Siena Market Line
1st week of November 2015

U.S. Physical Therapy, Inc.

NYSE:USPH

Analyst: Andrew Varone
Sector: Healthcare

BUY

Price Target: $55.11

Key Statistics as of 10/29/2015

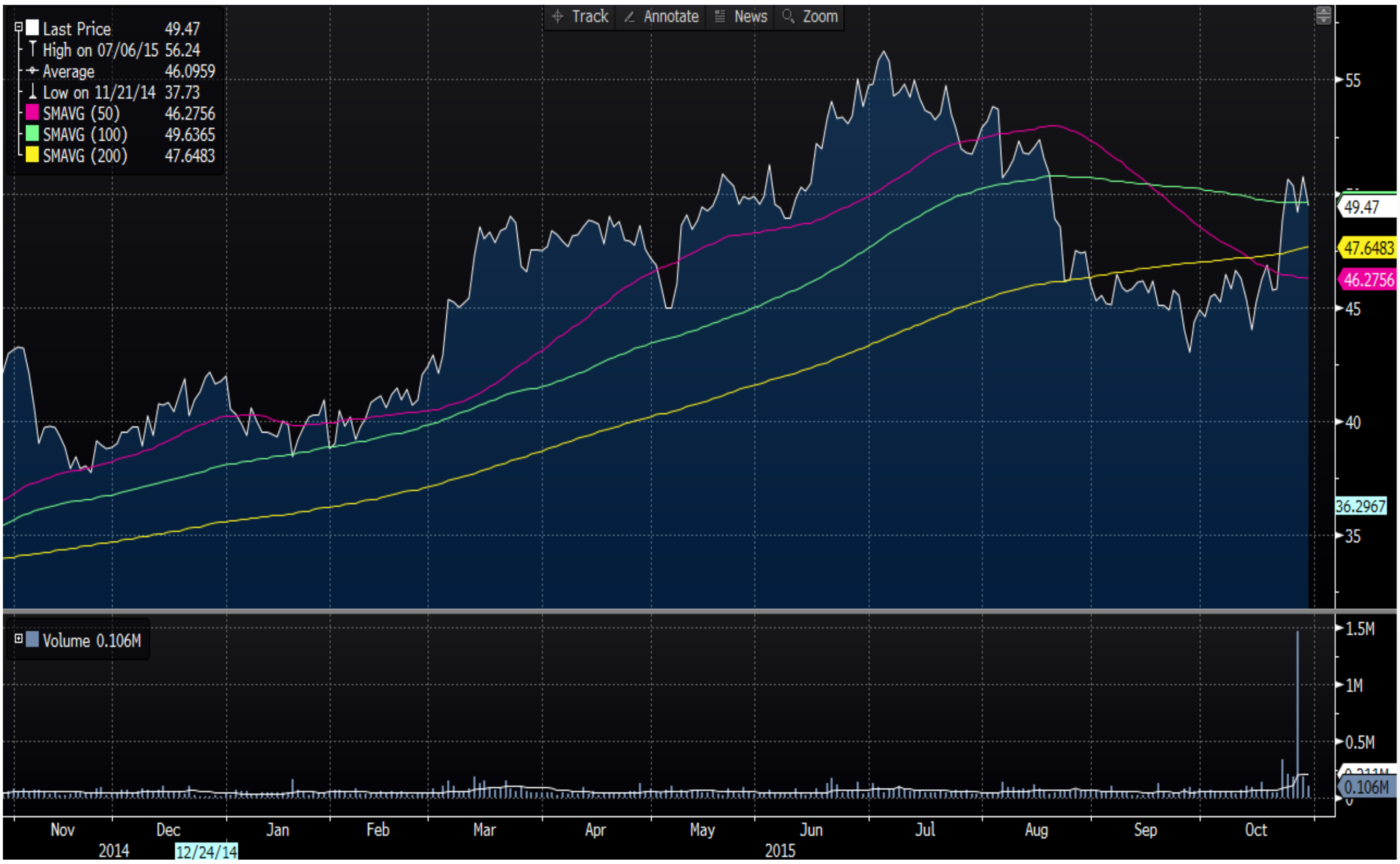
Market Price:	$49.47
Industry:	Specialized Health Services
Market Cap:	$614.47
52-Week Range:	$37.44-$56.37
Beta:	1.05

