Annual Healthcare M&A Report

2023

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VMG Health's

2023 Healthcare M&A Report

Mergers and acquisitions (M&A) activity in 2022 can be described in two phases. The first half of the year was characterized by continued growth from 2021, and the second half of the year was characterized by an economic slowdown. The inflection point occurred on June 16, 2022, when the Federal Reserve began the first of the four 75 basis point interest rate hikes. Nevertheless, the healthcare services' M&A activity stood out for its resilience. Despite a 36.0% year-over-year decrease in volume for M&A transactions, when aggregated for all subindustries the value for healthcare services' M&A increased by approximately 5.0%.

Payer-provider convergence and nontraditional buyers continued to make headlines with Amazon's acquisition of One Medical, CVS's announced acquisition of Signify Health, and Optum's pending acquisition of LHC. Looking ahead to 2023, we expect dealmaking to heat up due to three persistent factors:

First, plentiful levels of corporate cash and private equity (PE) dry powder persist. Corporate growth theses have not changed and small and midsize deals will remain integral to 2023 strategies. Additionally, the average PE fund size has increased approximately 35.0% from 2021. Strategic companies with strong balance sheets and PE firms with undeployed capital will take advantage of liquidity premiums in the M&A market.

Second, higher interest rates may impact deal structures. Small and early-stage companies have looked toward acquisitions requiring less upfront cash. To achieve valuation targets, a higher percentage of consideration is being pushed into earn-out structures, incentive equity, or promissory notes.

Third, divestitures may play a larger role in value creation through 2023. Corporations seeking to achieve growth and shareholder return objectives may look to portfolio optimization as a growth strategy.

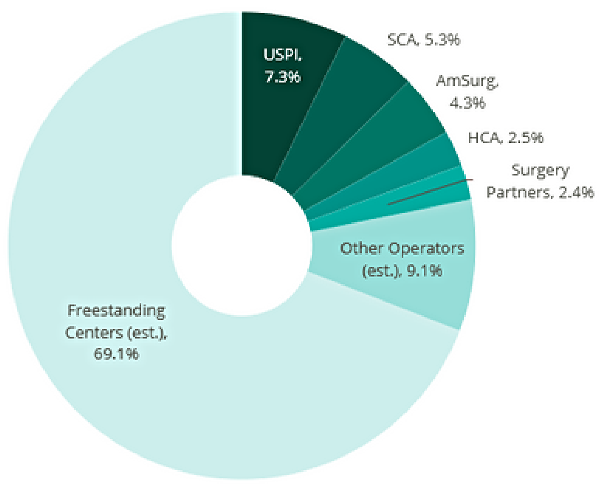
This annual report examines the healthcare M&A landscape in 2022 and the 2023 outlook by leveraging VMG Health's expertise as the leading provider of healthcare transaction and valuation services. We analyze transaction activity, regulatory changes, reimbursement outlook, M&A outlook, and other industry dynamics driving M&A across several prominent healthcare verticals including:

Ambulatory Surgery Centers

Industry Overview

Between 2011 and 2022, the total number of Medicare-certified ambulatory surgery centers (ASCs) in the United States grew at a compound annual growth rate of 1.3%, and increased from 5,217 to 6,028 Medicare-certified ASCs. The ASC industry continues to remain highly fragmented with approximately 70.0% of freestanding ASCs being independently owned and operated. The remaining 30.0% of the ASC industry is owned and operated by large players including AMSURG, which merged with Envision Healthcare; United Surgical Partners International (USPI), parent company Tenet Healthcare (Tenet); SCA Health (SCA, owned by Optum/UnitedHealth Group), HCA Healthcare (HCA); Surgery Partners, Inc. (54.0% owned by Bain Capital); and other multi-site owners/operators.

Market Share by Center Count, 2022



In recent years, certain higher acuity procedures traditionally performed in an inpatient or hospital outpatient department (HOPD) setting have begun to shift to a freestanding ASC setting. This shift established a new standard for the level of acuity an ASC setting could handle safely and efficiently. Director of ASC Operations at Virtua Health Catherine Retzbach said ASCs that perform these high acuity cases “offer patients more options to have procedures be performed in a high-quality, low-cost environment." As an example, ASCs are projected to perform half of all cardiology procedures by the mid to late 2020s.

M&A Trends

The ASC subindustry continues to focus on higher-acuity specialties when considering both organic growth and M&A opportunities. Tenet, parent company of USPI, is the largest outpatient surgery center operator in the United States. Tenet’s President Saum Sutaria noted a continued focus of the ASC business toward higher-acuity service lines in the company’s Q3 2022 earnings call. Tenet reported that due to growth in their orthopedic and spine business these procedures made up 20.0% of USPI’s year-to-date volume. Sutaria further said “the [USPI] team is focused on organic growth, increase in higher-acuity services and M&A.” These insights highlight the ASC subindustry’s focus on higher-acuity service lines, and indicate that the shift towards ASCs performing these types of procedures is likely to continue in the future.

In addition to the major multi-site operators, PE investors have continued investing more intentionally in this space. PE interest in ASCs is often tied to their physician practice portfolio companies, notably gastroenterology (GI) practices and, increasingly, orthopedic and cardiology practices. Driven by favorable tailwinds this type of investment in ASCs allows PE investors to capture additional revenue streams related to their physician practice investments. PE interest in an ASC strategy outside of a physician practice portfolio company has also increased recently.

> "The multiples that we just executed on were sub-8, heavy orthopedic. In the past, we've been around 8 or so in orthopedic space, sub-7 for ophthalmology, GI cases. So, based on the mix of specialties that we might acquire, you could expect us to be somewhere in that range."
>
> **David T. Doherty, Executive Vice President & CFO, Surgery Partners, Inc.**
> Bank of America Healthcare Conference, May 2022

In February 2022, an impact investing strategy managed by TPG, called The Rise Fund, announced the acquisition of Blue Cloud Pediatric Surgery Centers, the largest operator of pediatric dental ASCs in the United States. TPG Rise is a large impact investing platform with more than $13.0 billion in assets across its various funds including The Rise Fund, TPG Rise Climate, and the Evercare Health Fund.

In 2022, VMG Health observed further tightening in the valuation multiple ranges for ASC transactions. While the median total invested capital (TIC) to earnings before interest, taxes, depreciation, and amortization (EBITDA) multiples remained flat, the 25th percentile increased and the 75th percentile decreased from 2020 to 2021. The wider range in 2020 is likely attributable to the uncertainty in the industry due to the COVID-19 pandemic. Relative to before COVID-19, we observed an increase in multiples toward the 8.0x range which is consistent with Doherty's comments during Surgery Partners' May 2022 presentation.

TIC/EBITDA	2017	2018	2019	2020	2021	2022
25th Percentile	6.0x	6.6x	6.5x	6.9x	7.5x	7.4x
Median	6.8x	7.4x	7.7x	7.8x	7.8x	7.8x
75th Percentile	7.4x	7.9x	8.4x	9.7x	8.4x	8.0x
Number of Observations	24	30	30	21	25	19

Source: VMG Health Internal Database
Note: The chart above represents VMG Health observed ASC multiples for single-site control-level transactions.
Disclaimer: The median multiples and multiple ranges can be used to observe a market trend (increase, decrease, tightening, etc.) and should not be used in isolation to develop a valuation for an individual center, which may bear unique characteristics and circumstances. It should also be noted that the valuation multiples above represent those for individual ASCs and not ASC platform companies.

PE deal activity in the ASC space has remained consistent over the last six years. Based on data from PitchBook's Q3 2022 Healthcare Services Report sponsored by UnitedHealthcare, the ASC industry saw five trackable PE deals through September 30, 2022. These deals were a mix of platform, add-on, and growth investments.

Notable Transactions

Between 2015 and 2018, the ASC industry went through a period of consolidation culminating in several mega-mergers. As a result, these mega-mergers reshaped the industry.

In 2015, Tenet and USPI merged; while in 2016, Envision Healthcare and AMSURG merged. In 2017, SCA was acquired by Optum (a subsidiary of UnitedHealth Group), National Surgical Healthcare was acquired by Surgery Partners, and

Bain Capital acquired a controlling equity interest in Surgery Partners. In addition, private equity firm KKR & Co. (KKR) made two large acquisitions of ASC operators during this period by acquiring Nashville-based Covenant Physician Partners, an operator of ASCs and physician practices across 17 states. In October 2018, KKR finalized its acquisition of Envision and its subsidiary AMSURG. The history of mega-transactions has left only one publicly traded pure-play ASC company remaining, Surgery Partners. The company is publicly traded but controlled by Bain Capital.

On June 21, 2022, USPI and United Urology Group formed a joint venture partnership involving 22 ASCs. USPI acquired a portion of United Urology Group's ownership interests in ASCs located in Maryland, Colorado, and Arizona. The ASCs will be owned and operated by the joint venture, and USPI will provide management and support services to the ASCs. The transaction closed in the third quarter of 2022.

On December 9, 2022, Michigan-based Sparrow Health System and Michigan Medicine, formerly the University of Michigan Health System, announced an $800.0 million partnership. Michigan Medicine will invest $800.0 million in the expansion of Sparrow's ASC and neonatal care unit.

In April 2022, UnitedHealth Group's Optum announced the purchase of Kelsey-Seybold Clinic, a Houston-based physician group, for $2.0 billion. The acquisition expanded Optum's presence in the primary care market. As part of this acquisition, Optum gained two ASCs that were owned by Kelsey-Seybold.

Finally, on May 3, 2022, Surgery Partners and ValueHealth announced a partnership that aims to construct new ASCs and implement ValueHealth's value-based surgical programs at Surgery Partners' existing and upcoming locations. Additionally, Surgery Partners will manage and take over ValueHealth's stake in three ASCs, as well as four more ASCs that are in the development phase.

Reimbursement

On November 1, 2021, Centers for Medicare & Medicaid Services (CMS) released the 2022 Hospital Outpatient Prospective Payment System (OPPS) and the ASC payment system policy changes and payment rates final rule. Based on the final ruling, CMS increased the ASC conversion factor by 2.0% in the calendar year (CY) 2022. This was a decrease from the CY 2021 final rule which increased ASC payment rates by 2.4%.

Moreover, the ASC payment final rule for CY 2023 was released by CMS on November 1, 2022, and it resulted in overall expected growth in payments equal to 3.8% in CY 2023. This increase is determined based on a projected inflation rate of 4.1% less the reduction of 0.3% mandated by the ACA. The 3.8% growth in payments represents the largest increase in projected payments year over year and is a direct result of the increase in labor, supplies, and other cost pressures seen over the last year. Although the ASC industry recognizes the increase in payments as a win, many major players believe the increase was insufficient given the extraordinary cost pressures hospitals and ASCs are facing.

Regulatory

In 2018, CMS removed total joint replacements from the inpatient-only list (IPOL). Additionally, private insurance companies have become more willing to cover total joint procedures in an outpatient setting. In 2019, a revision by CMS added 12 cardiac catheterization procedures to the list of procedures approved by Medicare to be performed in an ASC setting.

In 2020, total knee arthroplasty was made eligible for Medicare payment in the ASC setting by CMS. Knee mosaicplasty, six coronary intervention procedures, and 12 procedures with new CPT codes were also made eligible for Medicare payment. With the 2021 final rule, CMS announced its plan to phase out the IPOL over a three-year period. Notably, in the CY 2022 final rule CMS stated it would reverse course on this policy change that added a significant number of codes to the ASC-approved list and began the process of eliminating the IPOL. As a result, many of the procedures that were removed in 2021 were added back to the IPOL. This change could potentially reduce the speed that cases have been shifting from a hospital outpatient setting to an ASC.

CMS considered 64 recommendations for new procedures to be added to the ASC covered procedures list (CPL) for CY 2023. After reviewing the clinical characteristics of these procedures, four were chosen to be added to the CPL for the upcoming year. These procedures are typically performed in outpatient settings and have few to no inpatient admissions. The addition of only four codes resulted in a pushback and a continued desire for more procedures to be added to the CPL that are being performed safely and successfully by ASCs.

Additionally with the CY 2023 final rule, CMS has implemented a new policy that will provide complexity adjustments for certain ASC procedures in CY 2023. These adjustments will be applied to combinations of primary procedures and add-on codes deemed eligible under the hospital OPPS. In the past, add-on codes did not receive additional reimbursement when bundled with primary codes. However, with this new policy, Medicare will provide adjustments to the payment rate for certain primary procedures to account for the additional cost of performing specific add-on services.

Conclusion

The ASC marketplace continues to be an active transaction arena as major operators consolidate and look for new opportunities in this space. In addition to the legacy operators, we are beginning to see other types of investors show interest in the marketplace. ASCs are expected to remain attractive targets over the long-term investment horizon due to their ability to generate consistent, distributable cash flows and to contribute to lower cost of care in the United States. Growth opportunities provided by the outpatient care setting will likely continue to attract additional suitors and further drive the growth and consolidation of the subindustry. Overall, ASC transactions of all types are expected to continue the positive momentum that persisted in 2022 and the subindustry is expected to see the level of transactions increase through 2023.

More ASC Thought Leadership

- ASCs in 2022: A Year in Review
- CY 2023 Medicare OPPS and ASC Payment System Final Rule
- ASC Reimbursement Considerations for a Transaction

Diagnostic Imaging Centers

Industry Overview

In the United States, the market for diagnostic imaging services is estimated to generate over $115.0 billion in net revenues annually, with over 700 million diagnostic imaging procedures performed annually. The industry is highly fragmented as most industry players are “mom-and-pop” radiologists who own a single facility, or small groups of radiologists who own multiple facilities. Approximately 40.0% to 50.0% of imaging procedure volumes occur in non-hospital-based settings (i.e., freestanding centers and physician offices), while 50.0% to 60.0% of imaging procedures occur within hospitals. RadNet, Inc. (RadNet) remains the largest single operator, and is responsible (directly or indirectly through joint ventures) for 357 centers as of December 31, 2022. This is a modest sum when compared to the estimated 6,000 locations believed to exist across the United States.

Radiology services are critical for efficient, quality healthcare and directly impact areas such as patient safety, patient experience, length of hospital stay, and downstream healthcare resource utilization. Overall, the industry is expected to continue to grow at a low, single-digit pace which is consistent with historical growth. The increasing aging population is leading the positive trend, and Medicare lives are utilizing imaging services three times more frequently than commercial lives. In addition, (i) technological improvements to the quality and resolution of imaging equipment, (ii) advances in contrast materials, radioactive pharmaceuticals, and post-processing software, (iii) more education within the referring physician community, (iv) and greater consumer awareness of and demand for preventative diagnostic screenings are frequently cited as factors supporting industry growth estimates.

M&A Trends

M&A activity within the diagnostic imaging industry was relatively modest until the passage of the Deficit Reduction Act of 2005 (DRA). The passage of this legislation launched a decades-long downward pressure to reimbursement within the industry and is often cited as a turning point for consolidation. Prior to the DRA, mergers of radiology groups, imaging centers, and imaging center operators were primarily a response to new technologies or specific market conditions.

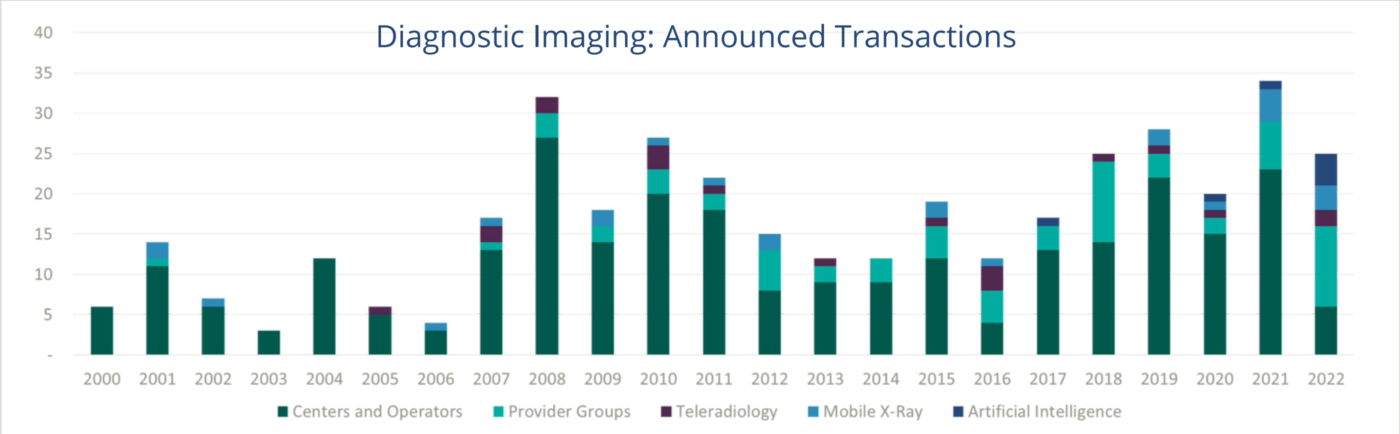
However, as the implications of the DRA and further reimbursement cuts were implemented by CMS in the years following, local centers and providers turned to regional and national owners and operators. The acquisitions of freestanding imaging centers and the growth of large radiology provider groups increased substantially and continues through the present day. Driving the consolidation are increased profitability, access to capital, additional market share, and access to new technology as benefits of consolidation.

In recent years, hospitals and health systems have started to reevaluate their strategy when it comes to diagnostic imaging services. An increasing number of investments and joint ventures (JVs) with both radiology groups and independent imaging facilities are being reported as hospitals and health systems capitalize on the positive margin contribution of diagnostic imaging and the extent to which it draws both patients and specialists to the institution.

> "Another one of our significant initiatives is expansion through hospital and health system joint ventures. In the past, we have stated that we see a path forward towards holding as much as 50.0% of our imaging centers in these partnerships."
>
> **Howard G. Berger M.D., Chief Executive Officer and Chairman of the Board, RadNet, Inc.**
> Q3 2022 Earnings Call

Though M&A activity within the industry has fluctuated with some unpredictability in recent years, consolidation remains elevated and will likely continue given the highly fragmented nature of the industry. According to a 2020 survey performed by the American College of Radiology, approximately half (49.0%) of its members reported to have experienced some form of consolidation, and 40.0% of its members expect to be significantly impacted by consolidation in the future. On the operational side, the growth in the number of centers owned and/or managed by RadNet within the last five years has been primarily driven by targeted acquisitions as opposed to internal development.

M&A activity in 2022 softened compared to 2021, but the decline is likely a function of the broader interest rate volatility, recessionary fears, and labor shortages felt throughout the broader healthcare sector in the United States and abroad. Most transactions announced in 2022 involved radiology physician groups. However, investments in mobile x-ray providers and artificial intelligence software seem to have kept pace with historical trends contrary to the traditional industry participants.



PE activity within the diagnostic imaging subindustry remains modest when compared to other specialties such as emergency medicine and anesthesia. The highly fragmented nature of the industry and skepticism towards "corporatization" among radiologists has made it difficult for PE to gain significant traction. Still, a number of private equity investments made headlines during 2022.

Notable Transactions

On October 1, 2022, RadNet acquired Montclair Radiological Associates (Montclair) through its subsidiary New Jersey Imaging Network (NJIN) for approximately $112.6 million. Montclair consists of six multi-modality radiology centers located throughout the state of New Jersey and is projected to add over $40.0 million of annual revenue to NJIN, implying a 2.8x revenue multiple. In discussing the reason for the transaction, Montclair's president said, "NJIN and RadNet will provide the management and imaging expertise needed to grow our practice and to allow our physicians to focus on patient care." Interestingly, this acquisition received relatively brief attention in RadNet's reports and other filings published throughout 2022. The company's reporting was dominated by the acquisitions of Aidence Holding B.V. (AHBV) and Quantib B.V. (QBV), both healthcare technology companies focused on the development of artificial intelligence software to aid in the interpretation of radiology scans. AHBV and QBV were effectively acquired on January 20, 2022, via separate transactions for aggregate consideration of $50.0 million and $42.3 million, respectively.

Another notable merger involved the consolidation of X-Ray Consultants, Naugatuck Valley Radiology, and Huron Valley Radiology, three private radiology practices spread across the states of Indiana, Connecticut, and Michigan. Together, the groups will form Advanced Imaging Alliance (AIA). When speaking of the merger, President and CEO of AIA said it "reflects an enhanced alignment with Trinity Health and will deepen and augment the subspecialized radiological patient care provided by each division." The merger is another example highlighting the continued interest health systems have in expanding their diagnostic imaging capabilities.

US Radiology Specialists, a PE-backed owner and operator of diagnostic imaging centers based in Raleigh, North Carolina, announced its largest practice acquisition in its four-year history. With $450.0 million in debt and $188.0 million of rollover equity, US Radiology Specialists acquired South Jersey Radiology Associates and Larchmont Imaging Associates. The two radiology practices are based in New Jersey and altogether comprise 65 physicians and 17 centers. The acquisitions were estimated to contribute $48.0 million incremental EBITDA and implied a nearly 13.0x forward EBITDA multiple.

Reimbursement

Diagnostic imaging accounts for an average of 8.0% of total Medicare Part B expenditures and 1.4% of total Medicare costs. However, a series of legislative actions within the last several decades have resulted in significant reimbursement cuts for imaging services: (i) In 1997, the Hospital OPPS transitioned outpatient services from a cost-based reimbursement model to a prospective payment model, and multiple procedures related to a single outpatient encounter were reduced to a single payment; (ii) The DRA mandated the technical component (TC) of in-office imaging procedures to be paid at the lower of the HOPPS or Physician Fee Schedule (PFS) rate, which decreased the reimbursement for imaging procedures performed in private offices and freestanding imaging centers; (iii) The DRA's Multiple Procedure Payment Reduction also decreased the TC payment for certain imaging procedures performed in the same sitting; (iv) In 2006, CMS reduced the TC by 25.0% for certain imaging procedures performed on contiguous body parts; (v) In 2011, CMS reduced the TC by 50.0% and the professional component by 25.0% for all billing codes; (vi) The Affordable Care Act of 2010 (ACA) decreased the TC for radiologic procedures by increasing the Assumed Imaging Utilization rates for CT and MRI to 90.0% compared to 50.0%, which resulted in lower technical fees for studies performed with equipment used at high frequency.

According to a study published in 2022, 50 of the most common imaging studies in diagnostic radiology experienced a combined mean reduction of inflation-adjusted payments of 44.4% from 2011 to 2021. Unsurprisingly, these reimbursement pressures have been a leading factor in driving M&A activity within the diagnostic imaging industry and achieving economies of scale is one of the most common reasons cited for mergers. In 2022, the diagnostic imaging industry experienced reimbursement cuts (with the conversion factor adjusted to $33.5983 due to changes in relative value units), redistributive effects of the CMS proposed clinical labor pricing update, and phase-in implementation of previously finalized updates to supply and equipment pricing.

However, the cuts in 2022 were mitigated by a 3.0% increase to the conversion factor pursuant to the protecting Medicare and American Farmers from Sequester Cuts Act. The Medicare PFS final rule for CY 2023 is set to further reduce reimbursement for imaging services.

Regulatory

For decades, federal legislation has shaped the diagnostic imaging industry. The first voluntary standards for the accreditation of educational programs and certification of individuals performing radiologic procedures were set forth in the Consumer-Patient Radiation Health and Safety Act of 1981. Since then, notable legislation has included the (i) Mammography Quality Standards Act, (ii) the Medicare Improvements for Patients and Providers Act, and (iii) the Nuclear Regulatory Commission Medical Uses of Nuclear Materials.

More recent legislative issues include the “surprise” billing and “no surprises” acts passed by Congress, and the proposed Medicare Access to Radiology Care Act (MARCA). The No Surprises Act (i) bans balance billing for out-of-network emergency care until the patient can consent and safely be moved to an in-network facility; (ii) bans balance billing for scheduled out-of-network services at an in-network facility when the patient has not been notified or provided consent; (iii) prohibits insurers from assigning higher deductibles (and other cost sharing) to patients for out-of-network care than they do for in-network care without patient notification and consent; and (iv) requires providers to give patients a good faith estimate of the cost of services provided to uninsured and self-pay patients in advance of the patient’s appointment. Although MARCA currently has little congressional support, it would provide payment to the supervising radiologist for performing registered radiologist assistant (RRA) services in a facility setting and would not allow for independent RRA practice or payment.

