

UNIVERSITY GENERAL HEALTH SYSTEM, INC.

Undervalued Health Care Company Poised for Growth

Rob Goldman
rob@goldmanresearch.com

April 10, 2014

UNIVERSITY GENERAL HEALTH SYSTEM, INC (NASDAQ - UGHS - \$0.19)

Price Target: \$0.42

Rating: Speculative Buy

COMPANY SNAPSHOT

University General Health System, Inc. operates integrated, multi-specialty hospitals and their surrounding networks consisting of ambulatory surgery centers, diagnostic imaging facilities, sleep disorder clinics, and centers for physical therapy, endoscopy, weight loss and wound care. Delivered under a physician-centric model, this 'eco-system' has three divisions: Hospital, Senior Living, and Support Services. In recent years, University General has made a series of strategic acquisitions to strengthen its geographic reach, increasing the number of physicians on staff and patient referrals, resulting in significant revenue gains.

KEY STATISTICS

Price as of 4/9/14	\$0.19
52 Week High – Low	\$0.15 – \$0.73
Est. FD Shares Outstanding	400M
Market Capitalization	\$76M
3 Mo Avg Vol	421,000
Exchange	OTCQB

COMPANY INFORMATION

University General Health System, Inc.
 7501 Fannin Street
 Houston, TX 77054
www.ughsystem.com

IR : RJ Falkner & Company, Inc.
 P.O. Box 310
 Spicewood, TX 78669
 800- 377-9893

INVESTMENT HIGHLIGHTS

University General Health's rapidly-growing healthcare provider network operates in one of the fastest-growing markets in the U.S. The estimated \$923 billion hospital industry is experiencing meaningful growth rates, especially in Texas and the Southwest, as demand for healthcare services rises.

With a reputation for providing quality care, and unmatched comfort and amenities at an affordable cost, University General Health's flagship hospital resembles a first-rate hotel, a feature they work to replicate in other facilities. As a result, the Company's facilities have emerged as the regional hospital of choice among doctors and patients alike.

The development of new regional and outpatient facilities and targeted acquisitions should drive consistent traffic to its key facilities and future profitability. In addition to its current core Houston and Dallas hospitals, UGHS will invest \$16M over time in 3 facilities slated to open during 2015.

Adjusted EBITDA growth and a sum of the parts valuation should drive these shares meaningfully higher. While the Company's flagship operations in Houston enjoys an acceleration in adjusted EBITDA profitability, the Company's Dallas facility is nearing a key inflection point in its business cycle which will enhance overall adjusted EBITDA profits this year.

Our 1-year price target of \$0.42 is based on a conservative discounted cash flow forecast and does not include any contribution from the 2015 expansion, which would raise the target even higher. As other facilities contribute to adjusted EBITDA of over \$18M in 2015, we believe UGHS could quickly reach \$0.70 based on a sum of the parts facilities value analysis and a price/EBITDA calculation. We rate these shares Speculative Buy.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

COMPANY OVERVIEW

Founded in 2005 and publicly traded since 2011, University General Health System has built itself into a rapidly-expanding regional healthcare delivery network in and around the greater Houston and Dallas metropolitan areas. The Company provides diversified, multi-specialty acute and sub acute care within an integrated suite of services designed to appeal to both doctors and patients. Its business is divided into three segments – Hospital, Senior Living, and Support Services. The largest of the three and highest revenue generator is the Hospital segment, where two facilities exist – University General Hospital, with 69 beds and the former Dallas South Hampton Community Hospital, acquired by the company in December 2012, with 111 beds. University General Health's entire 'ecosystem' of services includes three ambulatory surgical centers, three diagnostic imaging centers, two physical therapy centers, two hyperbaric wound care centers, two sleep diagnostic centers, a sports medicine and rehabilitation center, and six facilities for senior living.



Figure 1: University General Hospital

Source: www.ughsystem.net

Hospitals are the focal point of University General Health's platform and provide an array of medical and surgical services on an inpatient and outpatient basis. These are comprised of an emergency/intensive care unit; a pathology lab; radiology; internal and general medicine, where patient wellness is diagnosed and maintained through a choice of 'packages' of test panels for health risk assessment and disease prevention; general surgery that includes doctors trained in areas of vascular, critical care and pediatrics; cardiovascular services with heart catheterization procedures to open clogged arteries; specialists in gastroenterology that routinely perform colonoscopies; orthopedics and pain

management services; spine surgery, bariatric surgery to prevent obesity from becoming fatal; a department dedicated to preventing an outbreak of infectious disease; and departments for urology, neurology, and podiatry.

Ancillary services such as MRI or CAT imaging can be done inside the hospital or through one of its three outlying facilities. Patients requiring physical therapy are directed to any of six stand-alone clinics. Sleep studies for apnea, narcolepsy or restless leg syndrome are referred outside the hospital, to one of University General Health's sleep centers, where prevention is important to avoid the risk of heart disease, high blood pressure, stroke, and injuries from falling. Cosmetic or reconstruction surgery, particularly of the hand, is done within the hospital, as are bronchio thermoplasty treatments using radio frequency via catheter for severe asthma.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

COMPANY OVERVIEW (cont.)

Hospital food and nutrition services are provided by wholly-owned SYBARIS of Houston, which also provides catering, janitorial, plant maintenance and engineering, and a variety of environmental functions. University General Health's hospitals, however, do not support open heart surgery, organ transplant, long-term cancer patients, or obstetrics which keeps costs down (a potential savings of up to \$500,000 per bed) and allows a higher degree of efficiency and quality directed toward other services.