Thesis Points:

- Growing Industry Due to Aging Demographics
- Diversification of Sources of Revenues
- Lower Operating Margins than Peers

Company Description:

U.S. Physical Therapy, Inc., through its subsidiaries, operates outpatient physical therapy clinics that provide pre-and post-operative care and treatment for orthopedic-related disorders, sports-related injuries, preventative care, rehabilitation of injured workers and neurological-related injuries. The Company provides services at its clinics on an outpatient basis. Patients are treated for approximately one hour per day, two to three times a week for two to six weeks. The Company operates approximately 489 clinics in 42 states of the United States.



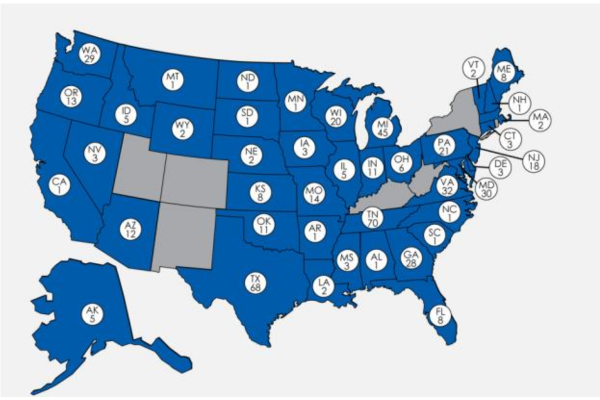
Thesis

U.S. Physical Therapy (USPH) is a BUY as the industry is speculated to be one of the fastest growing sectors in the economy through 2016. The annual growth is expected to be 5%. The growth is driven be a higher rate of the population above the age of 65 and a more active society. USPH grows inorganically as well through the use of acquisitions that later become partnerships with physical therapy clinics. Being in a highly fragmented industry, USPH tries to capture the growth in the industry. By partnering with startup clinics, they try and grow the clinic's clientele while keeping their brand on facilities. This is done to keep previous relationships that the rehabilitation clinics have built up. Also, the company's only goes for acquisitions that they believe will increase their EPS. There has been a push to diversify their revenues by making a push for worker's comp. This has been evident as their revenues from worker's comp has increased to 20%.

The company currently has a one year upside potential of 11% and a 1.2% dividend that makes a one year return of 12%.

Growth Opportunities

The physical therapy market is a $19B industry. The projected annual growth for this industry is between 5%. The growth for this industry is fueled by an aging demographics and more self-awareness for physical health. U.S. Physical Therapy can capture this organic growth due no company having over 6% market share. What sets U.S. Physical Therapy apart from the other 16,000 clinics is that they own or operated 489 clinics throughout 42 states.

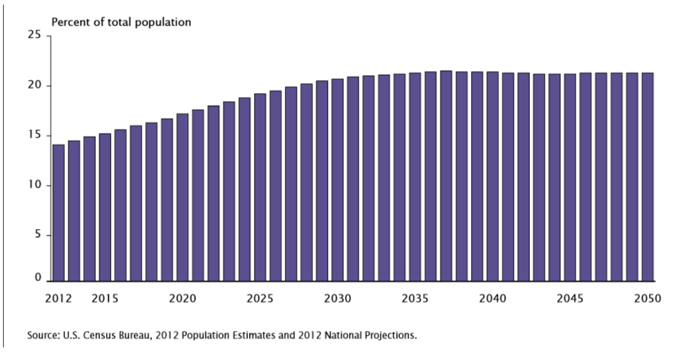


This ranks third most for physical therapy clinics in the United States. What sets them apart from other competitors is there coverage and their focus. Despite Select Medical having 400 more clinics than U.S. Physical Therapy, there do not have the same coverage. Currently USPH is offered in 12 more states than Select Medical. This allows them to capture growth throughout the United States and not just in selected parts. Select Medical also practices in inpatient rehabilitation hospitals and occupational health. USPH is just focused on physical therapy and will be more aggressive when growing their company.

