Renal Care Review

Issue 1 Fall 2008

Our Perspective on the Dialysis Sector

With the nation's economy in a recession and financial markets experiencing large losses, there is one bright spot for readers of this newsletter: it is a good time to be in renal care. Despite all of the turmoil taking place in both the economy and financial markets, the value of renal care companies continues to be strong. Why is this? There are a number of reasons.

Renal care is a *sustainable* business model and in today's economic environment sustainable business models, both short term and long term, appear to be few and far between. Renal care's sustainability is driven by an aging population, lower mortality rates, continued high prevalence of End-Stage Renal Disease (ESRD) precursors like hypertension and Type II diabetes, and better treatment and survival rates for ESRD patients.

In a highly regulated healthcare environment, renal care has a *reimbursement* risk that is both manageable and, with the advent of CMS's bundling plan for 2011, predictable. There is still some degree of uncertainty surrounding the fully bundled, case-mix adjusted prospective payment system for dialysis patients that is part of the Medicare Improvements for Patients and Providers Act (MIPPA) enacted in July. However, we view bundling as a net positive because it will provide certainty of inflationary adjustments.

Renal care is a *local* business. Patients who must travel to renal care centers three times a week for dialysis treatments rely on a local provider. This allows small operators to effectively compete with much larger companies, including Fresenius and DaVita, on the basis of highly respected nephrologists and high-quality service.

Renal care is a *profitable* business. The financial metrics of renal care are compelling. From an operating standpoint, dialysis centers that are managed with a high degree of efficiency and productivity procure a correspondingly high level of profitability. Further, capital requirements for renal care centers are relatively modest, as the cost of a dialysis machine is significantly less than the cost of most equipment utilized to treat life threatening diseases.

As a result of these factors, investor interest in renal care remains high, even in today's uncertain economic environment. Dialysis providers are better positioned in a downturn than most segments of the healthcare sector because nearly 90% of patients are already government reimbursed. Dialysis providers also have a minimal uninsured patient population. All of this has created an environment in which both financial investors and larger renal care companies remain actively interested in acquiring and investing in dialysis centers.

For owners of dialysis centers contemplating retirement or a liquidity event, this presents an opportunity to sell their company potentially at premium and tax-advantaged value (*see accompanying articles on the last page: "Ownership Transition" and "Capital Gains Taxes"*). For renal care owners building a business, there is capital available for growth.

Renal care centers, like any operating business, must focus on growth to increase shareholder value. However, unlike many operating companies that are struggling to maintain revenues and profitability in the current economic environment, renal care companies have a strong operating base and can continue to grow. This growth can come from aggressively pursuing a patient population that is aging or particularly prone to ESRD; or it can come from expansion activity, either opening new sites in targeted geographic areas or merging with existing facilities that can be productively and profitably integrated into current operations.

We believe that potential liquidity events and growth initiatives are both strategies that warrant serious consideration in the current environment. If we can provide perspective or assistance as you evaluate either of these strategies, please do not hesitate to call us.

Inside this issue:

Transaction Activity

Strategic acquisitions continue to play an important role for larger dialysis companies in the U.S.

- At Fresenius (DB: FRE3), the largest renal care company in the U.S., dialysis care revenues in the third quarter of 2008 were up 6% versus the third quarter of 2007, with 1% year-over-year growth coming from acquisitions. Fresenius acquired 31 clinics during the first nine months of 2008. In North America, cash outlays for acquisitions during the first nine months of 2008 totaled $86 million, up more than 21% from the same period in 2007. Fresenius expects to spend between $150 million and $250 million on acquisitions in 2008.

- At DaVita (NYSE:DVA), the nation's second largest renal care company, acquisitions are equally important. DaVita acquired 16 dialysis centers during the first nine months of 2008 versus ten centers acquired during the same period in 2007. Cash outlays for acquisitions and purchases of ownership interests was over $100 million during the first nine months of 2008, up 24% from the $82 million outlay during the same period in 2007.

