AIM Advisers, Inc.
Maximizing Present & Future Value

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Constellation Healthcare Technologies Raises $15 Million in AIM IPO

Overview

Houston, Texas-based Constellation Healthcare Technologies, Inc. raised $15.1 million in its recent IPO on the London Stock Exchange's AIM.

Constellation is a healthcare services organization providing outsourced revenue cycle management (RCM), practice management (PM) and group purchasing service to hospital-based physicians and physician groups across 18 U.S. states. The Company was formed in June 2013 through acquisitions.

The core strategy has been to move back office functions to India. The staff of a typical medical billing company comprises many low skilled workers performing predominately linear tasks, such as explanation of benefits, coding and customer payment processing. In the U.S., such businesses typically employ lowly qualified workers and experience high levels of turnover, resulting in an annual cost of employment of $50,000. In India, the Company is able to employ college graduates who are more motivated and stay in their jobs longer, resulting in an annual cost of employment of $15,000. This differential has allowed the Company to significantly decrease operating expenses and increase EBITDA by 169% during 2013.

RCM services accounted for 63% of the Company's revenue in 2013 at a relatively high margin. These services are provided to hospital-based physicians and physicians who are part of a larger group practice; including, pathologists, anesthesiologists and radiologists. Physicians utilizing the Company's RCM services avoid the infrastructure investment and costs associated with maintaining their own back office operations, thereby reducing administrative costs and increasing the amount and velocity of cash flow.

The Company has developed a proprietary business intelligence platform, Pegasus, which provides the Company and its RCM clients with transparency relating to payment and operational performance. It consists of web-based dashboards, interactive reports and data visualization tools for effective financial and operational decision making. Pegasus captures data from across the revenue cycle continuum and transforms that data into actionable information. The Company has access to a team of 35 technology specialists based in the U.S. and India who developed, maintain and are extending Pegasus, providing the Company with a significant point-of-differentiation versus the wide range of outsourced RCM vendors.

PM services accounted for 34% of the Company's revenue in 2013 at a relatively low margin. These are comprehensive business and practice management services provided to primary care practices. The Company also offers a group purchasing service that helps physicians lower vaccine costs through volume pricing with pharmaceutical suppliers such as Sanofi Pasteur and Merck. This service accounted for 3% of the Company's revenue in 2013 at a relatively high margin given its pass-through nature.

The Company retains all 387 front office jobs in the U.S.; including, management, customer service and client relationship management. Since the Company was formed in June 2013 through acquisitions, 340 back office jobs have been moved to two third-party Indian BPO providers, one of whom is exclusive.

The Company plans to act as a consolidator of the U.S. third-party medical billing market, which consists of over 2,000 companies, many of whom have revenues below $20m and low profitability. Targets will typically have at least 75 employees, the majority of whom are based in the U.S, $5m - $15m of revenue, EBITDA margins of 5% - 25%, positive cash flow, an organizational structure based on skill sets with well-documented jobs and procedures and owners willing to accept a significant proportion of deferred consideration contingent upon achieving performance targets for at least two years post-acquisition.

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Key Financial Metrics

(in USD millions)	Y/E 12/31/11	Y/E 12/31/12	Y/E 12/31/13	Δ '11 - '12	Δ '12 - '13
Revenue	$55.2	$51.7	$52.0	-6%	+1%
Operating Expenses	56.5	54.1	48.9	-4%	-10%
Interest Expense	5.1	7.2	4.2	+41%	-42%
Other Income	-	-	1.6	N/A	N/A
Income Tax Expense	0.3	-	1.3	-100%	N/A
Net Loss	6.7	9.6	0.8	+43%	-92%
EBITDA	4.5	2.6	7.0	-42%	+169%
Total Assets	42.7	40.0	56.7	-6%	+42%
Cash	0.2	0.8	4.0	+300%	+400%

The Company's revenue was entirely generated from the U.S. The largest customer only accounted for 6% of revenue in 2013 and the top ten only accounted for 29%. Since the 2013 financials were more than nine months old, unaudited, comparative, six-month stub period financials were required. The aggressive drive for operational efficiency continued into 2014 with the generation of $7.2 million of EBITDA during the six months ended June 30, 2014, a 320% increase over the same period during 2013.

