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2024 Healthcare M&A Report

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VMG Health's

2024 Healthcare M&A Report

Healthcare merger and acquisition (M&A) activity in 2023 was characterized by a status of constantly changing expectations. We entered the year with uncertainty driven by inflation, rising interest rates, global security concerns, and a fear of recession. However, the U.S. economy remained unexpectedly resilient; not only was a recession avoided, but economic and employment growth have also continued to beat expectations.

In the face of uncertainty and constantly shifting expectations, M&A typically does not thrive. However, in the face of outsized economic growth, M&A investors typically do not stay on the sidelines for long. Healthcare M&A activity remained resilient in 2023 and we expect the pace of activity to continue to pick up through 2024. For example, a survey of Health System leaders found that 70% invested more in 2023 than expected, and 61% plan to increase dealmaking in 2024 relative to 2023.

As part of their 2023 M&A strategy, healthcare companies looked to divest noncore assets. With interest rates remaining stubbornly high, we expect companies to continue identifying margin-dilutive assets for divestiture. On the buy-side, the cash generated from the divestments will increase dealmaking capacity for strategically aligned verticals.

Leveraging VMG Health's expertise as the leading provider of healthcare transaction and valuation services, this annual report examines the healthcare M&A landscape before and after COVID-19. We analyze transaction activity, regulatory changes, reimbursement outlook, post-COVID-19 M&A outlook, and other industry dynamics driving M&A across several prominent healthcare verticals:

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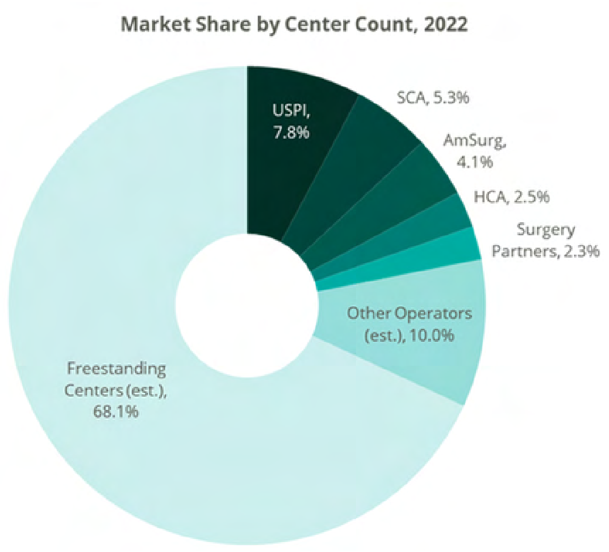
Ambulatory Surgery Centers

Industry Overview

Between 2011 and 2023, the total number of Medicare-certified ambulatory surgery centers (ASCs) in the United States steadily climbed, reflecting the nationwide shift toward outpatient care. This growth wasn't explosive in a given year, but rather a sustained increase of a compound annual growth rate of 1.3%, translating to a jump from 5,217 to 6,087 Medicare-certified ASCs. Despite the industry's upward trajectory, the ASC market continues to remain highly fragmented, with approximately 68% of freestanding ASCs being independently owned and operated. The remaining 32% of the ASC industry is owned and operated by large players, including AmSurg Corp. (merged with Envision Healthcare), United Surgical Partners, Inc. (USPI, parent company Tenet Healthcare and recently acquired SurgCenter Development's centers), SCA Health (owned by Optum/UnitedHealth Group, Inc.), HCA Healthcare, Inc., Surgery Partners, Inc. (54% owned by Bain Capital), and other multi-site owners/operators.



Industry Trends

In recent years, higher-acuity procedures, once exclusive to an inpatient or hospital outpatient department (HOPD) setting have increasingly migrated to the freestanding ASC setting. This shift redefines the capabilities of ASCs, establishing them as safe and efficient hubs for complex procedures and establishing a new standard for the level of acuity that an ASC setting could handle safely and efficiently. Chief Executive Officer of the Ambulatory Surgery Center Association (ASCA), Bill Prentice, says that the continued shift to higher acuity cases being performed in the outpatient setting "benefits both Medicare beneficiaries, who now have a lower-cost choice for the care they need, and the Medicare program itself, which will save millions of dollars as volume moves to the high-quality surgery center site of service."

The ASC subindustry continues to focus on higher-acuity specialties when considering both organic growth and M&A opportunities. In their Third Quarter 2023 Investor Presentation, Tenet reported that USPI same-facility ASC total joints had grown 14.2% year to date as of September 2023. Furthermore, Surgery Partners noted in its presentation at the 41st Annual J.P. Morgan Healthcare Conference in 2023 that musculoskeletal case volume has seen approximately quadrupled growth over the last 10 years.

Saum Sutaria, President of Tenet Healthcare, parent company of USPI, the largest outpatient surgery center operator in the United States, noted continued focus of the ASC business toward higher-acuity service lines in the company's Q3 2023 earnings call. Sutaria reported that Tenet is committed to scaling their ASC portfolio, noting that, "During the quarter, we added six new centers, the majority of which were focused on higher acuity orthopedic services." These observations underscore the ASC subindustry's emphasis on higher-acuity service lines suggesting a sustained trend toward utilizing ASCs for such procedures in the future.

In addition to the major multi-site operators, private equity (PE) investors have continued investing more intentionally in the ASC market. PE interest in ASCs in recent years has most often been tied to related physician practice portfolio companies. 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: Based on data from PitchBook's Q3 2023 Healthcare Services Report, the ASC industry saw six total, trackable PE deals through September 30, 2022. These deals were mostly add-on investments, with one deal being a growth investment. PE total deal activity in the ASC space has remained fairly consistent over the last five years, though 2023 notably marks the first time since 2020 where no platform PE deals were tracked through PitchBook's report.

Although the larger end of the ASC market has seen general stability with its major players, like USPI and SCA, being entrenched in the market for some time, further consolidation at the lower-middle-market level has continued, driven by PE interest and investment. A newly founded, multispecialty ASC development and management company, SurgNet Health Partners, Inc., announced the acquisition of two ASCs in Michigan and Ohio in October 2023. SurgNet is newly backed by Fulcrum Equity Partners, Leavitt Equity Partners, and Harpeth Capital. A $50 million equity check was syndicated to launch the platform, and presumably additional investments will follow to support further investments. SurgNet, together with its equity partners, is expected to rapidly expand in the outpatient surgery market through aggressive growth strategies, including acquisitions, de novo ventures, and effective center management.

The 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.

In 2023, VMG Health observed stabilization in the valuation of multiple ranges for ASC transactions. While the median total invested capital (TIC) to earnings before interest, taxes, depreciation, and amortization (EBITDA) multiples dropped slightly, the 25th and 75th percentiles remained stable from 2022 to 2023. The wider range in 2019–2021 is likely attributable to the uncertainty in the industry as a result of the COVID-19 pandemic during that time. Relative to before COVID-19, we have observed a convergence in multiples at the 8.0x range.

This multiple range is backed by two key industry leaders. In Tenet Healthcare's quarterly investor presentations, they highlight an average initial acquisition multiple of 8.0x for their ASC ownership interest. Similarly, in a Q3 2023 earnings call, Surgery Partners' CEO communicated an average purchase price multiple of less than 8x, trailing 12 months earnings for acquisition capital deployed through September.

TIC / EBITDA	2017	2018	2019	2020	2021	2022	2023
25th Percentile	6.0x	6.6x	6.5x	6.9x	7.5x	7.4x	7.4x
Median	6.8x	7.4x	7.7x	7.8x	7.8x	7.8x	7.7x
75th Percentile	7.4x	7.9x	8.4x	9.7x	8.4x	8.0x	8.0x
Number of Observations	24	30	30	21	25	19	21

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.

Transaction Activity

Between 2015 and 2018, the ASC industry went through a period of consolidation, culminating in several mega-mergers—which are transactions that unite two large corporations valued at billions or more. Mega-mergers have reshaped the industry.

In 2015, Tenet and USPI merged; while in 2016, Envision Healthcare Holdings and AmSurg Corp. 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. made two large acquisitions of ASC operators during this period and acquired Nashville-based Covenant Surgical 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.

> "We remain focused on opportunities to expand our Ambulatory Care segment through acquisitions, organic growth, construction of new outpatient centers and strategic partnerships."
>
> **Tenet Healthcare Corporation**
> 2023 Form 10-k

In 2020, Tenet finalized a deal for $1.1 billion to acquire 45 ASCs from SurgCenter Development. Additionally, in Q4 2021, USPI entered into a $1.2 billion deal to acquire SurgCenter Development's remaining centers and established a long-term development deal. The transaction included acquiring ownership interest in an additional 92 ASCs, other support services in 21 states, and providing continuity for future de novo development projects.

In 2023, there were no notable mega-mergers or large platform–level transactions. That said, the industry continued to see transaction activity at the multi-site operator level and through local and regional health systems.

On February 9, 2023, United Musculoskeletal Partners (UMP) partnered with two orthopedic practices based in Dallas-Fort Worth. The UMP platform acquired both All-Star Orthopaedics, which has four clinic locations, and OrthoTexas Physicians and Surgeons, PLLC, which operates five clinics and one surgery center. In August, UMP expanded this partnership, acquiring an ortho-focused surgery center, Pinnacle Orthopaedics, in an add-on LBO transaction.

In May 2023, The Office of Health Strategy (OHS) approved two settlement agreements allowing Hartford HealthCare (HHC) to acquire two outpatient surgical centers in Connecticut. On May 12, 2023, HHC acquired Surgery Cener of Fairfield County, a subsidiary of HCA Health, for an undisclosed amount. Further, in October 2023, HHC acquired Lichfield Hills Surgery Center, also for an undisclosed amount.

Covenant Physician Partners expanded its ASC footprint with the merger of its St. Vincent Eye Surgery Center and Wilshire Center for Ambulatory Surgery, adding an additional facility for surgeries.

On September 18, 2023, Unifeye Vision Partners (UVP), a management and support services company with an ophthalmology and optometry practice network including 13 ASCs, announced the acquisition of Insight Vision Group, a comprehensive eyecare platform in California. Insight Vision Group is made up of 10 clinics and two multispecialty ASCs. UVP was active in the M&A space earlier in the year, acquiring Premier Surgery Center of Santa Maria through an LBO for an undisclosed amount.

Surgery Partners further expanded its reach in September 2023, with the announcement of the acquisition and partnership with NorCal Orthopedic Surgery Center in San Ramon, CA. The center, an out-of-network ASC originally comprised of nine separate operating entities along with 25 physician partners, was advised by Merrit Healthcare Advisors in structuring the merger of the nine entities into one ASC to then be sold to Surgery Partners.

TriasMD, the parent company of DISC Surgery Centers and another musculoskeletal management company, declared its acquisition of Pinnacle Surgery Center in October 2023. This strategic move extends DISC's data- and evidence-driven ASC model into Northern California, marking the second acquisition within the past six months. TriasMD previously acquired Gateway Surgery Center in Santa Clarita in February.

In November 2023, Regent Surgical Health acquired majority ownership in Oregon Surgical Institute (OSI), expanding a joint venture partnership that started in 2016. Notably, OSI was the northwest US' first ASC to focus on complex spinal and total joint replacement cases. Regent COO Jeff Andrews said: "Our evolved partnership was made possible by the trust OSI's leadership team has placed in us, and this will bolster both value and access by strengthening OSI's position as a home for the growing list of procedures being delivered through ambulatory surgical centers nationally." This development highlights the continued emphasis on pushing more complex cases to the outpatient setting through health system joint venture partnerships.

Reimbursement

On November 1, 2022, CMS released the current year (CY) 2023 Hospital Outpatient Prospective Payment System (HOPPS) and ASC payment system policy changes and payment rates final rule. Based on the final ruling, CMS increased the ASC conversion factor by 3.8% in CY 2023, a substantial increase from the CY 2022 final rule, which increased ASC payment rates by 2.0%.

Moreover, the ASC payment final rule for CY 2024 was released by CMS on November 2, 2023, resulting in overall expected growth in payments equal to 3.1% in CY 2024. This increase is determined based on a projected inflation rate of 3.3% less the MFP reduction of 0.2% mandated by the ACA. The 3.1% growth in payments represents a continuation of elevated increases in projected payments compared to years prior to 2023, a direct result of the increase in labor, supplies, and other cost pressures seen over the last two years. Although the overall ASC industry recognizes the relative increase in payments over the last two years as a win, many major players believe the increase was insufficient given the extraordinary cost pressures hospitals and ASCs are facing and the lower increase compared to 2023. Stacy Hughes, Executive Vice President of AHA commented, "The AHA is concerned that CMS has again finalized an inadequate update to hospital payments. Today's increase for outpatient hospitals of only 3.1% comes in spite of persistent financial headwinds facing the field. Most hospitals across the country continue to operate on negative or very thin margins that make providing care and investing in their workforce very challenging day to day."

In the CY 2023 final rule, CMS considered 64 recommendations for new procedures to be added to the ASC Covered Procedure List (CPL). After reviewing the clinical characteristics of these procedures, four were chosen to be added to the CPL for the upcoming year. The addition of only four codes resulted in pushback and continued desire for additional procedures that are being performed safely and successfully by ASCs to be added to the CPL.