In addition to managing the implications of payment provision changes the regulatory and legislative environment is increasingly becoming more complex. The challenge of navigating rules and regulations is also a common reason for the level of M&A activity within the industry.

Conclusion

In summary, the M&A landscape for diagnostic imaging remains relatively sporadic given the highly fragmented nature of the industry. However, it is likely that M&A transactions in 2023 will meaningfully increase over 2022 numbers. A combination of the provider and staff burnout brought by COVID-19, increased regulatory challenges, and consistent reimbursement pressures may give local freestanding imaging centers and small provider groups more incentive to consolidate.

More Imaging Thought Leadership

- Reviewing the 2023 Final Rule’s Potential Impact on Diagnostic Imaging and Radiology Providers

Acute Care Hospitals

Industry Overview

As of January 2023, the total number of acute care hospitals (ACH) in the United States was approximately 5,448. Of this total, just under 60.0% operated as a not-for-profit, approximately 25.0% were investor-owned for-profit, and the remainder were operated by state and local governments. Excluded from this total are the hospitals that are not accessible to the public, including federal prison hospitals, college infirmaries, and psychiatric hospitals. In 2022, spending on hospital services accounted for an estimated 32.0% of total national health expenditures, representing the single largest expense category. Total hospital spending has increased 5.9% compounded annually from $1.078 trillion in 2017 to an estimated $1.435 trillion in 2022.

Observed financial and operating performance levels and trends for the ACH industry were significantly clouded by the pandemic in CY 2020 and 2021. Although financial performance in CY 2021 was universally quite favorable for the ACH industry, it was challenging to decipher the level of influence that stimulus funds, increased COVID admissions, and pent-up volume demand created. CY 2022 brought some clarity in identifying the trends that were transient and the trends that will persist in the industry moving forward. Certain trends that emerged in CY 2021 have now become established headwinds for the industry in CY 2022 and 2023. These include rising labor expenses, growing inflationary pressures, declining inpatient admissions, and intermittent supply chain disruptions. These headwinds have created significant pressure on profit margins across the industry. Through the mid-point of Q4 2022, the median hospital operating margin equaled (0.5%) as compared to 4.0% during this same period in 2021.

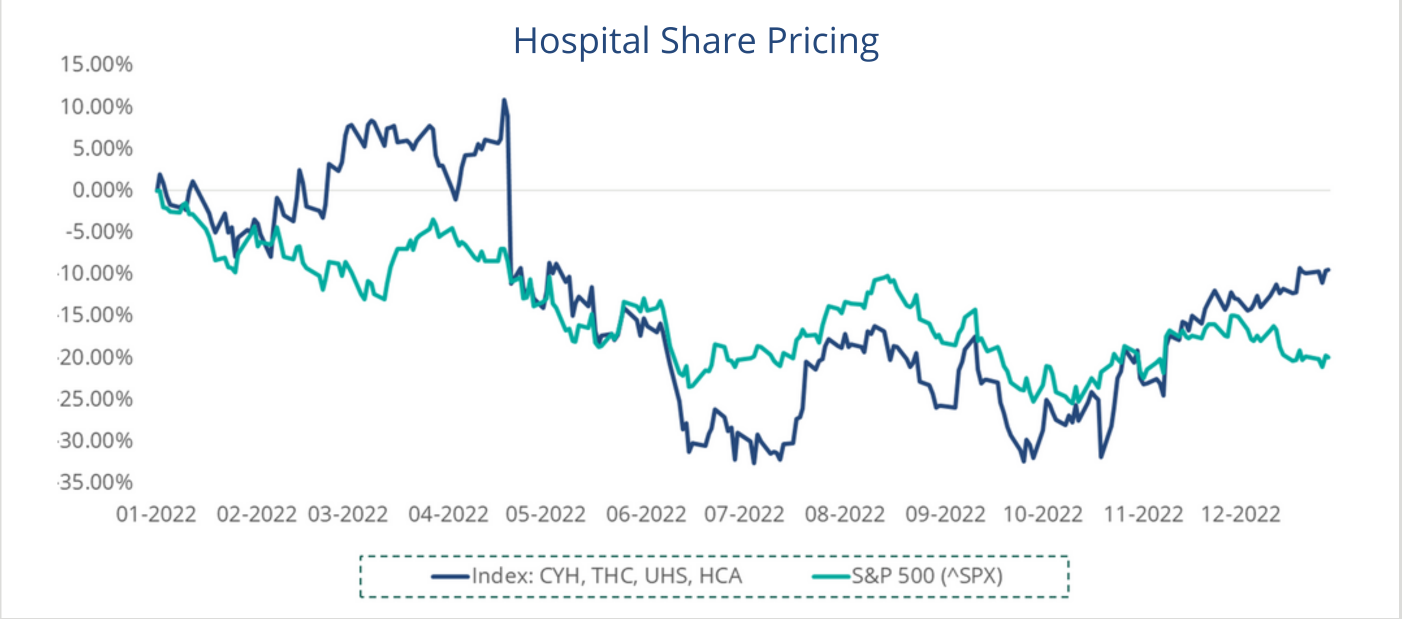
Perhaps the most acute of these headwinds are those surrounding labor costs. Labor is the largest single expense for the ACH industry, and labor pressure has significantly impacted operators in 2022. This impact is expected to moderate but continue into 2023. Operators of public and private ACHs have been plagued with higher-cost temporary labor and enhanced wages required to recruit and retain clinical personnel.

> "In terms of labor, we did see labor inflation in the third quarter at about 5.0% on a base pay rate basis. That was a little higher than we had previously expected...and if we think about the first couple of quarters of the year, we were in the 8.0% to 8.5% year-over-year inflation. And we think going into 2023, [that] will remain higher than it has been historically, but we do think that there will be some continued moderation."
>
> **Kevin J. Hammons, President & CEO, CYH**
> Q3 2022 Earnings Call

The inflationary impact on labor costs is even more acute if viewed from a pre-pandemic lens. The median labor expense per adjusted discharge has risen 28.0% from CY 2019 to CY 2022.

In addition to the higher labor expenses, hospitals experienced a decline in admissions as the industry trended away from hospital-based care into outpatient settings coupled with the decreased number of COVID-19 admits. On a same-facility basis, admission volumes declined as much as 5.0% from the comparable prior year quarter (Q3 2021) for acute care hospital operators. Despite the weakening of COVID-19, the decline in volumes was attributed to higher-than-average cancellation rates (as reported by Tenet Healthcare), the migration of certain procedures to outpatient status (as reported by Community Health Systems and HCA), and capacity constraints (HCA). Inpatient volumes generally remained at or below pre-pandemic levels. The increased expenses and decreased volumes have led to depressed margins relative to pre-pandemic levels. Nationwide hospital EBITDA margins were down 32.0% year-over-year from November 2021, and 27.0% year-over-year from November 2019 to November 2022.

The impact of the factors described above were also observed in the equity prices of the four public companies that operate acute care hospitals: HCA (HCA), Community Health Systems, Inc. (CYH), Tenet (THC), and UHS (UHS). The chart below displays the indexed share prices of these companies relative to the S&P 500. Toward the end of April 2022, the ACH index experienced a drastic decline from its stock price high of nearly +11.0% relative to baseline January 2022. This decrease coincided with the release of Q1 2022 earnings, during which most of these companies revised their 2022 outlook downward. Shortly after the ACH index reached a YTD low in July of 2022 and was down over 30.0% from January 2022 prices. Over this same period, the S&P 500 reached a low in October 2022 and was down 25.0% from January 2022 prices. The ACH index prices recovered more rapidly than the S&P 500 toward the end of the year, although both remained down. The healthcare industry is typically recession-resistant relative to other markets, so the downward trend in equity prices is representative of the acute care hospital industry's operational experiences during 2022. Health system financials are under significant stress with expenses rising faster than revenues and no further COVID-19 stimulus funneling in.

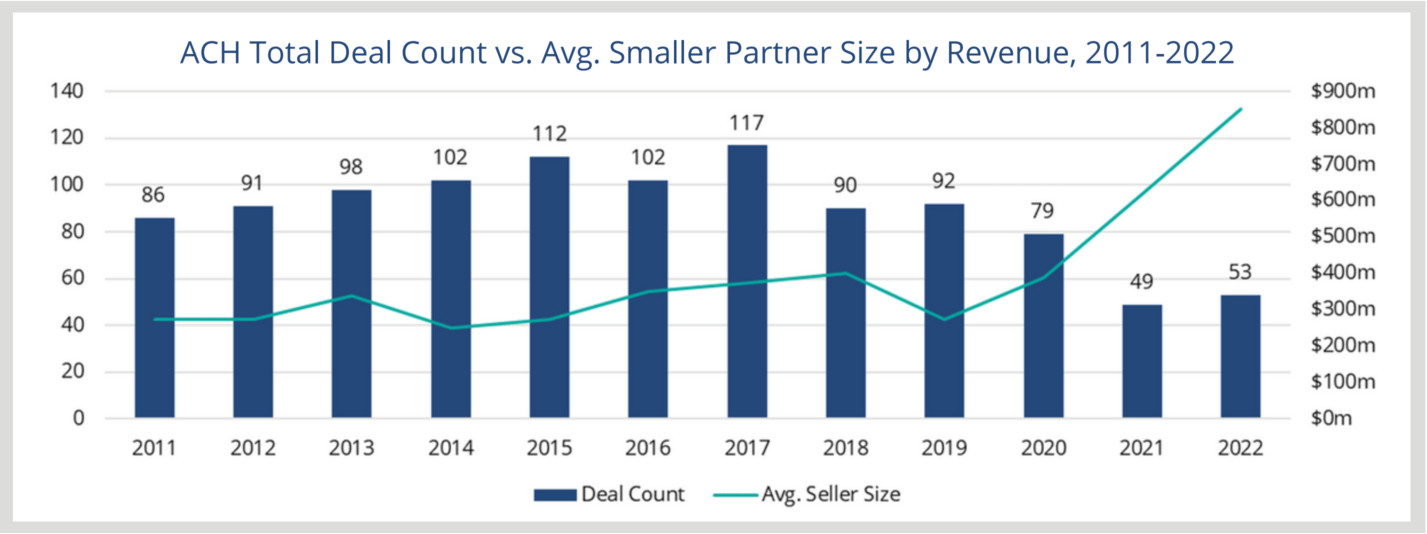


M&A Trends

Significant parallels can be observed when comparing the ACH M&A market in 2022 against the backdrop of the industry dynamics described above. Consistent with a theme observed in 2021, transaction volumes remained low as many ACH systems faced financial challenges, limited large-scale capital commitments, and focused on more near-term margin preservation activities. Instead, scarce available capital was deployed on outpatient expansion strategies that involved lower capital commitments and higher perceived return on investment opportunities. Also, the decline in the number of perceived attractive targets limited transaction volume. Dealing with their own headwinds, many would-be acquirers were reluctant to take on additional acute care assets that might require significant and costly turnaround and integration efforts.

Similar to recent years, the transaction market for ACHs was largely comprised of not-for-profit buyers and sellers entering transactions with little-to no cash being exchanged. Such transactions are referred to as member substitutions and they represent the most common nonprofit transaction structure. These transactions are comparable to stock purchases where the acquirer becomes the “sole member” (or equity holder) of the target entity. In member substitutions, the “purchase price” is often comprised of future capital commitments and an assumption of seller debt. Many of the prominent transactions described in the following section can be described as member substitutions involving nonprofits, and most frequently involving non-cash purchase prices. Given the headwinds described previously, coupled with tightening debt markets, the noncash purchase price characteristic of the member substitution deal structure is attractive. From a valuation and pricing standpoint, the lack of cash transferal in member substitutions leads to difficulties in determining the transaction’s true implied value.

The ACH M&A activity in 2022 was still below pre-pandemic levels but did increase slightly from the lows experienced during 2021. Though the number of announced transactions remains below pre-pandemic levels, total revenues generated by the targets have reached historic highs. The prevalence of these “megamergers” over the course of 2022 resulted in more than $45 billion in total transacted revenue for the year, surpassing 2017 levels of $44.1 billion. The 2022 average transaction size represents an approximate 12.0% compound annual growth rate since 2012.



Note: Announced mergers, acquisitions, JVs, and minority-interest deals. Excludes canceled deals.

In 2022, we observed transaction activity that involved many nonprofits representing some of the largest systems in the U.S. On May 11, 2022, Advocate Aurora Health and Atrium Health merged and created a Joint Operating Company that was branded Advocate Health. The combined enterprise represents a $27 billion, 67-hospital system and is the fifth-largest nonprofit health system in the U.S. The Charlotte-based combined system has footprints in Illinois, Wisconsin, North Carolina, South Carolina, Georgia, and Alabama. The two systems were subject to regulatory scrutiny despite operating in different regional markets (South and Midwest). The Illinois State Board initially voted against the deal, but later agreed to reconsider and ultimately approved the transaction. Meanwhile, in a report to the Winston-Salem Journal, the North Carolina Attorney General Josh Stein said he “conducted a thorough review into the transaction and concluded there [was] no legal basis to prevent it.” Such regulatory challenges have increasingly become a common theme within the healthcare M&A market.

Salt Lake City-based Intermountain Healthcare and Broomfield, Colorado-based SCL Health merged into a 33-hospital system with 385 clinics and more than 58,000 employees across six states. The nonprofit system also provides health insurance to about 1 million people. The health systems completed the transaction in March 2022 less than a year after entering negotiations. The consummation of this merger created the eleventh-largest nonprofit system in the country. Other notable transactions are described in the chart below.

Notable Transactions

Announced Date	Closed Date	Target	Acquirer	Description
Mar-23	-	UnityPoint Health	Presbyterian Healthcare Services	In March 2023, Presbyterian Healthcare Services and UnityPoint Health announced their intent to merge. Combined, the health systems would operate health insurance plans, hundreds of clinics, and over 40 hospitals across Illinois, Iowa, New Mexico, and Wisconsin. The systems have no timeline for the merger.
Feb-23	-	5 Steward Health Care Hospitals	CommonSpirit Health	CommonSpirit announced February 15th they will acquire Davis Hospital and Medical Center in Layton, Jordan Valley Medical Center in West Jordan, Jordan Valley Medical Center-West Valley Campus, Mountain Point Medical Center in Lehi, and Salt Lake Regional Medical Center in Salt Lake City from Steward Health Care.
Dec-22	-	Cooper University Health Care	Cape Regional Health System	In December 2022, Camden, Cooper University Health Care and Cape Regional Health System signed a letter of intent to merge into a two-hospital system with revenue exceeding $2.2 billion a year. According to their transaction announcement, the health systems hope to sign a definitive agreement in March 2023, but transaction close "could take until the first quarter of 2024" due to the regulatory approvals required.
Nov-22	-	Fairview Health	Sanford Health	In November 2022, Sanford Health and Fairview Health signed nonbinding letters of intent to merge. The combined system would be called Sanford Health and include more than 50 hospitals and 78,000 employees. The Minnesota Attorney General has opened an investigation into the merger and recommended the companies delay their transaction close. Sanford and Fairview agreed to the delayed timeline, stating they have “voluntarily extended [their] target planning date for completion of the merger to May 31, 2023.”
Nov-22	-	CharterCare Health Partners	Centurion Foundation	A transaction between Prospect and the Centurion Foundation was announced. Under this transaction, the Centurion Foundation would establish CharterCare Health of Rhode Island as a 501(c)(3) nonprofit and acquire the CharterCare Health Partners system. The deal is pending regulatory approval from the Rhode Island Department of Health and state attorney general.
Oct-22	-	Marshfield Clinic	Essentia Health	Essentia Health and Marshfield Clinic Health System have had discussions involving a potential merger that would comprise 25 hospitals and a network of 3,800 providers. The two health systems announced their intent in October 2022. According to a Dec. 12 news release, the organizations expect to reach a definitive agreement in the "coming months," and shared plans for the CEO of Marshfield to step down in September 2023.
Oct-22	Jan-22	3 Tulane University Hospitals	LCMC	January 3, 2023, New Orleans-based LCMC acquired three Tulane University hospitals from Nashville, Tenn.-based HCA Healthcare for $150 million. The transaction announcement followed regulatory approval from the Louisiana Attorney General.
Sep-22	Jan-23	4 AdventHealth Hospitals & Related Facilities	University of Chicago Medicine	University of Chicago Medicine and AdventHealth signed a definitive agreement to enter into an affiliation in September 2022. Under the agreement, UChicago Medicine will acquire a controlling interest in AdventHealth's Great Lakes Region, which includes four Illinois hospitals, and AdventHealth will retain the remaining interest and manage daily operations of the facilities. The deal is closed January 1, 2023.

Announced Date	Closed Date	Target	Acquirer	Description
Jun-22	Jan-23	Butler Health System	Excela Health	Excela Health and Butler Health System finalized their merger in January 2023, comprising a five-hospital system. The deal creates the third-largest health system in the state, employing approximately 7,300 people and generating a projected $1 billion a year in revenue.
May-22	Dec-22	Atrium Health	Advocate Aurora Health	Atrium Health and Advocate Aurora Health merged into a $27 billion, 67-hospital system called Advocate Health, the fifth-largest nonprofit health system in the U.S. The combined system has footprints in 6 states. This merger was completed on December 2, 2022, after a delay in approval from The Illinois Health Facilities & Services Review Board. The Board approved an exemption allowing the merger for no cost.
Apr-22	Sep-22	MercyOne Health System	Trinity Health	Livonia, Mich.-based Trinity Health acquired MercyOne Health System from Chicago-based CommonSpirit Health in September 2022, closing out a process that began in April. The mega-merger made Trinity the sole owner of Clive, Iowa-based MercyOne, which includes 16 medical centers, 27 affiliate organizations and more than 20,000 staff.
Feb-22	-	Connecticut Health System	Yale New Haven Health System	Yale New Haven Health System signed an agreement to acquire the Connecticut Health Systems from Prospect Medical Holdings in February 2022. The transaction is subject to regulatory approval. According to the Yale New Haven Health Obligated Group Event Notice dated October 18, 2022, the net purchase price is expected to be approximately $411.5 million, subject to further adjustment.
Feb-22	May-22	St. Elizabeth Hospital and St. Catherine Hospital-Dodge City	Centura Health	In May 2022, Centennial, Colo.-based Centura Health acquired its 18th and 19th hospitals St. Elizabeth Hospital and St. Catherine Hospital-Dodge City from Brentwood, Tenn.-based LifePoint Health, forming a 19-hospital system. This health system addition marks Centura Health's first transactions in approximately 7 years.
Dec-21	Apr-22	SCL Health	Intermountain Healthcare	Salt Lake City-based Intermountain Healthcare and Broomfield, Colo.-based SCL Health merged into a 33-hospital system with 385 clinics and more than 58,000 employees across six states. The nonprofit system also provides health insurance to about 1 million people. The health systems completed the transaction in March, less than a year after entering into negotiations.
May-21	Mar-22	University Health Care System	Piedmont Healthcare	University Health Care System, a three-hospital system in Augusta, Ga., officially joined Atlanta-based Piedmont Healthcare, in March 2022, resulting in Piedmont growing to 19 hospitals. This was a little less than a year after signing their letter of intent in May 2021. Piedmont plans to invest more than $1 billion into University Health.

In addition to the transactions noted above, on February 14, 2023, CommonSpirit Health and AdventHealth announced they would be dissolving their 20-hospital joint venture, Centura Health. They cited the reason for the dissolution was that the partnership had reached its "natural maturity" after 27 years. The dissolution would result in AdventHealth operating the five Adventist hospitals and clinics located in Colorado, and CommonSpirit operating the remaining 15 hospitals and affiliated clinics. Throughout the transition, Centura Health will continue to manage and operate the hospitals, clinics, and care sites.

Reimbursement

On August 2, 2022, CMS released the FY 2023 Inpatient Prospective Payment System (IPPS) policy changes and payment rates final rule. Based on the final rule, IPPS payment rates will increase by 4.3% in 2023. This is an increase from the FY 2021 final rule which increased the IPPS payment rates by 2.5%.

> "This is the highest market basket update in the last 25 years and is primarily due to higher expected growth in compensation prices for hospital workers."
>
> **Centers for Medicare and Medicaid Services, Press Release**
> August 2022

CMS also noted the updated hospital reimbursement rates are higher than in the proposed rule because of the revised outlook regarding the U.S. economy. The increases are offset by the resumption of full 2.0% sequestration, which impacts payments for all Medicare Fee-for-Service (FFS) claims. The CARES Act suspended the sequestration payment adjustment percentage of 2.0% applied to all Medicare FFS claims from May 1 through December 31, 2020. The Consolidated Appropriations Act, 2021 extended the suspension period to March 31, 2021. Public Law 117-7, an act to prevent across-the-board direct spending cuts, and for other purposes, was signed into law on April 14, 2021, and extended the suspension period to December 31, 2021. Full 2.0% sequestration was resumed on July 1, 2022, and will be in force for 2023.

CMS estimates it will distribute roughly $6.5 billion in FY 2023 for uncompensated care payments, which is less than FY 2022's $7.2 billion amount. Similarly, on November 1, 2022, CMS finalized the FY 2023 OPPS changes. The 2023 OPPS Rule provides an increased rate of 3.8% from the 2.7% included in the proposed rate. Under the 2023 Hospital OPPS Rule, CMS expects the payment adjustment, in addition to other changes in the rule to increase OPPS payments by a total of 4.5% as compared to CY 2022 data. Also, and total payments for hospitals (including beneficiary cost-sharing) are expected to increase by approximately $3.0 billion in CY 2023 as compared to CY 2022 data.

The 2023 final rule builds further upon measures to improve consumer price transparency. Starting on January 1, 2023, the rule required health plans to start offering an online shopping tool to allow consumers to see the negotiated rate between their provider and their plan. The tool also is required to include a personalized estimate of consumers' out-of-pocket cost for 500 of the most shoppable items and services. Additionally, the Statutory Pay-As-You-Go Act (PAYGO) established in 2010 resumed on January 1, 2023. This act requires spending cuts when legislation enacted within the current year increases the deficit.

In response to the inflationary pressures and compressed margins, health systems and hospitals are turning to commercial payor negotiations for additional relief. According to the Q3 2022 earnings calls, operators are cautiously optimistic with rate increases for the coming year anticipated to range from a minimum of 3.0% (THC) to upwards of 6.0% (CYH).

Regulatory

Governmental agencies have attempted to block approximately 22 deals since January 2021. In early 2022, Rhode Island's two largest hospital systems, Lifespan and Care New England Health System called off their merger after the FTC pushed back. Shortly after, a federal appeals court upheld a lower court's injunction that blocked a merger between Hackensack Meridian Health and Englewood Healthcare Foundation in New Jersey, which the FTC alleged would raise prices; the hospitals scrapped the deal in April 2022.

Saint Peter's Healthcare System and RWJBarnabas Health terminated a definitive agreement to merge in June 2022. This fell less than two weeks after the FTC filed a challenge alleging the consolidation would harm competition for inpatient general acute care services in Middlesex County, New Jersey, resulting in a combined market share of approximately 50.0% for general acute care services in the county.

In August of 2022, the FTC authored a paper summarizing its policy perspectives on Certificates of Public Advantage. State-level Certificate of Public Advantage (COPA) laws enable hospitals to circumvent federal antitrust enforcement when they can show the benefits outweigh the reduced market competition. LCMC Health and Tulane

University announced their partnership on January 3, 2023, following approval from the Louisiana Department of Justice. The partnership increased LCMC's market share to approximately 55.0%. Transactions of this size are typically subject to FTC review, however, this transaction was shielded by Louisiana's COPA law.

In September 2021, HCA and Steward Health Care (Steward) announced the signing of an agreement for HCA to acquire the operations of five Utah-based hospitals from Steward. The exact financial terms of this merger have not been disclosed. While this was expected to be the next big megamerger, the transaction faced scrutiny from the FTC due to concerns about an increase in patient fees and a decline in patient care. The FTC sued to block this merger on June 2, 2022, and the deal was called off. Future notable deals may be subject to the same FTC review.

