

Mednax, Inc. (NYSE/MD)

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BUY Q3/2011 results strong; Maintain Buy rating and price target

Mednax manages physician practices in neonatology and anesthesiology

Investment Highlights

1) Mednax reported **strong earnings results for their Q3/2011 this morning**, earning \$1.19 per share (non-GAAP) versus \$1.06 in the prior year period on revenues of \$407.7 million, up 16.1% year-over-year. Our estimates for the quarter had been revenues of \$398.5 million (an increase of 13.5% year-over-year) and earnings per share of \$1.17, representing a solid upside surprise in the quarterly results for Mednax. Revenue growth for the quarter was divided between acquisition-related growth of 11.1% and same-unit revenue growth of 5%. Same-unit growth, which was very strong for the quarter, was split between increases in volume (1.9%) and reimbursement-related factors (3.1%). Operating expense metrics were very similar year-to-year, with operating margins improving slightly to 23.3% as compared to 23.2% in the prior year period. Cash flow was strong for Mednax during the quarter, at \$100.1 million, and is now up to \$180.9 million through the first nine months of the year, helping the Company finance \$83.6 million in acquisitions and related contingent payments (six physician practices), as well as repay approximately \$96.5 million on its line of credit.

2) Company management also provided **financial guidance for the upcoming fourth quarter**, including earnings in the range of \$1.15-\$1.20 per share, assuming same-unit revenue growth of 2%-4% year-over-year. This is the same guidance provided in August for the upcoming third quarter, and Mednax's results came in on the high side of that guidance. Considering this recent guidance as well as better-than-expected results for the third quarter, we are lowering our EPS estimates for Mednax for Q4/2011 slightly from \$1.22 per share to \$1.20 per share, allowing our original \$4.48 per share estimate for 2011 to stay the same. On the revenue side, we are keeping our estimate of \$409 million for Mednax for Q4/2011, equating to an 11% year-over-year increase, accounted for by an 8% increase in acquisition-related growth and a 3% increase in same-store revenue.

Current Price \$66.73

Target Price \$80.00

Estimates	F2009A	F2010A	F2011E
Sales(\$mil)	\$1,288.3	\$1,401.6	\$1,592.4
1Q	303.9	332.9	382.3 A
2Q	319.8	349.1	393.4 A
3Q	331.3	351.1	407.7 A
4Q	333.3	368.5	409.0 E
Prev. Rev. Estimate (\$ mil.)			\$1,583.2
EPS	\$3.78	\$4.04	\$4.48
1Q	\$0.74	\$0.82	\$0.94 A
2Q	\$0.93	\$1.04	\$1.15 A
3Q	\$1.03	\$1.06	\$1.19 A
4Q	\$1.07	\$1.12	\$1.20 E
Previous EPS Estimate			\$4.48
P/E (x)	17.7	16.5	14.9
EBITDA/Share	\$6.61	\$7.07	\$7.92
EV/EBITDA (x)	10.2	9.5	8.5
Stock Data			
52-Week Range		\$57.83-\$75.47	
Shares Outstanding (mil.)	48.9		
Market Capitalization (mil.)	\$3,265.4		
Enterprise Value (mil.)	\$3,296.7		
Debt to Capital (6/11)	4.0%		
Book Value/Share (6/11)	\$32.50		
Price/Book	2.1 x		
Average Trading Volume (3-Month)	360,000		
Insider Ownership	4.1%		
Institutional Ownership	93.3%		
Short interest (Million shares)	2.4		
Dividend / Yield	\$0.00/0.0%		



Price target and ratings changes over the past 3 years:
 Initiated - January 2, 2010 – Target \$80

We are also assuming net operating margins of 23.6% for Mednax for Q4/2011, slightly above the 23.3% achieved both in the prior quarter and prior year quarter, due primarily to economies of scale. We are not assuming any share buybacks or a significant pickup in acquisition activity over the last two months of the year; also recent purchases in early October (6 physician group in St. Louis) and early November (5 physician group in San Antonio) will boost results in Q4/2011 to some extent. For the year as a whole, our forecasts average out to revenue growth of 13.6% and earnings per share of \$4.48, or 11% year-over-year.

3) Mednax has maintained its recent pace of acquisitions, adding two new physician practices in recent weeks (one in pediatric surgery, a new subspecialty for Mednax, and one in maternal-fetal medicine), for a total of eight practices added so far this year. The Company to date is right on track with its typical pace for the first nine months of the year (9 acquisitions at this point in 2009 and 10 in 2010), although historically this pace has accelerated in the last few months of the year and may do so again in 2011. In today's conference call, Mednax management did not rule out completing one or even two large anesthesiology group practice acquisitions by the end of this year, and the Company has plenty of operating cash flow and availability on its recently increased and extended line of credit in order to do so.