CMS made major strides in CPL additions in the CY 2024 final rule, finalizing the addition of 37 surgical procedures to be added to the ASC CPL for CY 2024. These include 26 dental codes that were included in the proposed rule, as well as 11 surgical codes that were not included in the proposed rule—most notably total shoulder arthroplasty. These codes correspond to procedures that have few to no inpatient admissions and are widely performed in outpatient settings.

Adding a larger number of surgical procedures to the CPL in the 2023 final rule was well received by major players in the ASC market. The further shift of higher-acuity procedures to the outpatient setting continues to drive the ASC market growth as a whole and strengthens the trends of the last few years.

Conclusion

The ASC marketplace continues to be an active transaction arena as major operators consolidate and look for new opportunities in this space. As the market continues to mature, we will see more strategic acquisitions of multiple ASCs (platform transactions) by larger players seeking geographical expansion and operational synergies. In addition to the legacy operators, we are beginning to see other types of investors show interest in the marketplace. PE firms are increasingly attracted to the ASC market's stable cash flow and growth potential. Overall, ASC transactions of all types are expected to continue the positive momentum that persisted in 2023, and the subindustry is expected to see the level of transactions increase through 2024.

More ASC Thought Leadership

- ASCs in 2023: A Year in Review
- ASC New Partnership: Management Fee Split
- ASCs: The Latest Trends in Strategy & Operations
- ASC Transaction Value: The Not-So-Simple Algebra of Multiples
- Private Equity Investment in Ambulatory Surgery Centers

Diagnostic Imaging Centers

Industry Overview

In the United States, current estimates indicate that over 700 million diagnostic imaging procedures are performed each year, generating over $115 billion in net revenues annually. Radiology services are critical to the provision of quality and efficient healthcare and directly impact areas such as patient safety, patient experience, length of hospital stay, and downstream healthcare resource utilization. The industry is projected to grow at a single-digit compound annual growth rate (estimates generally range between 4% and 6%) over the next decade as a result of the increasing aging population; technological improvements to the quality and resolution of imaging equipment; advances in contrast materials, radioactive pharmaceuticals, and post-processing software; more education within the referring physician community; and greater consumer awareness of and demand for preventative diagnostic screening.

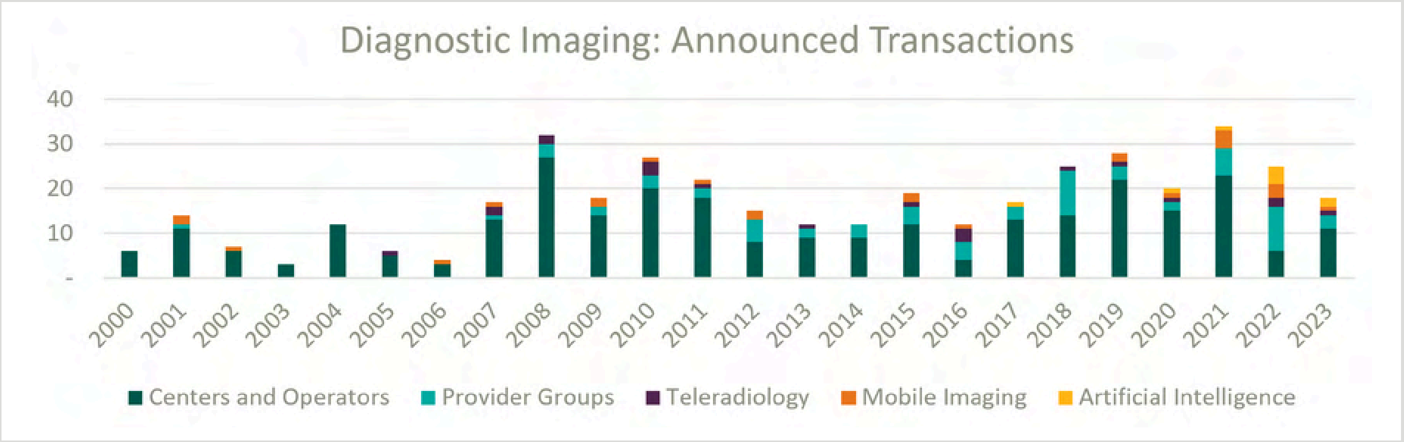
The industry is highly fragmented, as a large percentage of industry players are “mom-and-pop” radiologists who own a single facility or small groups of radiologists who own multiple facilities. Approximately 40%–50% of imaging procedure volumes occur in non-hospital-based settings (i.e., freestanding centers and physician offices), while 50%–60% of imaging procedures occur within hospitals. RadNet, Inc. remains the largest single operator, responsible (directly or indirectly through joint ventures) for 366 centers as of September 30, 2023, a modest sum when compared to the estimated 6,000 locations believed to exist across the United States.

M&A Trends

M&A activity within the diagnostic imaging industry primarily involves smaller, tuck-in acquisitions of the mom-and-pop or single-modality imaging providers that dominate the market share of the imaging services industry. In response to reimbursement pressures, mom-and-pop and single-modality imaging providers may benefit from consolidation, as they may be disproportionately impacted by reimbursement changes as compared to multi-modality facilities, which generally have a higher cost structure and less negotiating power. In turn, the regional and national owners and operators create additional capacity at under-utilized facilities and currently, they generally transact between 4x and 6x EBITDA.

In more recent years, price transparency regulations and payer coverage of inpatient imaging procedures have caused volumes to shift to outpatient facilities. In response, hospitals and health systems have notably increased their interest in joint ventures with both radiology groups and independent imaging facilities. According to RadNet’s Executive Vice President and Chief Financial Officer, Mark D. Stolper, at the Bank of America Securities 2023 Leveraged Finance Conference in November of 2023, hospitals and health systems are looking for strategies to recapture revenue they are losing to lower-cost ambulatory outpatient providers and strategies to participate in community health, where they can expand their operations into catchment zones that can feed their acute-care services. For RadNet, the company typically owns between 40% and 60% of the joint venture, which now represent approximately 36% of RadNet’s overall imaging center portfolio.

In 2023, M&A activity within diagnostic imaging experienced a second consecutive year of softening volumes since peaking in 2021. The continued decline may be a function of numerous factors, including the lingering effects of the COVID-19 pandemic like interest rate volatility, recessionary fears, and labor shortages felt throughout the broader healthcare sector in the U.S. and abroad. For RadNet specifically, company management recently indicated that "...there's been fewer suitable, tuck-in acquisitions of companies that weren't busy or didn't have that excess capacity." Industry participants may have less time to focus on M&A considering the rapidly growing shortage of radiologists and technologists—one of the biggest topics covered at the 2023 Radiological Society of North America. Recently, RadNet significantly increased capital expenditures related to de novo facilities to address capacity constraints, which are expected to average between $3.0 and $5.0 million of annual revenue and 15.0% to 20.0% EBITDA margins once operational. With the capital expenditures increase, Radnet also aims to continue pursuing opportunities and investments in artificial intelligence (AI) technologies.



Notable Transactions

On November 8, 2023, RadNet announced the expansion of an existing joint venture partnership with Cedars-Sinai Medical Center (CSMC), a nonprofit academic healthcare organization based in California. The expansion included the establishment of a new, wholly owned subsidiary, Los Angeles Imaging Group, LLC (LAIG), and the expansion of an existing joint venture, Santa Monica Imaging Group, LLC (SMIG). To form LAIG, RadNet contributed to the operations of three centers and retained a 65% controlling economic interest, while CSMC purchased a 35% non-controlling economic interest for a cash payment of $5.9 million. The expansion of SMIG included RadNet's contribution of two imaging centers, valued at $27.2 million, and the purchase of an additional 6% economic interest in SMIG for a cash payment of $5.2 million. Simultaneously, CSMC contributed five additional imaging centers.

> "The ventures will streamline and improve patient care by improving workflow, providing better access to records, and producing more timely and accurate results for patients and referring physicians."
>
> **Dr. Howard Berger, President & CEO, RadNet**

Additionally, on December 5, 2023, RadNet and Walmart announced an agreement to open diagnostic imaging centers in multiple Walmart locations. On December 8, 2023, the first MammogramNow clinic opened in Milford, Delaware, with plans to open additional clinics in Walmart locations in Phoenix, Arizona and Hanford, California. These clinics will utilize AI tools from RadNet's subsidiary, DeepHealth, optimizing detection without incurring additional time.

"With MammogramNow, we are endeavoring to improve population health and encourage preventative care. We believe RadNet currently performs close to 5% of all mammograms in the United States annually, and the pilot with Walmart is designed to provide even greater, convenient access for women, driving better compliance with annual breast cancer screening guidelines," said Berger as part of the announcement. There may also be potential to expand services beyond mammography in the future, including the opportunity to add CT scanners that would allow for lung cancer screening.

Fairfax Radiology Centers, located in Virginia added two outpatient imaging centers and 15 physicians through its purchase of the Association of Alexandria Radiologists. The acquisition will take effect in January of 2024, resulting in over 115 trained physicians employed by Fairfax Radiology Centers.

Reimbursement

As previously mentioned, M&A activity within the diagnostic imaging industry primarily involves smaller, tuck-in acquisitions of mom-and-pop or single-modality imaging providers in response to reimbursement pressures that have specifically targeted imaging services and persisted for decades. In 1997, the Hospital Outpatient Prospective Payment System (HOPPS) 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. The Deficit Reduction Act (DRA) mandated the technical component 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. The DRA's Multiple Procedure Payment Reduction (MPPR) also decreased the TC payment for certain imaging procedures performed in the same setting. In 2006, CMS reduced the TC by 25% for certain imaging procedures performed on contiguous body parts. In 2011, CMS reduced the TC by 50% and professional component by 25% for all billing codes. Additionally, the Affordable Care Act of 2010 decreased the TC for radiologic procedures by increasing the Assumed Imaging Utilization rates for CT and MRI to 90% compared to 50%, 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.

Subsequently, many payors are no longer covering certain radiology scans performed at hospitals, requiring patients to receive care at lower-cost outpatient settings. For example, the average network rate for an abdominal MRI scan at an outpatient diagnostic imaging center is approximately 61% less than the average rate for an inpatient imaging procedure. RadNet management recently commented, "The payers over the last five years have gotten more and more aggressive in attacking cost, meaning they're trying to move more and more patient volumes into lower-cost sites of care." In response, hospitals and health systems have notably increased their interest in joint ventures with both radiology groups and independent imaging facilities as part of the migration of imaging procedure volumes from inpatient to outpatient facilities.

Regulatory

In addition to managing the implications of reimbursement changes, the regulatory environment governing the diagnostic imaging industry is complex, including facility licensing and certification laws, corporate practice of medicine laws, federal and state anti-kickback statutes and stark laws, healthcare reform legislation, U.S. Food and Drug Administration requirements, radiologist licensing requirements, and insurance laws and regulations. The labyrinth through which industry participants must navigate directly affects operating profitability and may be more challenging for the mom-and-pop and single-modality imaging providers that dominate the industry's market. The regulatory environment is often cited as a factor for mergers and acquisitions within the industry, as larger, sophisticated owners and operators have more resources to monitor developments in healthcare law and ensure compliance with applicable regulations.

Recent legislative issues include surprise billing and the No Surprises Act passed by Congress, and the proposed Medicare Access to Radiology Care Act (MARCA). The No Surprises Act bans balance billing for out-of-network emergency care until the patient can consent and safely be moved to an in-network facility; bans balance billing for scheduled, out-of-network services at an in-network facility when the patient has not been notified or provided consent; prohibits insurers from assigning patients higher deductibles (and other cost sharing) for out-of-network care than they do for in-network care without patient notification and consent; and 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. MARCA would provide payment to the supervising radiologist for registered radiologist assistant (RRA) services performed in a facility setting and would not allow for independent RRA practice nor payment. Notably, MARCA currently has little congressional support.

Conclusion

In summary, the M&A landscape for diagnostic imaging remains modest compared to other sectors within the U.S. healthcare industry, which is likely a function of the industry's highly fragmented nature and lack of regional or national providers with enough capital and resources to make such acquisitions.

In the short term, it is unclear how M&A activity in 2024 will compare to 2023 considering the lingering effects of the COVID-19 pandemic have led to two consecutive years of softening volumes since peaking in 2021. Industry participants are currently focused on addressing capacity constraints and labor shortages, resulting in fewer opportunities for standard, tuck-in acquisitions. However, the diagnostic imaging space will continue to experience growth in teleradiology and artificial intelligence, services that continue to grow in popularity and demand.