Another area of growth that USPH takes advantage of is inorganic growth. Since 2005, USPH has acquired 21 clinic groups that included anywhere from 3 to 52 facilities. When acquiring another clinical group, USPH has them continue to operate the clinics. Also, USPH only acquires clinics that reflect in their earnings. This is done by them only going for acquisitions that they believe are accretive. USPH is consistently seeking de novo growth opportunities which can continue to fuel inorganic growth as gain new clinics.

Aging and Active Demographics

The driver for growth is the aging demographics that the United States have. Though physical therapy is for all ages as anyone can receive musculoskeletal injuries, the older generations are more prone to have these injuries. As the population continues to grow, there will be more potential patients for the physical therapy industry. Another driving factor is not only is the number of people above the 65 growing, the percent of population above the age of 65 is also growing.



Source: U.S. Census Bureau, 2012 Population Estimates and 2012 National Projections.

Citizens over the age of 65 made up around 14% of the total population in 2012. By the year 2030, it is estimated that those over the age of 65 will be around 20%. This increase can drive growth due to the higher need for patient rehabilitation.

Another big role that plays into an increase in growth for physical therapy is the activeness of the general public. There has been a push for people to eat healthier and do physical activity to lower health risk. This has been reflected in an 8% increase in those going to health clubs. When putting extra strain on the body or exposing it to more activity than it is use to, there is an increase risk in injury. This injury can be repaired through physical therapy through the number of rehabilitating programs that they offer.

Insurance and Revenues

USPH have a diverse area where they collect their revenues from. 50% come from private insurance & managed care, 25% from Medicare & Medicaid, 20% from worker's comp and 5% from other sources. USPH have made a push to grown their worker's comp to 20% of company's patient revenues. They have done this through treating, educating, assessing and preventing work related injuries. It is important to have multiple payers for your patients due to the practice. Many insurances will put a cap on the amount they will pay annually for physical therapy. If it goes over the cap, then the case then must be reviewed and approved for the patient to receive the higher cost of physical therapy. The greater percentage of workers comp in the payer's mix allows for the patient to not be as reliance on one form of paying.

There has been a push for universal healthcare which will give more insurance coverage throughout the United States. This is good news for physical therapy as this brings in new patients that would otherwise be unable to go. Also, there has been a push for cost-effective alternatives such as physical therapy rather than having people receive surgery on their musculoskeletal inconveniences. Those that do receive surgeries may also need to have some form of rehabilitation. When replacing areas such as joints, they body must be worked to insure that the joints can move in every natural position in the future. This means as there is technological increases that help bring back functionality to different parts of the body, a greater demand for rehabilitation will be needed.

The Medicare legislation that came out in April kept rates flat. In the next few years, there is an anticipated 0.5% increase in Medicare which would result in no negative impacts from the Medicare legislation.

Porter Five Forces

The threat of new entrants is low. This is due to high capital requirements and customer loyalty to established brands. When starting a new clinic, high amounts of capital are needed for a building and the different equipment that are needed. Another area that is hard to obtain is customer loyalty. Most patients for physical therapy either continue at their current clinics or they take recommendations from their doctor to where go. It can be tough for new clinics to get their name out as most patients going to physical therapy will already have a relationship with their clinics.

The threat of substitutes is neutral. The rehabilitation in physical therapy in cost-effective, this is due to patients returning to full ability once they finish their treatment. Other treatments, such as surgery, require rehabilitation after the surgery is done. A reason for the neutral is that there is a low barrier of entry to operate in this environment. There are continuous breakthroughs in the medical field that can pose better competition for the cost-effective strategy.

The bargaining power of customers is low-neutral. The industry is susceptible to the rates that insurance providers are willing to pay. This could be positive or negative. It could be positive if rehabilitation is found to be the most cost effective, making other alternatives not feasible. On the other side, insurance companies may limit the amount a person can spend on rehabilitation without being proven. Depending on the injury that is sustained, outpatient rehabilitation could be a necessarily which would reduce bargaining power of the buyers. Customers are not likely to switch physical therapist if they already are established with one. This would lower the bargaining power of customers.

The bargaining power of suppliers is neutral. Depending on the insurance provider, the main supplier for rehabilitation could be doctors through referrals. Other insurances may just need the patient to file a form expressing their form of injury and the ways it limits their daily activity. If no referral is needed, the limits the bargaining power of the supplier as the patient can receive treatment when is needed.