Senior Living offers housing in a pleasant community setting with round-the-clock help for residents, and runs the gamut from individuals in good health to those that are more frail and elderly, thus setting up a continuum of care that typically captures patients in the early years before full-time care is necessary in one of University General Health's skilled nursing facilities. Memory care for Alzheimer's disease and progressive dementia are also available. TrinityCare is distinctive from a competitive standpoint as it is the only existing for-profit, 'faith-based' senior living facility.

Within Support Services, a fast-growing segment, billing, coding and revenue cycle management (to catch errors and improve collection of accounts receivable, leading to higher liquidity) is performed for the hospitals and its subsidiary healthcare providers. Concierge services, a unique hospitality offering not often seen in similar institutions, are also provided to patients and visitors. This unique high value, high touch service approach has enabled the Company to record higher occupancy rates than its competitors.

World-class physician talent totaling over 800 physicians (much of it culled from the nearby Texas Medical Center), attractive surroundings and patient comfort are hallmarks of University General Health's platform. Its facilities contract with most managed care payors; just recently, UnitedHealthcare members, nearly 4 million Texans, will have access to the network, significantly broadening the company's patient base.



Figure 2: University General Hospital Nurses Station

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

COMPANY OVERVIEW (cont.)

A Hub and Spoke-Based, Physician-Centric Business Model

Central to University General Health's strategy is to purchase or build acute care hospitals that act as a hub for a collection of auxiliary services like outpatient surgery centers, diagnostic imaging, free-standing emergency rooms, physical therapy and senior living facilities. This plan would in effect create a regional network able to provide services under the company's acute care licenses, in a geographic radius of 30-35 miles, for true vertical integration and a single source of services for physicians and patients alike. Many of the facilities under development or acquisition have a real estate component (owned by an affiliate of University General Health) and an operating component. The overriding philosophy is to build a physician-centric model where doctor-owners of each hospital are engaged to promote the tenets of high quality care using the latest medical tools in a calming and appealing environment, leading to better patient outcomes.

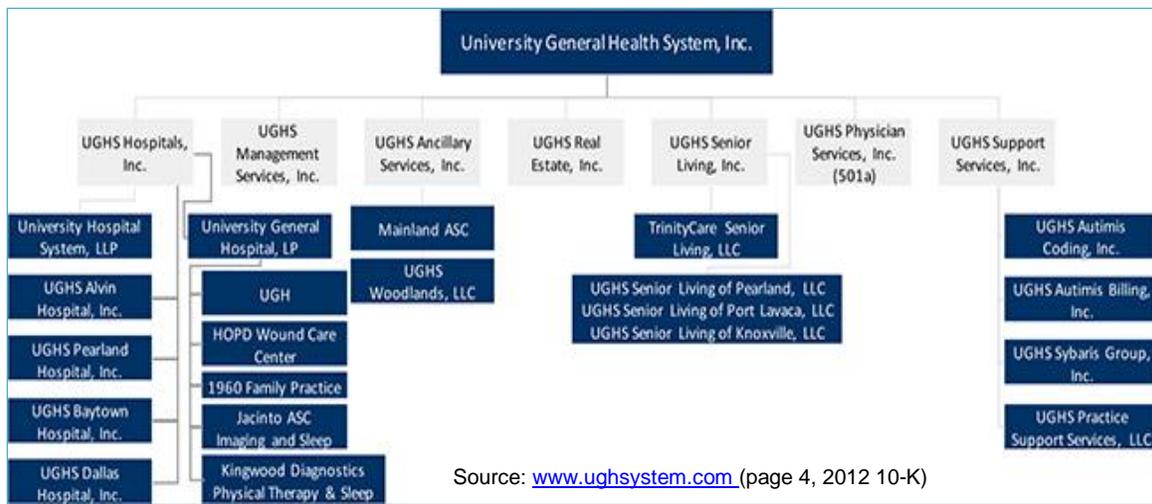


Figure 3: University General Health System Corporate Structure

Acquisitions are mostly opportunistic but favorable demographics play a large role. Besides its acquisition of South Hampton Community Hospital in Dallas and potential expansion of ancillary services around it, University General Health has purchased TrinityCare consisting of three senior living communities, and management of an assisted living facility, and two 'greenhouses', or clusters of small homes designed for patients who specifically require memory care. Autimis Billing and Coding was bought several years ago to augment the company's revenue cycle management effort in all of its facilities. Baytown Endoscopy Center, a three-bed ambulatory surgical center for gastroenterology and pain management joined University General's network in 2012 and will act as an outpatient department to University General Hospital. Other recent acquisitions and the launch of new facilities include those dedicated to diagnostic imaging and physical therapy, sleep disorders, sports medicine rehabilitation, a pain management medical practice and an additional ambulatory surgical center connected to the Dallas hospital.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)**COMPANY OVERVIEW** (cont.)