Conclusion

Over the last 12 months, the hospital and health system M&A market has been directly impacted by the financial realities facing the industry. From a revenue generation standpoint, the acute care hospital industry is dealing with declining inpatient admissions, an absence of federal stimulus funds, and the return of mandatory cuts related to sequestration. A potential counterbalance to these pressures will likely come in the form of reimbursement rate relief from governmental and commercial insurers. On the expense front, inflationary pressures, supply chain disruptions, and staffing difficulties are resulting in compressed profit margins. While these are generally expected to ease throughout 2023, these factors will further distinguish the hospitals and systems that are financially resilient from those that may require some level of partnership or transaction to avoid insolvency. We expect to continue to see large nonprofits being active in the M&A market as they position themselves favorably against their competition, both providers and insurers. Antitrust regulation and pushback will continue to be prevalent in the form of blocking certain transactions and driving health systems to pursue affiliation in new regions. This will expand the breadth and position of existing systems. We expect to see the emergence of transactions involving distressed hospitals. ACHs that find themselves unable to compete or adapt will be forced to consolidate with larger systems or face the possibility of closure. As the cost of capital increases to temper inflation and as hospitals navigate continued cost pressure during 2023, the market will likely experience continued M&A, but there may be pressure on valuations due to either underlying financial performance or the willingness of buyers to pay a premium multiple.

More Hospital Thought Leadership

- Academic Medical Center Growth & Strategic Opportunities
- Health System Financial Repositioning
- Aligning Physician Compensation & Reimbursement Models to Maximize Revenue Opportunities
- New Physician/Health System Models
- Looking to Formalize Your Physician Compensation Strategy? Follow the 1-3-5 Rule
- 2022 Not-For-Profit Health System Performance Trends

Physician Medical Groups

Industry Overview

The number of physicians in the United States increased 1.2% compounded annually from approximately 814,000 in 2000 to approximately 1.1 million as of January 2023. Approximately 87.0% of active physicians primarily focus on providing patient care. The remaining 13.0% of physicians primarily focus on teaching, research, and other professional activities. There are over 150 specialties and subspecialties recognized by the Accreditation Council for Graduate Medical Education. In terms of active physicians, the largest specialties are internal medicine and family medicine/general practice which account for approximately 19.0% and 13.6% of total active physicians, respectively.

National health expenditures continue to grow annually with these costs potentially increasing at greater rates due to long-term impacts of COVID-19. CMS expects that between 2023 and 2030 healthcare expenditures will increase at least 5.0% annually. Healthcare expenditures grew 9.7% from 2019 to 2020 due to the pandemic.

Despite the increased spending on physician services, rising costs have concurrently affected profit margins for physician medical groups (PMGs) mainly due to rising labor costs. Similarly, rising supply costs have also impacted these groups. These PMGs are expected to continue to face pressures associated with higher inflation and labor costs which have been a catalyst for consolidation within the space.

M&A Trends

Historically the annual volume of physician services transactions has been impacted by large regulatory changes such as the passage of the ACA in 2010 and the passage of Medicare Access and CHIP Reauthorization Act (MACRA) in 2015. Rather than face the burden, expense, and uncertainty of increased regulatory and data reporting requirements alone, physicians are increasingly opting to align into larger groups, adopt the accountable care organization (ACO) model, or align with health systems and other corporate entities.

Independent practices are struggling to keep pace with the capital requirements of the industry's transition to value-based payments while also facing increasing competition in physician recruiting from health systems, PE firms, and health insurers. PE firms and their management services organizations (MSOs) offer the capital and business expertise needed for the scale and operational efficiencies required to combat these pressures. For PE firms, their ability to "roll-up" these acquisitions into an efficient, large, and scalable platform is an attractive investment.

Platform practices are typically able to negotiate an acquisition price that is higher than smaller bolt-on practices which are subsequently acquired. A potential arbitrage opportunity exists if the PE firm can effectively buy a practice at a lower bolt-on multiple and sell the entire business at a higher platform multiple (often sold to another PE firm).

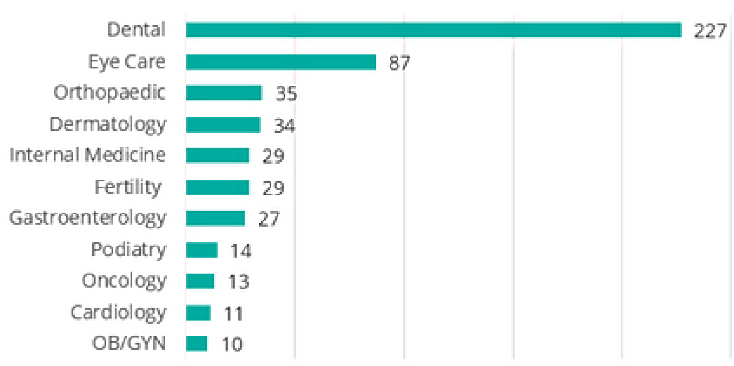
> "We believe there are opportunities for targeted acquisitive growth in our core, and we continue to expand and refine our pediatric, primary, and urgent care platforms."
>
> **James Swift, Chief Executive Officer, Pediatrix Medical Group, Inc.**
> Q4 2022 Earnings Call

PE firms typically target the ancillary revenue streams of practices which may have historically been performed in a local hospital or other outpatient settings. These ancillary services are consolidated to increase the revenue and earnings growth of the practices. Specialties with high prospects of generating additional incomes from ancillary services, and with low capital intensity, tend to be the targets of PE acquisitions.

M&A activity across the healthcare spectrum was robust in 2022, but particularly within the PMG sector. To quantify by volume, PMG transaction activity was approximately 33.0% higher in 2022 than 2021. A major impetus for this spike in M&A deals was increased PE activity with plenty of dry powder to spare for M&A activity. Approximately 70.0% of physician transactions in 2022 were attributable to a PE firm or their portfolio companies.

While PMGs cover a wide gamut of specialties, certain specialties showed greater activity than others. Eye care related practices represented 87 transactions and dental practices represented 227 transactions in 2022. This trend favoring ophthalmology and dental specialties held true prior to 2022, and consolidation is expected to continue into 2023. There is also burgeoning interest in primary care and other sub-specialties like cardiology and orthopedics are expected to continue to accelerate.

Top Physician Specialties by Deal Volume, 2022



Source: LevinPro HC, Healthcare Acquisition Report 2023

Given the fragmentation in the PMG sector, it is expected that interest in other specialties will also see increased deal activity. Of interest are specialties with greater allocation to commercial payors due to higher reimbursement and specialties with ancillary business lines.

As previously mentioned, dentistry stood out with more growth in deal volume than other subspecialties in the healthcare arena. U.S. Oral Surgery and Management (USOSM) continues to announce partnerships across the country. As of November 2022, USOSM had more than 170 oral and maxillofacial surgery practice locations across 24 states. USOSM President Richard Hall said the company expects to continue its deal volume momentum.

Continuing its growth from 2021, ophthalmology saw Vision Innovation Partners complete four acquisitions in 2022. It acquired Advanced Eye Care, Memorial Eye Institute, SIEHT, and Chesen Laser Eye Center.

Year	PE Deals as a Percentage of Total PMG Transactions
2017	65%
2018	74%
2019	80%
2020	71%
2021	70%
2022	70%

Source: LevinPro Healthcare Acquisition Report 2023

To emphasize the role of PE in the physician medical group space the table to the left presents the increase in PE deals over the last few years. The PE deal volume in 2022 reflects a continuation of the 2021 M&A activity. PE continues to play a significant role within the PMG subsector. 2022 saw the highest number of PE-driven deals in the sector on record. Looking ahead, practices that focus on women's health or fertility services should see increased private equity activity.

Notable Transactions

Throughout 2022, deal volume remained at elevated levels for the PMG sector, particularly groups with high levels of reimbursement from private insurance and out-of-pocket payment structures.

In February 2022, Partners Group, a private markets firm, acquired Forefront Dermatology which is a dermatology group practice with over 200 clinics across the United States. Partners Group acquired the majority stake in the practice from OMERS Private Equity. The acquisition had a total consideration of $1.5 billion.

In June 2022, UnitedHealth Group's Optum acquired Healthcare Associates of Texas, a primary care practice with 81 locations in Texas. The practice has a large value-based care portion of their business. Webster Equity Partners sold their stake in the practice which they acquired in 2016. The acquisition had a total consideration of $300.0 million, implying a 17.7x EBITDA multiple.

In July 2022, SSM Health, a St. Louis based health system, acquired SLUCare Physician Group which is the academic medical practice of Saint Louis University. SLUCare has over 600 physicians within its network that cover a wide array of specialties. The two organizations have had ties for many years, and the full acquisition only furthers the relationship between the companies. The financial terms were not disclosed for this deal.

Also in July 2022, Amazon acquired One Medical, a membership-based primary care company, in a deal valued at approximately $3.9 billion. This deal reflects the increasing interest in primary care by large players, and it reflects Amazon's reach into the healthcare space. One Medical provides access to comprehensive care along with 24/7 access to virtual care. While it provides a direct-to-consumer membership model, it also works with over 8,000 companies to provide One Medical health benefits to their employees.

In September 2022, CVS Health Corporation entered into an agreement to acquire Signify Health, a healthcare platform providing health risk assessments, value-based care, and provider enablement services. Signify Health's platform consists of over 10,000 clinicians in all 50 states. The acquisition advances CVS Health's long-term strategy to explore opportunities in value-based care and holistic care delivery, and it is expected to close in the first half of 2023. CVS Health entered into the agreement under the terms to acquire Signify Health for $30.50 per share in cash at a transaction value of approximately $8.0 billion, and made this a megadeal in the health services industry.

In September 2022, GI Alliance completed its physician-led buyout from Apollo Hybrid Value, a high-growth, global alternative asset manager. The physician owners, who previously owned approximately 70.0% of GI Alliance, repurchased the minority equity stake held by Waud Capital Partners, a private equity group. GI Alliance is the nation's largest gastroenterology practice with 688 independent physicians operating in 14 states. The deal values GI Alliance at approximately $2.2 billion and was facilitated by the non-control investment from Apollo which provided GI Alliance with a strategic partner and ongoing capital.

In November 2022, VillageMD acquired Summit Health-CityMD, a leading provider of primary, specialty, and urgent care. VillageMD is majority owned by Walgreens Boots Alliance, Inc. through an initial 2020 investment and an increased stake in 2021. The transactions will create one of the largest independent provider groups in the U.S. with over 680 provider locations in 26 different markets. Total consideration for the deal is valued at approximately $8.9 billion making this another megadeal of the year in the PMG sector.

Also in November 2022, CareMax, Inc. closed its acquisition of the Medicare value-based care business of Steward Health Care System. This transaction created one of the largest independent, senior-focused value-based care platforms in the country, and opened access to an additional 380,000 Medicare Advantage fee-for-service beneficiaries. The 380,000 acquired lives have an opportunity to transfer to risk-bearing arrangements and will begin transferring at the beginning of 2023. As of the Q3 2022 earnings call, CareMax saw success in fighting the high capital headwinds with its acquisition.

> "We remain very deliberate about our growth plans and believe that our hybrid delivery model of a capital-light MSO, combined with our high-performing centers, differentiates us from others in the health care industry. Our national MSO expansion plans are designed to provide economies of scale to allow our business to grow in a capital-efficient manner."
>
> **Carlos de Solo; Co-Founder, President, CEO, and Director; CareMax**
> Q3 2022 Earnings Call

Reimbursement

On April 14, 2015, the Senate passed MACRA which permanently removed the Sustainable Growth Rate (SGR) formula from the determination of the conversion factor under the Medicare PFS. Under MACRA, the SGR formula was replaced with fixed 0.5% annual increases through 2019 (Note: The annual increase was reduced to 0.25% by the Balanced Budget Act of 2019). After 2019, physician payments under the Medicare PFS will remain flat through 2025. During this time period, (i.e., from 2020 to 2025) individual physicians can achieve payment increases through participation in the Merit-Based Incentive Payment System which will be developed by the Secretary of Health and Human Services, or through participation in an alternative payment model such as an ACO.

On November 2, 2022, CMS released the CY 2023 Medicare PFS final rule payment and policy changes final rule. The CY 2022 PFS has a conversion factor of $33.06 which is a decrease of $1.55 from the CY 2022 PFS factor of $34.61.

Conclusion

As a result of economic and inflationary pressures, physician medical groups continue to face headwinds associated with rising costs, declining margins, provider recruitment challenges, a higher cost of capital, and uncertainty regarding future reimbursement. Further, uncertainty regarding the Federal Trade Commission's proposal to ban noncomplete clauses may provide an additional challenge to smaller physician practices because it could potentially exacerbate staffing costs. Nonetheless, these are not the only reasons physicians might choose to sell their practices. Other drivers may include impending retirement, a desire to reduce the administrative burden to focus on patient care, access to capital, and lucrative exit opportunities. These rationales provide opportunities for physician groups to align with larger groups, sell to private equity firms, or integrate with health systems and insurers. Due to the economic challenges physician practices face, we expect M&A activity within the physician medical group space to remain strong as consolidation increases.

More Physician Medical Group Thought Leadership

- Looking to Formalize Your Physician Compensation Strategy? Follow the 1-3-5 Rule
- How to Assess Medical Group Performance
- Three Key Considerations in Physician Medical Group Transactions
- New Physician/Health System Models
- Physician Practice Strategy: The Private Equity Play
- Designing & Valuing Quality Incentive Programs for Physicians
- Considerations in Structuring Physician Compensation-Per-WRVU Models
- Important Guidelines for Selecting Quality Metrics In Physician Arrangements

Post-Acute Care

Industry Overview, Reimbursement & Regulatory

Post-acute care facility types include inpatient rehabilitation facilities (IRF), long-term acute care hospitals (LTACH), skilled nursing facilities (SNF), home health agencies (HHA), and hospice agencies (HSPA). Of these facilities, SNFs, IRFs, and LTACHs provide post-acute services in an inpatient setting, while HHAs and HSPAs provide post-acute services in an outpatient setting.

The COVID-19 pandemic had a unique impact on the post-acute sector through a shift in historical referral patterns toward home health and away from IRFs, LTACHs, and skilled nursing facilities. Care in the home health setting provides a lower risk of transmission of the virus – approximately 40.0% of COVID-related deaths have occurred in nursing homes even though only around 8.0% of COVID-19 cases are attributable to nursing home residents.

Inpatient Rehabilitation Facilities (IRF)

The number of Medicare-certified IRFs decreased from 1,221 in 2004 to 1,161 in 2013. This decline is attributable to the reimplementation of the 75% rule in 2004. The 75% rule required that 75% of patients admitted to an IRF have a primary diagnosis that falls within 13 distinct high-acuity diagnostic categories. Even though the Medicare, Medicaid, and SCHIP Extension Act of 2007 (MMSEA) lowered the 75% threshold to 60%, the effects of the rule still resulted in a large decrease in IRF volume. This decrease was primarily due to limiting the number of hip and knee replacement patients that could be treated at an IRF. It should be noted that the number of Medicare-certified IRFs decreased 0.4% compounded annually from 1,182 in 2015 to 1,159 in 2020. An IRF can be licensed as a freestanding facility or as a hospital-based IRF, which is a specialty unit located within an acute care hospital. As of 2020, there were 310 Medicare-certified freestanding IRFs and 849 Medicare-certified hospital-based IRFs. Of Medicare-certified facilities, total freestanding IRFs increased 3.4% compounded annually since 2015 while total hospital-based IRFs decreased 1.6% compounded annually over the same period. In 2021, Medicare spent $8.5 billion on IRF care provided to FFS beneficiaries in about 1,180 IRFs nationwide. About 335,000 beneficiaries had 379,000 IRF stays. On average, the FFS Medicare program accounted for about 52.0% of IRF discharges.

On July 27, 2022, CMS released the FY 2023 final payment rule for the IRF prospective payment systems (PPS) which resulted in a standard payment conversion factor increase of approximately 3.7%. This was an increase from the FY 2022 final payment rule which had previously resulted in a standard payment conversion factor increase of approximately 2.3%.

Long-Term Acute Care Hospitals (LTACH)

LTACHs were first approved for Medicare funding with the passage of the Tax Equity and Fiscal Responsibility Act of 1982. By 2002, there were approximately 300 LTACH facilities and the total annual Medicare spending was approximately $2.2 billion. Medicare implemented a PPS for LTACH hospitals in 2002 which went into effect January 1, 2003. After the implementation of the LTACH PPS, the number of LTACH facilities and total Medicare spending in 2006 increased by 7.3% and 19.6% compounded annually to 398 facilities and approximately $4.5 billion, respectively. As a result, Congress passed the MMSEA which imposed a moratorium on new LTACHs from 2007 to

2012 unless specific exemptions were met. The moratorium on LTACHs was reinstated by the SGR Reform Act for a three-year period from April 1, 2014, to September 30, 2017. As a result of the moratoriums, the number of LTACH facilities decreased 1.7% compounded annually from 426 in 2008 to 348 in 2020. Over the same period, Medicare spending on LTACH services slowed, decreasing 2.5% compounded annually from approximately $4.6 billion in 2008 to approximately $3.4 billion in 2020. On September 30, 2017, the moratorium on LTACHs expired.

On August 10, 2022, CMS released the FY 2023 final payment rule for the LTACH PPS which resulted in a standard federal rate increase of approximately 3.8%. This was a decrease from the FY 2022 final payment rule which had previously resulted in a standard federal rate increase of approximately 1.9%.

The 2019 final rule required hospitals to make a comprehensive, machine-readable list of standard charges for all items and services public. At the time, the 2019 final rule did not define “standard charges” and hospitals could determine what type of data to report. However, the 2020 final rule released in July 2019 expanded upon these measures by defining “standard charges” to include specific third-party payor reimbursement and payment rates. This expansion was originally scheduled to go into effect January 1, 2020. The decision by CMS to formally define “standard charges” was a response to the majority of hospitals publishing their chargemasters to meet standard charge reporting requirements which did not include specific third-party payor data. CMS claimed these chargemasters “are not helpful to patients for determining what they are likely to pay for a particular service or hospital stay.” The 2020 final rule also required a new form of reporting in addition to the machine-readable format. It required that hospitals made public a consumer-friendly list of at least 300 “shoppable services” and their standard charges.

In response, hospitals and payors alike expressed heavy disapproval of both the rule and the 4-month time window of the proposed start date including a lawsuit by the American Hospital Association (AHA) which claimed CMS did not have the authority to enact these policy changes. As a result, CMS agreed to postpone the payor-specific measures by one year. Despite requests to further postpone the start date, CMS did not concede and these measures went into effect on January 1, 2021. The 2021 final rule included new measures aimed at improving price transparency for consumers. In recent years, CMS has continued to push for reduced healthcare costs by informing patients more about what they might pay for hospital items and services. The 2023 final rule continues the IPPS/LTACH PPS 2020 final rule that addresses wage-index disparities affecting low wage index hospitals. The 2022 final rule implemented the imputed floor wage index provision of the American Rescue Plan Act of 2021. In 2023, CMS will implement a policy that limits the decrease in a hospital's wage index by capping it at 5.0%. This will improve the predictability of Medicare payments for hospitals and will prevent instability that can result from changes to the wage index. Under this rule, a hospital's wage index will not drop below 95.0% of the previous fiscal year's final wage index regardless of the reasons for the decline.

Home Health Agencies (HHA)

In response to rapid increases in utilization and Medicare spending for home health services in the early 1990s, CMS implemented new coverage eligibility requirements, applied temporary spending caps, and replaced the historical cost-based payment system with a new PPS in 2000. After the implementation of the HHA PPS, the number of Medicare certified HHAs increased 4.2% compounded annually from 7,528 in 2000 to 12,311 in 2012. Effective July 2013 CMS imposed a moratorium on new HHA enrollment on the Chicago, Dallas, Detroit, Houston, Miami-Dade, and Fort Lauderdale areas because it was determined these areas to have a high risk of fraud. The moratorium was expanded in 2016 to include all of Florida, Illinois, Michigan, and Texas. As a result, the number of

HHAs has declined, and has decreased 1.7% compounded annually from 12,788 in 2013 to 11,456 in 2020. On January 30, 2019, CMS lifted the moratorium on new HHA enrollment in all states to improve patient access to home-based care in these regions. According to CMS, “implementation of additional and new safeguard measures in place of the moratoria” acted as catalysts to this decision.

> “Based on a survey of physicians who serve predominantly Medicare fee-for-service (FFS) and Medicare Advantage (MA) patients, we estimate that up to $265.0 billion worth of care services (representing up to 25.0% of the total cost of care) for Medicare FFS and MA beneficiaries could shift from traditional facilities to the home by 2025 without a reduction in quality or access.”
>
> **Oleg Bestsennyy, Michelle Chmielewski, Anne Koffel, and Dr. Amit Shah**
> McKinsey & Company, February 2022

The Bipartisan Budget Act of 2018, signed into law in February 2018, mandated a change in the HHA PPS unit of payment from 60-day episodes to 30-day episodes and went into effect January 1, 2020. The bill also required Medicare to stop using the number of therapy visits provided to determine home health payment. This continued the industry-wide transition from the fee-for-service model to a value-based model of care. The new payment method, referred to as the Patient-Driven Groupings Model (PDGM), went into effect January 1, 2020.

On October 31, 2022, CMS issued the FY 2023 final payment rule for the HHA PPS which resulted in a home health payment update percentage increase of 4.0%. This was an increase from the FY 2022 final payment rule which had previously resulted in a standardized 30-day episode payment increase of 2.6%. The Home Health PPS uses the latest core-based statistical area (CBSA) delineations and the latest available “pre-reclassified” hospital wage data collected under the Hospital Inpatient Prospective Payment System. The wage index is applied to the labor share of the payment rate to account for differing wage levels in areas in which home health services are rendered.

Hospice Agencies (HSPA)

The number of Medicare hospice beneficiaries increased 3.9% compounded annually from approximately 1.16 million in 2010 to approximately 1.70 million in 2020. During the same period, the number of HSPAs increased 3.8% compounded annually from 3,498 in 2010 to 5,058 in 2020. The increase in HSPAs is primarily attributable to growth in for-profit hospice providers which increased from 1,958 hospices in 2010 to 3,680 hospices in 2020, or approximately 6.5% compounded annually. This can be compared to the number of non-profit hospices and hospices with government or other ownership structures which decreased at compound annual growth rates of (0.8%) and (4.1%), respectively, over the same period. In 2020, with the onset of the pandemic, deaths among Medicare beneficiaries increased by nearly 18.0% and more than 1.7 million Medicare beneficiaries (including almost half of decedents) received hospice services from 5,058 providers. Medicare hospice expenditures totaled $22.4 billion.

On July 27, 2022, CMS issued the FY 2023 final payment rule for HSPA PPS which resulted in a hospice cap amount rate increase of 3.8%. This was an increase from the FY 2022 final payment rule which had previously resulted in a hospice cap amount rate of 2.0%. Hospices that are unable to reach quality reporting requirements are given a 2.0%-point reduction in their annual hospice payment percentage update.

Hospital at Home

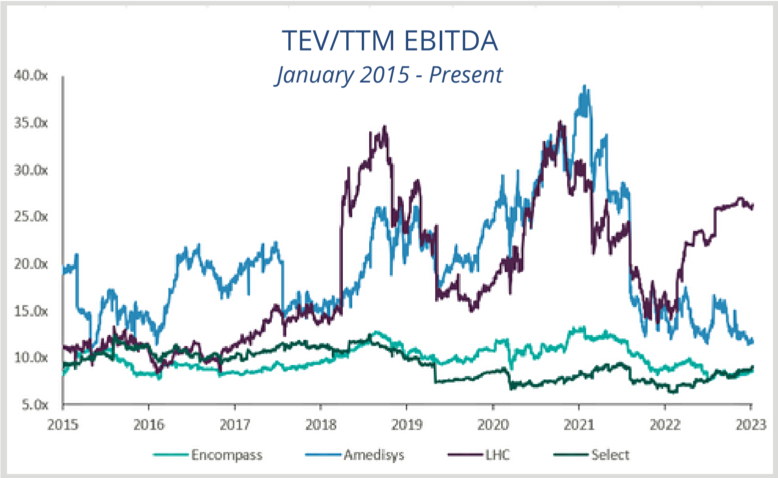
Hospital-at-home programs and providers have gained significant momentum in recent years due to healthcare operators looking to alternative care models in a post-COVID environment. Hospital-at-home programs enable some patients who need acute-level care to receive care in their homes rather than in a hospital. They have been shown to reduce costs, improve outcomes, and enhance the patient experience.