Key Listing Metrics

- $15.1m gross was raised, $12.9m net of offering costs, intended to be used for:
  - Acquisitions and their integration
  - Organic growth
    - Investment in sales and client relationship management strategies
    - Further development of Pegasus business intelligence / analytical tools platform
  - Working capital

- Offering costs amounted to 14.6% of the gross capital raised
  - The offering was undertaken on a 'best efforts' basis, as opposed to being underwritten
    - Corporate finance fee of £200k ($314k)
    - Broker and sub-placing agent commission of £304k ($477k)
      - £251k ($394k) of which was settled in shares
    - U.S. placement agent fee of $400k

- Opening market capitalization of $117.9m
- Dilution to existing shareholders of 12.8%
- Free float of 13.1%

- Trailing pre-money revenue multiple of 2.0
- Trailing pre-money EBITDA multiple of 14.7
- Trailing pre-money P/E ratio N/A

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Shareholder Base

The Company had 47.3 million shares outstanding prior to the AIM IPO, issued 7.1 million new shares for cash in the IPO, issued 1.0 million shares to an investment entity controlled by the Founder & CEO (see footnote 2 below) and issued 0.2 million shares to the AIM Broker and Sub-Placing Agent, leaving the Company with 55.6 million shares outstanding. The table below details those who held 3% or more of the Company prior to and after the IPO, along with other holdings that are of interest.

Shareholder	Pre-IPO %	Post-IPO %
Founder & CEO	80.00	68.08[1]
Third-Party Investment Entity	20.00	17.02[1]
Global Institution (Various Funds)	-	5.33
Investment Entity Controlled by the Founder & CEO	-	1.70[1,2]
AIM Broker and Sub-Placing Agent	-	0.33[3]
Directors	-	0.08[1]
Other New U.K. and U.S. Investors	-	7.46
Totals	100.00	100.00

As a result of the AIM IPO, and considering the fact that $17 million remains undrawn on the Company's $40 million Credit Facility, the Company now has an adequate amount of capital to execute on its strategic acquisition and integration campaign. The broadening of the shareholder base as a result of the IPO, should allow the Company to access further capital, if required, to support additional acquisitions and their integration over the medium-to-longer-term. In addition, the Company believes that its IPO and public market status on AIM will enhance its commercial profile and standing and generally assist with the growth of the business. Finally, the Company intends to adopt a Share Option plan so as to enhance its ability to attract, recruit and retain management, employees and consultants with equity-based incentives.

Accounting Considerations

Since the Company is incorporated in Delaware, and did not re-domicile into a European Economic Area country, which includes the U.K., they chose to report using U.S. GAAP. Since all of the Company's revenues are earned in U.S. Dollars, the U.S. Dollar is the functional currency and was also chosen as the reporting currency.

The U.K. Member Firm of an international accountancy network acted as Reporting Accountant and the U.S. Member Firms of another international accountancy network audited the 2011 - 2013 financials. Since the 2013 financials were more than nine months old, unaudited, comparative, six-month stub period financials were required.

An unaudited pro forma statement of net assets is never required in connection with an AIM IPO and was not provided in this instance since the effect of the net proceeds from the IPO on the net assets of the Company is obvious.

1 Subject to a 12-month lock-in and customary orderly market provisions for a further 12 months.
2 This shareholding arose from 1) the conversion of $1.2 million owed by the Company to an investment entity controlled by the Founder & CEO who made a prepayment under the Company's $40 million Credit Facility which was triggered by the actual and expected costs of the AIM IPO and 2) a $0.8 million Subscription.
3 Subject to orderly market provisions for 12 months.

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Board of Directors and Corporate Governance

The Board of Directors consists of two Executive Directors (the Founder & CEO and the CFO), an independent Non-Executive Chairman (NEC) and two independent Non-Executive Directors (NEDs); all with solid resumes and a good blend of complementary experiences and skill sets.

Companies listed on AIM are not required to comply with the U.K. Corporate Governance Code published by the Financial Reporting Council, which is mandatory for companies listed on the Main Market of the London Stock Exchange. AIM listed companies typically comply with, and the Company intends, in so far as is practicable given its size, nature and stage-of-development, the main provisions of the Quoted Companies Alliance Guidelines. The Company also intends to comply with the Policy and Voting Guidelines for AIM Companies issued by the National Association of Pension Funds. The overarching principle of corporate governance on AIM is to ensure that companies are managed in an efficient, effective and entrepreneurial manner for the benefit of all shareholders over the long term.