More Imaging Thought Leadership

- Four Key Valuation Considerations When Converting the Imaging Operations of a Hospital Outpatient Department to a Freestanding Center
- Imaging Center: Professional Interpretation Services Agreement
- Imaging Center Operator & Provider Group: Technical Compensation Arrangement

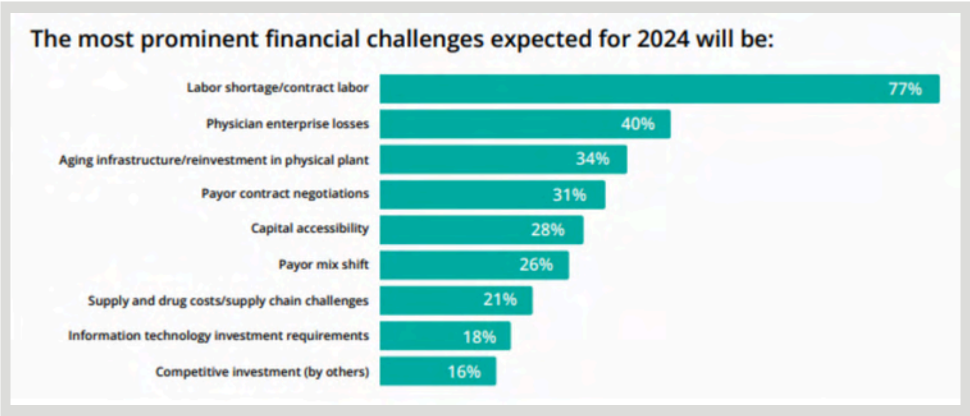
Acute Care Hospitals

Industry Overview

As of December 2023, the total number of acute care hospitals (ACHs) in the United States was approximately 5,450. Of this total, just under 60% operated as not-for-profit, approximately 25% were investor-owned for-profit, and the remainder were operated by state and local governments. Excluded from this total are the hospitals not accessible to the public, including federal prison hospitals, college infirmaries, and psychiatric hospitals. In 2023, spending on hospital services is estimated to account for approximately 31.3% of total national health expenditures, representing the single largest expense category. Total hospital spending has increased approximately 5%, compounded annually from $0.989 trillion in 2015 to an estimated $1.460 trillion in 2023.

Although the immediate, direct impact of the pandemic on hospitals and health systems has subsided, the lingering impact on clinical care patterns and financial performance stubbornly persisted in the years following. Such impacts include sustained, elevated labor expenses, continued inflationary pressures, and declining inpatient admissions. These headwinds continue to exert pressure on profit margins across the hospital industry; however, profit margins have improved throughout CY 2023 and performance has trended positively. Through November 2023, the median hospital calendar year-to-date (CYTD) operating margin, as observed in the Kaufman Hall National Hospital Flash Report, was approximately 2% as compared to (0.9%) during this same period in 2022. Although profitability has improved, margins remain razor thin and provide limited room to satisfy debt obligations, invest in aging physical infrastructure, or finance new initiatives. Higher revenue growth has helped to offset expense inflation and improve hospital profitability. Hospital EBITDA margins, as observed by Kaufman Hall, improved 9% from YTD November 2022 to YTD November 2023, though remain down 10% from YTD November 2020 levels.

A new market study conducted by VMG Health highlights optimism that is generally observed by hospital and health system industry leaders as we enter calendar year 2024. This study, VMG Health's Health System Leader Expectations for 2024, surveyed 141 hospital leaders across the country. Key takeaways with respect to financial performance in 2024 found that approximately 60% of respondents expected performance in 2024 to exceed that experienced in 2023. As it relates to the financial challenges facing health systems in 2024, the survey confirmed that the challenges that have plagued the industry over the last several years will continue to do so in 2024—notably labor costs and shortages, physician enterprise losses, and the need to invest in aging physical infrastructure (see chart below).



Communication from the public operators also mirror this cautious optimism toward the future:

> "Well, I think we've proven the teams have managed through that very well during the inflationary period we experienced. I think going forward, we expect to move back into kind of normal trends, which is generally 2.5% to 3% of wage inflation going forward. And then we believe there is continued improvement in contract labor to be achieved. And we have plans to execute that throughout 2024."
>
> William B. Rutherford, Executive VP & CFO, HCA Healthcare, Q4 2023 Earnings Call

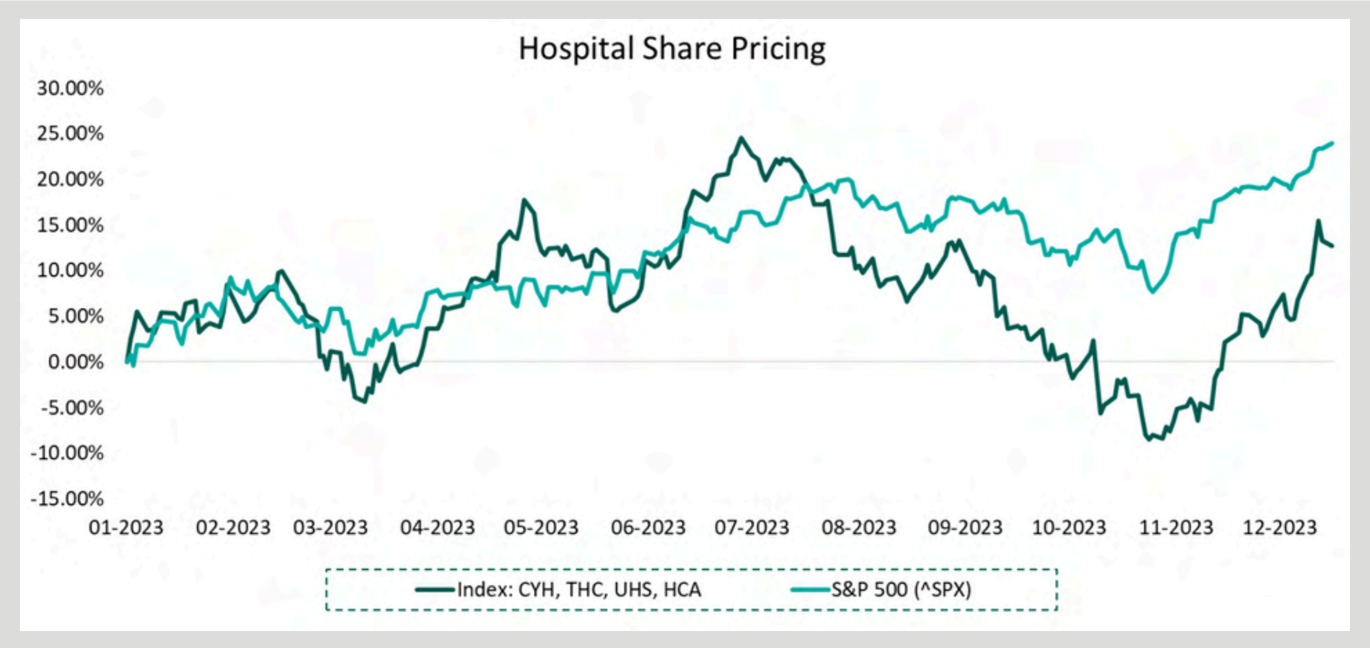
> "First of all, we had an outstanding year in the hospital segment. As you know, every quarter, we exceeded our expectations there.
>
> Look, for us, I mean, we took a lot of the benefit from contract labor reduction in '23. Now don't get me wrong, there's an annualization effect that will improve in the coming year. The volume strength was also very good during the year. And so, I think that we believe that we'll continue to see acute care recovery in 2024, like we saw in 2023. And if we're able to open up capacity effectively to service the demand that we want, which again is consistent with our high acuity strategy, I think that's what gets us to the upper end of our guidance, right? It's really the volume potential there."
>
> Sun K. Park, Executive VP & CFO, Tenet Healthcare, Q4 2023 Earnings Call

> "The market for labor has normalized in very material ways compared to where it was one year or 1.5 years ago. And we're seeing it in our cost per hour as a company, which has really lined up with the expectations we had for the year; and we've seen stabilization across the elements of our compensation programs..."
>
> Samuel N. Hazen, Chief Executive Officer & Director, HCA Healthcare, Q3 2023 Earnings Call

> "Year-over-year for the quarter, same-store admissions were up 3.7% and at the highest level since the fourth quarter of 2019 or pre-pandemic. Same-store adjusted admissions increased 4.2% and also reached to record levels, demonstrating the strong demand for care in our markets and the favorable impacts of our outpatient access point growth investments."
>
> Tim L. Hingtgen, CEO & Director, Community Health Systems, Q3 Earnings Call

Hospitals experienced a decline in the average length of stay, as patients continued to trend to pre-pandemic patterns of accessing care. On a same-facility basis, the average length of stay declined 5% from the comparable prior YTD period (YTD November 2022) for acute care hospital operators and remain in-line with the comparable YTD November 2020 period. CYH reported same-store volumes to be at their highest levels since Q4 2019. Nationwide, hospital inpatient discharges are up 2% month-over-month in November 2023 and are 3% higher year-to-date compared to November 2022.

The impact of the factors described above was also observed in the equity prices of the four public companies that operate acute care hospitals: HCA Healthcare, Community Health Systems, Inc. (CYH), Tenet Healthcare (THC), and UHS. The chart below displays the indexed share prices of these companies relative to the S&P 500. Toward the end of June 2023, the ACH index experienced a decrease from its stock price high of nearly +25% relative to baseline January 2023. This decline persisted through the end of October, reaching a low of approximately 8% around the same time as the release of Q3 2023 earnings. Thereafter, the stock prices rose steadily to reach nearly +16% in December. Over this same period, the S&P 500 reached a low in January 2023 and trended upward through December, where it reached nearly +24%. The ACH index prices varied more throughout the observed period when compared to the S&P 500, which steadily rose throughout the period. The healthcare industry is typically recession-resistant relative to other markets, so the large swings in prices are indicators of the acute-care hospital industry's continued financial headwinds throughout 2023. Health system financials are stabilizing from significant financial stressors experienced in 2022; however, inconsistent financial performance has prevented the sector from reaching long-term financial and share price stability.



M&A Trends

There are significant parallels when comparing the ACH M&A market in 2023 against the backdrop of the industry dynamics described above. As hospitals work to regain financial momentum, the M&A landscape faced the impact of a major theme observed in 2022: Transaction volumes remained low relative to historic levels, as many ACH systems faced financial challenges, limited large-scale capital commitments, and focused on more near-term, margin-preservation activities. Many of the announced transactions of 2023 were driven by operational and financial headwinds, portfolio realignment efforts, and divestitures of assets in non-core markets.

> "In 2024 . . . we expect to integrate a number of newly acquired hospitals and outpatient facilities that should complement our networks."
>
> **HCA Healthcare**
> 2024 Form 10-k

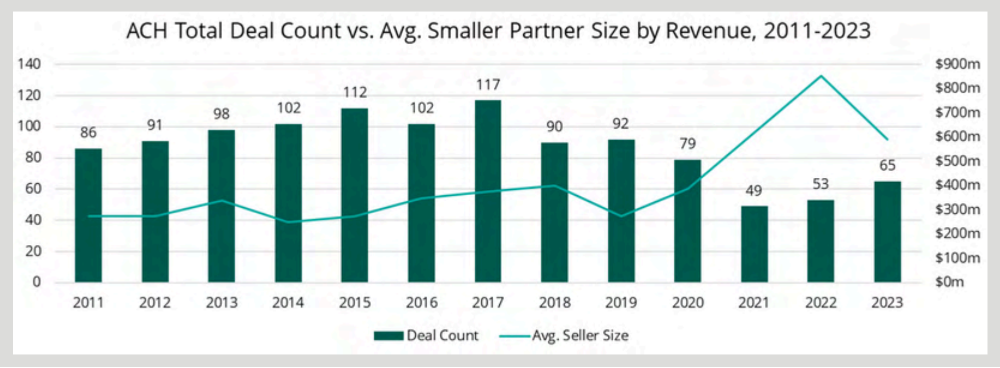
As observed in recent years, the transaction market for ACHs was largely comprised of not-for-profit buyers and sellers entering transactions with little to no cash being exchanged. Such transactions are called member substitutions and represent the most common nonprofit transaction structure. Member substitutions 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 non-cash purchase price characteristic of the member substitution deal structure is attractive. According to Scope Research, there have been approximately 22 affiliation agreements in 2023, in line with 2022 levels. 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.

A significant member substitution of 2023 was announced April 26, 2023. Kaiser Permanente announced the formation of a new nonprofit health system, Risant Health, and the acquisition of Geisinger Health to join the new nonprofit health system. Kaiser Foundation Hospital's intention in creating Risant Health was to "expand and accelerate the adoption of value-based care in diverse, multi-payor, multi-provider, community-based health system environments," according to a news release. Hospital systems acquired by Risant Health would operate as community-based systems with the backing of Risant Health's value-based platform. Kaiser is investing significant funds into Risant Health, planning for a minimum of $400 million. Risant provides a potential lifeline for health systems struggling in the 2023 operating environment to provide population health expertise, capital needs, and capability-based scale.

Although remaining below pre-pandemic levels, ACH M&A activity in 2023 did increase slightly from the lows experienced during 2022. By the end of 2023's third quarter, there were 53 hospital mergers or acquisitions announced, equivalent to the total 2022 deal count, according to data from Kaufman Hall. Additionally, total transacted revenue for Q1 2023 neared historic highs, at approximately $12.4 million in 2023 as compared to $12.7 million in 2018. Consistent with trends observed in 2022, the average size of parties involved in transactions has been inflated relative to historic levels, as shown through the approximately five "megamergers" announced in Q1–Q3 2023. In Q1 2023, the average size of the seller (as measured by revenue) was approximately $827 million, representing a CAGR of approximately 16% from 2017, and a decrease of nearly 3% from 2022 levels.

On May 31, 2023, St. Louis-based BJC Healthcare and Kansas City-based Saint Luke's Health System announced their intent to merge into what would create an $8.7B, 24-hospital system. In November, they entered into a definite agreement, with an estimated transaction close of January 1, 2024. This megamerger emphasizes the trends toward more cross-market mergers to help hospital systems expand and optimize financial and operational synergies. Such cross-market mergers have historically been met with more limited resistance from federal anti-trust concerns.