All current and new facilities under development will conform to University General Health's mission to build regional, diversified healthcare networks, with ambulatory surgical centers, physical therapy and diagnostic imaging facilities considered a hospital outpatient department (HOPD) of the nearby hospital hub. Physician-owners of acquired properties will integrate into the main hospital, expanding and strengthening the provider base to affect greater occupancy levels and gain share in the highly attractive but competitive Houston and Dallas healthcare market. As the company progresses, more purchases will be matriculated into new or existing networks within Texas or surrounding states with a concentration in the Southwest where healthcare is a booming business as more retirees seek out warm climates. As in the past, synergies can be realized through cost-cutting, mainly within Support Services. Economies of scale can be achieved through food services, and consolidated top-line revenues should benefit from a wider physician referral base.

University General Health's headquarters are in Houston, TX. The company employs approximately 1,300 people, 800 of whom are physicians, the balance consisting of nurses, technicians, therapists, facility workers and administrative staff.

Expansion in 2015 is a Game Changer

The Company plans to invest \$16 million in 3 facilities in the Houston suburbs that are slated to come on line during 2015. These facilities are a key to the hub and spoke strategy whereby these new sites under development will provide key services such as HOPD but also serve as a feeder for the core Houston hospital. University General Health already owns roughly 45% of the combined \$15M real estate value associated with the facilities, at no cash cost to the Company. This major benefit is due to the real estate partner's expectation that future cash flows and that the anticipated valuation of the properties will be substantial once operations are in full swing. At this time, management plans to make a \$16M investment in the operations of the combined facilities', which houses 112 beds in order to reach full occupancy and financial optimum financial performance.

With an estimated \$170 million in annual revenue and \$40 million in adjusted EBITDA from these facilities alone once they reach maturity, investors should be handsomely rewarded in the next 2-3 years. It should be noted that our forecasts do not include any contribution from these facilities. Moreover, this successful and logical strategy can be replicated throughout the region, thus making University General Health a top tier, high growth health care services provider.

As of early 2014, management expects the 3 expansion facilities to come on line as per the following timeline:

- The 48-bed *UGH Baytown* should open in 1Q2015. The Company owns 50% of the real estate associated with the facility and University General Health's plans to invest \$5M in operations
- *UGH Alvin*, which has 10-14 beds as part of the ER hospital, is slated to open in 2Q2015. The Company owns 70% of the real estate and plans a \$3.5M operations investment.
- With 50 beds, *UGH Pearland* is expected to open in 3Q2015. The Company owns 30% of the real estate and plans to invest \$7.5 million for operations.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)**MARKET/INDUSTRY OVERVIEW**

Healthcare is our country's largest industry, providing almost 14 million jobs over 6,013 hospitals and countless clinics for ambulatory surgery, diagnostic imaging, rehabilitation, skilled nursing facilities, family practice, and a host of medical specialties. *IbisWorld* estimates that hospitals comprise a \$923 billion industry, housing over five million employees and growing at 4% per year. People are living longer and expect the highest quality of care whether it is immediate or preventative. According to the National Center for Health Statistics, demand for physicians, nurses, physical therapists, technicians and administrative staff will grow at a healthy pace as hospitals focus on efficient management and profitability.

The hospital industry has been profitable although in recent years the swelling ranks of the uninsured have drained resources; only 10% of invoices billed to these patients are ultimately recovered. Bad debt expense has been rising through the industry as, by law, all patients presenting to the emergency room must be treated. Baby Boomer drain on Medicare often causes Congress to reduce reimbursements to healthcare providers, yet people 65 and over account for 40-50% of total spending on healthcare. Hospitals with older business models feel the heat of competition when confronted with independent and physician-owned surgical and diagnostic centers.

The implementation of the Patient Protection and Affordable Care Act (ACA) is expected to stimulate demand for healthcare services as more Americans become insured. However, high labor costs within the industry are predicted as hospitals experience a shortage of qualified workers. It is forecast that reimbursement from Medicaid and Medicare becomes tighter under a federal government that seeks to finance healthcare reform; coupled with states that must deal with budget deficits, an overall negative impact to hospital profitability could result.

Traditionally, those seeking careers in healthcare were attracted to its humanitarian and service aspect. The industry, however, is now viewed as a business, run like any major for-profit organization with similar strategic goals. Patients are treated more like customers – consumers of healthcare – who, like in any industry, expect a high level of quality and service for their money. Managed care, through which most Americans receive healthcare, in addition to Medicare and Medicaid, continues to plague providers with restrictive drug formularies, a cap on patient time, and unrelenting reimbursement adjustments.

Runaway costs in the hospital industry are common; rising malpractice insurance premiums and prescription-drug prices, and the uninsured that often use the emergency room doctor as their primary care physician, are factors leading to higher expenses for caregivers. In a type of push/pull contest, if revenues for doctors and hospitals fall, insurers attempt to lower payments for claims and ensure that revenue from premiums rise faster than claims payments.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)**MARKET/INDUSTRY OVERVIEW** (cont.)

The U.S. government limits the amount of hospital reimbursement for Medicare and Medicaid patients with a ceiling on prices charged to treat them. The impact to a hospital's revenue is typically significant since this group comprises 30%-40% of total patients. As this number grows over time, federal resources will be further taxed and possibly trigger more reimbursement cuts, affecting the hospital's ability to raise prices.

With thousands of providers throughout the country, the hospital industry is fragmented with competition limited to a given network's geography. A handful of hospital networks are public: Community Health System (CYH:NYSE) is the largest for-profit operator with 2% of the market, acquired with its 206 hospitals in 29 states and 31,000 beds. A recent merger with Health Management Associates will expand its reach even farther. Otherwise, no one operator has greater than 5% market share, and the four largest companies accounted for less than 10% of industry revenue in 2013.