Since the Company's Founder & CEO remains a substantial shareholder, he entered into a Relationship Agreement with the Company. The Relationship Agreement regulates certain aspects of the continuing relationship between the parties so as to enable the Company to conduct its business affairs independently from the Founder & CEO and at arm's-length and on normal commercial terms. In addition, and more specifically, the Relationship Agreement prevents the Founder & CEO from taking any action that would cause non-compliance with the AIM Rules, proposing or procuring the proposal of a shareholder resolution intended to circumvent the pre-emption rights of shareholders (see the Legal Considerations section on the next page) or voting in favor of the cancellation of the Company's shares to admission and trading on AIM. There is also a requirement that independent Directors constitute at least 50% of the Board and any dealings or disputes between the Founder & CEO and the Company be handled on behalf of the Company by a committee comprising only the independent Directors. Finally, the Relationship Agreement includes standard non-compete clauses that extend for one year following termination of the Relationship Agreement. The Relationship Agreement terminates if the Founder & CEO's shareholding drops below 15%, another party holds 30% or more of the Company or the Company's shares are no longer listed on AIM or the Main Market.

The Company has established an Audit Committee and a Compensation Committee with the Board retaining responsibility for nominations to the Board at this early stage of the Company's development. The Audit Committee is chaired by one of the NEDs with the other NED and the NEC serving as the other members and will meet at least two times a year. The CFO will, where appropriate, be invited to attend meetings and the Company's auditors will be regularly invited to attend meetings, including at the planning and reporting stages of the audit. The Compensation Committee is chaired by the NEC with both NEDs serving as the other members and will meet as and when required.

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Legal Considerations

Since the Company is not incorporated in the U.K. or one of its Crown Dependencies, the Channel Islands and the Isle of Man, but rather in Delaware, and its 'place of central management and control' is also outside these jurisdictions, the three most important elements of English corporate law do not automatically apply. As is customary, the Company amended its constitutional documents for these three main differences as outlined below.

1. Pre-emption rights (i.e. anti-dilution) – Shareholders may participate in, or the Company has to obtain approval from at least 75% of them for, the issuance of shares for cash of more than 10% of the then outstanding shares during any 12-month period.[4]

2. Notifiable Interests – Shareholders are required to notify the Company of, and the Company is required to publicly announce, holdings at or above the 3% level and whenever a full percentage point is breached in either direction.

3. Takeovers (i.e. mandatory offer) – If any party, or parties acting in concert, accumulates a holding of 30% or more, they must make a cash offer to the other shareholders at the highest price they paid for the Company's shares during the last 12 months.

The Company relied on the safe harbor afforded by Regulation S of the U.S. Securities Act of 1933 so as to not have to file a registration statement with the U.S. SEC. Shares subject to Reg. S (generally, those issued in the IPO for a period of one year, issued within one year prior to the IPO and/or held by affiliates) are not currently eligible for dematerialization and, as such, are held and traded in certificated form.

Since the Company did not re-domicile into the U.K. or one of its Crown Dependencies, the Channel Islands and the Isle of Man, its shares that are not subject to Reg. S are not eligible for direct trading within CREST; the most common electronic system for the holding and transfer of shares in the U.K., however, a Depository could be appointed and Depository Interests (DIs), which represent an entitlement to shares, could be created, allowing for the immediate trading of these non-Reg. S DIs within CREST.

Article 3(2) of the EU Regulation on Central Securities Depositories, which was published in August 2014, will require that all AIM listed shares be dematerialized and eligible for electronic trading and settlement. The London Stock Exchange is working with the companies who own and manage CREST on the technology solution necessary to accommodate 'restricted securities', implementation of which is scheduled for June 2015. At or around that time, the Company will apply for all of its common shares to be evidenced in CREST, and therefore eligible for electronic trading and settlement, in the form of DIs.

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[4] This is the typical level at which AIM-listed companies seek an annual standing authorization from their shareholders for the issuance of additional shares for cash. This flexibility increases the certainty and speed of small capital raises during the year and reduces transaction costs, since further communications with, and approvals from, shareholders are not required.