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

Notable Transactions

Other notable transactions are described in the charts below.

Announced	Seller Name	State	Seller Status	Revenue	Buyer	Buyer Status	Revenue
12/20/2023	Children's Hospital of Orange County	CA	Non-Profit	$1,211	Rady Children's Hospital Diego -San	Non-Profit	$1,460
12/19/2023	Lehigh Valley Health Network	PA	Non-Profit	$4,031	Jefferson Health	Non-Profit	$9,031
11/17/2023	Coastal Carolina / Hilton Head / East Cooper Med. Center (Tenet)	SC	For Profit	$550	Novant Health	Non-Profit	$7,280
10/18/2023	Ascension SE Michigan (9)	MA	Non-Profit	$2,996	Henry Ford / Ascension (JV)	Non-Profit	$7,105
8/16/2023	Legacy Health	OR	Non-Profit	$2,565	Oregon Health & Science Univ	Non-Profit	$3,808
7/12/2023	St. Lukes Duluth	MN	Non-Profit	$552	Aspirus Health	Non-Profit	$1,648
7/11/2023	Riverside Health System (Minority Acquisition)	VA	Non-Profit	$1,543	UVA Health	Non-Profit	$2,437
5/31/2023	St. Luke's Health System	KS/MO	Non-Profit	$2,349	BJC HealthCare	Non-Profit	$6,293
5/2/2023	Ardent Health (Minority Stake)	Various	For Profit	$5,000	Pure Health (Abu Dhabi SWF)	For Profit	N/R
4/26/2023	Geisinger Health	PA	Non-Profit	$6,857	Kaiser Permanente / Risant	Non-Profit	$95,408
4/11/2023	ThedaCare	WI	Non-Profit	$1,140	Froedtert Health	Non-Profit	$4,690
2/28/2023	Lake Norman Regional / Davis Regional Med. Center (CHS)	NC	Non-Profit	$186	Novant Health	Non-Profit	$7,280
2/15/2023	5 Steward Hospitals (Utah)	UT	For Profit	$685	CommonSpirit Health	Non-Profit	$34,045
2/15/2023	Logan Health	MT	Non-Profit	$583	Billings Clinic	Non-Profit	$975
2/2/2023	Flagler Health+	FL	Non-Profit	$293	UF Health	Non-Profit	$2,787

Reimbursement

On August 1, 2023, CMS issued the FY 2024 Inpatient Prospective Payment System (IPPS) policy changes and payment rates final rule. As promulgated by this final rule, IPPS payment rates will increase by 3.1% in 2024. The final rule is derived from a 3.3% hospital market basket update partially offset by (0.2%) productivity adjustment. This update follows on the heels of the FY 2023 final rule, which increased the IPPS payment rates by 4.3%. The increase in operating and capital IPPS payment rates will inflate hospital payments in FY 2024 by and aggregate $2.2 billion, according to CMS.

Additionally under the IPPS, hospitals may be subject to other adjustments, such as payment reductions for excess readmissions under the Hospital Readmissions Reduction Program (HRRP), a payment reduction of 1% for the worst-performing quartile under the Hospital Acquired Condition (HAC) Reduction Program, and upward and downward adjustments under the Hospital Value-Based Purchasing (VBP) Program, with the expected pool for VBP incentives of $1.7 billion.

CMS will decrease disproportionate share hospital (DSH) payments and Medicare uncompensated care payments by roughly $957 million in FY 2024, from the FY 2023 $6.5 billion amount. This decrease reflects the CMS Office of the Actuary's use of the updated estimates and data in its projections. CMS also projects that additional payments for inpatient cases involving new medical technologies will decrease by $364 million in FY 2024, driven primarily by the expiration of new technology add-on payments for 15 technologies that are no longer being considered new.

In a published statement, the American Hospital Association (AHA) responded with their concern: "The AHA is deeply concerned with CMS' woefully inadequate inpatient and long-term care hospital payment updates. The agency continues to finalize rate increases that are not commensurate with the near decades-high inflation and increased costs for labor, equipment, drugs and supplies that hospitals across the country are experiencing."

For outpatient services, CMS finalized its Hospital Outpatient Prospective Payment System (HOPPS) on November 2, 2023. This update directs the payments to be made to hospital outpatient departments and ambulatory surgery centers (ASCs). Consistent with the IPPS update, the final rule includes a 3.1% increase in payments. Hospitals that do not meet applicable quality reporting program requirements will be subject to a 2% reduction in payments, negating most of this increase. Other notable updates include no change to the statutory default for 340B-acquired drugs and biologicals (ASP +6%), and no procedures were removed from the inpatient only list while nine procedures were added to this list.

As stated previously and 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 2023 earnings calls, operators are cautiously optimistic, with rate increases for the coming year anticipated to range from a minimum of 2%–3% (EHC) to upwards of 4%–6% (CYH).

Regulatory

The FTC has remained active in regulating health system mergers and acquisitions activity throughout 2023. The commission has challenged two deals in 2023 after blocking four deals in 2022. In September, a federal judge ruled in favor of the process LCMC Health went through in their $150 million acquisition of three Louisiana hospitals, which are partnered with Tulane University in early 2023, from HCA Healthcare. The FTC brought an antitrust suit against LCMC Health and HCA, stating that the entities should have sought federal approval instead of solely relying on state approval. Louisiana is one of 19 states that have state-level Certificate of Public Advantage (COPA) laws, which give states the right to approve hospital mergers. The federal judge ruled that LCMC Health and HCA Healthcare abided by the correct state procedures to approve the merger, as COPA made it exempt from federal antitrust law.

The Federal Trade Commission (FTC) sued to block Novant Health's $320 million acquisition of Lake Norman Regional Medical Center and Davis Regional Medical Center from Community Health Systems, Inc. (CHS) on January 25, 2024. The FTC asserted the proposed deal threatened to cause higher prices and reduced incentives to invest in quality and innovative care because Novant would control nearly 65% of the inpatient, general acute-care services market in the Eastern Lake Norman Area of North Carolina.

On November 17, the FTC sued to block John Muir Health's proposed $142.5 million deal to acquire 51% of San Ramon Regional Medical Center, LLC from Tenet Healthcare Corporation. John Muir Health currently owns 49% of the entity. In a press release, the FTC stated that the deal threatens to increase healthcare costs in the local market, as John Muir Health would control more than 50% of the inpatient market.

As evidenced by recent budgetary requests, the federal government is looking to continue to play a prominent role in the near-term future of healthcare consolidation. The FTC has requested a budget of $590 million for 2024, with approximately $70 million of that total bookmarked to support the agency in addressing healthcare mergers. In addition, state legislatures are getting involved: During 2023, Illinois, Minnesota, and New York joined other states in passing legislature that requires notification of potential transactions when the transaction meets certain conditions. California also enacted a healthcare transaction review law, which will come into effect on April 1, 2024. This law requires a 90-day preclosing notice requirement for healthcare entities. Health system operators are also expecting the FTC to continue exerting significant influence. In a survey conducted by VMG Health at the end of 2023, of the 141 health system leaders who completed the survey, 20% list federal and state regulatory hurdles as the number one expected acquisition-related challenge for 2024.

The #1 expected acquisition-related challenge for 2024 is:

24% Mismatch of buyer/seller perception of value

23% Internal financial challenges

20% Federal/state regulatory hurdles

Outside of the FTC impact on M&A activity, there were numerous prominent health policy issues that impacted hospitals and health systems. First, in January 2023, the Biden Administration announced that the COVID-19 national emergency and public health emergency declarations would end effective May 11, 2023. While this impacted numerous areas of providing and financing patient care, particular impact to hospitals included the elimination of certain Medicare and Medicaid waivers, loosening of permission referrals implicated by the Stark Law, and the removal of add-on payments for patients with COVID-19 diagnoses. Also, front and center with respect to health policy is a heightened focus on increased transparency. With bipartisan support, the Lower Costs, More Transparency Act passed in the House of Representatives on December 11, 2023. This legislation will require hospitals to publish prices, such as discounted cash prices and negotiated charges, annually through machine-readable files. While this bill must still go through the Senate, there is an attitude of healthcare reform in Washington, and there could be more regulations regarding healthcare costs soon.

Conclusion

When compiling last year's healthcare M&A report, the ACH industry was grappling with declining admissions, the loss of federal stimulus funds, and the return of mandatory cuts related to sequestration in 2023. On the expense front, inflationary pressures, supply chain disruptions, and staffing difficulties were resulting in compressed profit margins. The expectation at the time was that these headwinds were expected to ease throughout 2023, resulting in improved financial and operational positions. Based on performance to date, this has largely played out as expected—margins have improved but still lag pre-pandemic levels. The financial challenges post-pandemic are a driving force behind many of the affiliations and divestitures observed in 2023. As compared to years past, hospitals in financial distress have represented a larger portion of the seller market.

Overall, M&A activity has again been dominated by the nonprofits, representing the buyers in approximately 85% of hospital transactions while representing only 75% of the total hospital market. For-profit buyers represented the sellers in 16 transactions in 2023, while acting in a buyer capacity in only 11 transactions. This reflects a continuation of the gradual trend of a decline in for-profit hospital operators.

More Hospital Thought Leadership

- Public Sector Predictions for Healthcare Utilization in 2024
- The Rise of Hospital and Health System JVs with Private Equity
- Partnerships Are the Future: How Health Systems & Private Equity-Backed Platforms Can Fuel Mutual Growth
- Survey: Health System Leader Expectations for 2024
- Pulse on the Public Market: Key Quotes & Takeaways from Earnings Call Results

Physician Medical Groups

Industry Overview

The number of physicians in the United States has increased 1.3%, compounded annually from approximately 814,000 in 2000 to approximately 1.1 million as of September 2023. Based on the 2022 Physician Specialty Data Report, approximately 87% of active physicians primarily focus on providing patient care. The remaining 13% primarily focus on teaching, research, and other professional activities. There are over 130 specialties and subspecialties recognized by the Accreditation Council for Graduate Medical Education. The largest specialties in terms of active physicians are internal medicine and family medicine/general practice, accounting for approximately 19.5% and 13.8% of total active physicians respectively.

National health expenditures continue to grow annually, with these costs potentially increasing at greater rates due to the long-term impacts of COVID-19 and the higher inflationary environment. The Centers for CMS expects healthcare expenditures to increase at least 5% annually between 2023 and 2030. In 2020, healthcare expenditures reached their highest historical level, with a growth rate of 10.3% compared to 2019, largely attributed to the effects of the pandemic.

Despite the increased spending on physician and clinical services, rising costs have concurrently affected profit margins for physician medical groups (PMGs), mainly due to rising labor costs. Rising supply costs have also impacted these groups. PMGs are expected to face continued 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 (i.e., the passage of the Affordable Care Act in 2010 and the passage of Medicare Access and CHIP Reauthorization Act [MACRA] in 2015). Physicians increasingly opt to align into larger groups, adopt the ACO model, or align with health systems and other corporate entities rather than face the burden, expense, and uncertainty of increased regulatory and data reporting requirements alone.

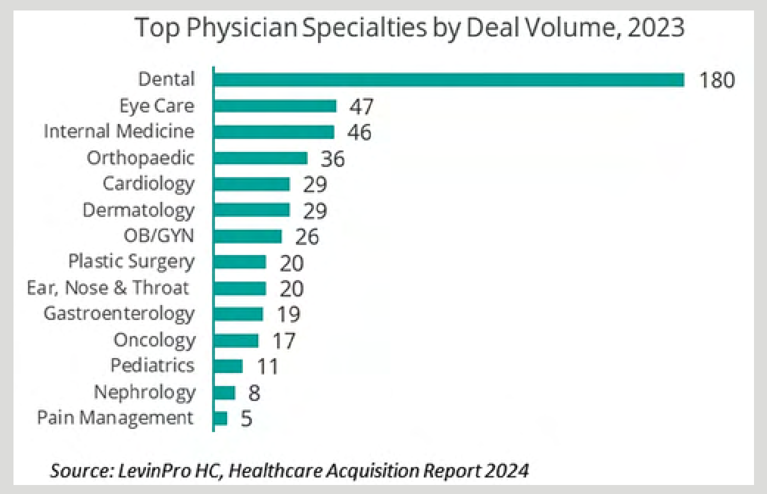
Independent practices are struggling to keep pace with the capital requirements of the industry's transition to value-based payments while also facing increasing competition in physician recruiting from health systems, PE firms, and health insurers. PE firms and their management services organizations (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.

Typically, platform practices can negotiate an acquisition price that is higher than smaller, bolt-on practices, which are subsequently acquired. A perceived 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 another PE firm).

PE firms typically target practices' ancillary revenue streams, which may have been performed in a local hospital or other outpatient setting historically. These ancillary services are consolidated to increase practices' revenue and earnings growth. Specialties with high probability of generating additional income 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 2023 but slightly lower than 2022, particularly within the PMG sector. To quantify by volume, PMG transaction activity was approximately 14% lower in 2023 than 2022.

