662

(in thousands of $US)	2013 12/31/2013	2014 1Q	2014 2Q E	2014 2Q E	2014 4Q E	2014 E 12/31/2014
Net patient service revenue	**31,128**	**12,121**	**15,100**	**19,566**	**26,332**	**73,119**
Operating expenses						
Salaries and benefits	5,329	1,915	2,386	2,935	2,798	10,034
Medical supplies	4,423	1,564	1,963	2,348	2,658	8,533
General and administrative expenses	10,648	5,906	5,889	6,652	6,064	24,511
Provision for doubtful accounts	-	-	-	-	50	50
Depreciation and amortization	650	298	301	304	307	1,210
Total operating expenses	**21,050**	**9,683**	**10,539**	**12,239**	**11,878**	**44,339**
Operating income	**10,078**	**2,438**	**4,561**	**7,327**	**14,454**	**28,780**
Salaries and benefits	2,285	559	696	1,174	1,292	3,721
General and administrative	2,228	552	688	880	1,023	3,143
Legal expenses	808	271	302	391	378	1,342
Amortization	81	32	23	23	23	101
Total corporate expenses	**5,402**	**1,414**	**1,709**	**2,469**	**2,716**	**8,308**
Other income (expense)						
Gain (loss) on bargain purchase	2,392	-	-	-	-	-
State franchise tax (expense)	(177)	(80)	(35)	(47)	(182)	(344)
Other income (expense)	1	(385)	(19)	98	(64)	(370)
Total other (income) expense	**2,216**	**(465)**	**(54)**	**51**	**(246)**	**(714)**
Net Income	**6,892**	**559**	**2,798**	**4,909**	**11,492**	**19,758**
Total income tax expense (recovery)	0	0	0	0	0	0
Net income attributable to noncontrolling int.	**5,476**	**1,359**	**2,543**	**4,084**	**8,057**	**16,043**
Net gain (loss) attributable to shareholders	**1,416**	**(800)**	**256**	**825**	**3,435**	**3,716**
Basic income (loss) per share	$0.04	($0.02)	$0.01	$0.02	$0.08	$0.09
Diluted income (loss) per share	**$0.04**	**($0.02)**	**$0.01**	**$0.02**	**$0.08**	**$0.09**
Basic weighted average shares outstanding	36,793,950	43,190,620	43,390,620	43,590,620	43,790,620	43,490,620
Diluted weighted average shares outstanding	37,637,662	43,190,620	43,390,620	43,590,620	43,790,620	43,490,620

HISTORICAL ZACKS RECOMMENDATIONS



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Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 15.7%, Hold/Neutral- 78.8%, Sell/Underperform – 4.8%. Data is as of midnight on the business day immediately prior to this publication.