The threat of rivals is high. The industry is very fragmented with no clinics having above 6% market share. Because of this, a competitive advantage is needed to obtain sustainable growth. The competitive advantage that is needed is customer loyalty. All clinics offer the same services, the relationships that are gained through the patients is what drives growth.

Financials

The revenue growth from 2012 has been increasing as it was 15.5% for 2014. The margin has decreased, this could do to a lower rate that insurance companies are giving them or by taking on more debt. If insurance companies are giving them a lower rate, this is a macroeconomic issue as all clinics will experience lower rates. What is a positive going forward is that operating cost are 82%, comparing this to their peers which is 85%. USPH can captures larger margin than their peers. This is important as the operating cost were what made pricing most sensitive. USPH has also had growing and positive cash from operating activities. A continual trend of positive cash flows can be used to pay off or refinance long-term debt. The long-term debt is 42.1M which is about 6% of their capital structure.

USPH also has a dividend policy in place that is currently 1.2%. It has been continually growing to this point.

There has been an overestimate on the decrease of the stock because of revenues not making estimated revenues. The previous four quarters, USPH had exceeded the estimates that were set. USPH has an earnings call on November 5th, surpassing expectations will cause the stock to raise.

Conclusion

U.S. Physical Therapy (USPH) is a BUY due to the business of the firm. USPH is the only public firm that specializes in physical therapy which has forecasted annual growth of 5%. This growth will be sustainable as there is a growth of aging demographics until 2030. An increase of demand will also be incurred from a higher rate of those insured in the United States. The push for worker's comp has also allowed USPH to not be dependent on restrictions that are set by insurance companies. Lastly, USPH has positive net cash flows that they can payoff future debts and a dividend policy that adds to the returns of the stock.

CENTER FOR GLOBAL FINANCIAL STUDIES

US Physical Therapy Inc.	USPH	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	1-y Return: 12.58%	NEUTRAL
		Andrew Varone	$49.47	$54.51	$55.11	1%		

General Info

Sector	Healthcare
Industry	Healthcare Providers and Services
Last Guidance	August 6, 2015
Next earnings date	November 5, 2015

Market Data

Enterprise value	$681.68
Market Capitalization	$614.47
Daily volume	0.10
Shares outstanding	12.42
Diluted shares outstanding	12.31
% shares held by institutions	96.09%
% shares held by insiders	4.43%
Short interest	4.03%
Days to cover short interest	5.34
52 week high	$56.37
52-week low	$37.44
5y Beta	0.96
6-month volatility	29.51%

Peers

Peers	Market Cap.
Adeptus Health Inc.	$956.68
Capital Senior Living Corp.	$666.71
BioScrip, Inc.	$136.09
Surgical Care Affiliates, Inc.	$1,167.40
Select Medical Holdings Corporation	$1,412.35
Acadia Healthcare Company, Inc.	$4,442.93
Five Star Quality Care Inc.	$158.42
The Ensign Group, Inc.	$1,097.50
AmSurg Corp.	$3,464.28
Brookdale Senior Living Inc.	$3,865.63

Current Capital Structure

Total debt/Common Equity (LTM)	0.36
Cost of Borrowing (LTM)	2.27%
Estimated Cost of new Borrowing	3.65%
Altman's Z	6.67
Estimated Debt Rating	AA
Current levered Beta	0.88
LTM WACC	0.54%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Reading, Christopher	Chief Executive Officer, President and Directc	$1,825,932	$1,903,888	$2,850,384
McAfee, Lawrance	Chief Financial Officer, Executive Vice Preside	$1,164,629	$1,177,979	$1,722,653
McDowell, Glenn	Chief Operating Officer	$1,044,882	$1,083,872	$1,625,749
Bates, Jon	Vice President and Corporate Controller	$0	$0	$0
Binstein, Richard	Secretary	$0	$0	$0
Keiser, Lester	Vice President of Contract Development	$0	$0	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	-1.13%	3.07%	-12.07%	4.51%
Last Quarter-1	3.19%	-12.10%	-2.86%	4.45%
Last Quarter -2	3.79%	-0.94%	2.50%	1.41%
Last Quarter -3	3.53%	0.37%	2.38%	0.92%
Last Quarter -4	5.56%	11.34%	20.45%	4.34%
Standard error	1.1%	3.8%	5.3%	2.06%