Greater competition also comes in the form of physical therapy clinics that have proliferated as older individuals remain active and often sustain minor injuries. Physician-run outpatient surgery centers and diagnostic imaging facilities are increasing in number, another aspect of competition to the traditional hospital model. Reuters Health reports that up to 30% of the 57 million surgeries done each year are performed through ambulatory surgical centers. Hospitals lose because the income provided by high-margin operations finance other, unprofitable departments. Winners in the industry will recognize the value of broad networks of healthcare under one hospital hub, and seek to adopt it.

The hospital industry has high barriers to entry due to strict regulatory requirements on federal, state and local levels, and the need for operators to have a strong base of experience to run hospitals and their networks efficiently. Hospitals must stay abreast of technological advances or risk physician flight to more modern tools in better-equipped facilities. Two-thirds of the country's 660,000 physicians are specialists, such as surgeons, anesthesiologists, neurologists, and radiologists, a group highly knowledgeable about current medical trends and demanding of state-of-the-art equipment.

Texas is known as having some of the best medical facilities in the country, such as M.D. Anderson Cancer Center in Houston, ranked first by U.S. News and World Report for cancer care. In the same report, Texas was home to 13 institutions out of a total of 193 top hospitals reviewed, the only state to receive such high recognition.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

THE UNIVERSITY GENERAL HEALTH SYSTEM TEAM

Hassan Chahadeh, M.D., Chief Executive Officer

Dr. Chahadeh received his medical degree at Damascus University in Syria and has studied general surgery and anesthesiology at Baylor College of Medicine, in Houston. Along with general residencies, he has achieved certifications in advanced microsurgery and cardiovascular anesthesia. After completing his residencies, Dr. Chahadeh pursued a fellowship in Pain Management at the University of Texas MD Anderson Cancer Center in Houston. He is Board Certified in anesthesiology with added qualifications in pain management.

Donald W. Sapaugh, President

Mr. Sapaugh has over 30 years of experience in the healthcare industry with an extensive background in mergers and acquisitions as well as business development, within both private and public companies. He was formerly the Founder, President and Chief Executive Officer of TrinityCare Senior Living, established in January 2000. Prior to this, Mr. Sapaugh founded PremierCare in 1996 which, in partnership with over 10 hospitals in six states, helped seniors avoid costly inpatient hospitalization. From 1986 to 1996, he was Chief Executive Officer of Rapha Treatment Centers, one of the largest specialty psychiatric management companies in the U.S., holding contracts with 49 hospitals in 18 states. Before that, he served in various financial positions from 1978 until 1986 and as Chief Financial Officer in five separate general acute care and psychiatric hospitals. Mr. Sapaugh also serves as a consultant and board member to a number of public companies.

Michael L. Griffin, Chief Financial Officer

Mr. Griffin has over 25 years' experience in the healthcare industry in areas such as healthcare finance, capital markets, operations, and development. His experience as an auditor with Peat Marwick and as Chief Financial Officer for various hospital systems has provided him with a unique understanding of the industry. Mr. Griffin formerly served as Chief Financial Officer for Simmons Healthcare, where he supervised the

development of medical facilities over a broad geographic reach that included Australia. Responsibilities in his current position are financial reporting, capital financing, budgeting, patient revenue cycle and billing, facility construction and development, and forecasting for new ancillary services.

Edward T. Laborde, Jr., General Counsel

Mr. Laborde joined the company in January 2011 after 18 years of private practice in Houston. From 2004 to 2011, he was a shareholder in the Corporate Securities and Finance Practice Group of the Houston office of Winstead PC. From 1993 to 2004, Mr. Laborde served as attorney in the Corporate Securities Practice Group of Houston-based Chamberlain Hrdlicka, and made a shareholder of the firm in January 2000. With experience as a corporate, securities and finance attorney, he has overseen healthcare facility and real estate development on a national scale. Within his healthcare practice, Mr. Laborde has also supervised leasing and lease financing, physician syndication and private placements, vendor and payor contracting, bank and lease financings, tax planning, government relations, and administrative proceedings. Mr. Laborde received his law degree from Tulane Law School and his undergraduate degree from Georgetown University.

Harmonee Vice, Chief Operating Officer

Ms. Vice coordinates the overall business operation that includes implementing new service lines, strengthening the internal accountability systems, overseeing effective management and fiscal viability of all facilities' departments so that each meets its strategic goals. She has hands-on experience in recruiting physicians and professional staff with a focus on high quality healthcare and service excellence. Ms. Vice has over 15 years of healthcare experience where she has held a variety of positions within the HCA and HPA healthcare systems, including supervision of human resources, risk management, quality, marketing, physician relations, laboratory, and imaging.

RISK FACTORS

Competition is a key risk for the company; there are 168 hospitals within the radius of University General Hospital, including 15 that are part of Texas Medical Center. HCA Holdings, Inc., concentrated in Texas and Florida, owns from 20% to 40% market share in those regions. Fortunately, University General Health has established a strong presence in the greater Houston market and is competitive for reasons outlined earlier. Demand for healthcare services continues to rise in Texas, yet the State remains below the national average in beds per capita, forcing healthcare providers to offer the best services in order to entice referring physicians and their patients. The Dallas market is under-penetrated with 75 hospitals, making it a good choice for University General Health to penetrate.