Several operators have made headlines in the last several years, including DispatchHealth, Contessa Health, and Medically Home Group, Inc. Generally, these companies act as a service provider to hospitals, HHAs, and HSPAs to provide certain acute-care services to patients who otherwise would require in-hospital care. While U.S. payors have been slow to accept these models, it is easy to see how post-acute providers can benefit from these programs and service providers by keeping patients who are under their care out of the emergency room or hospital for certain conditions.

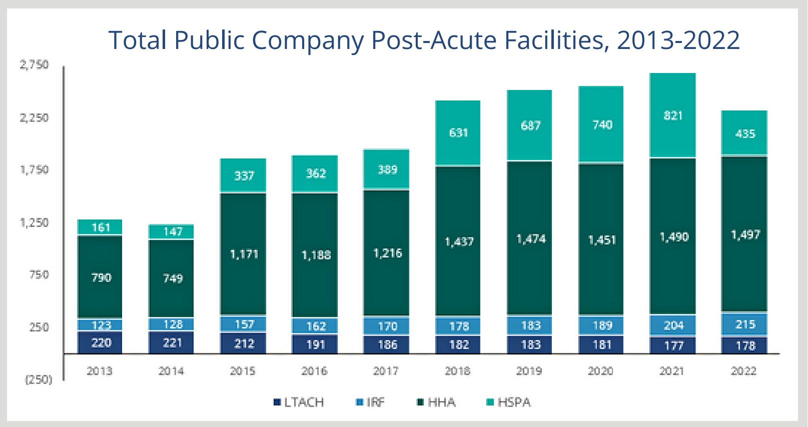
On January 10, 2022, Medically Home announced $110.0 million of funding from Baxter InternationalInc., Global Medical Response, Inc., and Cardinal Health, Inc. Additionally, Dispatch Health announced a $330.0 million capital raise on November 15, 2022, led by Optum Ventures. That brought Dispatch's total fundraising to over $700.0 million since it was founded in 2013. It remains to be seen how these investments and industry trends will impact the post-acute transaction environment, but there is evidence of institutional capital pursuing these opportunities.

M&A Trends

The chart below presents total enterprise value (TEV)/TTM EBITDA multiples for the major public post-acute operators and the VMG Health Post-Acute Index since January 1, 2015. The VMG Health Post-Acute Index consists of Encompass Health Corporation (Encompass, formerly known as HealthSouth), Amedisys, Inc. (Amedisys), LHC Group (LHC), and Select Medical Corp. (Select).



With the capital costs and regulatory pressure on LTACHs and IRFs, as well as the continued shift toward lower cost outpatient settings, M&A volume for HHAs and HSPAs has remained elevated in comparison to LTACHs. This trend can be seen in the portfolio mix of the large post-acute providers: Encompass, Amedisys, LHC Group, Enhabit, Select, and LifePoint/Kindred. Of the facilities owned by these companies from 2013 to 2022, the total number of LTACHs has decreased 2.3% compounded annually, the total number of IRFs has increased 6.4% compounded annually, the total number of HHAs has increased 7.4% compounded annually, and the total number of HSPAs has increased 11.7% compounded annually (with the removal of the hospice assets divested by Kindred at Home – if accounting for the number of hospice facilities owned by Kindred at Home in 2021, then the CAGR is 19.7%). It should be noted that in July 2021, Humana completed the acquisition of the remaining shares of Kindred at Home for $5.7 billion. Humana had previously acquired 40.0% of Kindred at Home in July 2018. In December 2021, Kindred's remaining business was acquired by LifePoint Health. Additionally, Humana divested a 60.0% stake in Kindred at Home's hospice and personal care divisions to private investment firm Clayton, Dubilier & Rice which was completed on August 11, 2022. Facility statistics for LTACHs and IRFs owned by LifePoint Health, and HHAs owned by CenterWell Home Health (formerly Kindred at Home), are included in the chart below. Please note hospice statistics for the assets now owned by Clayton, Dubilier & Rice are removed in 2022.



As a result of the Hospital Readmissions Reduction Program, the MACRA Act of 2015, and the Medicare Bundled Payments for Care Improvement Initiative, hospitals are increasingly incentivized to coordinate care in the post-acute setting to reduce potential penalties that would occur if patients were readmitted or had poor outcomes. As a result, hospitals have an incentive to direct patients to better performing post-acute care organizations and settings. Further, the historically fragmented post-acute industry has proven an opportunity for consolidation and investment from private equity funds, particularly in the home health and hospice settings.

> "So, a lot of great deals, a lot of things that have come into play recently and we feel very good to have such a full pipeline."
>
> **Scott G. Ginn, Executive VP, CFO, and Acting COO, Amedisys, Inc.**
> Q4 2022 Earnings Call

PE firms have been attracted to the home health and hospice industry due to the need for scale and efficiency driven by the transition from fee-for-service to value-based payment models and the continued emphasis on outpatient care to reduce healthcare costs. Like other healthcare sectors seeing increased interest from PE firms, such as behavioral health and physician medical groups, PE firms in the home health and hospice space tend to pursue a platform-building strategy. This strategy involves taking advantage of the arbitrage opportunity between the higher EBITDA multiple typically commanded by larger home health and hospice agencies (>$5m in revenue) and the lower EBITDA multiples for smaller agencies (<$5m revenue).

PE firms targeting home health agencies are looking to take advantage of perceived inefficiencies in site-of-care economic differentials. They aim to capitalize on changing reimbursement models which focus on value of care rather than frequency of care. Additionally, as Medicare and private insurers continue to push toward lower cost care settings PE firms aim to capitalize on increasing home health volumes.

In April 2022, Clayton, Dubilier, & Rice announced its intention to acquire 60.0% of the hospice and personal care assets of Kindred at Home from Humana for approximately $2.8 billion. 60.0% of Kindred at Home was previously acquired in July 2018 by TPG Capital and Welsh, Carson, Anderson, & Stowe.

In recent years, hospitals and health systems have been pursuing JV arrangements in the post-acute subsector. Driving this trend are (i) hospitals looking to free up inpatient resources for services with higher margins, (ii) hospitals looking to right-size financially underperforming units, (iii) increasing regulatory and financial incentive to manage the total post-acute continuum of care, (iv) and the efficiencies of scale and management expertise that large, specialized operators can bring. Encompass Health was the most active in completing JVs throughout 2022 compared to Select Medical and LHC Group. Select Medical and LHC Group, however, still formed strategic JVs in high-demand markets.

In May 2022, LHC Group and Archbold Medical Center announced the finalization of a JV partnership for in-home healthcare services located in and around Thomasville, Georgia. It was reported the agreement includes two locations serving the counties of Thomas, Brooks, Grady, Colquitt, Mitchell, Decatur, and Seminole which expands LHC Group's service area to five additional counties. In September 2022, LHC Group and the University of Maryland Medical System announced the signing of a definitive agreement to form a new JV partnership for in-home healthcare services throughout Maryland.

In January 2022, Encompass and Saint Alphonsus Health System announced a new JV agreement in Idaho, which includes Saint Alphonsus's home health and hospice locations in Boise, Idaho, and the Encompass Health home health and hospice locations in Boise, Idaho and Nampa, Idaho. In February 2022, Encompass announced an expanded JV agreement with Baptist Health South Florida that includes Baptist Health South Florida's home health agency in Miami, Florida. The transaction closed in December 2021.

In February 2022, Encompass and Lee Healthcare Holdings, LLC (a subsidiary of Lee Health) announced a collaboration to jointly own and operate two new inpatient rehabilitation hospitals in Southwest Florida. In June 2022, Encompass and NCH Healthcare System announced the intention to enter into a JV agreement to operate a 50-bed, freestanding inpatient rehabilitation hospital in Naples, Florida. The hospital opened in September 2022. It was also announced in July 2022 that Encompass and BJC HealthCare were awarded a Certificate of Need to build a freestanding, 40-bed inpatient rehabilitation hospital in Town and Country, Missouri. In addition, Encompass and Piedmont announced in October 2022 they were awarded a Certificate of Need to build a freestanding, 40-bed inpatient rehabilitation hospital in Athens, Georgia.

In June 2022, Select Medical and ShorePoint Health Venice, a subsidiary of Community Health Systems, announced the formation of a joint venture to operate a critical illness recovery (licensed as long-term care) and inpatient rehabilitation hospital in Venice, Florida. In June 2022, Select Medicaland Inova Health System announced a joint venture to own and operate the first critical illness recovery hospital in Northern Virginia. In October 2022, Select Medical announced a partnership with the University of Pittsburgh Medical Center to open a third inpatient rehabilitation hospital in Central Pennsylvania.

Notable Transactions

As previously mentioned above, in April 2022 it was announced that PE firm Clayton, Dubilier, & Rice intends to acquire 60.0% of the hospice and personal care assets of Kindred at Home from Humana for approximately $2.8 billion.

In March 2022 it was announced that UnitedHealth Group's Optum business intends to acquire LHC Group for approximately $5.4 billion. UnitedHealth Group agreed to pay $170 per share for LHC Group. LHC Group has 964 locations in 37 states and reported a revenue of $2.2 billion in 2021. The transaction is expected to close in the first quarter of 2023.

Conclusion

Given the shift in referral patterns away from LTACHs and IRFs along with the capital requirements and regulatory pressure, VMG Health expects M&A volume in the post-acute sector to continue focusing on HHAs and HSPAs. The fragmented status of both the HHA and HSPA industries has left plenty of room for consolidation. The HHA and HSPA space will likely remain a seller's market, especially for larger transactions, as strategic buyers seek to incorporate the entire continuum of care and to provide consumer-friendly alternatives to patients. In a post-COVID world, HHAs and HSPAs with sophisticated technological and telehealth capabilities will become increasingly popular targets.

More Post-Acute Thought Leadership

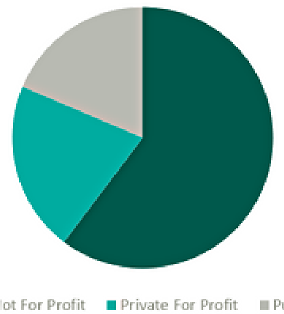
- Hospice Medical Directors: Compliance Considerations
- Is There Value in Your Inpatient Rehabilitation Facility?

Behavioral Health

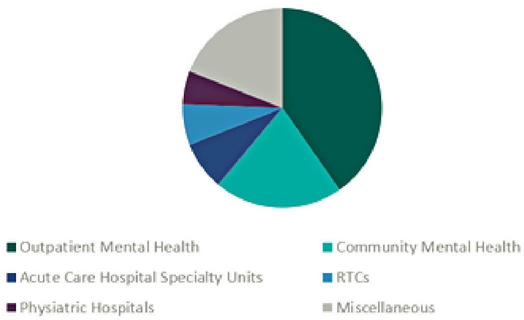
Industry Trends

Approximately 57.8 million (22.0%) adults in the United States have had a mental illness at some point in their lives and 14.1 million (5.5%) have had a serious mental illness within the past year. In addition, approximately 43.7 million (15.6%) people needed substance abuse treatment in 2021, but only 4.1 million (1.5%) people received any care. The number of people seeking care compared to the number of people with a need illustrates how there is a substantial imbalance in supply and demand in the industry.

Behavioral Health Facility Operators



Behavioral Health Facility Types



To service this demand the U.S. has over 15,400 behavioral health facilities (BHF) including psychiatric hospitals, acute care hospital specialty units, residential treatment centers (RTC), and outpatient clinics. According to the Department of Health and Human Service's National Mental Health Services Survey, the primary operators of BHFs are private not-for profit operators with approximately 60.3% of total facilities. The majority of BHFs are outpatient mental health and community mental health representing 40.3% and 20.8% of total facilities, respectively.

The largest behavioral health companies in the United States are the publicly traded Acadia Healthcare Company, Inc. (Acadia) and Universal Health Services, Inc. (UHS), and the privately held Legacy Lifepoint Health (Lifepoint). As of the end of Q2 2022, Acadia's U.S. operations included 246 BHFs with approximately 10,800 beds in 39 states (including Puerto Rico). As of Q3 2022, UHS' U.S. and U.K. operations comprised 331 inpatient BHFs,12 outpatient BHFs, and approximately 24,000 beds. Further, Lifepoint operates 30 behavioral health units in three inpatient behavioral health hospitals and in partner hospitals.

Furthermore, PE-backed behavioral health platform companies such as BayMark Health Services (398+ recovery programs backed by Webster Equity Partners), Discovery Behavioral Health (130+ facilities backed by Webster Equity Partners), and Summit BHC (30+ facilities backed by Patient Square Capital) have continued to become more prevalent and grow market share.

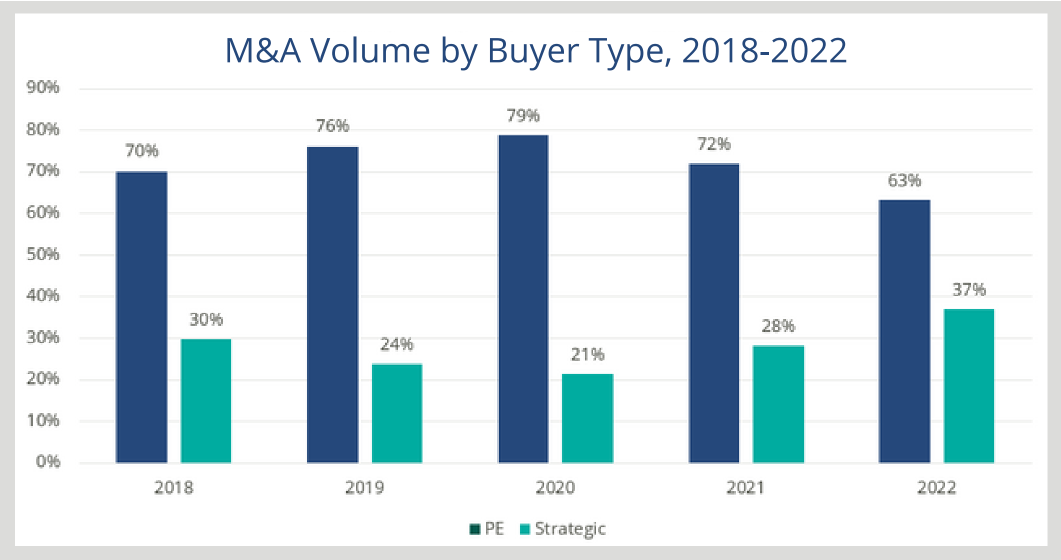
M&A Trends

Following a record-breaking year for M&A deals in the behavioral health space in 2021, transactions were down slightly in 2022 although they were still above historical levels. Transaction volume has largely been driven by staffing shortages (provider and non-provider), high fragmentation, demand outstripping supply, challenging reimbursement, and pressure on existing out-of-network strategies.

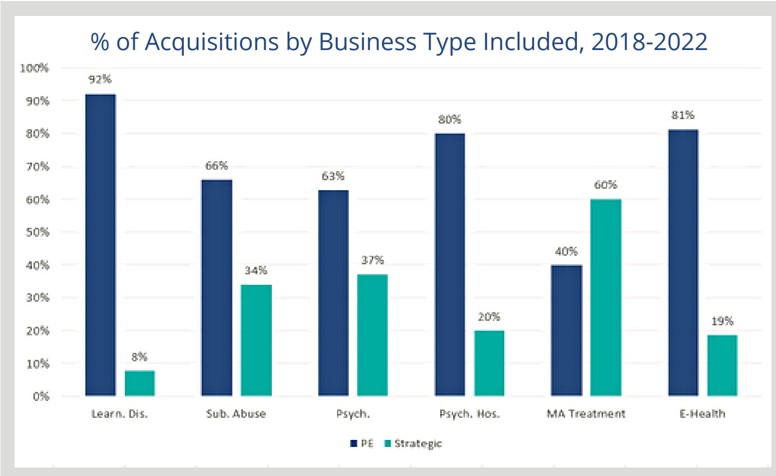
> "Moving forward, we believe that Acadia really is better positioned than ever for continued strong inorganic growth. And there are a few reasons for that, first is just the level of fragmentation of the market that we talked about earlier and the industry consolidation value opportunity that represents."
>
> **Andrew Lynch, Chief Strategy Officer, Acadia Healthcare**
> Analyst Investor Day Conference, December 2022

Recent transactions can be grouped into the following trends: PE investments and JV strategies with for-profit operators.

As seen in the following chart, PE continued to lead M&A deal activity in the behavioral health space over strategic transactions in 2022. Deal activity is expected to rebound in 2023 as investors continue to value the sector's positive long-term demand trends. Each year increased funding is provided at the federal, state, and local levels to combat the worsening behavioral health crisis.



In 2022, substance abuse led all behavioral health sub-sectors with the most transaction volume among learning disabilities, psychiatry, psychiatric hospital, medication-assisted treatment, and e-health.



The three large for-profit behavioral health operators are Acadia, Lifepoint, and UHS. All of these operators have continued to develop JVs with acute care operators.

In January 2023, Lifepoint announced a JV with Mercy Health to develop a 75,000 square foot, 72-bed inpatient hospital in Youngstown, Ohio. Lifepoint's foray into joint-ventured behavioral health units and hospitals follows a strategy led primarily by Acadia and UHS to tackle the psychiatric bed shortage. In June 2022, Acadia announced a 144-bed inpatient facility in Malden, Massachusetts through a JV with Tufts Medicine. This announcement was followed by another similar structure in Greenville, South Carolina with ECU Health for a total investment of $65.0 million. Both facilities are similar in the size and the scope of services offered.

Acadia	Lifepoint
ECU HEALTH TuftsMedicine	MERCYHEALTH

The JV model typically includes the development of a freestanding hospital with 90 to 150 beds that is specifically designed with behavioral health in mind. Acute-care hospital operators view the JV model as an opportunity to carve out non-core operations with both a challenging payor mix and long length of stay. Additionally, these operations require specific features such as anti-ligature requirements that are best suited in a purpose-built facility. Through a JV with an experienced operator, hospitals can participate in pro rata cash flows that may not have existed within its existing cost-structure.

Notable Transactions

Notable deals include the January 2022 Patient Square Capital's acquisition of Summit BHC for approximately $1.3 billion. Summit BHC was sold to Patient Square Capital from FLL Partners and Lee Equity, which originally made its investment in 2017.

In July 2021, Onex Partners took a 60.0% controlling interest in Newport Healthcare which valued the business at $1.3 billion. Newport Healthcare is a teens-focused mental health platform and was formerly backed by The Carlyle Groups US Equity Opportunity Fund.

Medical Properties Trust, a real estate investment trust, committed $950.0 million to purchase and leaseback 18 inpatient behavioral health hospitals and an equity interest in the operations of Springstone, LLC from Welsh, Carson, Anderson & Stowe.

In October 2022, Lee Equity Partners acquired Bradford Health Services from Centre Partners. Bradford Health Services provides substance abuse treatment and recovery services across 40 sites of care in the Southeast.

Acadia Healthcare acquired four comprehensive treatment centers (CTC) in the suburbs of Atlanta from Brand New Start Treatment Centers. These four centers continue the M&A activity of Acadia which has acquired 13 total CTCs from 2019 to 2022. In addition, the firm has identified an M&A outlook defined by joint ventures with acute care hospitals that often view the behavioral health service line as a non-core area of operations. For 2022, Acadia opened new behavioral health facilities joint-ventured with Covenant Health in Tennessee, and Lutheran Health Network in Minnesota. The joint-venture strategy will continue into 2023 with Geisinger and Bronson facilities opening.

In November 2022, ARC Health, a Thurston Group portfolio company, acquired Lotus Consulting which is a mental health therapy practice based in Ann Arbor, Michigan. ARC Health was founded in 2021 and already has more than 320 psychiatrists, psychologists, and therapists in 10 states across the country.

BayMark Health Services announced the acquisition of Fritz Clinic, a group of six office-based opioid treatment programs based in Alabama. Fritz was established in 2003 and will continue to operate under the brand name AppleGate Recovery. BayMark Health Services is the largest provider of opioid use services in North America and the leader in evidence-based treatment options for substance abuse. The organization provides treatment to over 70,000 patients in recovery across more than 400 treatment facilities in 37 states and three Canadian provinces.

> "On your question on the M&A front in this environment, I continue to believe that -- and I think we all believe that we're going to see more opportunity. I mean given our strong balance sheet, given the fragmentation of this market, there are many smaller players that I think will look to a partner over the next several years."
>
> **Christopher Howal Hunter, CEO & Director, Acadia Healthcare**
> Q3 2022 Earnings Call

BayMark later announced the acquisition of Nashville Recovery Suboxone Clinic in December and solidified their ninth acquisition of the year. Established in 2017, Nashville Recovery provides in-office and telemedicine opioid treatment services to individuals living with an opioid use disorder.

In March 2022, Optum which is UnitedHealth Group's health services division, acquired Refresh Mental Health from PE firm Kelso & Company. The acquisition came just 15 months after Kelso & Company announced its investment. Founded in 2017, Refresh provides outpatient mental and behavioral health services. The organization has 300 locations across 37 states offering a variety of services including psychiatry and substance abuse treatment.

Summit BHC is a leading national provider of behavioral health and addiction treatment services based in Franklin, Tennessee. In January 2022, the organization acquired seven psychiatric hospitals in six states from Strategic Behavioral Health. Summit now owns and operates 31 facilities across the country.

Lifepoint announced in late-August it entered into a definitive agreement to acquire a majority ownership interest in the operating company of Springstone. Springstone is a behavioral health provider with 18 hospitals and 35 outpatient locations spanning nine states.

Reimbursement

On July 27, 2022, CMS published its Fiscal Year 2023 Inpatient Psychiatric Facility (IPF) PPS final rule with a 3.8% increase in rates after a 0.3% productivity adjustment. CMS estimates total IPF PPS payments will increase by 2.5%, or $90.0 million, compared to FY 2022 payments. This final rule is up from the proposed rule issued by CMS at the end of Q1 2022 which proposed a 2.7% increase in rates after a 0.4% productivity adjustment. Behavioral health operators continue to shift services to off-site locations to relieve occupancy issues and to attract commercial patients who may be less inclined to choose an inpatient facility within an acute care hospital due to social stigma.

In 2022, CMS expanded and extended Medicare coverage for telehealth services through the PFS. Most notably, CMS permanently expanded coverage for the diagnosis, evaluation, or treatment of certain mental health disorders to include services delivered to beneficiaries located in their homes. Adoption of telehealth behavioral health services has continued to increase because of additional consumer options, increased awareness, and a strong demand for care. While access to telehealth has continued to expand, there are questions beginning to arise around providers' ability to treat patients through prescribed medication via telehealth. Specifically, in certain instances, local pharmacies have denied prescriptions for controlled substances used to treat opioid addiction prescribed by telehealth startups. While telehealth startups have helped close the gap in behavioral healthcare, there is still some skepticism that providers at these companies are simply prescribing medications without closely monitoring their patients. As telehealth startups continue to expand access to behavioral healthcare they continue to await more permanent guidance from the DEA on their ability to treat patients.

Regulatory

In 2022 the implementation of the No Surprises Act, part of the Consolidated Appropriations Act of 2021, began to affect many BHFs and providers who historically operated on an out-of-network basis. Facilities had historically done this to offset heavy governmental payor mixes that yielded less than favorable reimbursement dynamics. Under the No Surprises Act operators are seeing disruption to their revenue cycle as out-of-network claims are now going through arbitration. This is resulting in lower reimbursement for facilities who have historically deployed this strategy.

Conclusion

The behavioral health industry has been and will continue to be on the front lines of treating the U.S. mental health and substance abuse epidemic. At the same time, the industry is also emerging as a leader and prime candidate for the adoption of virtual healthcare delivery. Companies with a proven ability to provide virtual services will be popular acquisition targets and the opportunity to create a JV with inpatient facilities will be attractive to acute care hospital operators. An increase in mental health disorders caused by the pandemic and recent economic downturn is expected to persist long after COVID-19 subsides and this will likely benefit BHFs in the long term.