- A third publicly traded renal care company, Dialysis Corporation of America ("DCA", NasdaqGM:DCAI), has also been active on the acquisition front. So far this year, DCA has acquired a dialysis center in Georgia and taken minority ownership positions in two dialysis centers on the eastern seaboard.

It is not just the publicly traded renal care companies that are active acquirers. The renal care sector has drawn a great deal of interest from investors (*see accompanying article on the first page*) who are interested in funding growth-oriented renal care companies. Renal Advantage, Inc. is one such company. Renal Advantage was founded in 2005 when it acquired 73 dialysis centers from DaVita, which was forced to divest the centers to resolve competitive issues following its purchase of Gambro Healthcare, Inc.. The acquisition was financed with an investment from Welsh, Carson, Anderson and Stowe, a private equity firm that had targeted the renal care sector as a growth opportunity. Since then, Renal Advantage has continued to make acquisitions, both large and small. Earlier this year, Renal Advantage acquired a dialysis center in Florida citing what they saw as "favorable market conditions" in that geographic area. Then, just before Thanksgiving, Renal Advantage signed an agreement to acquire National Renal Alliance, a company with 45 dialysis centers and approximately $100 million in revenue.

With acquisition activity taking place at large renal care companies as well as single site facilities, the question is often asked, what are potential acquirers looking for. The answer, as stated by Dialysis Corporation of America in their public filings, is existing profitability, future profitability, and a sound relationship with the physicians affiliated with the selling facility. As for how they value potential acquisitions, DCA says only that their purchase price is "based on established current per-patient valuations for dialysis centers."

Recent Noteworthy Events in Renal Care

Recent News

11/4/08: DaVita received notice of a forthcoming civil inquiry from the Department of Justice and the U.S. Attorney's Office for the Northern District of Georgia relating to the administration of iron and vitamin D pharmaceuticals.

9/30/08: DaVita's increase in revenue per treatment in the third quarter was a function of an increase in non-government payment rates, partially offset by a decline in physician prescribed drugs and a change in the mix of non-government payers. The company's net increase in managed care rates supports a generally favorable outlook for the sector.

9/10/08: Fresenius announced the closing of an exclusive license agreement with Luitpold Pharmaceuticals for the manufacture and distribution of intravenous iron products in the U.S. In the U.S., the license agreement provides Fresenius with exclusive rights to manufacture and distribute Venofer to freestanding (non-hospital based) U.S. dialysis facilities.

Regulatory Environment Update

Recent Regulations

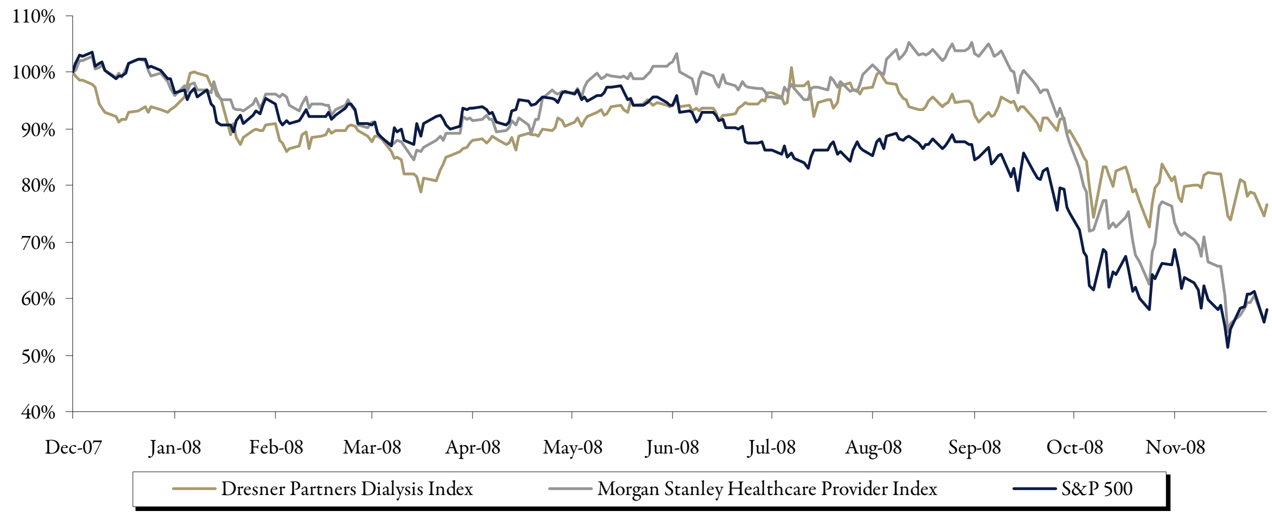
- With the July 2008 enactment of MIPPA, the dialysis payment system will move to a fully bundled, case-mix adjusted, prospective payment system over four years, starting in 2011
- Dresner Partners views bundling as a net positive since it provides certainty of inflationary adjustments
- For 2009, MIPPA provides a 1.0% increase to the composite rate

