

March 4, 2016

Dear clients and colleagues,

Demographics are an important theme in our investment process as we seek companies that will be favourably affected by demographic influences. It is a topic we have often discussed in our past weeklies. By 2050, the Silver Generation (people aged 65 years and older) is expected to outnumber children under 14 for the first time in human history according to Bank of America research. Countries like Japan, Spain, Germany and Italy are expected to have more than 30% of their population over the age of 65 by 2050.

The spending and savings of the global longevity sector is a huge investment theme; the US longevity sector, which covers areas like health care, finance and consumer services, is estimated to be \$7.1T. Our global society has never had to deal with a situation like this before. It will create enormous pressure on governments, health care costs will explode and pension costs will be enormous. This is an unsustainable situation today, and it will only get worse. Careful stock selection within the health care sector will be essential.

One company that should benefit from this demographic trend is U.S. Physical Therapy (USPH). We initiated a position in this company in the third quarter of last year. Some of our readers may recollect it was a volatile period for the health care sector, and this helped us buy in at a lower valuation. It's another example of how we at Global Alpha follow companies for some time and are ready to swing our bat when an opportunity presents itself.

U.S. Physical Therapy (USPH US - \$51.48)

<http://corporate.usph.com/>

Business Description

Headquartered in Houston, Texas, USPH was founded in 1990. It is one of the largest publicly traded, pure-play operators of outpatient physical and occupational therapy providers in the US with just 3% market share. It has 506 clinics in 42 states.

Target Market

The total rehabilitation industry (inpatient and outpatient) has an addressable market of \$26B. According to IBISWorld, 41.3% of the industry is inpatient rehabilitation and the balance is outpatient. USPH caters only to the outpatient side of the market, which is a \$15B opportunity.

According to the U.S. Bureau of Labor Statistics, there are 191,460 physical therapists in the US. Estimated demand for physical therapy is expected to grow 4% as baby boomers undergo operations and suffer injury. Physical therapy is a fragmented industry with about 16,000 clinics. The largest player has only 6% market share.

The major market drivers are obesity, an aging population and increased insurance coverage (<5% of the industry's revenue is from self-pay).

U.S. Physical Therapy Competitive Advantage

- Partnership model is the key — USPH offers a unique partnership model to their therapist clients, who can then focus on patient care and building their business while USPH provides all the administrative and marketing support.

Growth Strategy

- Organic through opening new clinics.
- Profits are maximized by increased patient volume and increased clinical productivity.
- M&A — USPH is a consolidator in a fragmented industry and has successfully completed 21 clinic group acquisitions since 2005. Each group ranged in size from 3 to 52 clinics.

Management

- Insiders own ~\$20M of the company.
- CEO Christopher Reading was a physical therapist himself and has demonstrated a deep understanding of the industry and an ability to connect with their target clients. He and CFO Lawrence McAfee joined the company in 2003 and have done a phenomenal job executing the corporate strategy. The company has tripled both revenue and earnings since they joined.

Risks

- Pricing or reimbursement.
- Weather — bad weather leads to increased cancellations, a trend during the winter months.

Market Data

Market Cap: \$643M, P/E (2017): 23.8x, EV/EBITDA (2017): 12.1x, Dividend Yield: 1.3%.

Have a good weekend.

The Global Alpha Team