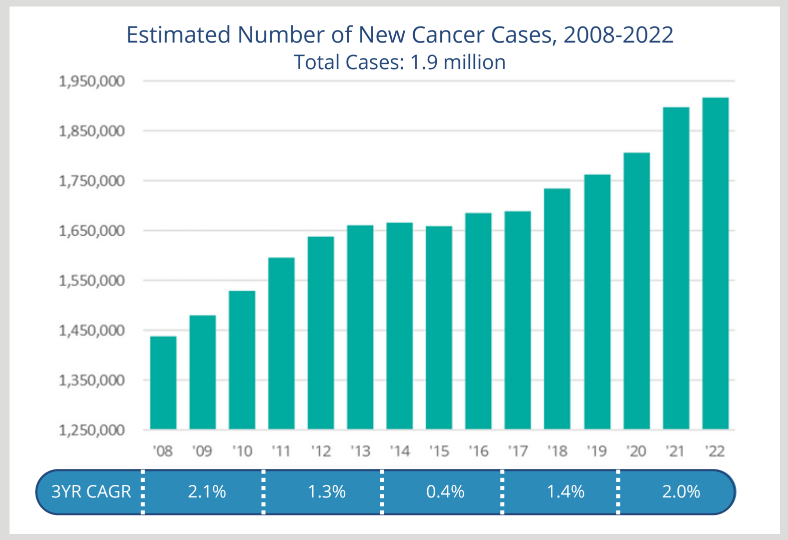
More Behavioral Health Thought Leadership

- Strategic Case Study: Behavioral Health Services Assessment
- Inpatient Behavioral Health Joint Ventures: State of the Market
- Now Trending in Behavioral Health: Integration Strategy, Regulatory Compliance, & Transactions

Oncology

Industry Overview

Approximately 1.9 million new cancer cases were diagnosed in the U.S. in 2022. This is a 1.0% increase over 2021 and a 1.9% increase since 2010, compounded annually. Based on research by Lola Rahib, PhD published in the National Library of Medicine, the estimated number of U.S. cancer incidences is projected to increase by 0.8% compounded annually until 2030.



Based on the 2022 Oncology Market Report by Precedence Research, the global oncology market was valued at $286.0 billion in 2021. By 2030 it is projected to reach $581.0 billion and represent an 8.2% growth rate, compounded annually.

The number of oncologists in the U.S. has increased 2.4% compounded annually from 21,869 in 2015 to 25,228 in 2021. Of the total oncologists, 66.1% were hematologists and oncologists, 12.6% were pediatric hematologists and oncologists, and 21.3% were radiation oncologists. In 2022, the AMA estimated that 22.0% of oncologists were near retirement (64+), and only 13.9% of oncologists were under the age of 40. Due to the aging population of active oncologists, the American Society of Clinical Oncology projects a shortage of nearly 2,200 oncologists by 2025.

M&A Trends

Following the emergence of several PE and corporate-backed oncology platforms from 2018 to 2020, there has been a recent trend of tuck-in acquisition activity as existing platforms have focused on growth through affiliation with practices and physicians.

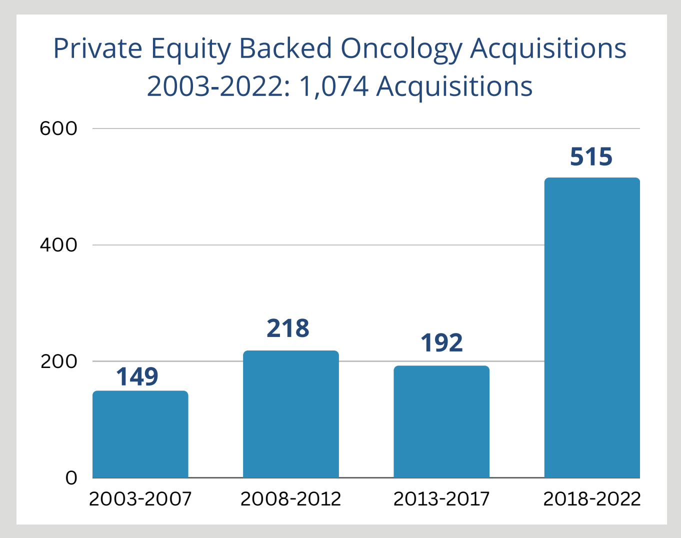
The value-based care model has rapidly gained traction within the oncology space and has given rise to new market entrants such as The Oncology Institute, which became publicly traded in 2021, and most recently, Oncology Care Partners. At the same time, existing operators such as OneOncology, The US Oncology Network, and American Oncology Network (AON) have started to pursue value-based opportunities through strategic partnerships and investments.

In February 2022, Valtrius, a Welsh, Carson, Anderson & Stowe company, announced the launch of Oncology Care Partners, a platform of owned and affiliated oncology practices built solely to provide valued-based care. In January 2023, OCP launched its first two practices in Phoenix and Miami as the first steps of its national growth plan. The platform entered a JV arrangement with AON to provide administrative support, technology, and resources to advance value-based care for Phoenix-based Medicare Advantage patients. In South Florida, OCP acquired United Oncology Medical Associates, a medical oncology practice with two Miami locations.

> "With cancer costs rising exponentially and care becoming more complex, we see an opportunity to create a better, more focused patient journey in medical oncology care that simultaneously provides value for payors and at-risk primary care groups,"
>
> **Erich Mounce, Oncology Care Partners CEO**
> January 2023

On January 1, 2023, The US Oncology Network closed the acquisitions of Epic Care and Nexus Health, two large multidisciplinary practices in Northern California and Sante Fe, New Mexico. Epic Care operates out of 21 locations with 47 physicians including medical oncologists, radiation oncologists, and multispecialty surgeons. Nexus currently has nine physicians from a wide range of specialties.

> “With the addition of these well-respected multidisciplinary practices, we are entering new communities and expanding our ability to empower high-quality care that benefits patients, as well as physicians. The wide range of specialties these practices offer enables more comprehensive care, helping to ensure patients can conveniently receive the care they need in their local areas during their entire healing journey.”
>
> **Carlos de Solo; Co-Founder, President, CEO, and Director; CareMax**
> Q3 2022 Earnings Call



There has been a recent trend of large, high-profile cancer providers continuing to expand their reach into new areas and markets through partnerships and affiliations. Examples of this include City of Hope’s acquisition of Cancer Treatment Centers of America and MD Anderson’s partnership with Community Health Network in Indiana.

Over the past two decades, there have been over 1,000 medical and radiation oncology practices acquired by a total of 23 PE-backed oncology platforms. As evidenced in the chart below, PE involvement in the oncology space is rapidly increasing with nearly half of all the acquisitions over the last 20 years occurring in the past four years.

These PE-backed platforms strategically target practices for consolidation to leverage geographic expansion, economies of scale, or hospital affiliations.

Recent PE Investment	Platform	Locations	Providers	PE Firm	Vintage
Medical & Radiation Oncology Platforms		**310+**	**890+**		
	OneOncology	260+	885	General Atlantic	5 years
	Integrated Oncology Network	50	n/a	Silver Oak Services Partners	5 years
	Verdi Oncology	3	9	Pharos Capital Group	5 years
	Alliance HealthCare Services (1)	n/a	n/a	Tahoe Investment Group	5 years
Urology Platforms (2)		**525+**	**1,010+**		
	United Urology Group	220+	95	Audax Private Equity	7 years
	Urology Management Associates (3)	n/a	n/a	Prospect Hill Growth Partners	4 years
	Solaris Health	183+	509	Lee Equity Partners	3 years
	Urology America	28	83	Gauge Capital	3 years
	US Urology Partners	40+	150+	NMS Capital	5 years
	Unio Health Partners (4)	54	182	Triton Pacific Capital Partners	2 year
Grand Totals		**830+**	**1,900+**	**Average Age**	**4.4**

(1) Acquired by Akumin Inc in 2021. 200+ locations at time of acquisition.

(2) Urology platforms and investments considered due to radiation oncology component.

(3) Acquired by Summit Health in January 2022. 150 Providers and 60+ locations at time of acquisition.

(4) Formerly Urology Partners of America. Please note location and provider counts include most recent partership with inSite Digestive Health Care which added 67 gastroenterologists and three pathologists.

OneOncology, a national platform of oncology practices founded by General Atlantic in 2018, expanded its existing operations in California through a partnership with Medical Oncology Associates of San Diego and the acquisition of Compassionate Oncology Medical Group by LA Cancer Network, an affiliate of OneOncology. In June 2022, the platform announced a new affiliation with the Cancer & Hematology Center of Western Michigan, a medical oncology practice with 25 physicians and 55 advanced practice providers across four Michigan locations.

> "By aligning with other leading oncology practices, our participation in OneOncology brings the technology and data that will place CHCWM at the forefront of value-based contracting arrangements with employers and payers – a must to provide patient-centric, high-quality cancer care in our communities."
>
> **Mark Campbell, President, Cancer & Hematology Center of Western Michigan**
> June 2022

OneOncology also announced a new partnership with Oncology Specialists of Charlotte in October 2022 to expand value-based care in North Carolina. OneOncology plans to assist the practice with its participation in the new Enhancing Oncology Model and other risk-bearing arrangements with commercial insurers.

Overall, OneOncology added 159 physicians to its platform in 2022, and it now operates across 11 states with 260+ locations and close to 900 physicians.

In April 2022 the Integrated Oncology Network (ION), backed by Silver Oak Services Partners, announced its acquisition of California Cancer Associates for Research and Excellence (cCARE). cCARE is an integrated cancer care network that provides medical oncology, radiation oncology, diagnostic imaging, and other ancillary services in the Fresno and San Diego markets. With the acquisition of cCARE, ION operates from 57 cancer centers across 14 states.

NMS Capital's US Urology Partners announced strategic partnerships with Florida Urology Center in June 2022 and with Urology of Indiana in January 2023. With locations in five cities throughout the state, Florida Urology Center offers comprehensive urologic and cancer care services. US Urology Partners formed its fifth partnership with Urology of Indiana, a practice comprised of 60+ providers at 14 locations including two Integrated Cancer Centers for Prostate Cancer.

Lee Equity Partner's Solaris Health added The Urology Group Central Indiana, based in Muncie, Indiana, to its platform in September 2022. With four physicians and five advanced practice providers, Urology Associates professionals practice out of eight offices across the state. Urology Associates providers perform all approved treatments for benign and malignant prostate diseases, including the newest treatments for prostate cancer. Solaris Health's platform now spans over 500 providers at over 183 locations.

In January 2022, Triton Pacific Capital Partners' Unio Health Partners announced its partnership with West Coast Urology which marked the third major practice to join the platform. With this affiliation Unio added nine providers, including a board-certified urologic oncologist, and it added four offices to its growing network which is expected to reach 200+ physicians within the next few years.

Also active in 2022 was Gauge Capital's Urology America which announced partnerships with the Urology Associates of Denver and the Southern Surgical and Medical Specialists. These affiliations added more than 30 providers to the platform including specialists in radiation oncology.

Notable Transactions

In October 2022, AON announced it had entered into a definitive business combination agreement with Digital Transformation Opportunities Corp. at a pro forma enterprise value of $500.0 million and implied TEV/Adjusted EBITDA multiple of 13.8x. After the transaction is approved and completed, the combined entity will be listed on the Nasdaq and AON will join TOI as the only other publicly traded pure-play oncology platform. AON's platform currently includes 24 practices across 18 states with over 100 physicians.

Since becoming publicly traded, The Oncology Institute (TOI) has acquired five independent practices expanding its presence to five states across the country (Arizona, California, Florida, Nevada, and Texas).

In February 2022, City of Hope closed its acquisition of Cancer Treatment Centers of America, a comprehensive oncology network comprised of three hospitals in Atlanta, Chicago, and Phoenix. The $364.4 million transaction was announced in December 2021 and had an implied TEV/revenue multiple of 0.46x.

Reimbursement

On November 2, 2022, CMS released the final rule for the 2023 MPFS which included a 4.5% reduction in Medicare reimbursement, and cut payments from $34.61 per RVU (2022) to $33.06 per RVU. On December 20, 2022, Congress passed an omnibus appropriation bill that included provisions to reduce the initial 4.5% cut to Medicare reimbursement to 2.0% in 2023 with an additional 3.0% for 2024. Overall, payments for both hematology/oncology and radiation oncology physicians are expected to decline by 1.0% due to RVU changes. When combined with the expiration of the 3.0% supplemental increase in PFS payments from the pandemic, this decrease will provide additional pressure on oncologists in 2023.

A 2018 final rule by CMS reduced the payment rate calculation for hospitals within the 340B program by nearly 30.0%, and from a rate of average sales price (ASP) plus 6.0% to a payment equal to ASP less 22.5%. Since this implementation, the reimbursement cuts have been challenged throughout the court system. In June of 2022, the Supreme Court ruled in American Hospital Association v. Becerra that the price reduction was illegal because CMS did not survey hospitals to determine their average acquisition cost. Due to this ruling, CMS settled on raising the rate to ASP plus 6.0% which will increase drug reimbursement by nearly $2.0 billion for hospitals participating in the 340B program. To offset this increase and maintain budget neutrality CMS reduced payments for non-drug services by 3.09%.

On August 25, 2022, CMS finalized its ruling to indefinitely delay the Alternative Payment Model (APM) for radiation oncology. The APM would have established a bundled, site neutral, episode-based payment for all radiation therapy services provided in a 90-day episode of care.

The Enhancing Oncology Model (EOM) was released by CMS in June 2022 as a replacement to the Oncology Care Model which expired June 30, 2022. Similar to its predecessor, the EOM is a five-year voluntary episode-based payment model set to launch July 1, 2023. Per CMS, EOM aims to drive transformation and improve care coordination in oncology by enhancing the quality of care to individuals undergoing cancer treatment and by reducing program spending under Medicare fee-for-service. Participating practices are responsible for the total cost of care during a six-month episode. In result, they can either earn performance-based payment or owe CMS a performance-based recoupment based on total episode expenditures and quality performance. Participants can also bill a monthly enhanced oncology services payment per beneficiary per month for the provision of enhanced services.

Conclusion

With increasing demand, reimbursement headwinds, and a complex regulatory environment, the oncology sector remains poised for further consolidation. It is likely there will be a continuation of the tuck-in acquisition activity seen in 2022. This is expected as oncologists pursue alignment with larger organizations to hedge against financial uncertainty and obtain capital funding for technology infrastructure related to risk-based contracting and other value-based arrangements.

In addition, recapitalizations of these investments are likely to occur over the next few years given that PE firms typically hold their investments for five to seven years and each of the identified oncology platforms are approaching vintages of five years.

More Oncology Thought Leadership

- Strategic Case Study: Oncology Services Assessment

Urgent Care

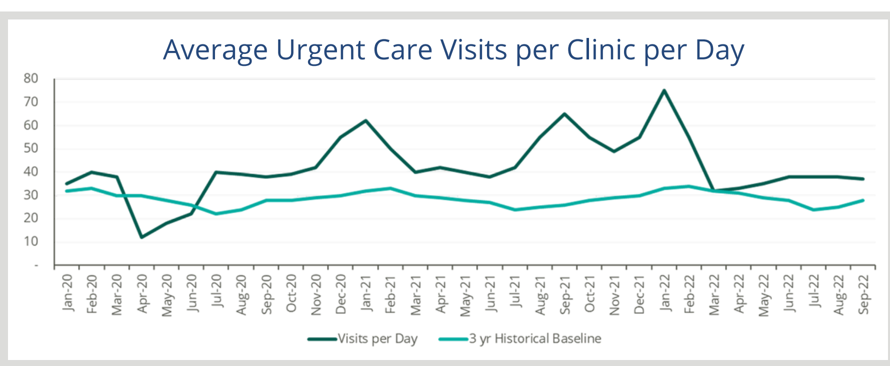
Industry Overview

The number of urgent care centers (UCCs) in the United States has grown 7.0% compounded annually from 6,100 UCCs in 2013 to 11,150 UCCs in 2022, and future industry growth is estimated between 7.1% to over 11.5% through 2030.

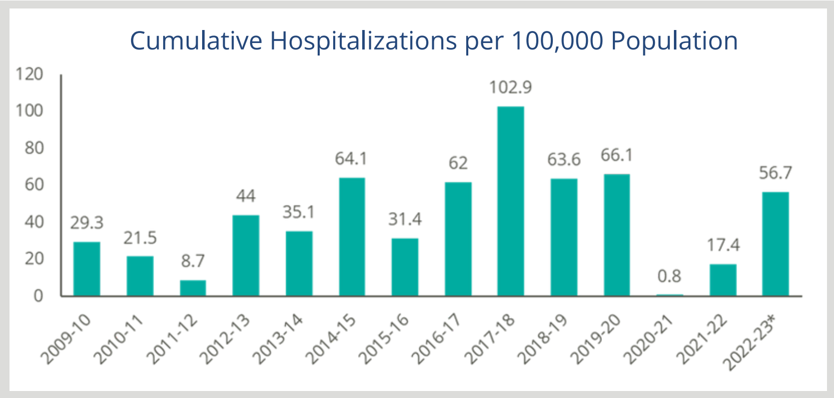
The growth in urgent care locations is driven by increased demand. Urgent care visit volumes continue to outpace other sites of service driven by several macro factors. First, consumers continue to demand accessible, on-demand health services. Second, patients are bearing more financial responsibility for their own healthcare leading to increased price scrutiny. Third, patients are expecting a digital healthcare experience in line with their online retail digital experience (i.e., Apple, Amazon, etc.). Fourth, many large commercial payors are changing their policies about what qualifies as a reimbursable visit to the emergency room. An emergency room visit is approximately 10 to 12 times the cost of an average urgent care visit according to the U.S. Department of Health. This has led to the transition of patient volume from the emergency room (some freestanding) to the urgent care setting. And finally, many patients were hesitant to visit an emergency room during the COVID-19 pandemic which lead patients toward less populated sites of care such as urgent care centers. Future industry growth is expected to continue for these reasons along with a rising shortage of primary care providers. The Association of American Medical Colleges expects a shortage of up to 50,000 primary care physicians over the next 10 years.

UCCs were at the forefront of treatment and testing services throughout the COVID-19 pandemic. After initial volume disruptions during the early onset of the pandemic, urgent care centers experienced a significant increase in testing volumes and new patient visits. Average patient visits per clinic reached record highs during summer 2020 as UCCS ramped up testing capabilities and adopted telehealth services.

Despite the lower overall COVID-19 volumes recently, patient visits per day at UCCs have remained elevated throughout 2022 compared to historical pre-COVID levels. In September 2022, there were approximately 35 visits per clinic per day compared to a three-year historical baseline of 28 visits per day for the month of September. This represented a 25.0% increase for clinic visits in September. COVID-19 still has an impact on urgent care volumes and represents 34.0% of urgent care visits.



Historically UCCs' patient visit volume experienced seasonality with flu season (higher volume) and the summer months (lower volume). In 2020 and 2021, the number of hospitalizations for influenza declined dramatically from a historical average as social distancing, masks, and other patient behavior limited both COVID-19 exposure and typical flu exposure. The 2022-2023 flu season is on track to be more severe as compared to the 2020-2021 and 2021-2022 seasons during the height of the pandemic and is even expected to outpace 2019-2020 pre-pandemic levels in terms of hospitalizations.



**Data through January 14, 2023, does not represent a full traditional flu season (October - April).*

In addition to traditional flu and COVID-19 volumes, the 2022-2023 season experienced a rise of RSV-related illnesses. Healthcare providers referred to this season as a "tripledemic." At the same time, non-COVID related injuries and illnesses are still below pre-COVID levels.

While the elevated visits per day experienced in 2021 is expected to be one-time for many centers, it is estimated that future urgent care volumes will remain elevated compared to pre-COVID levels. Patients who started to use urgent care during the pandemic are expected to continue to use UCCs for future care. Overall retention of patients who visited an UCC during the pandemic is 66.0% compared to 75.0% pre-COVID.

The average historical baseline visits per clinic per day was approximately 38 in 2019. It is estimated that there will be approximately 47 visits per clinic per day in 2023. This estimate implies a 20.0% increase in visit volume over pre-pandemic 2019 visit volume numbers. This is in line with estimates from The Journal of Urgent Care Medicine, which projects post-pandemic urgent care visits to stabilize at 15.0% to 20.0% of pre-pandemic levels based on visit volume trends observed through December 2022.

While there are many opportunities for UCCs visit volume growth, the future is still uncertain. During January 2022, through funding from the American Rescue Plan, at-home COVID testing kits were offered online for free. The program has offered several rounds of free at-home testing mailed through USPS. The program had an initial promise of 500 million tests and four additional tests per household were approved for distribution during December 2022. In addition, pharmacies, online stores (e.g., Amazon), and retail locations have expanded the accessibility of at-home testing kits and many commercial payors are covering the costs of at-home tests. Patients who turn to at-home testing alternatives for COVID-19 symptoms could directly impact UCCs.

Several large retailers are making significant investments in the primary care space by expanding services and the availability of retail clinics. The growth of these clinics could compete for lower-acuity urgent care visit volumes in the future as they offer comparable testing services at a lower cost.

Cost Comparison for Select Low Acuity Healthcare Services

	Retail Clinic Operators			Traditional Urgent Care
	CVS	Walgreens	Walmart	
Office Visit	**$99 - $139**	**$89**	**$40**	**$137**
Flu Test	**$70 - $100**	**$66**	**$20**	**$102**
Strep Test	**$35 - $45**	**$25**	**$20**	**$102**
Lipid Panel	**$37**	**$35**	**$10**	**$102**

Finally, UCCs are not immune to the staffing and inflation challenges facing other healthcare entities. UCCs are experiencing margin pressure based on several challenges:

- 94.0% experienced an increase in staff costs. UCCs are also competing with other healthcare providers for similar positions, particularly radiology technologists.
- 77.0% experienced supply cost inflation, and 60.0% of those respondents indicated cost increases of over 10.0%.
- 58.0% experienced increased technology and software costs.
- 52.0% expect a decline in blended net revenue per visit as COVID-19 volumes “normalize” and the ratio of established vs. new patients returns to historical baselines.

UCCs supported by COVID-19 testing and treatment volumes may experience financial distress if patients turn to alternative treatment sources and non-COVID volumes do not recover. Additionally, UCCs are not immune from challenges facing the healthcare industry, and staff costs and inflation are pressuring margins. Locations that struggle financially could seek to partner with a larger organization and become tuck-in acquisition targets in the next year. At the same time, there is a strong demand for urgent care services and strong growth is projected in the future. In other words, UCCs who remain profitable despite volume variability and margin pressure will remain attractive acquisition targets.

M&A Trends

The demand for urgent care services and industry growth continues to make UCCs attractive acquisition targets to a diverse buyer pool. Health systems, PE groups, and other buyers were active in the market during 2022. For health systems, UCCs offer a convenient access point into the health system that is less costly than operating emergency rooms or employed primary care networks. UCCs typically can provide both strategic and financial buyers with positive investment returns through the expansion of an existing platform and/or operational changes.

In addition, the urgent care market is highly fragmented with the top 10 providers accounting for approximately 20.0% of the total UCC locations. As of December 2022, Concentra (subsidiary of Select Medical Corp.) was the largest operator of UCCs with 536 locations. This was an increase from its approximately 300 locations in 2015 which represents a 10.0% compound annual growth rate. American Family Care, the second largest operator, celebrated the opening of its 300th urgent care clinic on December 6, 2022, and has communicated a goal to operate over 500 clinics by 2025.

The market fragmentation offers consolidators the opportunity to generate financial returns through economies of scale. In addition, an urgent care platform with multiple locations will be able to share staff and resources to help combat some of the current labor challenges. For financial and strategic buyers, optimizing the staffing model with lower-cost mid-level providers is the most common operational change being pursued. However, this varies by location as state laws regulate the amount of physician oversight required in individual UCCs.

Despite industry headwinds and risks, many urgent care platforms are communicating optimistic pipelines and an appetite for continued growth through acquisitions.

Next Level Urgent Care completed the acquisition of three urgent care centers in the Houston area during 2022. In addition, the company intends to open several de novo urgent care centers in the San Antonio and Beaumont regions of Texas this year.

PE buyers were involved in approximately 50.0% of UCC transactions in 2022, and there are no indications that activity will slow down in the future. The table below shows the largest non-hospital owned urgent care operators in the U.S. Of these, 10 are currently backed by a PE firm. Of the 10 PE-backed urgent care operators, five are exceeding the typical three-to-seven-year investment window ("vintage"), indicating a potential exit opportunity in the near future.