4) For 2012, we are forecasting that Mednax will earn \$5.00 per share on revenues of \$1.73 billion, representing increases of 11.6% and 8.5% respectively, based on moderately improving margins, acquisition growth of 6% and same unit revenue increases of 2%-3%. Our estimate for 2012 remains the same as before. Mednax management has not yet provided fiscal guidance for 2012, but most likely will do so early next year. Our estimates for 2012 assume no share buybacks, similar operating margins as in 2011, and an acquisition pace similar to 2011's, or between 10-15 physician practice purchases including one large anesthesia group. Mednax has fared well so far relating to government reimbursement rates proposed for next year, in particular for Texas, Mednax's largest area, which bodes well for operating margins for 2012 and beyond.

Conclusion

We are maintaining our Buy rating on Mednax and 12-18 month price target of \$80, 18X estimated 2011 earnings of \$4.45 per share and 16X estimated earnings of \$5.00 per share for 2012. We believe Mednax represents a fast-growing yet value-based investment in the health care services area with an exemplary earnings track record, strong operating cash flow, leading market share position, and plenty of room for both internal efficiencies and acquisition-related growth.

Stock Valuation/Comparables

We have compiled a four-member group of comparable stocks to Mednax, although the Company remains a unique survivor in the physician practice management area. Our comparable companies include surgical service provider Amsurg (Nasdaq/AMSG/Not Rated), a dialysis center operator DaVita (NYSE/DVA/NR), and two therapy services providers, Rehab Care (purchased earlier this year by Kindred Healthcare (NYSE/KND/NR) for \$900 million) and US Physical Therapy (Nasdaq/USPH/NR). Mednax' shares currently trade in the mid-point of our industry group in terms of price/earnings valuation multiple (based on 2011E), although this year's strong buyout-related bounce back for Rehab Care shares has raised the average for our group since the start of the year. Still, we believe that Mednax's valuation ratios and share price can return to levels of just a few years ago in the time of a higher stock market and fewer concerns regarding the near-term direction of the US health care system, more similar to the valuation metrics historically enjoyed by dialysis leader DaVita. Thus we are recommending that investors BUY shares of MD, with a 12-18 month price target of \$80, 18X estimated earnings of \$4.48 per share estimated for 2011, or approximately 20% above current levels.

Risk Factors

In addition to normal economic and market risk factors that impact most equities and the common risks shared by Mednax with other companies in the industry, we believe risks to our price target include the following:

- **Reliance on government funding** — Mednax derives a majority of its revenues from Federal (CMS) reimbursement, including **Medicaid** for neonatal/pediatric cases and **Medicare** in the anesthesiology area. With the large number of recent anesthesiology acquisitions by the Company, the percentage of revenues from Medicare is expected to increase in the future; likewise a poor economy is expected to drive more maternal care patients into government programs such as Medicaid in the near future.
- **Reliance on acquisitions** – In recent years, Mednax has depended on acquisitions for revenue and earnings growth. However, should tax laws, new competitors in the physician practice management area, or other factors hamper the Company's ability to find and close accretive acquisitions, this steady, historical source of growth could disappear for Mednax.
- **Legal proceedings** – In the past, Mednax has been the subject of a number of lawsuits related to its business, including with the US Department of Justice over billing practices, the US Attorney's office over the practice of granting stock options, and by other individuals (including medical practitioners) over the normal course of business. Each of these lawsuits required legal defense (and related expenses) by the Company and in some cases resulted in settlement, requiring cash outlays. There can be no assurances that additional litigation against Mednax is not filed in the future.
- **Increased borrowings** – Mednax increased its long-term borrowings in the most recent complete fiscal year ending December 31, 2010 as a result of recent stepped-up acquisition activity. Although Mednax has historically been able to repay its lines of credit and we are forecasting future operating cash flow to be positive, there can be no assurance that the Company will be able to repay its new indebtedness should its business undergo a serious downturn in the future.
- **Reliance on existing management** – Mednax's current operating management has been in place for an extensive number of years, and in the case of CEO Roger Medel even since the founding of the Company. Should any of the Company's top management retire or leave the firm for other reasons in the near future, this could result in a lack of confidence with investors and/or an interruption of the Company's multi-year track record of increasing revenues and earnings.