> **Some major impetuses for this decrease in M&A deals were high-interest rates, increasing labor costs, and a consolidated market. Approximately 63% of physician transactions in 2023 were attributable to a PE firm or their portfolio companies.**

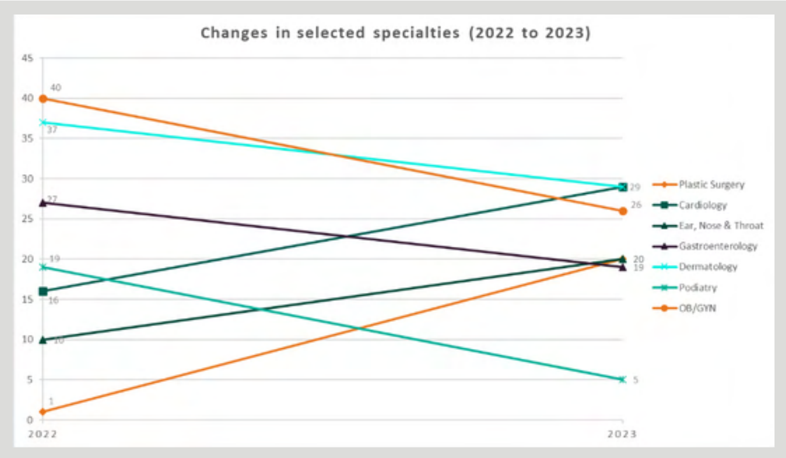


While PMGs cover a wide gamut of specialties, certain specialties showed greater activity than others. In 2023, internal medicine represented 46 transactions and dental practices represented 180 transactions. This trend favoring dental specialties held true prior to 2023 and consolidation is expected to continue into 2024, with burgeoning interest in primary care and other sub-specialties, like cardiology and orthopedics, continuing to accelerate.

It is important to note that, historically, eyecare had significantly more transactions and a larger percentage of overall transactions, with peak transaction volume at 101 in 2020. But since 2020, transaction volume has steadily declined. Significantly, eyecare volume experienced a drop from 87 deals in 2022 to 47 deals in 2023; dental deals similarly declined from 231 deals in 2022 to 180 deals in 2023. As shown in the table below, other large movers in 2023 were plastic surgery, cardiology, ENT, gastroenterology, dermatology, podiatry, and obstetrics and gynecology.

Given the fragmentation in the PMG sector, it is expected that interest in other specialties will continue see deal activity. Of interest are specialties with greater allocation to commercial payors due to higher reimbursement and those with ancillaries.

Despite its decline from 2023, dentistry stood out in 2023 with greater deal volume than other subspecialties in healthcare. U.S. Oral Surgery and Management (USOSM) continues to announce partnerships across the country.



As of August 2023, USOSM had more than 180 oral and maxillofacial surgery practice locations across 26 states. Its president, Richard Hall, notes that USOSM expects to continue its deal volume momentum.

To emphasize the role of PE in the PMG space, the table below presents the increase in PE deals over the last few years. 2023's PE deal volume reflects a continuation of the 2022 M&A activity but with a slight decline. 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. In the first few months of 2023, the trends are down compared to 2022. Through the end of 2023, there have been 338 PE firm transactions, which represent 63% of the overall PMG healthcare transactions of 2023. The PMG sector accounted for the second most activity of all M&A activity at 29.5% of the market. Additionally, PE acquisitions of PMGs accounted for 51.8% of all PE deals in 2023. Looking ahead, practices that focus on ancillaries should see increased PE activity.

Year	Total Deals	PE and PE Sponsored Deals	Share of Total
2017	207	134	65%
2018	258	191	74%
2019	245	195	80%
2020	188	133	71%
2021	461	325	70%
2022	607	424	70%
2023	535	338	63%

Source: Levin Pro, Healthcare Acquisition Report. 2024

Notable Transactions

Throughout 2023, deal volume remained at elevated levels for the PMG sector, particularly those with high levels of reimbursement from private insurance and out-of-pocket payment structures.

Some of the largest acquisitions in the past two years were with Optum. In July 2022, Optum acquired Healthcare Associates of Texas, a Dallas-based physician practice management company, for $300 million. In April 2022, Optum acquired Houston-based Kelsey-Seybold Clinic, a group that employs more than 500 physicians and allied health professionals, for $2 billion; and Massachusetts-based Atrius Health, a 30-location, independent physician group with 645 physicians, for $236 million on May 31, 2022.

In January 2023, Health Network One (HNO), a PE firm backed by H.I.G. Capital, acquired Premier Eye Care, Inc. Premier partners with health plans to optimize care across ophthalmology and optometry benefits and has a network of more than 20,000 eyecare providers across 37 states with in-house clinical specialists. HNO collaborates with health insurance companies and with a network exceeding 10,000 providers, serves as a single point of contact for its customers, provides care to more than five million members, and delivers convenient access to qualified medical specialists. This acquisition further establishes HNO as a leading specialty benefit manager by creating the the leading ophthalmology and optometry network across the U.S. The financial terms of the acquisition were not disclosed.

In March 2023, ASG EYE Hospitals acquired Chennai-based eyecare chain, Vasan Eye Care, for $64 million. This acquisition will expand ASG Eye Hospital's market presence in India with Vasan Eye Care joining ASG's existing network of hospitals, bringing the total count to over 150 facilities in 21 states across the country. Additionally, this acquisition will give ASG the widest geographical footprint among healthcare chains in India.

In March 2023, Clairvest Group Inc., a Toronto-based PE management firm, acquired Bluetree Dental, a multispecialty, pediatric- and orthodontics-focused dental service organization with 29 providers and more than 45 offices, centered in the Mountain West region of the U.S. Clairvest's portion of the investment totaled $9 million, while the total acquisition price was $32 million. Bluetree Dental is their 61st platform investment and 10th investment in the Clairvest/CEP VI co-investment pool, which was capitalized at $850 million. This represents Clairvest's second partnership in the dental industry.

Also in March 2023, PE firm Kohlberg & Company, LLC acquired United Digestive (UD) for $500 million from Frazier Healthcare Partners. UD offers a fully integrated management platform for gastroenterology practices and has more than 200 employees across 80 locations in the Southeastern United States. UD was formed from a partnership between Atlanta Gastroenterology Associates and Frazier Healthcare Partners in December 2018 and is a leader in the industry. This acquisition will allow Kohlberg & Company to leverage their experience investing in provider-based businesses to support UD's continued expansion.

In April 2023, TPG and AmerisourceBergen acquired OneOncology Inc. for $2.1 billion. OneOncology is a national network of 700 independent community oncologists assisting partner practices to expand their cancer care services at more than 181 sites, serving approximately 280,000 patients annually. TPG, a global asset management firm, will take a majority stake in OneOncology, while AmerisourceBergen, a sourcer and distributor of pharmaceutical products, is buying a minority interest for about $685 million in cash (about 35% ownership). OneOncology's affiliated practices, physicians, and management team will also retain a minority interest in the company.

Also in April 2023, Optum, a division of UnitedHealth Group, acquired New York-based Crystal Run Healthcare, a multispecialty physician group with over 400 providers across more than 30 locations. This transaction expands and strengthens Optum's presence in New York, and now Optum employs or is affiliated with more than 70,000 physicians. The financial terms of the acquisition were not disclosed.

In May 2023, CVS Health completed its $10.6 billion acquisition of Oak Street Health, a subscription and technology-enabled primary care company with 206 locations nationwide. On February 8, 2023, CVS Health announced its definitive agreement to acquire Oak Street Health in an all-cash transaction for $39 per share, representing an enterprise value of approximately $10.6 billion. The acquisition had a total purchase price of $9.7 billion plus $1.03 billion assumed debt, less $201 million assumed cash. The acquisition will broaden CVS Health's value-based primary care platform and significantly benefit patients' long-term health by improving outcomes and reducing costs—particularly for those in underserved communities.

In August 2023, INVO Bioscience, Inc. closed its acquisition of The Wisconsin Fertility Institute, a Madison-based fertility center that primarily offers conventional IVF procedures with its three providers. The acquiring company, INVO Bioscience, Inc. is a medical device company that is focused on commercializing an infertility treatment called INVOcell. The acquisition was $10.5 million with $529,000 assumed debt. This acquisition expands INVO Bioscience's fertility clinic presence.

In October 2023, Ascend Capital Partners, a healthcare-focused PE partnership, announced that it has acquired a majority stake in Seoul Medical Group (SMG), a leading, physician-run Independent Physician Associations (IPA) dedicated to providing high-quality clinical and non-clinical healthcare services to patients. SMG is the largest Korean American-focused IPA, serving over 70,000 patients and 4,800 providers, including nearly 400 primary care physicians and more than 4,400 specialists in seven markets across the U.S. Terms of the transaction were not disclosed.

In November 2023, American Shared Hospital Services expanded its presence in the U.S. by acquiring a 60% majority equity interest in two cancer centers, Southern New England Regional Cancer Center, LLC and Roger Williams Radiation Therapy, LLC, as well as certain payor contracts from GenesisCare USA, Inc. for $2.85 million. This acquisition adds three fully functional, turn-key radiation therapy cancer centers in Rhode Island, equipped with state-of-the-art cancer treatment technology, and is expected to be accretive to the company's base.

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 Physician Fee Schedule (MPFS). Under MACRA, the SGR formula was replaced with fixed 0.5% annual increases through 2019. (The annual increase was reduced to 0.25% by the Balanced Budget Act of 2019.) After 2019, physician payments under the MPFS will remain flat through 2025. During this time, 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, 2023, CMS released the CY 2024 MPFS final rule payment and policy changes final rule. The CY 2024 physician fee schedule has a conversion factor of $32.74, a decrease of $1.15 from the CY 2023 PFS factor of $33.89.

Conclusion

As a result of economic and inflationary pressures, PMGs 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 noncompete clauses may provide an additional challenge to smaller physician practices because this ban could potentially exacerbate staffing costs. Nonetheless, these are not the only reasons physicians may 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 PE firms, or integrate with health systems and insurers.

Because of the economic challenges that 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

- Physician Group Integration: Trends & Challenges
- Insights into Healthcare Provider Compensation Trends for 2024
- How Post-Transaction Physician Compensation Structure Affects Fair Market Value of Physician Practices
- Orthopedic Medical Group Spotlight: Market Drivers and Alignment Opportunities
- Strategic Options to Strengthen Cardiovascular Medical Group Affiliations
- Private Equity and the Dermatology Industry

Post-Acute Care

Industry Overview, Reimbursement & Regulatory

Post-acute care facility types include inpatient rehabilitation facilities (IRFs), long-term acute care hospitals (LTACHs), skilled nursing facilities (SNFs), home health agencies (HHAs), and hospice agencies (HSPAs). 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 SNFs. Care in the home health setting provides a lower risk of transmission of the virus—approximately 40% of COVID-related deaths occurred in nursing homes even though only around 8% of COVID-19 cases were attributable to nursing home residents.

Inpatient Rehabilitation Facilities

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 particularly 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 increased 0.5%, compounded annually from 1,178 in 2017 to 1,211 in 2023. 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 2021, there were 329 Medicare-certified freestanding IRFs and 852 Medicare-certified hospital-based IRFs. Of Medicare-certified facilities, total freestanding IRFs increased 6.1% year over year and total hospital-based IRFs increased 0.4% year over year. 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% of IRF discharges.

On July 27, 2023, CMS released the FY 2024 final payment rule for the IRF prospective payment systems (PPSs), which resulted in a standard payment conversion factor increase of approximately 3.6%. This was a decrease from the FY 2022 final payment rule, which had previously resulted in a standard payment conversion factor increase of approximately 3.9%.

In 2023, IRFs faced significant staffing challenges, particularly in nursing roles. These challenges were part of broader trends affecting the post-acute care sector. To address these issues, IRFs increasingly turned to innovative solutions, such as telehealth and artificial intelligence (AI). The integration of telehealth offered cost-effectiveness and convenience, while AI and automation helped alleviate staff workload by assisting with tasks like scheduling and data analysis. These strategies highlight the critical role of technological adoption and strategic planning in IRFs, aiming to navigate workforce challenges and maintain high standards of care

Long-Term Acute Care Hospitals

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 began 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 Medicare, Medicaid, and SCHIP Extension Act (MMSEA), which imposed a moratorium on new LTACHs from 2007 to 2012 unless they met specific exemptions. 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 1, 2023, CMS released the FY 2024 final payment rule for the LTACH PPS, which resulted in a standard federal rate increase of approximately 3.3%. This was a decrease from the FY 2023 final payment rule, which had previously resulted in a standard federal rate increase of approximately 3.8%.

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 that was 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 four-month time window of the proposed start date, including a lawsuit by the American Hospital Association (AHA). The lawsuit 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 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%. This will improve the predictability of Medicare payments for hospitals and prevent instability that can result from changes to the wage index. Under this rule, a hospital's wage index will not drop below 95% of the previous fiscal year's final wage index regardless of the reasons for the decline.

2023 saw significant legislative action targeting staffing agencies in the long-term care sector, particularly those that emerged or rapidly expanded during the pandemic. Several states introduced or passed legislation aimed at regulating these agencies to address challenges, such as exorbitant buyout clauses and conversion fees. Indiana enacted a law that established a complaint process against staffing agencies engaging in questionable practices and prohibited conversion fee clauses from July 1, 2023. Colorado and Illinois also passed laws to limit or eliminate conversion fees, allowing healthcare facilities to hire temporary employees as permanent staff without incurring extra costs. These legislative efforts reflected a broader concern about the practices of staffing agencies, especially those that appeared during the pandemic, and aimed to protect healthcare facilities and ensure fair employment practices.