University General Health is at present concentrated in Texas. Any adverse economic condition there could affect its entire business. However, plans are being made to expand to other regional markets with a long term plan to branch out into other geographic areas, somewhat mitigating this risk.

Physicians are the lifeblood of University General Health's hospitals. Although they may terminate at will, the company hopes to retain its medical talent with contracts, and by offering the convenience of accessibility to its outpatient clinics where patient flow is more predictable and greater efficiencies can be reached. Likewise, obtaining and keeping managed care plans are essential and so far, University General Health has been successful.

Reimbursement risks from third-party payors will always persist, no matter who the healthcare provider. Hospital networks must endure reimbursement volatility from federal, state and local authorities as well. The majority of regulations under the ACA, signed into law in 2010, won't take effect until 2014 and it has already started affecting out of network providers. However, University General Health has focused on being an in-network healthcare provider, partnering with two more major insurance providers at the beginning of 2014. University General Health now has a large share of in-network insurance providers which will alleviate concerns of declines in reimbursements.

Conforming to requests for licenses and certifications can be daunting, although University General Hospital is accredited by the Joint Commission, an organization that approves healthcare facilities within certain performance measurement requirements. A blessing by the Joint Commission is recognized by most states as a condition of licensure, easing the company's burden of regulatory compliance.

Finally, expansion timing could be delayed due to funding delays associated with one or more of the facilities contemplated for 2015 expansion.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)**FINANCIAL DISCUSSION AND PROJECTIONS**

University General Health is in a high-growth phase of its business cycle, as evidenced by its most recent financial statements. For 3Q2013 (ended September 30), net revenues for patient services increased 35%, to \$43.1 million, reflecting both organic growth and growth through acquisitions of new facilities, including those for outpatients. Overall revenue that counts in Senior Living and Support Services rose 38%, to \$49.6 million. The company's flagship Houston hospital showed an average occupancy rate of 65%, similar to the same period last year and higher than the industry average for hospitals its size as calculated by the American Hospital Association. Further gains in net patient revenues are expected throughout the remaining quarters of 2014.

Revenue mix was favorable in the quarter: managed care providers continued to dominant with over 70%, alleviating headaches associated with collecting from government agencies. Operating income of \$2.8 million had declined year-over-year due to losses at the newly-acquired Dallas facility, and greater spending for marketing and management services as the company continues to expand operations. Consequently, adjusted EBITDA of \$5.5 million was lower than the comparable period last year, although net income attributable to common shareholders of almost \$1 million, or \$0.00 per share, was in line with last year's figure despite a higher share base.

For the nine months ended September 30, 2013, total revenue of \$127.2 million was 51% higher than last year; net patient revenue rose 48%, to \$111 million; and occupancy rate remained a steady 62% in the Houston facility.

To cast our revenue projections, we used as a basis annualized figures for 2013, and applied a trend in top-line growth rates throughout the duration of the model that was designed to be conservative. Operating expenses as a percentage of revenue were held steady, moderating slightly to reflect management's growing skill in finding economic synergies among its acquisitions. We predict that University General Health will generate \$5.5M in adjusted EBITDA in 2013 and over \$14M in adjusted EBITDA in 2014, rising to \$18M+ in 2015. It should be noted that our forecasts do not include any contribution from the new facilities slated to open next year. Clearly, these facilities alone will be a major contributor once they reach the maturation stage in the 2-3 years following their respective launches. Management projects that these sites could generate \$170M in revenue and \$40M in adjusted EBITDA alone. While its core facility enjoys solid profitability, the Dallas site, which is the current drag on overall operating EBITDA, should turn dramatically in the coming quarters. As a result, investors can enjoy a rise in these shares as the Company's financial performance reaches a key inflection point.

Like similar firms undergoing rapid growth, University General Health's balance sheet reflects debt incurred in order to fuel its business. Of comfort to investors is the fact that the company has proven its ability to raise funds in the marketplace, if necessary. Prudent financial management orchestrated by a highly-experienced team should soon result in greater cash flow and a shift to a more 'top-heavy' balance sheet favoring liquidity.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