MEDNAX, Inc.
Consolidated Statement of Earnings
 (in \$000s, except EPS)

Calendar Year	2004	2005	2006	2007	2008	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q11E	2011E	2012E
Revenues	619,629	693,700	818,554	928,498	1,068,277	1,288,264	332,927	349,094	351,058	368,480	1,401,559	382,283	393,402	407,665	409,000	1,592,350	1,728,000
Less Charges	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Revenues	619,629	693,700	818,554	928,498	1,068,277	1,288,264	332,927	349,094	351,058	368,480	1,401,559	382,283	393,402	407,665	409,000	1,592,350	1,728,000
Operating expenses:																	
Salaries and benefits	350,354	393,137	468,498	535,097	643,445	783,493	213,402	208,762	211,884	220,872	854,920	243,894	235,292	246,687	245,400	971,273	1,040,260
Supplies and other	24,254	27,678	33,055	37,360	44,767	52,232	13,095	14,062	13,980	16,374	57,511	15,090	16,253	16,718	17,180	65,241	69,100
General & admin	79,445	115,304	109,057	121,410	124,965	147,162	38,099	39,164	37,499	39,505	154,267	41,798	42,702	43,010	43,350	170,860	186,600
Depreciation & amort	9,353	9,915	9,470	10,347	13,071	16,448	4,780	5,006	6,321	5,843	21,950	5,781	6,032	6,213	6,400	24,426	26,000
Total operating costs	463,406	546,034	620,080	704,214	826,248	999,335	269,376	266,994	269,684	282,594	1,088,648	306,563	300,279	312,628	312,330	1,231,800	1,321,960
Income from operations	156,223	147,666	198,474	224,284	242,029	288,929	63,551	82,100	81,374	85,886	312,911	75,720	93,123	95,037	96,670	360,550	406,040
Investment income	893	1,177	3,836	6,855	2,982	1,682	404	265	438	327	1,434	325	329	337	350	1,341	2,400
Discontinued & other				743													
Interest expense	(1,295)	(2,262)	(1,032)	(749)	(3,593)	(2,911)	(710)	(1,118)	(481)	(884)	(3,193)	(911)	(988)	(1,056)	(1,100)	(4,055)	(4,400)
Income before taxes	155,821	146,581	201,278	230,390	241,418	287,700	63,245	81,247	81,331	85,329	311,152	75,134	92,464	94,318	95,920	357,836	404,040
Income tax provision	57,542	57,544	76,813	88,411	94,736	111,896	24,982	31,889	20,061	31,529	108,461	29,678	36,523	36,077	36,930	139,208	157,170
Net income (loss)	98,279	89,037	124,465	141,979	146,682	175,804	38,263	49,358	61,270	53,800	202,691	45,456	55,941	58,241	58,990	218,628	246,870
Basic income per share	\$1.99	\$1.86	\$2.59	\$2.92	\$3.12	\$3.80	\$0.81	\$1.04	\$1.29	\$1.12	\$4.26	\$0.94	\$1.15	\$1.19	\$1.20	\$4.48	\$5.00
Diluted income per share	\$1.99	\$1.86	\$2.52	\$2.86	\$3.12	\$3.78	\$0.81	\$1.04	\$1.29	\$1.12	\$4.26	\$0.94	\$1.15	\$1.19	\$1.20	\$4.48	\$5.00
Diluted income - non-GAAP	\$1.99	\$2.33	\$2.83	\$2.96	\$3.09	\$3.78	\$0.82	\$1.04	\$1.06	\$1.12	\$4.04	\$0.94	\$1.15	\$1.19	\$1.20	\$4.48	\$5.00
Basic shares outstanding	49,494	47,875	47,924	48,782	47,166	46,225	47,267	47,528	47,482	47,998	47,569	48,364	48,730	48,935	49,135	48,791	49,400
Diluted shares outstanding	49,494	47,875	49,387	49,903	47,166	46,476	47,267	47,528	47,482	47,998	47,569	48,364	48,730	48,935	49,135	48,791	49,400
Key ratios:																	
Revenue growth	12.4%	12.0%	18.0%	13.4%	15.1%	20.6%	9.6%	9.2%	6.0%	10.6%	8.8%	14.8%	12.7%	16.1%	11.0%	13.6%	8.5%
Salaries/Revenues	56.5%	56.7%	57.2%	57.6%	60.2%	60.8%	64.1%	59.8%	60.4%	59.9%	61.0%	63.8%	59.8%	60.5%	60.0%	61.0%	60.2%
Supplies/Revenues	3.9%	4.0%	4.0%	4.0%	4.2%	4.1%	3.9%	4.0%	4.0%	4.4%	4.1%	3.9%	4.1%	4.1%	4.2%	4.1%	4.0%
G&A/Revenues	12.8%	16.6%	13.3%	13.1%	11.7%	11.4%	11.4%	11.2%	10.7%	10.7%	11.0%	10.9%	10.9%	10.6%	10.6%	10.7%	10.8%
Operating Margin	25.2%	21.3%	24.2%	24.2%	22.7%	22.4%	19.1%	23.5%	23.2%	23.3%	22.3%	19.8%	23.7%	23.3%	23.6%	22.6%	23.5%
Tax Rate	36.9%	39.3%	38.2%	38.4%	39.2%	38.9%	39.5%	39.2%	24.7%	36.9%	34.9%	39.5%	39.5%	38.3%	38.5%	38.9%	38.9%
EBITDA/share	\$3.36	\$3.32	\$4.29	\$4.84	\$5.47	\$6.61	\$1.45	\$1.84	\$1.86	\$1.92	\$7.07	\$1.69	\$2.04	\$2.08	\$2.10	\$7.92	\$8.79
Cash Flow/share	\$2.18	\$2.45	\$3.12	\$3.42	\$3.78	\$4.52	\$1.01	\$1.24	\$1.52	\$1.52	\$5.29	\$1.20	\$1.41	\$1.45	\$1.47	\$5.52	\$5.61