Urgent Care Chain	Locations (Dec. 2022)	Type	PE Firm	Vintage
Concentra	536	Health System	Select Medical Corp; WCAS	8 years
MedExpress	280+	Payor	n/a	n/a
American Family Care	300	Franchise	n/a	n/a
FastMed	200	Private Equity	ABRY Partners; BlueMountain Capital Management	8 years
GoHealth	195	Private Equity	TPG Capital	9 years
NextCare	170	Private Equity	Enhanced Capital Partners	12 years
CityMD	150	Private Equity	Walgreens / VillageMD	0 years
Fast Pace	170	Private Equity	Revelstoke Capital Partners	6.5 years
WellNow Urgent Care	183	Private Equity	SV Life Sciences, Petra Capital Partners, River Cities Capital Funds	11 years
Patient First	77	Independent	n/a	n/a
Urgent Team	74	Private Equity	Petra Capital, River Cities	7 Years
PM Pediatrics	71	Private Equity	Comvest Capital Partners	3.5 Years
Doctors Care	70	Independent	n/a	n/a
Nova Health	67	Private Equity	Shore Capital Partners	4.5 Years
CRH Healthcare	62	Private Equity	Freeman Spogli & Co.	4 Years

PE buyers were highly active in 2015 and several large platform transactions occurred. In addition, PE investors have deployed capital for new urgent care platforms during recent years. Since PE firms typically hold their investments for three-to-seven years, there is a possibility for increased M&A activity fueled by PE exits in the near future.

The current interest rate environment has increased the cost of debt which has made large transactions more expensive for investors and has added pressure to valuations. The disconnect between seller and buyer expectations could extend these PE hold periods. Even with an increasing hold period, these platforms are expected to continue pursuing tuck-in acquisition and other high-growth strategies.

Notable Transactions

Throughout 2022 there have been several notable urgent care transactions from a diverse set of buyer types including PE, strategic platforms, health systems, and other buyers.

In January 2022 HCA announced the completion of the acquisition of MD Now Urgent Care, the largest urgent care provider in Florida with 59 locations. HCA announced in November 2021 the plan to build three hospitals in the state and the platform of urgent care locations will assist HCA with its goal of providing a comprehensive statewide network of care in the Florida market. MD Now was acquired from Brentwood Associates which concluded an approximate 3.5 year holding period. HCA has continued to be active in the urgent care transaction space.

In April 2022HCA signed an agreement to acquire BetterMed, a 12-location urgent care platform in Richmond, Virginia. The deal closed in June 2022 and the clinics were rebranded as CareNow clinics in January 2023. HCA now owns and operates over 250 locations with the combination of the CareNow network of urgent care centers (185) and these two recent acquisitions (59 and 12 locations).

In March 2022, Atlantic Health purchased Immediate Care, a seven-location urgent care platform in New Jersey. Atlantic Health intends to incorporate the system's primary care, ambulatory surgery, and specialty care in the location's markets.

ICV partners completed the acquisition of Urgent Care Group in March 2022 as the first add-on acquisition to the Total Urgent Care platform. Urgent Care Group was founded in 2017 and operates 24 urgent care locations in the North Carolina, Georgia, and South Carolina markets. The combined platform now operates more than 50 urgent care locations with continued expansion plans through de novo opportunities and acquisitions.

In July 2022 WellNow Urgent Care, an urgent care platform with over 120 locations, acquired Physicians Immediate Care which is an urgent care platform with 55 locations in Illinois, Indiana, and Wisconsin.The combined platform will operate approximately 183 locations. Also, in June 2022 WellNow acquired Primary Urgent Care, a two-location business in New York.

Memorial Hermann also announced a joint venture with a strategic operator in April 2022. 10 Memorial Hermann clinics, including one dedicated pediatric location, will be contributed to a partnership with Go Health Urgent Care in the Houston, Texas market.

Piedmont and WellStreet formed a joint venture in 2014. In February 2022 the partnership acquired Village Medical Associates, a single urgent care location. Following that acquisition the partnership acquired SmartCare Medical Group, a 10-location urgent care business in the Atlanta, Georgia market.

In addition to PE and health systems, operators of hybrid care models, which combine primary care strategies and brick-and-mortar clinics, are looking at urgent care centers as acquisition targets.

Carbon Health, a tech-enabled healthcare company with the goal of combining virtual app-based services with brick-and-mortar primary care clinics, became an active buyer of urgent care locations and small urgent care platforms in 2021 and early 2022:

- 8/20/2021 Med7 Urgent Care – Four clinic urgent care business in the California market
- 8/20/2021 South Arizona Urgent Care – Nine-location urgent care business in Arizona
- 10/7/2021 Central Jersey Urgent Care – 10-location urgent care business in New Jersey
- 4/19/2022 MedPost California – Acquired 17 of MedPost's California locations from Orange County, Palm Desert, and Paso Robles

Carbon Health currently operates over 125 primary care or urgent care clinic locations across 13 states with continued expansion plans in the future. In January 2023, CVS announced a $100.0 million Series D investment in Carbon Health. The investment will be used to fund new primary care and urgent care clinic locations. The partnership intends to launch Carbon Health's urgent care operations in select CVS retail stores.

VillageMD (majority-owned by Walgreens Boots Alliance) and Evernorth, the healthcare services portfolio of Cigna Group, closed the $8.9 billion acquisition of Summit Health during January 2023. Summit Health is a multi-specialty physician group with over 2,800 providers and in 2019 it acquired CityMD, an urgent care operator with over 150 locations in the New York and New Jersey markets.

> "I think at the most strategic level there continues to be recognition that an integrated, coordinated, connected model of care is one that will ultimately deliver the best results."
>
> **Tim Barry, CEO and Chair**
> VillageMD

The transaction creates one of the largest provider groups with more than 680 locations in 26 markets. The combined entity will employ over 20,000 individuals.

> "This transaction accelerates growth opportunities through a strong market footprint and wide network of providers and patients across primary, specialty, and urgent care,"
>
> **Roz Brewer, Chief Executive Officer, Walgreens Boots Alliance**
> November 2022

Reimbursement

Under the Emergency Medical Treatment and Labor Act (EMTALA), emergency departments are required to stabilize and treat patients regardless of insurance status or their ability to pay. UCCs are not subject to EMTALA and therefore can choose which payors and patients to accept. Therefore, UCCs are not required to accept Medicaid, Medicare, or to be in network with private insurance payors. Since commercial insurance typically reimburses higher than Medicare and Medicaid, UCCs tend to have a higher commercial payor mix.

The urgent care industry is largely unregulated. Most states do not require a facility-specific license for urgent care clinics. Instead, UCCs are typically licensed under an individual physician's license or under an affiliated hospital. There are no states that currently require a certificate of need (CON) to open a UCC. This makes it easier for platform operators to achieve growth through opening de novo clinics and it has increased market saturation of UCCs in many suburban areas.

The top 50 U.S. Census core-based statistical areas (CBSA) have approximately 2.8 UCCs per 100,000 people in 2019 (the latest data available) which is an increase from 2.7 in 2018. Close to half of the top 50 CBSAs have three UCCS per 100,000 people and 10 CBSAs have over four UCCs per 100,000 people. Approximately 90.0% of the U.S. population is within a 20-minute drive of a UCC, and 80.0% of the population is within a 10-minute drive.

UCC Location Distribution	2017	2018	2021
Urban	16.0%	29.0%	28.0%
Suburban	78.0%	55.0%	50.0%
Rural	16.0%	15.0%	22.0%

Market saturation in the UCC sector is most prevalent in large suburban metro areas. Suburban UCC operators represent approximately 50.0% of total UCCs. However, the ratio of locations in rural areas has grown in recent years as certain operators have focused on rural health strategies.

Conclusion

The urgent care industry was positively impacted by the rise of COVID-19 testing volumes throughout 2021 and 2022. The sustainability of these volumes could be at risk throughout 2023 due to retail clinic competition and variability in future upper respiratory incidence rates. This could put financial pressures on UCCs that are smaller or recently opened. In addition, the UCC industry is not immune from other risks facing the healthcare industry and the U.S. economy such as the current labor market and supply cost inflation pressures.

However, these risks could be mitigated by several factors. Patients who came to clinic sites for COVID-19 testing are more likely to return to that location in the future. The ease of COVID-19 precautions (e.g., masks, social distancing, etc.) could result in the return of typical urgent care visit types. Technological advancements (e.g., adoption of telehealth capabilities), and specialization of services (e.g., pediatric urgent care) could result in operational efficiencies and a competitive advantage for some UCCs. Finally, the UCC industry will continue to experience growth due to macro factors such as the rise in consumerism, patient expectations, and payor pressures to redirect emergency room visits to lower-cost sites of care.

M&A activity and transaction volume is expected to continue to be strong as private equity buyers look to exit historical investments, platforms seek tuck-in acquisition opportunities, and health systems and other entities look to expand their outpatient and primary care service area. UCCs proved their resiliency and flexibility in providing patient care throughout the COVID-19 pandemic. UCC operators with sophisticated telemedicine capabilities, COVID-19 testing and treatment capabilities, and the ability to adapt to changes in patient visit types will be popular acquisition targets in the future.

More Urgent Care Thought Leadership

- Where Are My Earnings? Quality of Earnings Analysis in Post-COVID-19 Urgent Care Transactions

Dialysis

Industry Overview

Following years of relative stability in the dialysis and broader kidney care industry a shakeup is beginning to unfold. This shakeup has been driven by legislative directives prioritizing care outside of traditional dialysis facilities and a growing number of consolidators in the nephrology practice. The result of these emerging trends is a slowdown in the growth rate of traditional in-center hemodialysis, an increased prevalence of home-based kidney care, and the introduction of new value-based kidney care models. These trends are poised to drive continued innovation and change to this industry.

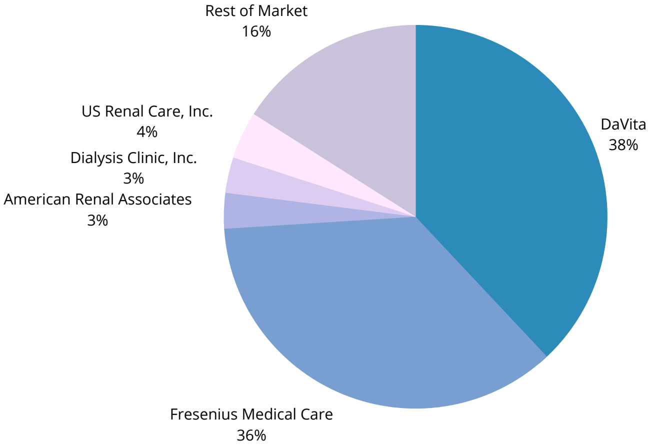
Historically, dialysis care has been dominated by hemodialysis offered in outpatient dialysis centers. As of the most recent data published by CMS, in November of 2022 there were approximately 7,960 dialysis centers in the U.S. The number of centers has grown at a compound annual growth rate of 3.7% over the last ten years, and grew from 5,413 dialysis facilities in 2010 to 7,800 facilities in 2020. More recently growth has slowed compared to prior years. There was only 0.7% growth in the number of facilities occurring between 2022 and 2020..

As of 2022, approximately 91.0% of dialysis facilities were freestanding and the remaining 9.0% were hospital-based. The number of hospital-based facilities has shown negative growth rates during the most recent five years, and freestanding facilities have consistently increased in number (though the rate of growth did slow significantly in 2020).

In comparison to most other healthcare verticals, the dialysis industry is highly consolidated and is dominated by two large dialysis operators – DaVita, Inc. (DaVita) and Fresenius Medical Care (Fresenius). When combined the two operate 74.0% of the dialysis facilities in the United States.

DaVita's business is focused primarily on operating dialysis facilities and is headquartered within the U.S., and Fresenius' parent company is headquartered in Germany and operates dialysis facilities and other related businesses. The next three largest operators combine to account for only 11.0% of the remaining market share in the United States, and each operates roughly 3.0-4.5% of total U.S. dialysis facilities. These include US Renal Care (4.4%), American Renal Associates (3.0%), and Dialysis Clinic Inc., which operates approximately 3.3% of facilities and is the largest nonprofit operator of its kind. The rest of the market is comprised of single-site or smaller multi-site independent operators which account for the remaining 16.0% of outpatient dialysis facilities in the U.S.

Market Share of U.S Dialysis Companies (by # of facilities)



During the third quarter of 2022, COVID-19 and other factors continued to strain staffing in an already challenging labor market that is experiencing volatility and uncertainty. Companies are currently facing increased general labor and supply chain costs. The pandemic exacerbated inflationary pressures with rising labor costs and difficulties in hiring nurses due to a nationwide shortage of skilled clinical personnel. During the company's third quarter 10-Q 2022, DaVita discussed how it has incurred higher incentive pay, increased utilization of contract labor, and inefficient productivity. In DaVita's Q3 2022 earnings call, it was noted that contract labor cost in Q3 increased relative to Q2, and it is forecasting the decline will be later and slower than originally anticipated. Additionally, training costs were $20 million dollars higher in Q3 than expected. Due to elevated turnover rates, these increased expenses have not resulted in a positive impact on contract labor or staffing level.

The cumulative impact of the previously stated topics will continue to put additional pressure on companies' cost structures. This prolonged pressure could lead to unplanned closures of certain centers or could adversely impact clinical operations. In addition, this pressure may have a material adverse impact on dialysis facilities' ability to provide services or the cost of providing those services.

Fresenius and DaVita both noted in their Q3 2022 earnings calls that the core drivers of their medium and long-term business prospects remain unchanged. However, DaVita stated in its earnings call that new patient admits were down, and volume is expected to be down 2.0% in FY 2023. It is anticipated that over time the decline in new patient admissions will be offset due to the pace that patients will progress from CKD into ESKD. Fresenius noted in its earnings call that treatment numbers have been growing sequentially between Q1 and Q3 2022. There will continue to be growth in the long-term for dialysis care providers as the U.S. population continues to age and there is increased incidence of contributing risk factors for ESRD such as hypertension and diabetes.

The larger facility operators have continued to invest in opportunities and services that will contribute to growth in home dialysis and will allow them to benefit from the ETC Model's payment structure. DaVita did not provide figures for the incremental growth in home dialysis treatments in its Q3 2022 10-Q and earnings call, but the company did indicate they are "increasing the proportion of [their] home dialysis patients," which represented 15.0% of overall treatment volumes in FYE 2021. DaVita indicated in its Q3 2022 10-Q that the increases in home dialysis have incurred higher-than-normal charges for center capacity closures.

Fresenius indicated that home dialysis treatments accounted for approximately 15.4% of overall treatment volumes during Q3 2022. Although the percentage of overall treatments occurring at home has continued to increase, the growth has been slower than expected and was just up from 15.0% of overall treatment volumes in Q4 2021. Fresenius said it still expects home dialysis to be a key growth area. During their Q3 2022 earnings call the company said, "We are also well positioned for future expansion into value-based care and home dialysis." Due to the impact of training and staffing expenses, Fresenius has not seen the full benefit of lower costs that are anticipated as a result of an increase in home dialysis treatment.

For the third year in a row Proposition 29 was rejected in California. Proposition 29 is a measure that would require a doctor, nurse practitioner, or physician assistant to be present during dialysis treatments in all 600 outpatient dialysis facilities in California. DaVita and Fresenius operate about three-quarters of the clinics in California, and there are approximately 80,000 dialysis patients in the state. If this proposition did pass] then many dialysis facilities would be required to have a minimum of two to three doctors in each facility. This would lead to a substantial financial burden for the largest dialysis providers and might cause some clinics to cut back on their services and potentially close. Thus, this proposition would make it harder for dialysis patients to get access to their treatments.

Value-based care, shared savings arrangements, and ACOs have become more prevalent among many types of healthcare providers in recent years. With that said, ESRD care providers have their own opportunity to participate, and potentially benefit, through the Kidney Care Choices (KCC) Model. There are four KCC model options. The Kidney Care First option is open to participating nephrologists, nephrology professionals, and nephrology practices. This option allows participants to receive adjusted capitation payments for managing care of aligned beneficiaries with Chronic Kidney Disease Stage 4 or 5 (a precursor to ESRD), and for those who are on dialysis.

There are also three alternative options under the Comprehensive Kidney Care Contracting (CKCC) models. These options allow nephrologists to partner with transplant providers and dialysis facilities to form Kidney Care Entities (KCEs). KCEs are eligible to receive monthly and quarterly capitated care management payments and transplant bonus payments, similar to the capitation payments under the KCF Option. However, KCE stake responsibility for the total cost and quality of care for their patients, and, in exchange, can receive a portion or all the Medicare savings they achieve. The first cohort of KCC Model participants began their participation in the model performance period on January 1, 2022.

In June 2022 the U.S. Supreme Court ruled in favor of the Marietta Memorial Hospital Employee Benefit Plan. DaVita lost the ruling that the group health plan provides limited benefits for outpatient dialysis, which does not violate the Medicare secondary payor uniformly for all plan participants.

Notable Transactions

In March 2022 Satellite Healthcare, Inc., a nonprofit provider of kidney dialysis, and Dialyze Direct, a leading provider of home hemodialysis services in skilled nursing facilities (SNFs) executed a Letter of Intent to enter a strategic collaboration to make care improvements for dialysis patients. This strategic growth collaboration will allow both organizations to pursue business opportunities centered on home hemodialysis and chronic kidney disease (CKD) management for geriatric patients in SNFs. Dialyze Direct's position as the leading SNF dialysis provider in the U.S. will be enhanced through this collaboration.

In May 2022 Fresenius acquired Ivenix, Inc, a specialized infusion therapy company, as a part of Fresenius Kabi. This acquisition is a milestone for Fresenius Kabi's Vision 2026 growth strategy through expansion in MedTech, and it will provide state-of-the-art offerings in infusion therapy. Significant scale and growth synergies are expected. The acquisition of the leading international biopharmaceutical company, mAbxience Holding S.L., closed in August of 2022, and resulted in Fresenius Kabi gaining a 55.0% stake.

DaVita entered into an agreement with Medtronic, Inc. in May 2022 to create NewCo, an independent kidney care-focused medical device company. Medtronic's healthcare technology expertise combined with DaVita's comprehensive kidney care services will position NewCo to advance the development of differentiated therapies for patients. NewCo will focus on developing home-based products and will make various dialysis treatments more accessible. The transaction is anticipated to close in 2023.

In August 2022, Fresenius closed on a three-way merger with InterWell Health and Cricket Health to create a physician-centric joint venture. The JV will allow InterWell Health to provide services for kidney patients under at-risk arrangements with public and private payors across kidney care. The resulting entity will combine Fresenius Health Partners' kidney care expertise with InterWell's clinical care models and network of 1,600 nephrologists. In addition, the entity will combine with Cricket's tech-enabled care model that uses its proprietary StageSmart informatics and patient engagement platforms. The new company, valued at $2.4 billion, operates under the InterWell Health brand and is fully consolidated by Fresenius Medical Care as the majority owner (75.0%). Prior to the transaction, Fresenius Medical Care owned about 46.0% of InterWell Health LLC. InterWell Health aims to provide care for more than 270,000 people with kidney disease.

DaVita continues to acquire new centers at a slowing pace in favor of setting up facilities that are home dialysis oriented and then letting the market adjust. In its Q3 2022 10-Q DaVita said, "We will continue to optimize our U.S. dialysis center footprint through center mergers and/or closures, and expect our center closure rates to remain at elevated levels over the next several quarters." Center acquisitions have been trending downward, apart from a peak of 17 acquisitions in 2021. DaVita acquired 13 centers in 2018 and five in 2022 within the U.S.

Conclusion

Despite uncharacteristically sluggish growth over the past two years resulting from ongoing COVID-19 challenges, operators in the dialysis industry remain bullish about their future growth prospects. The industry's major operators have expressed the belief that the core drivers of new patient growth in the dialysis industry remain unchanged and unequivocally positive. High growth is expected to continue with home hemodialysis and peritoneal dialysis services, and many providers have made significant investments to foster growth in this service line. The two largest dialysis operators, jointly accounting for nearly the entirety of the market, will continue to take pole position as industry leaders in the dialysis and kidney care M&A market. Both have made significant investments in introducing home-based services and have embraced the novel value-based care models. Market observers should continue to watch the myriad of emerging consolidators in the nephrology practice side. These emerging companies, backed by significant private equity investment, are seeking to consolidate a fragmented industry and leverage technology, analytics, and scale to accelerate the introduction of value-based care and shared-risk models.

Laboratories

Industry Overview

Laboratory tests and procedures are generally used by hospitals, physicians, and other health care providers and commercial clients. These tests and procedures assist in the diagnosis, evaluation, detection, therapy selection, monitoring, and treatment of diseases and other medical conditions through the examination of substances in the blood, tissues, and other specimens. The laboratory industry primarily consists of three types of providers: hospital-based laboratories, independent clinical laboratories, and physician-office laboratories.

Hospital-based laboratories are segmented by the type of testing and are staffed by trained specialists. Some labs focus on microbiology, hematology, chemistry, and blood banking while others may focus on more specialized tests such as electron microscopy and immunohistochemistry.

Independent clinical laboratories are separate from an attending or consulting physician's office and from a qualified emergency hospital. The independent laboratory market includes the nation's largest commercial laboratory companies, Quest Diagnostics (Quest) and Laboratory Corporation of America (Labcorp), as well as hundreds of local, regional, and specialty reference laboratory companies.

Physician office laboratories (POLs) are maintained by a physician or group of physicians to perform diagnostic tests in connection with the physician practice.

As noted above, Quest and Labcorp are public companies and independent clinical laboratories. Both companies have historically been very active in expanding their market share through acquisitions. Quest and Labcorp have roughly 1,000 locations combined which accounts for less than 1.0% of all lab testing locations in the United States. However, they account for over 15.0% of the test volume market share in the industry. Further, over half of the two companies' revenue growth over the past 25 years has come from acquisitions. During 2022, both companies continued to expand through their M&A pipelines. This was primarily accomplished through acquisitions and partnerships with hospital outreach laboratories as the COVID-19 pandemic subsided and regulatory uncertainty existed.

> "Our hospital and local lab acquisition and investment pipeline is very robust, and we see major opportunity now through 2023."
>
> **Adam Schechter, CEO, LabCorp**
> Q3 2022 Earnings Call

M&A Trends

Quest and Labcorp continued to actively acquire hospital outreach laboratories during 2022. Due to the COVID-19 pandemic, Quest, Labcorp, and other lab providers made a significant pivot to focus on COVID-19 testing during 2020 and 2021. This slowed down lab activity in the M&A space as these companies had an "all-hands-on-deck" approach to producing the most accurate, efficient COVID-19 tests. Testing slowed throughout 2022, and this is expected to continue through 2023. Therefore, laboratory businesses are returning to expanding their traditional operations through acquisitions. Outreach laboratories for hospitals and health systems are a significant target for Quest and Labcorp.

> "We see that hospital systems are more open to discussions than before the pandemic. Many large and small health systems face substantial financial and labor pressures that make our range of services very attractive."
>
> **James Davis, CEO Elect, Quest Diagnostics**
> Q3 2022 Earnings Call

Notable Transactions

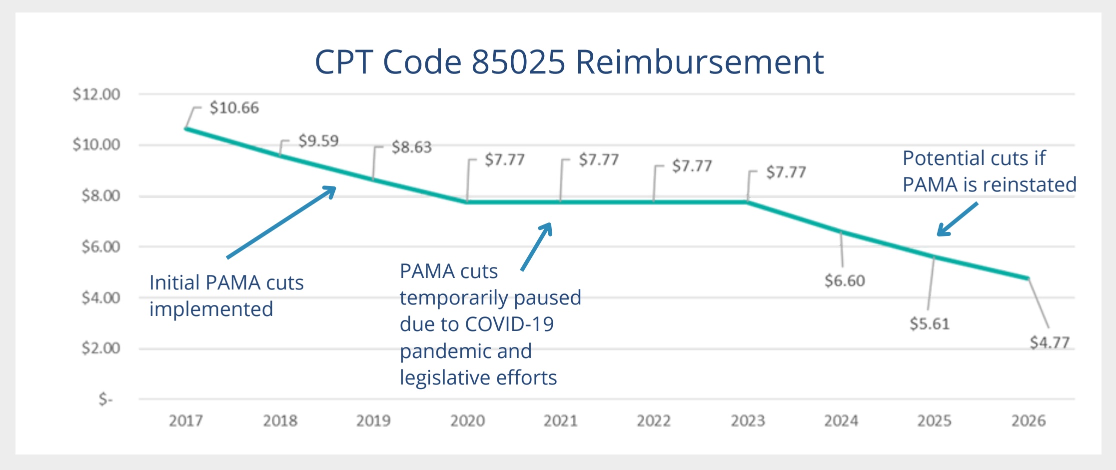
Labcorp and Quest are the two most prominent players in acquiring independent labs. Below is a list of major acquisitions that were announced for these public companies throughout 2022.