University General Health System Actual and Projected Income Statements

	2011	2012	2013E	2014E	2015E	2016E
Revenues						
Patient serv. revs, net of contractual adjust.	\$68,302,619	\$112,184,538	\$184,121,437	\$206,216,009	\$236,323,547	\$269,408,843
Provision for doubtful accounts	<u>(1,332,434)</u>	<u>(10,384,706)</u>	<u>(34,798,952)</u>	<u>(39,181,042)</u>	<u>(35,921,179)</u>	<u>(40,950,144)</u>
Net patient service revenue less provision for doubtful accounts	68,302,619	101,799,832	149,322,485	167,034,968	200,402,368	228,458,699
Senior living revenues	3,564,514	7,712,750	7,916,413	8,122,240	8,528,352	8,954,769
Support services revenues	465,639	2,501,449	6,681,766	7,349,943	8,452,434	9,720,299
Other revenues	<u>174,211</u>	<u>1,209,227</u>	<u>7,626,316</u>	<u>8,625,000</u>	<u>12,937,500</u>	<u>19,406,250</u>
Total revenues	71,174,549	113,223,258	171,546,980	191,132,150	230,320,653	266,540,018
Operating expenses						
Salaries, wages and benefits	29,157,012	39,627,334	75,480,671	86,009,467	101,341,088	111,946,807
Medical supplies	13,202,829	16,194,606	27,104,423	28,669,822	27,638,478	29,319,402
Management fees (includes related party fees of \$0 and \$461,814, respectively)	5,346,456	—	—	—	—	—
General and administrative expenses	18,078,907	32,766,205	51,464,094	57,339,645	78,285,990	91,316,610
Gain on extinguishment of liabilities	(4,441,449)	(3,644,068)	(86,023)	(1,000,000)	(950,000)	(900,000)
Depreciation and amortization	<u>7,336,710</u>	<u>9,215,713</u>	<u>12,750,498</u>	<u>11,750,000</u>	<u>9,750,000</u>	<u>6,750,000</u>
Total operating expenses	<u>68,680,465</u>	<u>94,159,790</u>	<u>166,713,663</u>	<u>182,768,935</u>	<u>216,065,556</u>	<u>238,432,819</u>
Operating income (loss)	2,494,084	19,063,468	4,833,317	8,363,215	14,255,097	28,107,198
EBITDA	10,330,794	14,546,961	5,505,928	14,213,215	18,255,097	28,107,198
Other income (expense)						
Interest expense, net of interest income	(4,938,603)	(6,111,582)	(7,635,526)	(8,200,000)	(8,000,000)	(8,000,000)
Other income (expense)	500,000	(381,026)	630,942	750,000	750,000	750,000
Direct investor expense	—	(6,853,356)	(9,158,495)	(5,650,000)	(5,500,000)	(6,500,000)
Change in fair market value of derivatives	—	<u>(4,937,170)</u>	<u>(3,550,334)</u>	<u>(1,000,000)</u>	<u>(1,000,000)</u>	<u>(1,000,000)</u>
Income (loss) before income tax	(1,944,519)	(780,334)	(14,880,096)	(5,736,785)	505,097	13,357,198
Income tax	<u>443,862</u>	<u>4,564,195</u>	<u>670,000</u>	<u>500,000</u>	<u>500,000</u>	<u>500,000</u>
Income (loss) before noncontrolling interest	(2,388,381)	(3,783,861)	(15,550,096)	(6,236,785)	5,097	12,857,198
Net inc. (loss) attributable to noncontrol. Int.	<u>(182,814)</u>	<u>363,531</u>	<u>350,000</u>	<u>350,000</u>	<u>350,000</u>	<u>350,000</u>
Net loss (income) attributable to the Company	<u>(\$2,571,195)</u>	<u>(\$3,420,330)</u>	<u>(\$15,200,096)</u>	<u>(\$5,886,785)</u>	<u>\$355,097</u>	<u>\$13,207,198</u>
Less: Cash dividend-Convertible Preferred C Stock	—	(46,921)	(58,198)	(58,000)	(58,000)	(58,000)
Less: Accretion non-cash dividend-Convertible Preferred C Stock	—	<u>(512,190)</u>	<u>(500,000)</u>	<u>(500,000)</u>	<u>(500,000)</u>	<u>(500,000)</u>
Net loss attributable to common shareholders	<u>(\$2,571,195)</u>	<u>(\$3,979,441)</u>	<u>(\$15,758,294)</u>	<u>(\$6,444,785)</u>	<u>(\$202,903)</u>	<u>\$12,649,198</u>
Basic and diluted loss per share data:						
Basic loss per common share	<u>(\$0.01)</u>	<u>(\$0.01)</u>	<u>(\$0.04)</u>	<u>(\$0.02)</u>	<u>\$0.00</u>	<u>\$0.03</u>
Fully-diluted shares outstanding	254,401,405	311,995,342	400,100,000	400,150,000	400,200,000	400,250,000
MARGIN ANALYSIS						
Salaries, wages and benefits	41%	35%	44%	45%	44%	42%
Medical supplies	19%	14%	16%	15%	12%	11%
General and administrative expenses	25%	29%	30%	30%	34%	34%

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

UNIVERSITY GENERAL HEALTH SYSTEM, INC.