Home Health Agencies

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 1.3%, compounded annually from 12,788 in 2013 to 11,474 in 2021. 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.

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. Medicare payments in FY 2024 are expected to increase by 0.8%, compared to the 2.2% decrease originally proposed.

On November 31, 2023, CMS issued the FY 2024 final payment rule for the HHA PPS, which resulted in a home health payment update percentage increase of 3%. This was an increase from the FY 2023 final payment rule, which had previously resulted in a standardized, 30-day episode payment increase 3.8%. 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 where home health services are rendered.

Hospice Agencies

The number of Medicare hospice beneficiaries increased 3.7%, compounded annually from approximately 1.15 million in 2010 to approximately 1.71 million in 2021. During the same period, the number of HSPAs increased 4.5%, compounded annually from 4,488 in 2017 to 5,358 in 2021. The increase in HSPAs is primarily attributable to growth in for-profit hospice providers, which increased from 3,101 hospices in 2017 to 4,008 hospices in 2021, or approximately 6.6% compounded annually. This can be compared to the number of nonprofit hospices and hospices with government or other ownership structures, which decreased at compound annual growth rates of (0.6%)

and (2.9%), respectively, over the same period. In 2021, more than 1.7 million Medicare beneficiaries (including almost half of Medicare beneficiary decedents) received hospice services from 5,358 providers. Medicare hospice expenditures totaled $23.1 billion.

On July 28, 2023, CMS issued the FY 2024 final payment rule for HSPA PPS. FY 2024's final payment rule resulted in a hospice cap amount rate decrease of (3.1%). This was a decrease from the FY 2023 final payment rule, which had previously resulted in a hospice cap amount rate of 3.8%. Hospices that are unable to reach quality reporting requirements are given a 4% reduction in their annual hospice payment percentage update.

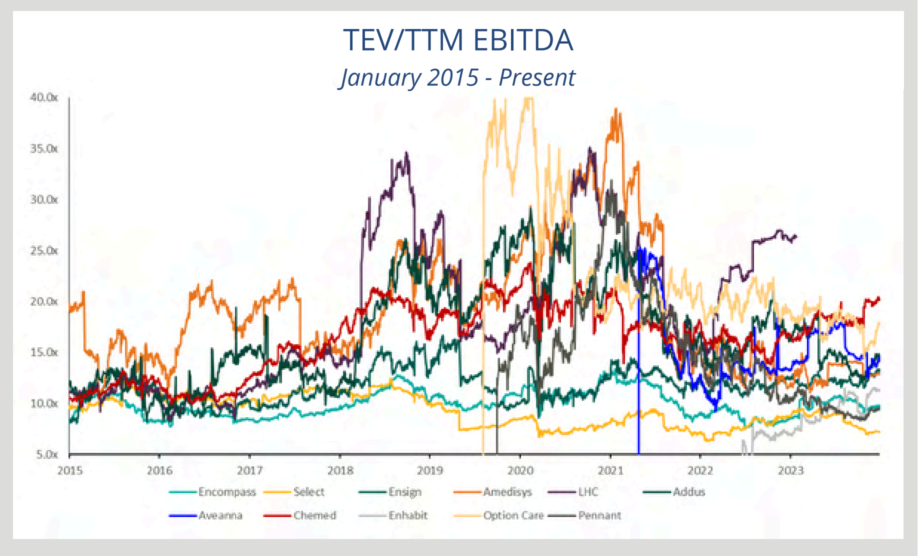
Hospital at Home

Hospital-at-home programs and providers have gained significant momentum in recent years due to healthcare operators looking for 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.

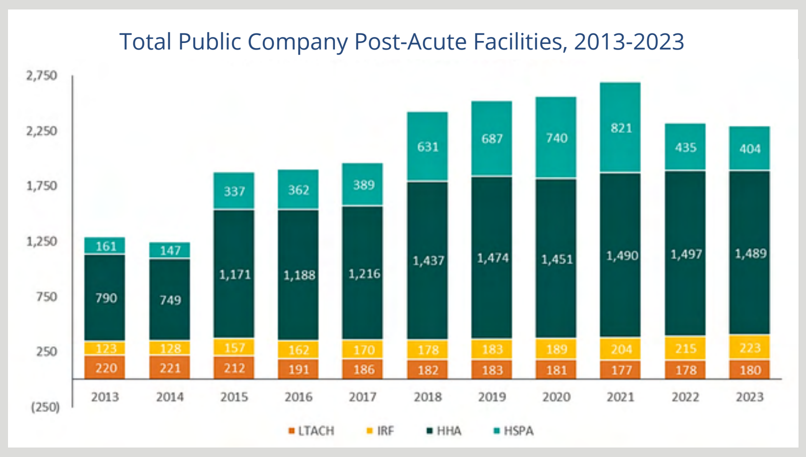
Many operators have made headlines in the last several years, including DispatchHealth, Contessa Health, and Medically Home Group, Inc. Generally, these companies act as a service provider to hospitals, HHAs, and HSPAs to provide certain acute-care services to patients who would otherwise require in-hospital 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. According to a report by Chilmark Research, the hospital-at-home market is expected to grow approximately 50% to approximately $300 billion by 2028.

M&A Trends

The chart below presents total enterprise value (TEV)/TTM EBITDA multiples for the major public post-acute operators since January 1, 2015. The chart consists of: Encompass Health Corporation; Select Medical Holdings Corporation; The Ensign Group, Inc.; Amedisys, Inc.; LHC Group, Inc. (acquired by Optum); Addus HomeCare Corporation; Aveanna Healthcare Holdings Inc.; Chemed Corporation; Enhabit, Inc.; Option Care Health, Inc.; and The Pennant Group, Inc.



For LTACHs and IRFs, with the continued shift toward lower-cost outpatient settings and relatively expensive capital cost environment, M&A volume for HHAs and HSPAs has remained elevated in comparison to LTACHs and IRFs.



As a result of the Hospital Readmissions Reduction Program, the (Medicare Access and CHIP Reauthorization) 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 could 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 and existing public operator competitors, particularly in the home health and hospice settings.

> "Over the past few months, we have continued to see limited strategic opportunities in both personal care and home health due to the reimbursement uncertainty that exists in each of these segments. As we have more clarity around these particular issues, we believe that we will start to see increasing acquisition opportunities in these segments that will meet our strategic objectives."
>
> **R. Dirk Allison , CEO and Chairman of the Board, Addus HomeCare Corporation**
> Q3 2023 Earnings Call

Public operators targeting home health agencies are aiming to expand their existing platform while consolidating its presence in existing markets or entering new geographic markets. Additionally, public operators can expand their scope of at-home care through acquisition and capture more home-based volume while simplifying care coordination in post-acute care.

Notable Transactions

In June 2023, it was announced that UnitedHealth Group's Optum business intends to acquire Amedisys in an all-cash transaction at $101 per share, which valued the company at approximately $3.3 billion (or $3.7 billion). Amedisys has 522 care centers in 37 states and the District of Columbia, and reported a revenue of $2.2 billion in 2022. In May, Amedisys initially agreed to an all-stock acquisition with Option Care Health, but the deal was subsequently terminated after Optum's bid. On September 11, 2023, Amedisys shareholders voted to approve the acquisition by Optum, though the deal is still subject to federal review and scrutiny, such as the Department of Justice's (DOJ's) request for additional information. As covered in VMG Health's 2022 M&A Report, Optum closed on its acquisition of LHC Group for approximately $5.4 billion in February 2023.

> "Our growth strategy depends on our ability to acquire additional care centers and integrate and operate these care centers effectively."
>
> **Amedisys**
> 2023 Form 10-k

In February 2023, Enhabit completed the acquisition of Specialty Home Health Care, Inc. for approximately $3.1 million. In August 2023, Enhabit announced a formal process to explore strategic alternatives for the business, such as a potential sale, merger, or other strategic transaction.

In August 2023, Addus acquired American Home Care, LLC and its subsidiaries (Tennessee Quality Care) for approximately $111.2 million. Tennessee Quality Care is a provider of home health, hospice, and private duty nursing services with 17 locations in Tennessee.

Joint Ventures

In recent years, hospitals and health systems have been pursuing joint venture arrangements in the post-acute subsector. Driving this trend are hospitals looking to free up inpatient resources for services with higher margins, hospitals looking to right-size financially underperforming units, increasing regulatory and financial incentive to manage the total post-acute continuum of care, and the efficiencies of scale and management expertise that large, specialized operators can bring. Select Medical was the most active in completing joint ventures throughout 2022 compared to Encompass, Enhabit, and other post-acute operators. Encompass primarily focused on the build-out and opening of de novo centers in 2023.

In February 2023, Select Medical announced a joint venture agreement with AtlantiCare regarding new inpatient rehabilitation hospitals and 13 outpatient physical therapy centers in New Jersey. In March 2023, Select Medical and Lutheran Health Network of Indiana, LLC, a subsidiary of Community Health Systems (CHS), announced the formation of a joint venture, which includes the contribution of CHS' existing, 36-bed Lutheran Health Network Rehabilitation Hospital of Fort Wayne, located in Fort Wayne, Indiana. In April 2022, Select Medical announced an agreement to acquire Vibra Hospital of Richmond, a 63-bed LTACH in Richmond, Virginia.

Private Equity

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 pushing toward lower-cost care settings, PE firms aim to capitalize on increasing home health volumes.

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.

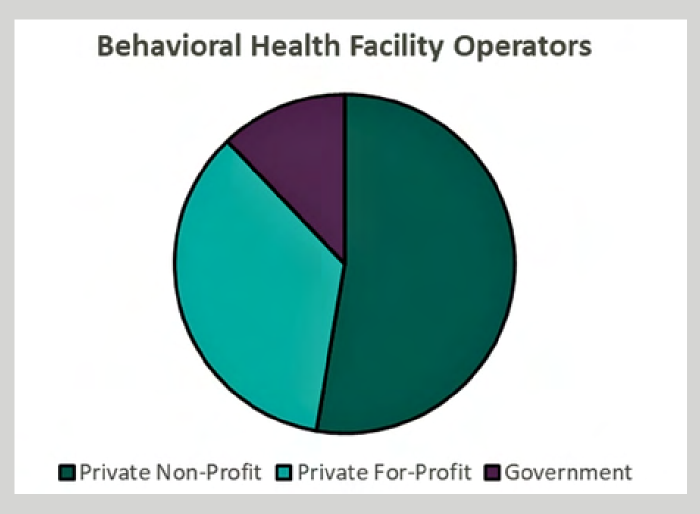
More Post-Acute Thought Leadership

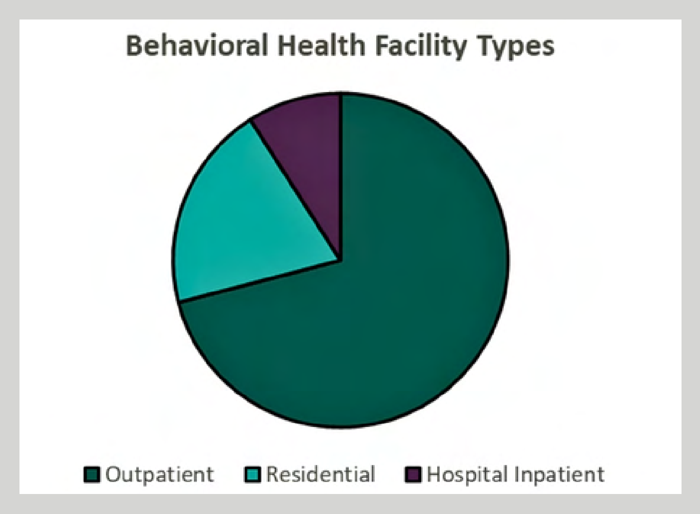
- Supply-Side Constraints and Operational Headwinds in Skilled Nursing Valuation
- Strategic Partnerships in the Inpatient Rehabilitation Industry: Highlights, Opportunities, and Risks

Behavioral Health

Industry Trends

The behavioral health services market sector of the healthcare industry continues to comprise a large portion of the industry's growth. The U.S. behavioral health market size was valued at $79.99 billion in 2022 and is projected to grow from $83.70 billion in 2023 to $115.21 billion in 2030. Approximately 59.3 million (23.1%) adults aged 18 or older in the United States have had a mental illness, and 15.4 million (6.0%) have had a serious mental illness within the past year. In addition, approximately 54.6 million (19.4%) people aged 12 or older needed substance abuse treatment in the past year, but only 13.1 million (4.6%) people received any care. The supply and demand mismatch in the industry is clearly illustrated by the number of individuals seeking care relative to those with a need for care.





To service this demand, the United States has over 25,000 mental health treatment facilities, substance abuse treatment facilities, and joint mental health and substance abuse facilities (behavioral health facilities or BHFs) in total as of 2022. BHFs include psychiatric hospitals, acute care hospital specialty units, residential treatment centers (RTCs), outpatient clinics, as well as telehealth outpatient programs. According to the Department of Health and Human Service's National Substance Use and Mental Health Services Survey, the primary operators of BHFs are private, non-profit operators with approximately 52.7% of total facilities. Additionally, the majority of BHFs are comprised of outpatient mental health services, representing 70.9% of total facilities.