Acquirer	Target	Description
Quest	Summa Health	Acquisition of outreach laboratory business and select related assets
Quest	Lee Health	Professional lab services relationship
Quest	Northern Light Health's	Acquisition of outreach laboratory business and select related assets
LabCorp	RWJBarnabas Health	Acquisition of outreach laboratory business and select related assets
LabCorp	Prisma Health	Acquisition of outreach laboratory business and select related assets
LabCorp	AtlantiCare Health	Acquisition of outreach laboratory business and select related assets
LabCorp	St. Dominic Hospital	Acquisition of outreach laboratory business and select related assets
LabCorp	Ascension	Comprehensive laboratory relationship consisting of management of hospital labs in 10 states as well as the purchase of select outreach laboratory business assets.

Quest and Labcorp have been inking deals with large regional and national health systems to take control of their respective lab businesses.

Reimbursement

The transactions mentioned previously relate heavily to the current reimbursement and regulatory environment that is impacting laboratory outreach businesses. Despite regulatory pressures to decrease rates, CMS reimbursement has held steady over the past four years for laboratory services. In 2014 the Protecting Access to Medicare Act (PAMA) was passed to slowly phase in cuts to the Clinical Laboratory Fee Schedules (CLFS). The goal of PAMA was to put Medicare reimbursement closer to commercial payor reimbursement through mandatory reporting of commercial payor rates to the government. Unlike other medical services, it is common for commercial payors to reimburse laboratory services below the Medicare rate. With this information, CMS planned to slowly phase in cuts to the CLFS over five years. Initially, these cuts were 10.0% each year in 2018 through 2020 and were expected to continue into future years. However, the COVID-19 pandemic halted and delayed these cuts in 2020. Currently, these cuts are set to phase in 2024 through 2026 and may be up to 15.0% in a year. The chart below shows historical reimbursement since 2017 and potential future reimbursement.



Regulatory

In 2022 the Saving Access to Laboratory Act (SALSA) was introduced in Congress. The goal was to reform PAMA and minimize the cuts to the CLFS. This act would delay reductions and reform how data from the commercial payors was collected. Advocates of the bill believed the initial data reporting process in PAMA was flawed and would lead to historical and potential proposed cuts to be unstainable for the industry in the future. Key players in the lab industry, including the American Clinical Laboratory Association (ACLA), believed that if SALSA passed the CLFS would be on a more sustainable path moving forward. The law did not pass during 2022, but it continues to be a priority going into 2023. Quest Diagnostics and Labcorp are also strong proponents of the bill.

Conclusion

Consolidations of laboratories continued throughout 2022. As COVID-19 minimizes its role in the laboratory business, Quest and Labcorp were active in acquiring both hospitals' outreached labs. There were uncertainties for the first part of 2022 surrounding the laboratory industries in regards to regulatory and reimbursement trends. This will continue in 2023 with the current delay of PAMA cuts and the failure to pass lasting reform legislation to PAMA. Based on this, Quest and Labcorp will continue to work through their acquisition pipeline throughout 2023.

More Laboratory Thought Leadership

- Laboratory-Developed Tests Save the Day!

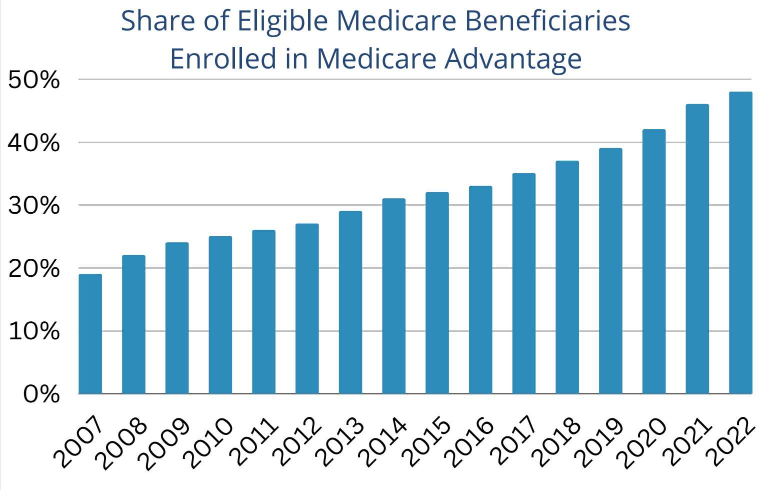
Value-Based Care & Risk-Bearing Organizations

Industry Overview

In recent years, there has been a notable increase in the number of entities seeking to capitalize on the shift from the fee-for-service payment structure to a value-based care (VBC) model. The portion of the insured population in "at risk" contracts is expected to increase by 10.0% annually from 2021 to 2025 compared to the 1.0% growth in the overall insured population. The current participants in the VBC space span a wide range of verticals including payers, health systems, provider groups, technology-enabled primary care platforms (CareMax, Privia Health, etc.), retailers (CVS, Amazon, etc.), and financial investors. Given the variety of participants in the VBC space, this emerging market remains highly fragmented and is poised for continued transaction activity.

M&A Trends

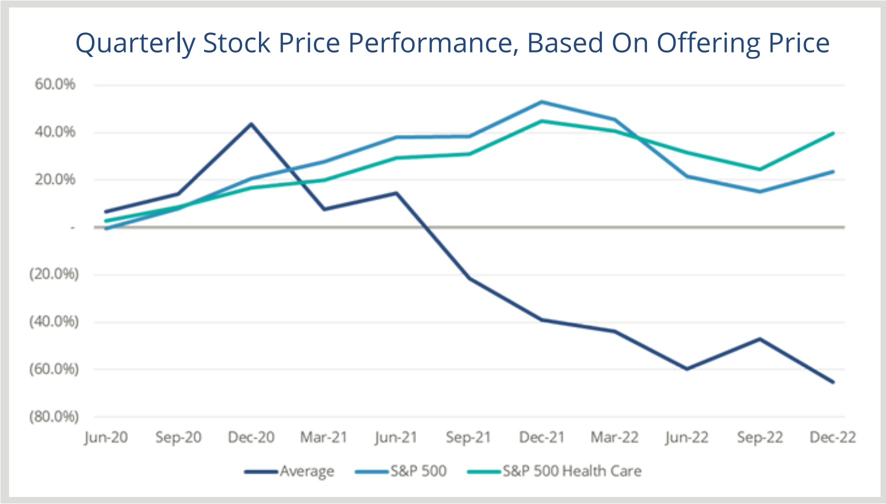
The shift towards VBC has been in discussion for many years, and this was most notable when the CMS Innovation Center was established in 2010 as a part of the ACA. Since then CMS has continually pushed containing healthcare costs by moving lives from traditional fee-for-service Medicare to Medicare Advantage. As a result of these efforts, over the past decade Medicare Advantage enrollment has nearly doubled as a percentage of eligible Medicare beneficiaries. This percentage is expected to increase further over the next decade, and makes Medicare Advantage a fast-growing portion of the overall market due to aging demographics. As a result, companies that can effectively manage these lives are in a position to capitalize on these trends.



Source: Kaiser Family Foundation, Medicare Advantage in 2022: Enrollment Update and Key Trends

Over the past 10 years we have seen similar trends toward the reallocation of risk and the containment of healthcare costs across the spectrum of lives. This includes Medicare, primarily through the Medicare Shared Savings Program (MSSP), and commercial payors.

Recently, several market participants have started to tout the importance of technology in enhancing patient care and lowering the cost of managing a patient population. As a result, the VBC sector drew attention as several of these VBC-focused companies entered the public markets after a period of volatility and uncertainty due to the COVID-19 pandemic. Many of these companies' objective is to leverage technology in the shift toward VBC. Several entered the markets through typical means such as initial public offering (IPO), but a notable amount entered the market through special purpose acquisition companies (SPACs). Although there was high interest in these innovative companies, the market began to cool in late 2021 and stock prices began to decline as illustrated in the chart below.



**Please note the average includes the following companies (listed in order of offering date): TOI, CLOV, CANO, OSH, CMAX, SGFY, OSCR, INNV, ALHC, PIII, AGL, PRVA, LFST, BHG.*

Despite all the initial excitement, many of these companies were unable to acquire lives as quickly as expected or were not able to execute on shared savings rates and medical loss ratio targets. As a result, expectations were readjusted. Even though the public markets cooled down the sector remained active as other players identified opportunities and the potential for value creation in the VBC space, particularly in the primary care portion of the market. As a result, this past year was marked by rapid vertical consolidation.

During 2022 nontraditional players, such the retailers Amazon and Walgreens, made major investments in this space (discussed in further detail in the next section). These nontraditional players identified opportunities to leverage their national reach and their existing operations with the goal of improving outcomes and reducing costs for primary care patients. These are major components of the continued shift toward VBC. Attracted by these opportunities in the primary care market, these non-traditional players have accelerated transaction activity in the VBC space which had already seen an influx in market participants toward the end of 2020 and throughout 2021. Due to the number of well-capitalized players and continued tailwinds propelling the shift to VBC, market activity in this sector is expected to remain elevated throughout 2023.

Notable Transactions

Retailers

On July 21, 2022, Amazon announced its acquisition of One Medical, a membership-based and tech-enabled primary care organization for $3.9 billion, with an implied revenue multiple of 3.6x. The acquisition follows Amazon's initial attempt to break into the healthcare market with Amazon Care which closed as of December 2022. One Medical has an established clinical footprint of over 214 offices serving 815,000 members for in-person and virtual services. Additionally, Amazon will gain access to Iora Health, One Medical's value-based care segment. One Medical acquired Iora Health in June 2021 for $2.1 billion, with an implied revenue multiple of 9.5x. Iora Health is a technology-enabled primary care platform delivering value-based care for Medicare Advantage and other at-risk reimbursement models. The acquisition of Iora Health propelled One Medical into full-risk Medicare reimbursement models. With Amazon's resources and customer base the acquisition aims to make the healthcare experience more affordable and accessible.

On September 5, 2022, CVS Health announced it would acquire Signify Health for $30.50 per share, or approximately $8.0 billion in cash, implying multiples of 9.4x revenue and 31.8x EBITDA. Signify Health connects clinicians and providers to 2.5 million members in the home through nationwide value-based provider networks and through its technology and analytics platform. Signify Health expanded in the value-based care space in March 2022 with its acquisition of Caravan Health. Caravan Health partners with providers who participate in accountable care organizations (ACOs) which produced over $138 million in gross savings in 2021. Signify Health expects over

700,000 Medicare lives will participate in Caravan Health's ACOs in 2023. The acquisition is consistent with CVS's strategy to connect with patients in the home and CVS's entry into value-based care.

Walgreens Boots Alliance, Inc. (Walgreens) announced its plans to proceed with a full acquisition of CareCentrix by acquiring the remaining 45.0% stake for $392 million. The announcement followed Walgreens' completion of a 55.0% majority investment in August 2022. The total deal size was valued at $800 million, or a guided revenue multiple of 0.5x and implied EBITDA multiple of 10.0x. CareCentrix, a care coordination platform for post-acute and home health industries, manages care for over 19 million members through 7,400 provider locations. The full acquisition advances Walgreens' entry into the home health sector and value-based care models.

Provider Groups and Technology-Enabled Primary Care Platforms

Walgreens-backed primary care provider VillageMD completed its acquisition of Summit Health-CityMD on January 3, 2023. The investment was valued at $8.9 billion, an implied multiple of 3.0x revenue, with investments from Walgreens and Cigna's healthcare unit, Evernorth, which will be a minority owner in the deal. The partnership will operate more than 680 provider locations in 26 markets with 20,000 employees. By utilizing VillageMD's expertise in value-based care and Summit Health-CityMD's expertise in the delivery of care and its geographic coverage, the partnership seeks to provide high-quality care through focusing on patient outcomes and the patient-provider experience.

In May 2022 Skylight Health, a healthcare services and technology company, completed its acquisition of NeighborMD for $8.0 million and a $20 million debt facility, an implied multiple of 0.2x revenue. NeighborMD operates nine primary care practices serving over 5,000 lives in Central Florida and Southern Florida. Of these 5,000 lives, NeighborMD manages over approximately 1,100 full-risk Medicare Advantage lives and an additional 1,400 Medicare Advantage lives through affiliated providers and practices. NeighborMD's unaudited revenues from primary care were roughly $35.0 million for the twelve-month trailing period and include Medicare Advantage contracts. Skylight Health expects to maintain NeighborMD's Medicare Advantage average reimbursement of $10,000 to $12,000 per member per year. The acquisition accelerates Skylight Health's entry into full-risk contracts.

Throughout 2022 Optum, an information and technology-enabled health service subsidiary of UnitedHealth Group, continued to execute on its historical trend of buying primary care operations and utilizing them as platforms to execute risk-based contracting strategies. In April 2022, Optum purchased Kelsey-Seybold Clinic, a large risk-bearing physician organization based in Houston, Texas. Prior to the transaction, TPG Capital held a minority interest in Kelsey-Seybold Clinic. Later that month, Optum acquired Atrius Health for $236.0 million plus $200 million in facility upgrades over five years, implying multiples of 0.2x revenue and 24.6x EBITDA (considering the capital commitments). Atrius Health is a community-based physician group providing services throughout Eastern Massachusetts. The transaction received some regulatory scrutiny but it was able to close after receiving approval from the Massachusetts Attorney General's Office. A month later Optum acquired Healthcare Associates of Texas (HCAT), a Dallas-based physician practice management company, for $300.0 million, implying a 17.7x EBITDA multiple. Prior to the transaction, HCAT invested heavily in its VBC strategy which makes it an attractive target as Optum continues to grow its risk-based contracting business.

CareMax, Inc., a provider of value-based care for seniors, completed its acquisition of the Medicare Advantage value-based care business of Steward Health Care System (Steward) on November 11, 2022. The business consists of a Direct Contracting Entity (DCE), MSSPs, and ACOs. CareMax paid $25 million in cash and issued 23.5 million shares of Class A common stock to Steward's equity holders, implying multiples of 2.0x revenue and 4.8x EBITDA. The acquisition expands CareMax's network to approximately 2,000 providers and over 200,0000 senior value-based patients. Additionally, CareMax will serve as the management services organization (MSO) for Steward's additional 380,000 Medicare Advantage fee-for-service patients and 480,000 traditional Medicare patients. Together CareMax and Steward plan to continue looking for opportunities to provide value-based care to these patient populations.

Value-based care management company P3 Health Partners, Inc. (P3) closed its acquisition of Medcore HP, a health plan licensed under the California Knox-Keene Health Care Service Plan Act of 1975, and Omni IPA Medical Group, Inc. (Omni), an independent practice association located in San Joaquin County, California. The acquisition closed in January 2022 and expanded P3 into California which is its fifth state of operation. Medcore HP contracts directly with health plans in California andtakes on global risk for more than 10,500 Medicare Advantage members under its license. At the time of acquisition, Omni consisted of over 400 contracted physicians and other healthcare providers under Medcore HP's provider network. Together Medcore HP and Omni provide P3 with the opportunity to grow its membership in San Joaquin County and the surrounding areas with its expertise and ease of an existing provider footprint.

Privia Health Group, Inc. (Privia), a technology-driven physician enablement company, and Surgery Partners, Inc. announced their partnership in February 2022. Privia will provide physician-enabled capabilities and build a provider network in Montana through Surgery Partners' subsidiary, Great Falls Clinic. In addition, the companies formed a JV to create Privia Management Company of Montana to provide clinical, operational, and technological services to Great Falls clinic and to other providers who join the network. Later in 2022 Privia announced another JV and partnership with Novant Health Enterprises (Novant) which is a division of Novant Health. The JV, called Privia Medical Group – North Carolina, will assist Novant with the transition to value-based care through a clinically integrated network (CIN). Providers who join the group will be able to access the proprietary Privia platform to optimize practice operations and to enhance the physician-patient relationship.

In March 2022, agilon health, inc. ("agilon") announced its first long-term partnership with MaineHealth, the largest integrated health system in Maine and New Hampshire. agilon is a healthcare services and technology platform that assists healthcare systems and providers with the shift from traditional fee-for-service models to value-based care models. Throughout the year agilon continued to announce partnerships with many health systems and providers including the following: United Physicians in Michigan, Palmetto Primary Care Physicians in South Carolina, Liberty Doctors in South Carolina, Entira Family Clinics and Richfield Medical Group in Minnesota, The Jackson Clinic in Tennessee, and Piedmont HealthCare in the Southeast United States. agilon plans to assist these health systems, clinics, and providers in implementing value-based care models to provide high-quality, cost-effective care for the senior populations in their communities.

Other Players and Investors

In February 2022, private investment firm Kinderhook Industries, LLC (Kinderhook) announced a $500.0 million investment in Physician Partners, LLC, implying a valuation of $2.7 billion and multiples of 3.3x revenue and 22.5x EBITDA. Physician Partners, a value-based primary care physician group and MSO based in Florida, delivers care for over 137,000 members with a provider network of over 545 physicians. Kinderhook's investment will accelerate Physician Partners' growth in the Florida market and will allow entry into out-of-state markets.

In April 2022, Genuine Health Group announced it acquired Accountable Care Medical Group (ACMG). This acquisition follows Genuine Health Group's acquisition of Premier Care Associates and PreventiMed, which were all funded by a $160.0 million capital infusion from Crestline Investors. All three companies have added over 20,000 Medicare patients to Genuine Health Group's membership base. Additionally, ACMG added over 60 primary physicians. ACMG operates ACOs, and Genuine Health Group recently transitioned its own ACO into a DCE. Now the company will operate both care models for their Medicare Advantage patient population.

In May 2022, Welsh, Carson, Anderson & Stowe (WCAS), majority owner, and Humana Inc.'s CenterWell Senior Primary Care, minority owner, entered into a second JV to develop value-based primary care clinics for senior patients. The JV will establish 100 new Medicare-focused clinics between 2023 and 2025 with $1.2 billion of committed capital. This second JV follows an earlier JV that is currently in the process of opening 67 new clinics with $800.0 million of capital. CenterWell Senior Primary Care currently serves approximately 180,000 patients in Medicare value-based arrangement and continues to scale with investments from WCAS.

In July 2022, Molina Healthcare, a health plan company offering Medicare and Medicaid programs, acquired My Choice Wisconsin, a Medicaid managed care organization, for approximately $150.0 million or implied multiple of 0.2x revenue. My Choice Wisconsin has a long history of serving managed long-term services and supports (MLTSS) populations with over 44,000 total MLTSS and Medicaid members as of May 2022. Additionally, My Choice Wisconsin delivered approximately $1.0 billion in premium revenue during the twelve months ending on March 31, 2022. The deal will expand Molina Healthcare's footprint in the state of Wisconsin and will scale its existing Medicaid business.

Reimbursement

On November 1, 2022, CMS released the 2023 PFS final rule including changes to MSSP that aim to increase participation in ACOs by improving the quality of care, increasing health equity, and increasing total savings. Examples of specific changes include adding options for advanced payments to ACOs in underserved communities, adjusting risk scoring, reducing administrative burdens, and smoothing the transition to performance-based risk.

Regulatory

In an effort to achieve the latter, the final rule made the ENCHANCED track optional for periods beginning on or after January 1, 2024. The ENHANCED track has the greatest level of downside financial risk. As a result, the ability for ACOs to delay or opt out of the ENHANCED track could offer certain ACOs greater flexibility in the program. Despite the larger downside risk, the ENHANCED track continues to increase in adoption due to the greater shared savings rate (i.e., 75.0% vs. 50.0%). These shared savings opportunities continue to make the ENHANCED track a popular option for high revenue or experienced ACOs.

ACO Tracks	1/1/2023	1/1/2022	1/1/2021	1/1/2020
Number of ACOs				
One Sided	151	199	163	191
Two Sided	305	284	195	192
ENHANCED Track	*161*	*146*	*76*	*80*
Percentage				
One Sided	33.1%	41.2%	45.5%	49.9%
Two Sided	66.9%	58.8%	54.5%	50.1%
ENHANCED Track	*35.3%*	*30.2%*	*21.2%*	*20.9%*

MSSP has 456 ACOs and 10.9 million Medicare beneficiaries participating for 2023. While these figures represent a decrease from the previous year, the new Accountable Care Organization Realizing Equity, Access, and Community Health (ACO REACH) Model is expected to make up the difference (i.e., 132 ACOs and 2.1 million Medicare beneficiaries participating in ACO REACH for 2023).

The ACO REACH Model has replaced or rebranded the Global and Professional Direct Contracting (GPDC) Model, also known as DCE. ACO REACH started its participation on January 1, 2023, and largely focuses on bringing health equity to underserved communities. While both MSSP and ACO REACH change focus on an aspect of health equity, a health equity plan is not required for MSSP like it is for ACO REACH. Other changes from the GPDC Model to ACO REACH include increased provider-led governance, increased savings through reduced benchmark discounts, adjusted performance benchmarks including the health equity adjustment, and increased transparency and vetting of model participants.

Conclusion

Strong M&A activity in the VBC and risk-bearing entity space is expected to continue in 2023 as nontraditional players scale their services, technology-enabled providers optimize care coordination and management, and health systems seek to improve the patient-provider experience. Industry growth is expected to propel due to opportunities with Medicare Advantage lives, continued vertical consolidation, and investments in technology and data analytics. Market players will look to participate in the emerging and growing industry as the transition to VBC seeks to deliver improved patient outcomes and better care while reducing healthcare costs to industry.

More Risk-Bearing Organizations Thought Leadership

- The Vertical Consolidation of Tech-Enabled Primary Care Practices

Private Equity

Industry Overview

PE firms seek to provide their limited partners with positive returns by making investments in companies through various strategies including growth, buyout, and mezzanine debt. This industry offers qualifying individuals/entities with an alternative to public debt and equity investments with the hope of providing outsized returns relative to those markets.

The PE playbook oftentimes involves buying a company, achieving operational synergies through either investment or cost cutting, growing the business, and ultimately exiting the investment through a sale. The J-curve economic theory is utilized to illustrate the prototypical PE investment life cycle. The theory is that as investments are made in the first three years to improve the business the resulting growth of the business drives increased cash flow to the PE firm after the third year. With this in mind, PE firms will often analyze a potential investment with a time horizon between four and seven years.

During their ownership period, PE firms aim to provide value to their portfolio companies through several avenues such as management expertise and oversight, access to lower cost of capital, and readily accessible capital to fuel growth strategies including mergers and acquisitions.

Over the last decade, PE involvement within the healthcare industry has increased from 443 deals in 2012 to an estimated 1,318 deals in 2022 (a 11.5% annual growth rate). Specifically, investment in healthcare services represented nearly half of all PE investment in the healthcare industry, and roughly 10.0% of PE buyout and growth deals overall in the U.S. in 2022. The increased interest in the healthcare industry is driven by trends in demographics (an aging population), technology (advancements in patient care and operational tools), the fragmented nature of the industry, and economics (healthcare spending as a percentage of U.S. GDP and recession-resilient qualities). Looking to the future, Pitchbook estimates that U.S.-based PE firms currently have $62.0B in dry powder available to deploy to the healthcare services industry. After considering the leverage that will also be utilized in an acquisition by a PE firm, this dry powder could equate to nearly $150.0B in total enterprise value.