Consolidated Balance Sheets

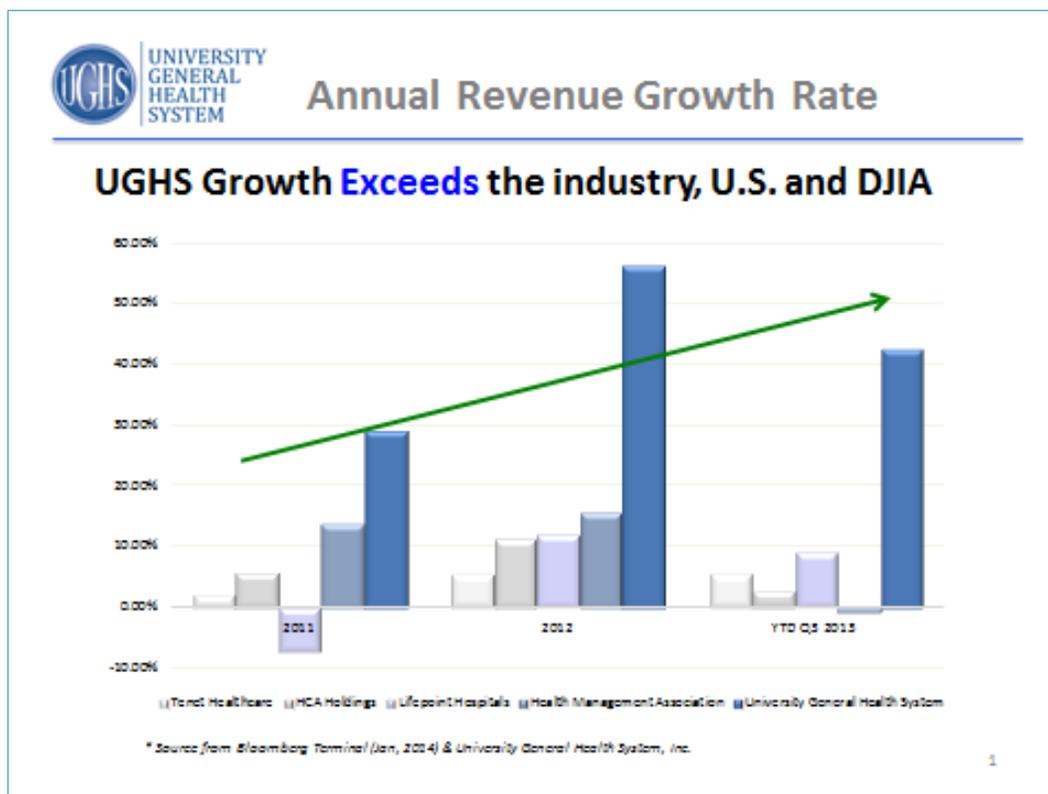
September 30, 2013 and December 31, 2012

	2013	2012
ASSETS		
Current Assets		
Cash and cash equivalents	\$1,471,292	\$1,188,230
Accounts receivable, less allowance for doubtful accounts	28,617,887	20,941,005
Inventories	2,392,581	1,458,089
Prepaid expenses and other assets	4,253,796	3,986,378
Current deferred taxes	2,187,792	1,729,150
Total Current Assets	38,923,348	29,302,852
Long-Term Assets		
Property, equipment and leasehold improvements, net	98,839,623	96,965,889
Intangible assets, net	4,848,153	5,919,000
Deferred tax assets	2,853,551	659,405
Goodwill	41,831,642	39,271,829
Other non-current assets, net	2,159,371	2,721,587
Total Long-Term Assets	150,532,340	145,537,710
Total Assets	\$189,455,688	\$174,840,562
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable	\$18,260,258	\$9,699,411
Payables to related parties	2,154,739	2,133,053
Accrued expenses	13,405,037	11,938,589
Payroll taxes payable	3,185,898	1,610,836
Income tax payable	14,896,483	11,813,198
Deferred revenue	1,385,592	238,846
Notes payable, current portion	21,510,306	26,089,305
Notes payable to related parties, current portion	1,329,375	1,853,380
Capital lease obligations, current portion	835,385	826,800
Derivative liability	564,824	4,897,053
Total Current Liabilities	77,527,897	71,100,471
Long-Term Liabilities		
Lines of credit, less current portion	18,613,293	12,579,933
Notes payable, less current portion	42,198,002	46,947,860
Capital lease obligations, less current portion	31,211,290	30,928,491
Total Long-Term Liabilities	92,022,585	90,456,284
Total Liabilities	169,550,482	161,556,755
Commitments and contingencies		
Series C, convertible preferred stock, \$0.001 par value, 20,000,000 shares authorized, 3,626 and 3,379 shares issued and outstanding, respectively (\$1,000 stated value)	3,079,292	2,566,308
Shareholders' Equity and (Deficit)		
Preferred, par value \$0.001, 20,000,000 shares authorized,		3
Preferred stock Series B—3,000 shares issued and outstanding	3	
Common stock, par value \$0.001, 480,000,000 shares authorized, 376,803,299 and 343,459,294 shares issued and outstanding, respectively	376,803	343,459
Additional paid-in-capital	86,525,014	65,419,774
Shareholders' receivables	(2,518,569)	(2,828,251)
Accumulated deficit	(72,321,878)	(57,186,915)
Total shareholders' equity (deficit)	12,061,373	5,748,070
Noncontrolling interest	4,764,541	4,969,429
Total equity (deficit)	16,825,914	10,717,499
Total Liabilities and Shareholders' Equity (Deficit)	\$189,455,688	\$174,840,562

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

VALUATION

To assign a target price for University General Health, we used a discounted cash flow model as the company is not projected to be net earnings positive until 2016. We chose a forward P/E multiple of 18x, reflecting the median P/E of its peer group comprised of Community Health Systems, Inc. (NYSE – CYH); HCA Holdings, Inc. (NYSE – HCA); Lifepoint Hospitals Inc. (NASDAQ – LPNT); Tenet Healthcare Corp. (NYSE – THC); and Universal Health Services Inc. (NYSE – UHS). Recent years' top-line performance and our estimates yield a compounded annual revenue growth rate from 2011 to 2016 of 30%, much higher than comparable companies whose five-year growth rates range from 9% to 17%, with an average of 11%. Keeping conservative, we did not inflate the forward P/E ratio for the purpose of calculating a target price. We chose a relatively high discount rate of 15% to reflect the stock's liquidity risk, company size risk, and its shorter duration of time operating within its industry, as compared to its peers. Based on our 2016 EPS estimate of \$0.03, we arrived at a price of \$0.55 per share. Discounted to the present, our near-term target price for University General is \$0.42 per share, which excludes the contribution from the launch of the 3 new facilities. When this is included, the target price likely rises by at least 25%.