The largest behavioral health companies in the United States are publicly traded, Acadia Healthcare Company, Inc. (Acadia) and Universal Health Services, Inc. (UHS), as well as privately held Lifepoint Health. As of the end Q3 2023, Acadia's U.S. operations included 253 BHFs with approximately 11,100 beds in 39 states (including Puerto Rico). As of Q3 2023, UHS' U.S. and U.K. operations comprised 335 inpatient BHFs, 14 outpatient BHFs, and approximately 24,200 beds. Further, LifePoint currently operates over 60 rehabilitation and behavioral health hospitals.

> "In recent years, our behavioral health services segment has been focused on efforts to partner with non-UHS acute care hospitals to help operate their behavioral health services. These arrangements include hospital purchases, leased beds and joint venture operating agreements."
>
> **Universal Health Services**
> 2023 Form 10-k

Furthermore, private equity (PE)–backed behavioral health platform companies have continued to become more prevalent and grow market share. BayMark Health Services, backed by Webster Equity Partners, has at least 234 locations across the United States. Discovery Behavioral Health, backed by Webster Equity Partners, has hundreds of facilities across 17 states. Summit BHC, backed by Patient Square Capital, has 35 facilities across 19 states as well. ARC Health, a Thurston Group-backed behavioral health company, has become a major player in the behavioral health M&A market, with at least 18 mergers or acquisitions since its creation in 2021. ARC Health operates mental healthcare practices with a strategy of ensuring founders and key clinicians remain with the company post-merger.

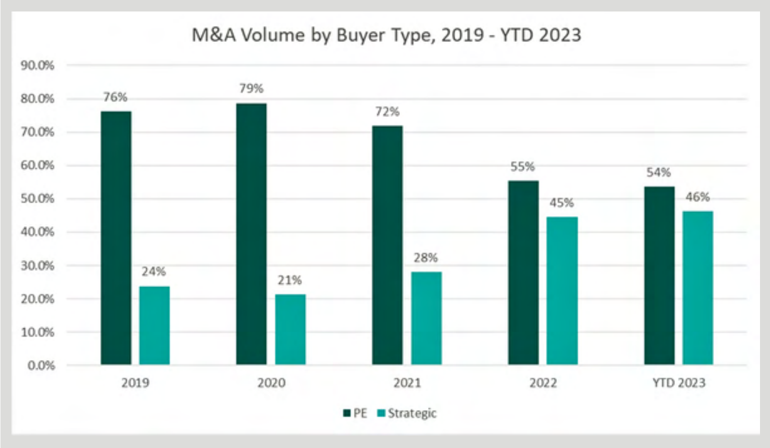
M&A Trends

Behavioral health M&A deal volume has continued to decline through the first three quarters of 2023. Based on data gathered by VMG Health, deal volume is down approximately 30% compared to YTD 2022. A decline in the industry's recent transactions have primarily been driven by economic challenges throughout the entire healthcare industry: staffing shortages (provider and non-provider), high fragmentation, unfavorable financing terms, challenging reimbursement, and pressure on existing, out-of-network strategies.

Recent transactions can be grouped into the following trends: joint-venture strategies with for-profit operators and private equity investment.

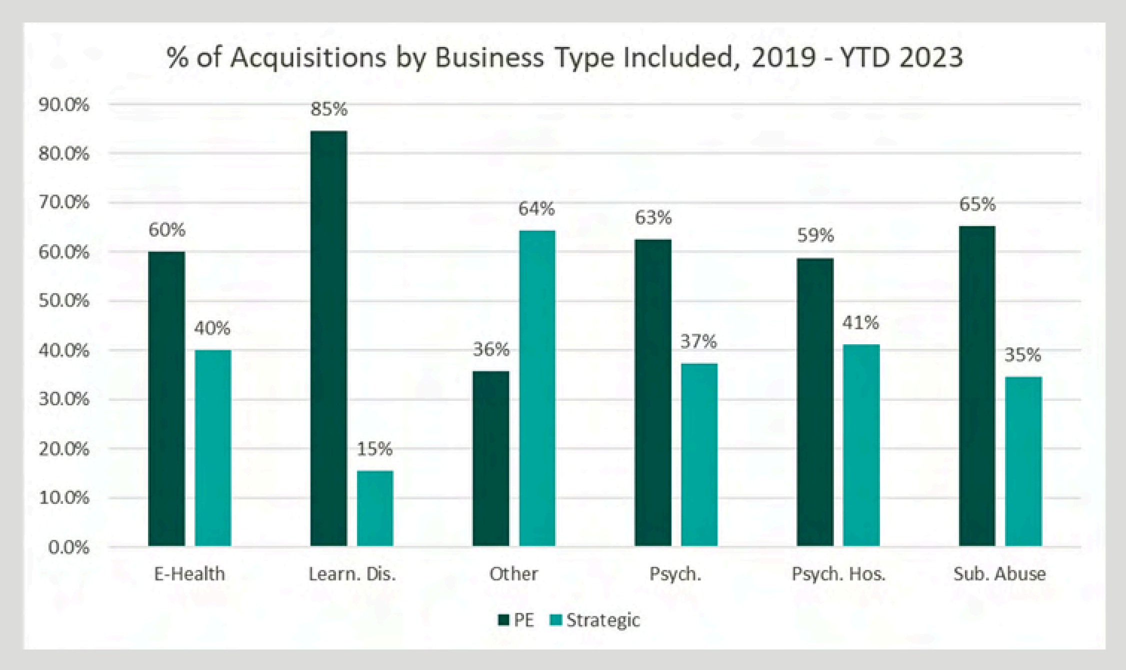
1. Private Equity

According to reports by Irving Levin and Scope Research, PE continued to lead M&A deal activity in the space over strategic transactions in 2023, as seen in the following chart. However, the margin narrowed once again compared to prior years due to economic headwinds, causing PE firms concern about inflation, staffing shortages, and reimbursement rates. According to Dexter Braff, president of The Braff Group—one of the nation's leading advisors in behavioral healthcare



transactions—demand for behavioral health services is still strong and far outweighs the supply. Investors are just taking a more disciplined approach to the volume of deals they seek out and what they are willing to pay. Since the COVID-19 pandemic, behavioral health services have experienced increasing demand as a result of the rise in mental health issues across the country, sparking interest from large health systems and retail companies to transact. Each year, more funding is being provided at the federal, state, and local levels to combat the worsening behavioral health crisis.

In 2023, psychiatry and substance abuse led all behavioral health sub-sectors with the most transaction volume among learning disabilities, psychiatric hospitals, telehealth, and others.



2. Joint-Ventures

The three large, for-profit behavioral health operators, Acadia, LifePoint, and UHS, have continued to develop joint ventures with acute care operators.

On June 30, Acadia announced that it formed a joint venture with SolutionHealth, the parent company of Southern New Hampshire Health and Elliot Health System. Together, the two companies will begin construction on a new, 144-bed inpatient hospital in southeastern New Hampshire. The following month, Acadia announced a joint venture with Nebraska Methodist Health System to build a 96-bed behavioral health hospital in Council Bluffs, Iowa. In the third quarter of 2023, Acadia opened two new behavioral health hospitals with joint venture partners, Bronson Healthcare in Michigan, and Geisinger in Pennsylvania. Acadia has 20 joint venture partnerships for 21 hospitals, with 11 hospitals already in operation and 10 additional hospitals expected to open over the next few years. “The pipeline for potential partners remains robust and joint ventures will continue to play an important role in Acadia's future growth,” said Chris Hunter, CEO of Acadia during their Q3 earnings call. On August 14, Lifepoint and Baystate Health celebrated the opening of Valley Springs Behavioral Health Hospital, a 122,000 square foot, four-story facility with 150 private and semi-private rooms in Holyoke, Massachusetts. In February 2023, UHS announced plans to construct a new, 144-bed behavioral health hospital with Lehigh Valley

Health Network (LVHN), located in Township, Pennsylvania, across from the Lehigh Valley Hospital. UHS also announced the location for Southridge Behavioral Hospital, their joint venture partnership with Trinity Health Michigan that they first reported in 2022, in February. The new Southridge Behavioral Hospital will accommodate up to 96 beds, serving adult and geriatric patients.

Acadia	Lifepoint	UHS
SOLUTIONHEALTH Founded by Southern & The Elliot	Baystate Health	Lehigh Valley Health Network

The joint-venture model typically includes the development of a 90–150-bed, freestanding hospital 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 length of stay. These operations also require specific features, such as anti-ligature requirements that are best suited in a purpose-built facility. Through a joint venture with an experienced operator, hospitals can participate in pro rata cash flows that may not have existed within their existing cost-structure.

Notable Transactions

Acadia Healthcare Company, Inc.

In July, Acadia Healthcare announced that it had acquired Turning Point Centers from InTandem Capital Partners, a specialty provider of substance use disorder (SUD) and primary mental health treatment services in Salt Lake City, Utah. Turning Point Centers is a 76-bed facility, and Acadia stated that it could potentially grow the facility by an additional 48 beds. “Our ability to extend our specialty footprint, but also the synergies with our other lines of business, just have made this [acquisition] particularly attractive,” Acadia CEO Christopher Hunter said. “This is a proprietary transaction that we identified and sourced ourselves. When we have historically looked back at those acquisitions that have been most successful at Acadia, the ability to have expansion opportunities has proven important.”

Also in July, Acadia announced the opening of Geisinger Behavioral Health Center Northeast, a 96-bed hospital in Pennsylvania. The opening was a celebration of the partnership between Geisinger and Acadia and is the first of two hospitals to be constructed under the new joint venture. Hunter stated, “Acadia continues to expand upon our joint ventures with healthcare organizations across the country, providing our behavioral health expertise and mission of treating the whole patient to those communities in need.”

Lifepoint Health

Lifepoint Health, a diversified healthcare delivery network, acquired Cornerstone Behavioral Health El Dorado, a 54-bed behavioral health facility in Tucson, Arizona, in January 2023. Lifepoint plans to invest in the facility and add nearly 50 beds to meet the region’s growing demand. Lifepoint President Russ Bailey stated, “There is a behavioral health crisis in our country today, and too few people have access to the care and services they need...Together, we have opportunities not only to further strengthen the care that Cornerstone Behavioral Health El Dorado provides its communities, but also to expand behavioral healthcare access to these vital services across our nation.”

In 2023, Lifepoint announced that it also acquired a majority ownership interest in the operating company of the national behavioral health provider Springstone. This transaction adds Springstone’s 18 behavioral health hospitals and 35 outpatient locations across nine states into Lifepoint’s network. “Both Lifepoint and Springstone share a commitment to providing high quality, compassionate behavioral healthcare to communities across the nation,” said David Dill, Chairman and CEO of Lifepoint Health. “By continuing to expand Lifepoint’s behavioral health platform, we have an opportunity to strengthen the care continuum, bring more services to our communities, better support hospitals and providers, and improve the overall health of patients across the nation.”

BayCare

BayCare, west central Florida’s largest provider of behavioral health, announced on January 3, 2023, that it had acquired Northside Behavioral Health Center in Tampa, Florida. BayCare had managed the Center for seven years prior to the acquisition. Stephanie Conners, BayCare President and CEO, stated, “We are stronger together, leveraging BayCare’s resources to support Northside’s commitment to meeting patients where they are.”

ARC Health

In January 2023, ARC Health announced the acquisition of Lilac Center, an integrated mental healthcare provider group with four locations in Kansas and Missouri. Lilac’s management stated that ARC Health’s support allows the center to strengthen the quality of services provided and expand its mission of helping those who live with borderline personality disorder.

Also in January 2023, ARC Health announced the acquisition of the Colorado Center for Clinical Excellence (CCCE), located in Denver. CCCE has two locations in Colorado and specializes in expert psychotherapy, serving clients who have had limited success with pervious therapy. ARC Health CEO, Vince Morra, stated, “CCCE makes a great addition, not only due to them expanding our presence into Colorado, but also for their commitment in training and producing evidence-based therapists focused on achieving better outcomes."

ARC Health announced on March 27, 2023, that it had acquired Wellington Counseling Group, a Chicago-based psychotherapy group that had two locations at the time of the transaction. “[Wellington Counseling Group] is committed to providing high-quality mental health services to all clients, and the partnership with ARC Health will allow the practice to expand its reach and impact throughout the Chicago metroplex,” Morra said in the release.

In May, ARC Health announced the acquisition of Positive Change Counseling Center, a mental health practice with four clinic locations across San Diego and Ventura counties. Morra stated, “We are excited to welcome PCCC to the ARC Health network. We share a commitment to providing high-quality mental healthcare to our patients, and we are confident that our partnership will enable PCCC to continue providing exceptional services to their patients and community.”

Also in May, ARC Health announced the acquisition of Denver Wellness Associates, a mental healthcare provider group in Denver, CO with two clinic locations. Morra stated, “The commitment of Jeanne (founder of DWA) and her team to clinical care aligns with our vision for mental healthcare, and we are confident that our partnership will enable Denver Wellness to continue providing exceptional services to their patients."

In June, ARC Health announced the acquisition of Silver Lake Psychology (SLP), a mental healthcare provider group spanning four states: California, Tennessee, Colorado, and Virginia. The founder of SLP, Dr. Brandy Engler, PsyD, cited ARC Health's belief in provider leadership as an aspect of the partnership that she is excited about. Morra shared "his shared commitment to prioritizing the well-being of patients and empowering mental health providers makes the collaboration with ARC Health a natural fit."