Standard Error of Revenues prediction	1.1%
Imputed Standard Error of Op. Cost prediction	3.6%
Imputed Standard Error of Non Op. Cost predictio	3.7%

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (63th Percentile), Bargaining Power of Customers (14th Percentile), Intensity of Existing Rivalry (33th Percentile), Threat of Substitutes (67th Percentile), Threat of New Competition (8th Percentile), and Overall (67th Percentile).

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Industry ratios over an explicit period of 10 years

General Assumptions

Money market rate (as of today)	0.37%
Risk-Free rate (long term estimate)	2.87%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	37.5%
Country Risk Premium	7.0%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$313.48
FY2015	4.9%	$328.86
FY2016	6.1%	$348.99
FY2017	4.6%	$364.91
FY2018	3.8%	$378.71
FY2019	3.4%	$391.55
FY2020	3.2%	$404.06
FY2021	3.1%	$416.58
FY2022	3.0%	$429.28
FY2023	3.0%	$442.26
FY2024	3.0%	$455.58
Continuing Period	3.0%	$469.25

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Industry)	Adjustment per year
Operating Cash/Rev.	0.00%	1.04%	0.1%
NWV/Rev.	6.95%	7.91%	0.1%
NPPE/Rev.	5.26%	5.30%	0.0%
Dpr/NPPE	34.77%	34.80%	0.0%
NET MARGIN	10.59%	10.60%	0.0%
Op. Exp./Rev.	81.97%	82.00%	0.0%
SBC/Rev.	1.27%	0.67%	-0.1%
Rent Exp./Rev.	8.17%	0.87%	-0.7%
R&D/Rev.	0.00%	3.09%	0.3%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	8.79%	15.49%	0.7%
ROE	-70%	28.44%	9.87%
P/E	20.45x	13.10x	-0.74x
P/BV	NA	3.72x	0.00x
Debt/Equity	36%	98%	6.2%
Unlevered beta	0.71	0.68	0.00
Dividends/REV	2%	1%	-0.1%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
R&D expenses are not capitalized
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (5.335%, 7%, 5.665%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value $\sigma(\varepsilon)$	$3.72
1-year target price $\sigma(\varepsilon)$	$3.97

Valuation

Forecast Year	ROE	Ke	Common Equity	Implied Equity Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	-70.2%	9.0%	-$39.80	$326.53	$4.97	12.42	$54.37
FY2015	-140.5%	9.1%	-$31.23	$308.85	$4.97	12.42	$54.79
FY2016	-126.2%	9.2%	-$6.01	$322.92	$5.01	12.42	$55.75
FY2017	-683.1%	9.2%	$21.69	$339.35	$4.96	12.42	$56.56
FY2018	195.8%	9.3%	$51.34	$358.07	$4.87	12.42	$57.35
FY2019	85.3%	9.4%	$82.68	$379.18	$4.74	12.42	$58.18
FY2020	54.4%	9.4%	$115.61	$402.91	$4.59	12.42	$59.07
FY2021	40.0%	9.5%	$150.11	$429.51	$4.42	12.42	$60.06
FY2022	31.6%	9.6%	$186.20	$459.30	$4.23	12.42	$61.15
FY2023	26.2%	9.7%	$223.93	$492.65	$0.00	12.42	$62.37
FY2024	22.3%	9.7%	$263.34	$529.98	$0.00	12.42	$64.46
Continuing Period	23.0%	9.8%	$132.00				

Monte Carlo Simulation Results

The $3\sigma(\varepsilon)$-adjusted intrinsic value is $54.51; the $3\sigma(\varepsilon)$-adjusted target price is $55.11; and the analysts' median target price is $52.17

Sensitivity Analysis

Revenue growth variations account for 47.7% of total variance
Risk premium's variations account for 2.1% of total variance
Operating expenses' variations account for 48.6% of total variance
Continuing period growth variations account for 1.6% of total variance