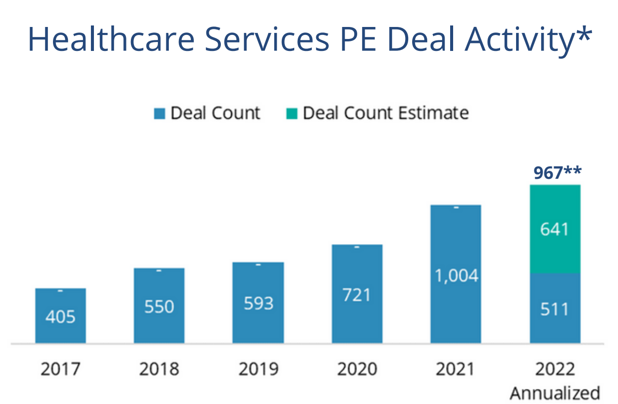
PE firms investing in the healthcare industry face competition from a growing number of groups such as: i) traditional hospitals and health systems; ii) vertically integrated payer-providers (UnitedHealth Group, Humana, CVS Health, etc.); and iii) other PE firms who previously did not invest in healthcare. Anecdotally it seems that limited partners are increasingly asking their PE firms why they are not invested in the healthcare industry, and they are driving those additional players into the space. This increased competition for deals helps explain the rising multiples experienced across the healthcare M&A landscape which have risen from ~8x in 2012 to ~12x in 2022.

One other component of the increased valuation multiples observed throughout the last decade has been the willingness by PE firms and other corporate acquirers to move further out on the acuity curve for physician practices. Historically, PE investment in the physician practice space has involved acquiring a medical specialty, building a platform, and adding physician groups within that specialty through the M&A process to achieve size and scale. For much of the past decade, these specialties were primarily ophthalmology, dentistry, and dermatology. In this buy-and-build model, value creation occurred because of many factors such as: i) organic growth; ii) multiple arbitrage; iii) financial leverage; and iv) other operational efficiencies resulting from achieving scale.

As PE firms have become more comfortable with the risks involved within the healthcare services space and continue to search for additional returns, they have started to apply this buy-and-build model to other provider services. These services include pain management, neurology, women's health, orthopedics, and cardiology. As a direct result, corporate entities (PE, public provider groups, vertically integrated provider groups) are now consolidating physician groups faster than hospitals and health systems. As of January 2022, hospitals and health systems employed 341,200 physicians (+18.3% from January 2020), and the corporate entities employed 142,900 physicians (+39.4% from January 2020).

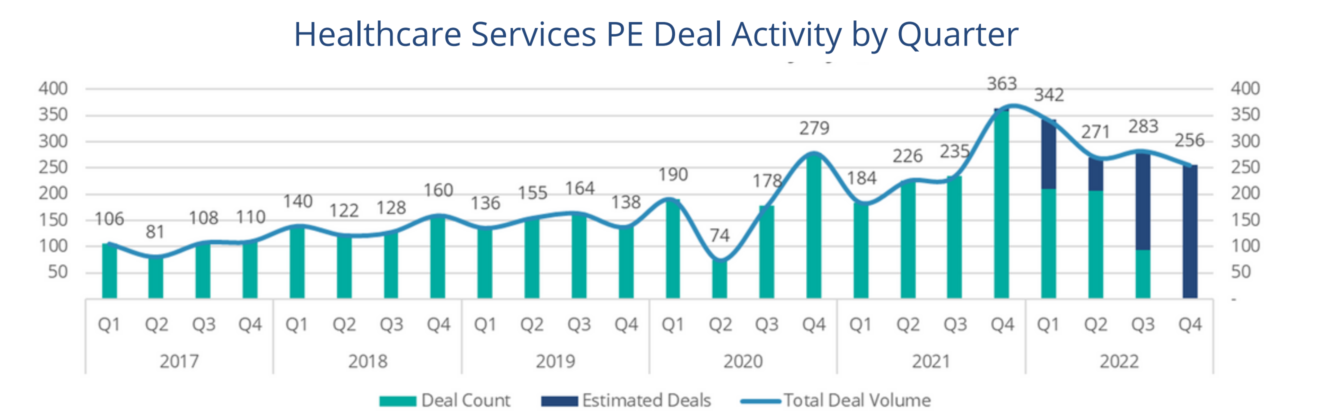
M&A Trends

Total deal activity for PE firms investing in the healthcare services industry in 2022 remained steady compared to 2021, but deal volumes slowed in the second half of the year. This relative decline in transaction activity during 2022 should not be interpreted by PE's unwillingness or inability to invest in the industry. As noted previously, dry powder allocated to the industry is at a record high. With that said, the decline in volume is likely a reversion to the mean from meaningful high-water marks, which were driven in part by low interest rates and "covenant-lite" deals. During Q1-2023, we note fewer deals being completed based upon future performance, or pro forma, as well as fewer buyer groups being seriously considered during the indication of interest phase of a deal. We have also noted longer times to close since management teams negotiate for multiples and concessions observed during the spring and summer months that do not reflect the current environment.



*Data through September 30, 2022
**Annualized estimate based on Pitchbook analysis of lagging deals

Additionally, the use of continuation funds continues to grow in relevance. Continuation funds are a PE firm's newer fund, and it purchases assets from the same PE firm's older fund. These funds are used primarily for two purposes: i) to increase the hold period for the PE firm for well-performing portfolio companies with remaining growth potential, or ii) to offer liquidity to older funds at the end of their life cycle so that said older fund can be closed. During COVID-19 these types of transactions increased in relevance as the market for IPOs and secondary buyouts dried up due to global economic uncertainty. This trend continued through 2022 as Zenyth Partners transferred three healthcare portfolio companies (The Smilist Management, ReFocus Eye Health, and Helping Hands Family) to its continuation fund.



Source: Pitchbook reasearch center; FY22 deal count derived from healthcare services screener

PE Activity by Subindustry

Physician Medical Groups

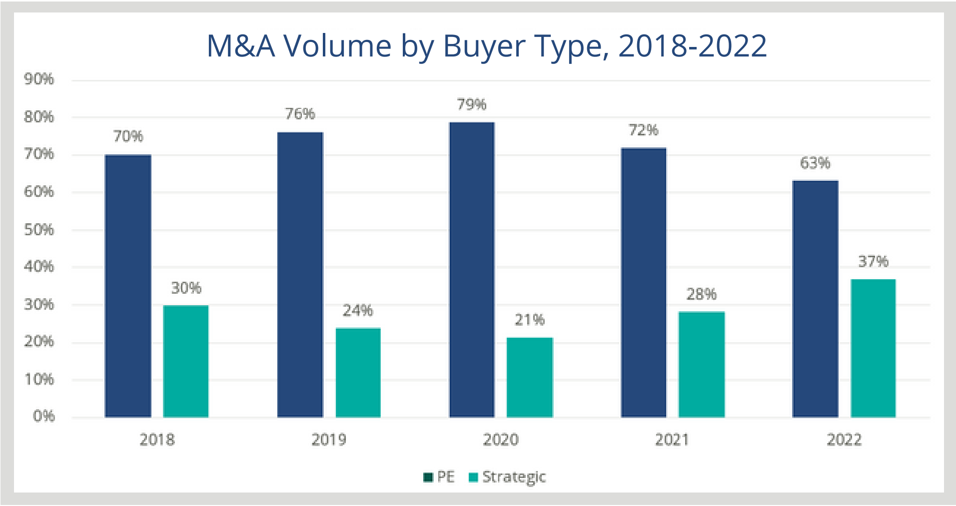
Independent PMGs are struggling to keep pace with the capital requirements of the industry's transition to value-based payments while also facing increased competition in physician recruiting. PE firms and their MSOs offer the capital and business expertise needed for the scale and operational efficiencies required to combat these pressures. For PE firms, their ability to "roll-up" these acquisitions into an efficient, large, and scalable platform is an attractive investment.

Platform practices are typically able to negotiate an acquisition price that is higher than smaller bolt-on practices which are subsequently acquired. An arbitrage opportunity exists if the PE firm can effectively buy a practice at a lower bolt-on multiple and sell the entire business at a higher platform multiple (often sold to another PE firm).

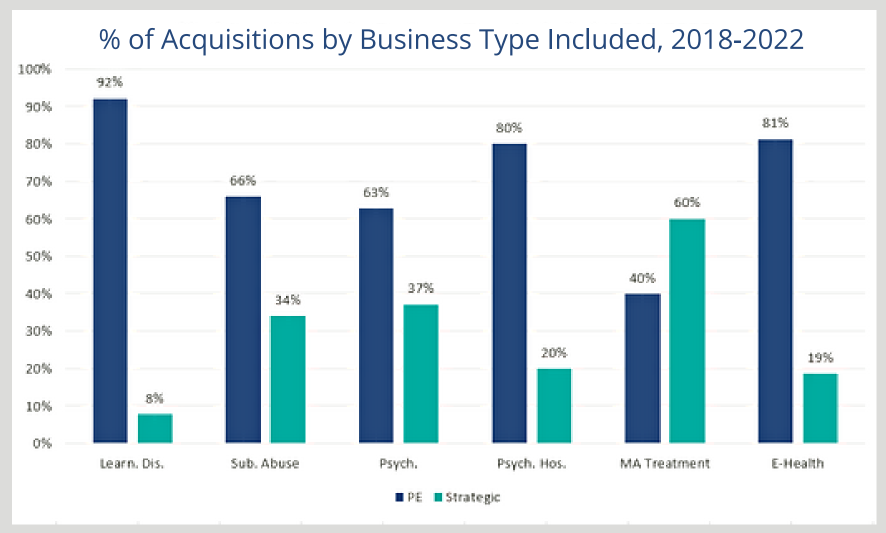
PE firms typically target the ancillary revenue streams of practices which may have historically been performed in a local hospital or other outpatient setting. These ancillary services are consolidated to increase the revenue and earnings growth of the practices. Specialties with low capital intensity and high prospects of generating additional income from ancillary services tend to be the targets of PE acquisitions.

Behavioral Health

PE continued to lead M&A deal activity in the behavioral health space over strategic transactions in 2022. Although it was muted relative to historical levels in 2022, deal activity is expected to rebound in 2023 as investors continue to value the sector's positive long-term demand trends. Each year increased funding provided at the federal, state, and local levels to combat the worsening behavioral health crisis.



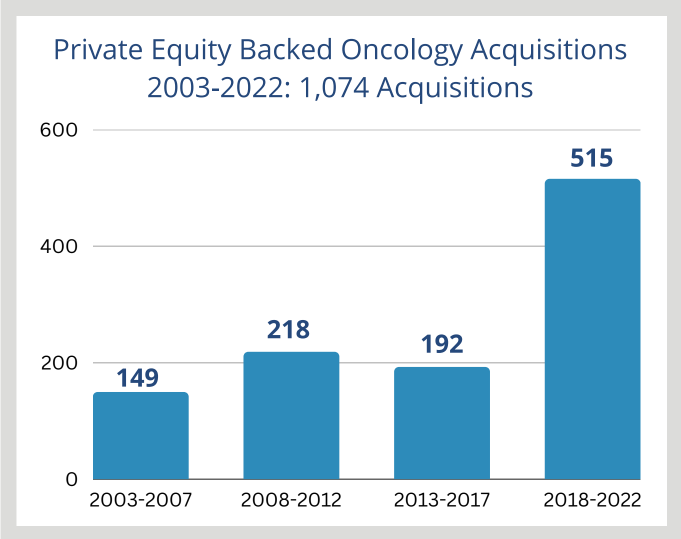
In 2022, substance abuse led all behavioral health subsectors with the most transaction volume. The other subsectors were learning disabilities, psychiatry, psychiatric hospital, medication-assisted treatment, and e-health.



Furthermore, PE-backed behavioral health platform companies such as BayMark Health Services (398+ recovery programs backed by Webster Equity Partners), Discovery Behavioral Health (130+ facilities backed by Webster Equity Partners), and Summit BHC (30+ facilities backed by Patient Square Capital) continued to grow market share.

Oncology

Over the past two decades there have been over 1,000 medical and radiation oncology practices acquired by a total of 23 PE-backed oncology platforms. PE involvement in the oncology space has been rapidly increasing with nearly half of all the acquisitions over the last 20 years occurring in the past four years.



Recent PE Investment	Platform	Locations	Providers	PE Firm	Vintage
Medical & Radiation Oncology Platforms		310+	890+		
	OneOncology	260+	885	General Atlantic	5 years
	Integrated Oncology Network	50	n/a	Silver Oak Services Partners	5 years
	Verdi Oncology	3	9	Pharos Capital Group	5 years
	Alliance HealthCare Services (1)	n/a	n/a	Tahoe Investment Group	5 years
Urology Platforms (2)		525+	1,010+		
	United Urology Group	220+	95	Audax Private Equity	7 years
	Urology Management Associates (3)	n/a	n/a	Prospect Hill Growth Partners	4 years
	Solaris Health	183+	509	Lee Equity Partners	3 years
	Urology America	28	83	Gauge Capital	3 years
	US Urology Partners	40+	150+	NMS Capital	5 years
	Unio Health Partners (4)	54	182	Triton Pacific Capital Partners	2 year
Grand Totals		830+	1,900+	Average Age	4.4

(1) Acquired by Akumin Inc in 2021. 200+ locations at time of acquisition.
(2) Urology platforms and investments considered due to radiation oncology component.
(3) Acquired by Summit Health in January 2022. 150 Providers and 60+ locations at time of acquisition.
(4) Formerly Urology Partners of America. Please note location and provider counts include most recent partership with inSite Digestive Health Care which added 67 gastroenterologists and three pathologists.

These PE-backed platforms strategically target practices for consolidation to leverage geographic expansion, economies of scale, or hospital affiliations.

Home Health and Hospice

PE firms have been attracted to home health and the hospice industry because of the need for scale and efficiency driven by the transition from fee-for-service to value-based payment models, and the continued emphasis on outpatient care to reduce healthcare costs. Similarly to other healthcare sectors that are seeing increased interest, PE firms in the home health and hospice space tend to pursue a platform-building strategy. They do this by taking advantage of the arbitrage opportunity between the higher EBITDA multiple, typically commanded by larger home health and hospice agencies (>$5m in revenue), and the lower EBITDA multiples for smaller agencies (<$5m revenue).

PE firms targeting home health agencies are looking to take advantage of perceived inefficiencies in site-of-care economic differentials. They aim to capitalize on changing reimbursement models which focus on value of care, rather than frequency of care. Additionally, as Medicare and private insurers continue to push toward lower cost care settings, PE firms aim to capitalize on increasing home health volumes.

In April 2022, Clayton, Dubliner, & Rice announced its intention to acquire 60.0% of the hospice and personal care assets of Kindred at Home from Humana for approximately $2.8 billion. 60.0% of Kindred at Home was previously acquired in July 2018 by TPG Capital and Welsh, Carson, Anderson & Stowe (WCAS).

Urgent Care

PE buyers were involved in approximately 50.0% of Urgent Care transactions in 2022, and there are no indications that activity will slow down in the future. The table below shows the largest non-hospital owned urgent care operators in the U.S. Of these operators, 10 are currently backed by a PE firm. Of the 10 PE-backed urgent care operators, five are exceeding the typical three-to-seven-year investment window ("vintage") which indicates a potential exit opportunity in the near future.

Urgent Care Chain	Locations (Dec. 2022)	Type	PE Firm	Vintage
Concentra	536	Health System	**Select Medical Corp; WCAS**	8 years
MedExpress	280+	Payor	**n/a**	n/a
American Family Care	300	Franchise	**n/a**	n/a
FastMed	200	Private Equity	**ABRY Partners; BlueMountain Capital Management**	8 years
GoHealth	195	Private Equity	**TPG Capital**	9 years
NextCare	170	Private Equity	**Enhanced Capital Partners**	12 years
CityMD	150	Private Equity	**Walgreens / VillageMD**	0 years
Fast Pace	170	Private Equity	**Revelstoke Capital Partners**	6.5 years
WellNow Urgent Care	183	Private Equity	**SV Life Sciences, Petra Capital Partners, River Cities Capital Funds**	11 years
Patient First	77	Independent	**n/a**	n/a
Urgent Team	74	Private Equity	**Petra Capital, River Cities**	7 Years
PM Pediatrics	71	Private Equity	**Comvest Capital Partners**	3.5 Years
Doctors Care	70	Independent	**n/a**	n/a
Nova Health	67	Private Equity	**Shore Capital Partners**	4.5 Years
CRH Healthcare	62	Private Equity	**Freeman Spogli & Co.**	4 Years

PE buyers were highly active in 2015 and several large platform transactions occurred. In addition, PE investors deployed capital for new urgent care platforms during recent years. Since PE firms typically hold investments for three-to-seven years, there is a possibility increased M&A activity that is fueled by PE exits is on the horizon.

The current interest rate environment has increased the cost of debt which has made large transactions more expensive for investors and has increased pressure on valuations. The disconnect between seller and buyer expectations could extend these hold periods. Even with an increasing hold period, these platforms are expected to continue to pursue tuck-in acquisition and other high-growth strategies.

Notable Transactions

PE firms looking to put their limited partners' capital to work will do so through two avenues at the onset: i) acquiring a sizable entity from which the platform will be built; and ii) acquiring other entities to add to the platform (bolt-ons). After completing their holding period and hopefully achieving their target internal rate of returns, the PE firm will look to exit their investment. They will do this either by taking the platform public (IPO, reverse-merger, SPAC, etc.) or selling to another private entity (PE firm, management buy-out, etc.).

Secondary Buyouts

During 2022, overall deal volumes saw several noteworthy secondary buyouts (sale from one PE firm to another institution), particularly within the physician practice management vertical. September 2022 was particularly eventful with four significant secondary buyouts closing across different verticals.

In July 2022, Novum Orthopedic Partners, sponsored by A&M Capital Partners, merged with United Musculoskeletal Partners (UMP), a portfolio company of WCAS. The merger coincides with WCAS' purchase of Panorama Orthopedics which joined Resurgens Orthopaedics and Arlington Orthopedic Associates as co-founding partners of UMP. A&M Capital Partners' initial investment in Novum Orthopedic Partners was a leveraged buyout in December 2021 at an undisclosed amount.

In September 2022, Shore Capital Partners sold their ophthalmology-focused MSO, EyeSouth Partners, to Olympus Partners for an estimated $1B. EyeSouth Partners is an operator of a network of integrated eye care practices located across the Southern United States. EyeSouth Partners was created as a platform by Shore Capital Partners in February 2017, and it was supported by senior debt funding from Madison Capital Funding in the amount of $48M.

In September 2022, the management team for GI Alliance, alongside Apollo Global Management, completed a physician-led buyout of GI Alliance from their previous PE sponsor, Waud Capital Partners. The buyout was an estimated $2.2B and the post-transaction entity now operates under the moniker Texas Digestive Disease Consultants. Waud Capital Partners performed a leverage buyout of GI Alliance in November 2018 at an undisclosed amount.

In September 2022, People, Pets & Vets was sold to VetCor, a portfolio company of Harvest Partners, by their previous PE sponsor Cressey & Company. Cressey & Company initially acquired People, Pets & Vets through a leveraged buyout in May 2018 at an undisclosed amount.

In November 2022, VillageMD acquired Summit Health-CityMD, a portfolio company of Warburg Pincus, for an estimated $8.9B. The transaction creates one of the largest independent provider groups in the U.S. The new entity will have more than 680 provider locations in 26 distinct markets. Summit Health was acquired by Consonance Capital and CityMD via its financial sponsor Warburg Pincus through a leveraged buyout on August 13, 2019, for an undisclosed amount.

Noteworthy Deals

In June 2022, Stone Point Capital purchased Tivity Health for $3.2B. Tivity Health is a provider of fitness, nutrition, and social connection solutions. The company offers an integrated portfolio of solutions to help people live longer and be healthier. These solutions include its SilverSneakers senior fitness program, Prime Fitness, and WholeHealth Living.

In August 2022, Humana divested a majority interest in Kindred at Home Hospice and Personal Care Divisions to Clayton, Dubilier & Rice for an estimated $2.8B. The Company offers clinical services including skilled nursing, occupational and speech-language therapy, cardiac and pulmonary care, neurorehabilitation, medication management and education, treatment for balance problems that can lead to fall risks, and hospice services.

Furthermore, the cardiology market continues to see increased activity as evidenced by the five acquisitions made by Webster Equity Partners in the fourth quarter of 2022 through its platform company, Cardiovascular Associates of America. Other PE firms seeking to enter the cardiology space face stiff competition from these existing platforms, and other private investment vehicles seeking to create their own platforms.

Cardiovascular Platforms with PE Sponsorship	
Private Equity Sponsor	**Platform Company**
Webster Equity Partners	Cardiovascular Associates of America
US Heart & Vascular	Ares Management
Cardiovascular Health Clinic	Assured Healthcare Partners
Varsity Healthcare Partners	Partners First Cardiology
Bain Capital	Nation Cardiovascular Partners
Deerfield Management	Novocardia

Regulatory

PE firms as corporate entities are subject to the Corporate Practice of Medicine doctrine which has laws that vary by state. These laws were created to ensure the practice of medicine is directed solely by licensed physicians to achieve the best outcome for the patient. As a result, doctors cannot work directly for corporations to help mitigate the risk that profit interests don't interfere with the provision of care. Therefore, these laws dictate the way a PE firm will structure its investment which creates the MSO entity.

There are two MSO structures often deployed by PE firms: i) the MSO purchases the non-clinical assets of the target entity and enters into a service agreement with the physicians, or ii) the MSO purchases the non-clinical assets of the target entity, a new practice is set up by the PE firm, but is owned by a "friendly captive" who employs the physicians from the selling entity. "Friendly captives" are routinely controlled by the long-term agreements they enter into with the MSO. The structure employed by the PE firm is largely dictated by the strength of the Corporate Practice of Medicine laws in the state that the target entity operates.

While the Corporate Practice of Medicine doctrine dictates how PE firms transact within the healthcare industry, the FTC has become more active in dictating which transactions can be consummated. The Biden administration has increased regulatory scrutiny of deal-making across most industries, and healthcare is no exception. Most notably, Cerberus Capital Management's portfolio company, Steward Health Care, had its sale of five hospitals to HCA Healthcare canceled as of June 17th, 2022 due to antitrust issues. Additionally, the management buyout (partnered with Leonard Green & Partners) of Prospect Medical Holdings' two hospitals was approved only after $80M was placed in escrow. This was done at the direction of the Attorney General of the State of Rhode Island to ensure operations were unaffected post-transaction.

Additionally, PE firms must stay up to date with reimbursement rate changes resulting from CMS' proposed rules on an annual basis. For 2023, the PFS conversion factor has been reduced, and has resulted in reimbursement contraction of approximately 4.5% relative to 2022 rates. However, the OPPS will see rates increase by 3.8% in aggregate. The way these rates change over time will help inform all investors, PE and non-PE, about the potential opportunities and challenges involved with investing in healthcare.

The healthcare industry's staffing cost headwinds gained additional strength in recent months and the FTC proposed a new rule to ban noncompete clauses from employment agreements. The clauses are currently found to "constitute an unfair method of competition and therefore violate Section 5 of the Federal Trade Commission Act." The FTC estimates the removal of noncompete clauses from employment agreements would increase wages by nearly $300B per year, and would only exacerbate the staffing cost dilemma for healthcare providers. While this proposed rule would limit an entity's ability to exercise control over associate physicians and other healthcare providers, there is an exception to the rule for sellers of a business. This exception would involve previous owners not being impacted by the rule. As of the date of this report, this rule remains in the proposal phase with the FTC seeking public comments. Anecdotally, many players within the transaction space do not expect this rule to take effect, and neither multiples or interest have been impacted by its announcement.

Conclusion

PE's investment in healthcare services declined slightly in 2022 relative to the record-high activity experienced in 2021. Private equity deal flow in the industry has seen a downward trend intra-year, and economic uncertainty increased due to rising interest rates and the threat of a looming recession. However, there continues to be additional capital raised and allocated to healthcare on top of the existing dry powder. With that said, we expect to see PE activity remain at healthy levels in 2023. The trend observed through the end of 2022 will likely sustain through the first half of the year as PE investment continues to be selective with their placement of capital. However, by the second half of 2023 and thereafter, we expect PE firms to deploy capital at higher levels in the healthcare services space, particularly within the middle and lower-middle market.

More Private Equity Thought Leadership

- Physician Practice Strategy: The Private Equity Play
- Private Equity: Piqued Interest in Medical Physics

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