As these other facilities contribute to overall profitability beginning next year, we will likely incorporate the use of alternative valuation metrics such as price/adjusted EBITDA or a sum of the parts analysis, given the varied contributions of the facilities in the entire system, value of the investment and the target markets of the Company's service offerings, such as Senior Living. By utilizing such measures, a more accurate valuation for the most profitable facilities and diversified segments can be garnered. In this manner, a preliminary estimated valuation of \$0.70 is not out of the question in the next 2+years.

UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

CONCLUSION

University General Health has made tremendous progress since its inception, and continues to execute its acquisition strategy to create a physician-centric delivery network seamlessly integrated within an eco-system designed to benefit both patients and physicians. Resources are shrewdly deployed toward the latest in technology, facility improvements, and the addition of new and valuable services, all in the name of better patient care. Expansion into the Dallas market gives University General a greater presence in its home state of Texas, and new ventures into other territories in the Southwest, a geographic area that increasingly draws aging retirees that insist on high-quality healthcare services, should ultimately result in rising revenue with a favorable impact on net income. Shares of University General are undervalued, a situation that may soon be rectified as the company delivers on its promises in 2014 and beyond. Thus, we rate UGHS Speculative Buy.

Recent Trading History For UGHS

(Source: Stockta.com)





UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

Senior Analyst: Robert Goldman

Rob Goldman founded Goldman Small Cap Research in 2009 and has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

Analyst Certification

I, Robert Goldman, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

Disclaimer

This *Opportunity Research* report was prepared for informational purposes only.

Goldman Small Cap Research, (a division of Two Triangle Consulting Group, LLC) produces research via two formats: *Goldman Select Research* and *Goldman Opportunity Research*. The *Select* format reflects the Firm's internally generated stock ideas along with economic and stock market outlooks. *Opportunity Research* reports, updates and Microcap Hot Topics articles reflect sponsored (paid) research but can also include non-sponsored micro cap research ideas that typically carry greater risks than those stocks covered in the *Select Research* category. It is important to note that while we may track performance separately, we utilize many of the same coverage criteria in determining coverage of all stocks in both research formats. Research reports on profiled stocks in the *Opportunity Research* format typically have a higher risk profile, and may offer greater upside. *Goldman Small Cap Research* was compensated by a third party in the amount of \$8000 for a research subscription service. All information contained in this report was provided by the Company via filings, press releases or its website, or through our own due diligence. Our analysts are responsible only to the public, and are paid in advance to eliminate pecuniary interests, retain editorial control, and ensure independence. Analysts are compensated on a per report basis and not on the basis of his/her recommendations.

Goldman Small Cap Research is not affiliated in any way with Goldman Sachs & Co.

The information used and statements of fact made have been obtained from sources considered reliable but we neither guarantee nor represent the completeness or accuracy. *Goldman Small Cap Research* did not make an independent investigation or inquiry as to the accuracy of any information provided by the Company, or other firms. *Goldman Small Cap Research* relied solely upon information provided by the Company through its filings, press releases, presentations, and through its own internal due diligence for accuracy and completeness. Such information and the opinions expressed are subject to change without notice. A *Goldman Small Cap Research* report or note is not intended as an offering, recommendation, or a solicitation of an offer to buy or sell the securities mentioned or discussed.

This report does not take into account the investment objectives, financial situation, or particular needs of any particular person. This report does not provide all information material to an investor's decision about whether or not to make any investment. Any discussion of risks in this presentation is not a disclosure of all risks or a



UNIVERSITY GEN'L HEALTH SYSTEM (NASDAQ - UGHS)

complete discussion of the risks mentioned. Neither *Goldman Small Cap Research*, nor its parent, is registered as a securities broker-dealer or an investment adviser with FINRA, the U.S. Securities and Exchange Commission or with any state securities regulatory authority.

ALL INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT WARRANTIES, EXPRESSED OR IMPLIED, OR REPRESENTATIONS OF ANY KIND. TO THE FULLEST EXTENT PERMISSIBLE UNDER APPLICABLE LAW, *TWO TRIANGLE CONSULTING GROUP, LLC* WILL NOT BE LIABLE FOR THE QUALITY, ACCURACY, COMPLETENESS, RELIABILITY OR TIMELINESS OF THIS INFORMATION, OR FOR ANY DIRECT, INDIRECT, CONSEQUENTIAL, INCIDENTAL, SPECIAL OR PUNITIVE DAMAGES THAT MAY ARISE OUT OF THE USE OF THIS INFORMATION BY YOU OR ANYONE ELSE (INCLUDING, BUT NOT LIMITED TO, LOST PROFITS, LOSS OF OPPORTUNITIES, TRADING LOSSES, AND DAMAGES THAT MAY RESULT FROM ANY INACCURACY OR INCOMPLETENESS OF THIS INFORMATION). TO THE FULLEST EXTENT PERMITTED BY LAW, *TWO TRIANGLE CONSULTING GROUP, LLC* WILL NOT BE LIABLE TO YOU OR ANYONE ELSE UNDER ANY TORT, CONTRACT, NEGLIGENCE, STRICT LIABILITY, PRODUCTS LIABILITY, OR OTHER THEORY WITH RESPECT TO THIS PRESENTATION OF INFORMATION.

For more information, visit our Disclaimer: www.goldmanresearch.com