Pharmaceuticals

- It is unlikely that ESRD EPO policy will be revisited before the end of the year due to the lack of definitive findings by the September 2007 Cardiorenal Advisory Panel
- Future changes in EPO reimbursement and utilization will lead to slightly lower payments to some EPO providers, since lower treatment rates will be the likely outcome
- Generic EPO (currently sold by Hospira in Europe) is expected to be available in the U.S. in 2012

Public Company Activity

Indexed Stock Performance



The positive operating attributes of renal care companies, as described in the accompanying article on the first page, have been reflected in the market performance of publicly traded renal care companies. Since the most recent market downturn began in early June, the S&P 500 has declined slightly more than 35%. During the same period, the Morgan Stanley Healthcare Provider Index (1) declined slightly more than 40%, while the Dresner Partners Dialysis Index (comprised of Fresenius Medical Care, DaVita Inc. and Dialysis Corporation of America) declined just over 16%.

(1) Morgan Stanley Healthcare Provider Index comprised of Omnicare, Quest Diagnostics, DaVita, LabCorp, PMC Capital, Psychiatric Solutions, AmSurg, Universal Health Services, LifePoint Hospitals, Lincare Holdings, Kindred Healthcare, Community Health Systems, MedCath, Tenet Healthcare, Health Management Association and Sunrise Senior Living.

Valuation Metrics

Company Name	Stock Price as of 12/4/08	Market Cap	TEV	LTM Revenue	LTM EBITDA	Enterprise Value to LTM: Revenue	EBITDA	EBIT	Price to: LTM EPS	Debt/Cap.
DaVita Inc.	$45.60	$4,851	$8,282	$5,554	$1,063	1.5x	7.8x	9.7x	13.8x	64.2%
Fresenius Medical Care	$44.00	13,092	18,293	10,460	2,078	1.7x	8.8x	11.0x	18.2x	48.7%
Dialysis Corp. of America	$6.50	58	66	83	8	0.8x	8.0x	11.8x	19.3x	15.6%
					Mean	1.3x	8.2x	10.8x	17.1x	
					Median	1.5x	8.0x	11.0x	18.2x	
S&P 500 Index	$870.70	$8,131,607	$9,931,933	$9,158,664	$1,436,152	1.1x	6.9x	9.4x	16.3x	53.8%

Glossary
TEV: Total Enterprise Value
LTM: Last Twelve Months
EBITDA: Earnings before Interest, Taxes, Depreciation & Amortization
EBIT: Earnings before Interest & Taxes

Renal care is a predictable business with stable revenues and cash flow. Top line growth has been driven by an inelastic demand for dialysis treatment for ESRD, a life-threatening disease and annual patient population growth that has been averaging 3-6%. Cash flows are strong because many dialysis centers have a high local market share which creates pricing power with commercial payers, and because capital expenditures in renal care are relatively low. As a result of these positive operating metrics, renal care companies are trading at strong valuations which currently have a median of 11.0x EBIT as compared to the S&P 500 Index which is trading at 9.4x EBIT.