Balance Sheets

(\$000)

Assets:	12/31/10	6/30/11
Cash and equivalents	26,251	23,964
Short-term investments	17,381	10,975
Accounts receivable, net	181,395	194,032
Prepaid expenses	5,162	5,316
Deferred income taxes	60,579	65,988
Other assets	5,241	5,046
Total current	296,009	305,321
Investments	27,393	25,666
Property & equipment, net	42,774	60,106
Goodwill	1,601,319	1,614,815
Other assets, net	70,151	66,819
TOTAL ASSETS	2,037,646	2,072,727
Liabilities:		
Accounts payable/acrued exp	207,937	159,110
Long-term debt, current	125	190
Deferred taxes and other	12,999	15,502
Total liabilities	221,061	174,802
Line of credit	146,500	66,000
Other long-term obligations	99,842	106,937
Deferred taxes	74,066	83,662
Other liabilities	48,723	51,108
Stockholders' equity	1,447,454	1,590,218
TOTAL LIAB & EQ	2,037,646	2,072,727

Quarterly Earnings Comparisons

	March	June	Sept	Decem	Total
Revenues (in \$000s)					
2000	\$59.4	\$61.7	\$64.3	\$64.2	\$249.6
2001	63.9	83.1	102.8	104.8	354.6
2002	107.3	116.2	122.5	119.5	465.5
2003	126.2	133.7	145.5	145.8	551.2
2004	148.1	152.2	158.3	161.0	619.6
2005	164.2	173.8	178.1	177.7	693.7
2006	187.7	203.8	215.8	211.3	818.6
2007	214.5	226.8	236.9	250.4	928.5
2008	245.6	257.7	267.2	297.8	1,068.3
2009	303.9	319.8	331.3	333.3	1,288.3
2010	332.9	349.1	351.1	368.5	1,401.6
2011E	382.3	393.4	407.7	409.0	1,592.4
Earnings per Share (non-GAAP)					
2000	\$0.22	\$0.22	\$0.12	\$0.13	\$0.69
2001	0.11	0.15	0.20	0.20	0.65
2002	0.25	0.31	0.37	0.36	1.29
2003	0.34	0.41	0.49	0.49	1.72
2004	0.42	0.50	0.52	0.55	1.99
2005	0.46	0.57	0.64	0.65	2.33
2006	0.55	0.72	0.80	0.76	2.83
2007	0.58	0.75	0.81	0.82	2.96
2008	0.67	0.80	0.81	0.81	3.09
2009	0.74	0.93	1.03	1.07	3.78
2010	0.82	1.04	1.06	1.12	4.04
2011E	0.94	1.15	1.19	1.20	4.48

Operating Statistics

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E
Number of births	381,600	450,205	501,832	522,612	567,794	629,948	674,336	707,274	730,049	744,202	736,191	750,000
NICU admissions	39,200	48,186	55,121	57,239	63,115	72,876	80,151	85,059	86,865	90,567	93,310	97,500
NICU patient days	636,900	804,293	983,733	1,087,753	1,195,936	1,347,064	1,472,428	1,556,093	1,566,485	1,658,845	1,710,904	1,750,000
Physicians:												
Neonatalogists	400	475	500	550	603	650	680	757	844	890	950	1,050
Anesthesiologists								53	141	165	400	500
Other subspecialists	70	100	120	140	173	200	220	240	289	296	300	250
Total	470	575	620	690	776	850	900	1,050	1,274	1,351	1,650	1,800

Source: Company reports; Dawson James Securities estimates

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:

Price Chart:



Price target and ratings changes over the past 3 years:

Initiated – January 2, 2010 – BUY – Price Target \$80

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Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Buy	27	84%	8	30%
Neutral	4	13%	3	75%
Sell	1	3%	0	0%
Total	32	100%	11	34%

Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISKS” sections of this report.

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