Public Operating Statistics

	Revenue (1)				Operating Income (2)				EBITDA (2)			
Company Name	2006	2007	YTD 9/30/07	YTD 9/30/08	2006	2007	YTD 9/30/07	YTD 9/30/08	2006	2007	YTD 9/30/07	YTD 9/30/08
DaVita Inc.	$4,881	$5,264	$3,909	$4,199	$737	$852	$646	$645	$911	$1,046	$789	$806
Growth / % Revenue	*64.1%*	*7.9%*	*NA*	*7.4%*	*15.1%*	*16.2%*	*16.5%*	*15.4%*	*18.7%*	*19.9%*	*20.2%*	*19.2%*
Fresenius Medical Care	$8,499	$9,720	$7,151	$7,890	$1,313	$1,580	$1,153	$1,240	$1,621	$1,944	$1,412	$1,547
Growth / % Revenue	*25.5%*	*14.4%*	*NA*	*10.3%*	*15.4%*	*16.3%*	*16.1%*	*15.7%*	*19.1%*	*20.0%*	*19.7%*	*19.6%*
Dialysis Corp. of America	$62	$74	$55	$63	$6	$6	$4	$4	$8	$8	$6	$6
Growth / % Revenue	*38.1%*	*19.7%*	*NA*	*16.0%*	*9.2%*	*7.8%*	*7.7%*	*6.3%*	*12.9%*	*11.3%*	*11.4%*	*9.7%*

Source: Capital IQ as of 12/4/08.
(1) Represents annual Revenue growth.
(2) Represents Operating Income and EBITDA as a % of Revenue.

Year to date operating results for publicly traded renal care companies have been positive. Revenue growth has been sustained despite a broader market downturn, and profitability continues to be strong.

Ownership Transition

Renal care is a young business. The first dialysis machines came to the market in 1948 and were purchased primarily by hospitals. It was not until the 1970's and 1980's that nephrologists began opening privately owned dialysis centers. Today, many of these nephrologists are approaching retirement and are evaluating how best to monetize the value of their ownership position while reducing their operating responsibilities.

This evolution from founder to operator to retiring shareholder is taking place at closely held private companies throughout the U.S., particularly in light of a potential increase in the capital gains tax rate. At many of these companies, the process is complicated by adverse market and operating conditions that make completing any kind of liquidity transaction problematic.

This is not the case with renal care centers. As shown in the accompanying article on the first page, renal care centers have solid operating characteristics and an active group of potential investors and acquirers. As a result, many renal care company owners are finding that now is a particularly opportune time to evaluate ownership transition plans.

Capital Gains Taxes: A Temporary Reprieve and an Opportunity

For owners of renal care centers, the capital gains tax rate is worth watching because it has fluctuated from a high of nearly 40% thirty years ago to an historic low of 15% today, and because it can have a very material effect on the after-tax proceeds from the sale of a business.

During the presidential elections, the Obama campaign spoke very clearly about their intent to raise the capital gains tax rate. However, given current economic conditions, it is looking increasingly unlikely that either President-elect Obama or the Democratic controlled Congress will pursue an increase in the capital gains rate in 2009.

This is a temporary reprieve because the current 15% rate will expire at the end of 2010, at which time the rate will increase to 20%. This is an opportunity because it allows physicians and other renal care center owners who are considering a liquidity event to complete the sale of their company next year at a tax rate that will likely remain at 15%.

The dollar benefit of a liquidity event today at a 15% tax rate vs. a sale in the future at higher tax rates is situation-specific and dependent upon a number of factors. However, most of the analyses we have performed comparing a sale today at 15% vs. a sale three years from now at a rate of 20% indicate that a company would have to maintain existing operating margins and show significant revenue growth over each of the next three years to achieve after-tax parity. We would never suggest that tax considerations should drive business decisions, but for owners contemplating retirement and an exit strategy in the next three years, we believe this is an analysis well worth doing.

Dresner Partners Investment Banking

Headquartered in Chicago, Illinois, Dresner Partners was founded in 1991.

Dresner Partners is a middle market investment bank specializing in merger & acquisition advisory, institutional private placements of debt and equity, valuation and strategic consulting. We are deeply committed to exceeding client expectations and maintaining the highest levels of integrity. Our experienced professionals have the foresight necessary to navigate through highly complicated transactions to maximize value for our clients.

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