In August, ARC Health announced the acquisition of mental healthcare provider GROW Counseling. GROW is a mental health group with multiple locations across Atlanta. The acquisition also includes the acquisition of the GROW Counseling Network (GCN), an innovative platform that partners with employers in providing mental health support. The integration of GCN expands ARC Health's service footprint to more of the United States as well as Canada.

Also in August, ARC Health announced the acquisition of Dayspring Behavioral Health, a mental health practice with four locations across Seattle. The practice offers specialized pediatric neuropsychological assessments and places a special emphasis on children and family care. Morra stated, "Through our partnership with Dayspring, we exemplify our commitment to the well-being of patients and the empowerment of mental health professionals."

In October 2023, ARC Health announced a partnership with LynLake Psychotherapy and Wellness Ltd., an integrative mental health and wellness practice based in Twin Cities, Minnesota with 14 locations across Minneapolis and St. Paul. Morra stated, "In uniting with LynLake, we proudly reaffirm our mission to prioritize client wellness and elevate the capabilities of mental health providers."

In November 2023, ARC Health announced the acquisition of Manhattan Psychology Group, a behavioral health practice catering to the greater New York City area. "Our partnership with Josh and Niloo and the integration of MPG into the ARC Health family will not only expand the scope and depth of services offered but also reinforces a shared dedication to excellence in mental healthcare," Morra said in a statement.

In December 2023, ARC Health announced the acquisition of Advanced Psychiatric Group (APG), a mental health practice providing behavioral health services to the Central Florida area. APG is the largest outpatient behavioral healthcare clinic in Central Florida. Morra shared, "Our collaboration with APG Health reflects our unwavering commitment to advancing mental health care, with a primary focus on client welfare and strengthening the capabilities of our providers. Embracing APG Health into the ARC Health network marks a thrilling endeavor, and we are confident that this partnership will bring ongoing advantages to their patients."

On December 29, 2023, ARC Health acquired Exult Healthcare, a mental health practice providing services at its two locations north of Dallas-Fort Worth, Texas. "Our collaboration with Exult Healthcare is poised to revolutionize mental healthcare, emphasizing accessibility and superior patient outcomes," Morra said in the release. "Exult's commitment to integrated care seamlessly aligns with the ARC Health network, marking an exciting venture."

Reimbursement & Regulatory Compliance

On July 27, 2023, CMS published its Fiscal Year 2024 Medicare Inpatient Psychiatric Facility (IPF) Prospective Payment System (PPS) final rule with a 3.3% increase in rates after a 0.2% productivity adjustment. CMS estimates total IPF PPS payments will increase by 2.3% or $70 million in fiscal year (FY) 2024 compared to FY 2023 payments. This final rule is up from the proposed rule issued by CMS at the beginning of Q2 2023, which proposed a 3.0%

increase in rates after a 0.2% productivity adjustment. Behavioral health operators continue to shift their focus to expanding their off-site locations to relieve occupancy issues and to attract a larger array of commercial patients who may be less inclined to choose an inpatient facility within an acute-care hospital due to lack of access and potential social stigma.

In FY 2023, CMS expanded and updated Medicare coverage for intensive outpatient services, increased the behavioral health workforce, updated their Physician Fee Schedules (PFS), and provided payment to address unmet social needs. CMS is covering gaps in access to behavioral health by finalizing the CY 2024 OPPS/ASC rule for an intermediate level of care, called the intensive outpatient program (IOP), and extending coverage for intensive outpatient services in opioid treatment programs (OTPs). The final ruling implements the Consolidated Appropriations Act, which creates a new benefit category for IOP services for individuals with acute behavioral health needs. CMS also updated and expanded Medicare coverage to allow for marriage and family therapists, opioid treatment providers, and mental health counselors to enroll as Medicare providers, which will open a pool of 400,000 providers to independently treat people. This initiative aims to address the increasing demand for behavioral health services and the rising need for a larger behavioral health workforce due to additional consumer options and increased awareness. CMS is also finalizing payment for community health integration and principal illness navigation services that can be provided by community health workers and peer support specialists when unmet social needs, such as food, housing, or transportation problems, interfere with healthcare. Lastly, CMS updated their FY 2024 PFS to increase the value of certain therapies to pay 150% of the usual PFS to better reflect the costs incurred for crisis care.

The adoption of telehealth behavioral health services has continued to increase because of additional consumer options, increased awareness, and strong demand for care. While access to telehealth continues to expand and telehealth startups continue to help close the gap in behavioral healthcare, there are questions and skepticism about the providers' ability to treat and monitor patients through prescribed medication via telehealth, specifically the controlled substances used to treat opioid addiction. As of November 11, 2023, the DEA has extended certain exceptions to existing regulations, allowing the prescription of controlled medications through telemedicine. This extension, outlined in the Second Temporary Rule, continues the telemedicine flexibilities established during the COVID-19 Public Health Emergency (PHE) until December 31, 2024.

The 2023 Consolidated Appropriations Act included several provisions that reauthorized, strengthened, and expanded mental health and SUD programs. The act reauthorized major funding sources for substance use prevention, treatment, and recovery services and includes three bills that facilitate the integration of behavioral health and primary care. These bills include the MATE Act, the MAT Act, and the Collaborate in an Orderly and Cohesive Manner Act. The implementation of these acts and other provisions began to affect many behavioral health facilities and enforced compliance with Mental Health Parity.

The No Surprises Act, implemented in 2022, has affected many BHFs and providers who historically relied on out-of-network billing to compensate for heavy governmental payor mixes. New proposed rules regarding the No Surprises Act were released in October 2023, mandating transparency in provider networks and requiring health plans to publicly disclose detailed information about their networks, including rates. Additionally, starting January 2024, the Act's Dispute Resolution Process will be streamlined and updated to increase accessibility for patients, providing faster and more affordable resolution to billing disputes. Operators are seeing disruption in their revenue cycle, as out-of-network claims are now going through arbitration. This disruption is causing lower levels of reimbursement for facilities that have historically deployed this strategy.

> "In our behavioral segment, we have been pleased with our strong pricing and related earnings growth to date but acknowledge significant upside opportunity in our existing occupancy rates, particularly as we continue to improve our recruitment and retention metrics."
>
> **Marc D. Miller, CEO, President & Director, Universal Health Services**
> Q3 2023 Earning Call

Conclusion

Clearly, the future of healthcare and patient outcomes will require a robust behavioral health delivery model. The industry is ripe for consolidation and transaction volume growth. Not-for-profit acute care health systems will continue to value the strategy of joint-venturing their non-core behavioral health assets in a partnership with national, for-profit operators. Additionally, a growing acceptance of behavioral health services and recognition of overall patient outcomes will continue to increase demand for services.

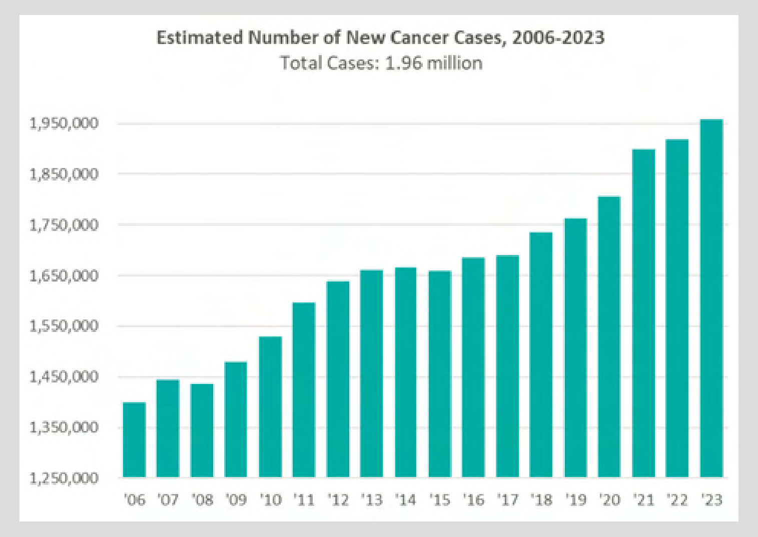
More Behavioral Health Thought Leadership

- MAT Clinics: At the Nexus of Healthcare Expansion and Investment

Oncology

Industry Overview

Approximately 1.9 million new cancer cases were diagnosed in the U.S. in 2023. This is a 2.1% increase over 2022 and a 1.7% increase since 2011, compounded annually.



Based on the 2023 Oncology Market Report by Precedence Research, the global oncology market was valued at $203.4 billion in 2022. By 2032 it is projected to reach $470.6 billion and represent an 8.8% growth rate, compounded annually.

The number of oncologists in the U.S. has increased 2.6% compounded annually, from 21,869 in 2015 to 26,756 in 2023. Of the total oncologists, 65.9% were hematologists and oncologists, 12.9% were pediatric hematologists and oncologists, and 21.2% were radiation oncologists.

M&A Trends

Despite the headwinds of the broader funding environment, oncology practice transaction activity continued throughout 2023 as existing platforms pursued additional tuck-in acquisitions.

Notable value-based care market participants—including The Oncology Institute (TOI), Oncology Care Partners, OneOncology, The US Oncology Network, and American Oncology Network (AON)—each pursued growth activities throughout the year.

Also active throughout 2023 was McKesson's The US Oncology Network, which closed on the acquisitions of Epic Care and Nexus Health on January 1, 2023. Both large, multidisciplinary practices operate out of Northern California and Santa Fe, New Mexico and add more than 20 locations and over 50 physicians to the Network. US Oncology also announced the affiliation of Regional Cancer Care Associates in April and Cancer Center of Kansas in July of this year, adding 40 total sites of service and 172 providers. More recently, in the fourth quarter, it was announced that Nashville Oncology Associates and Horizon Oncology, both of Pharos Capital Group's Verdi Oncology, Inc., had joined The US Oncology Network platform as well. As of the most recent transactions, The US Oncology Network's total provider count exceeds 2,400.

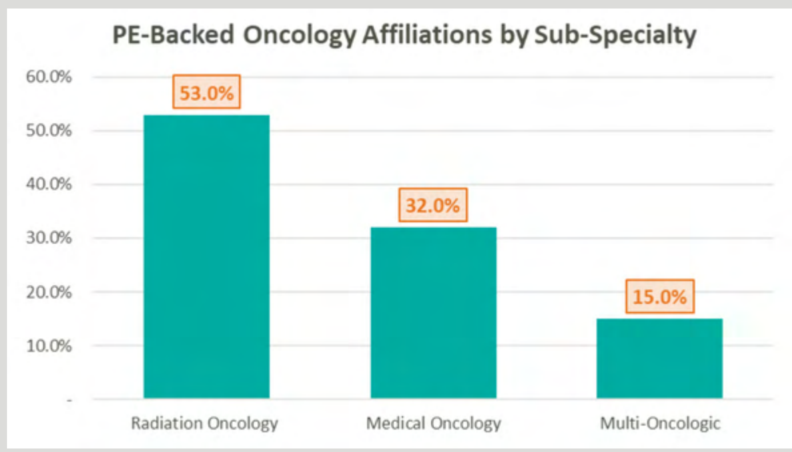
Through its business combination with a special purchase acquisition entity (SPAC), AON has joined TOI as one of the two publicly traded oncology operators in the market.

Prior to going public, AON notably received a $65 million investment from AEA Growth Partners in April before the opening of Lone Star Oncology in Georgetown, Texas in June and the affiliation of Florida Oncology & Hematology in Safety Harbor, Florida in July. AON also ventured into urology through the affiliation of Triple Crown Urology on September 1. With six locations across Arkansas, Triple Crown Urology helped usher AON's network of clinicians to include over 200 providers at 30 practices across 20 states (including Washington, D.C.).

Since becoming publicly traded in 2021, TOI has become the country's largest value-based oncology provider group by lives served and revenue under value-based arrangement. In June 2023, the company announced the acquisition of Southland Radiation Oncology Network, which has five radiation oncology clinics in the Los Angeles market. TOI identified expansion in radiation oncology as an effective means to enhance continuity of care and drive EBITDA margins in the company's legacy markets. TOI's platform now totals over 60 clinic locations across five states.

Private Equity

According to a recent study published in JAMA Internal Medicine, 724 oncology clinics became affiliated with a PE-backed platform between 2003 and 2022. As indicated to the right, most of these affiliations involved radiation oncology practices and approximately one-third included a medical oncology group. These PE-backed platforms target physician and practice acquisitions to leverage geographic expansion, economies of scale, or hospital affiliations.



Recent PE Investment	Platform	Locations	Providers	PE Firm	Vintage	Acquisition Status
Medical & Radiation Oncology Platforms		**360+**	**1,000+**			
	OneOncology	310+	994	General Atlantic	5 years	Acquired by TPG and AmerisourceBergen in 2023
	Integrated Oncology Network	50+	n/a	Silver Oak Services Partners	6 years	n/a
	Verdi Oncology	2	7	Pharos Capital Group	5 years	Joined The US Oncology Network in 2023
	Alliance HealthCare Services	n/a	n/a	Tahoe Investment Group	4 years	Acquired by Akumin, Inc. in 2021
Urology Platforms (2)		**465+**	**1,285+**			
	United Urology Group	95	220+	Audax Private Equity	8 years	n/a
	Urology Management Associates	n/a	n/a	Prospect Hill Growth Partners	4 years	Acquired by Summit Health in 2022
	Solaris Health	230+	650+	Lee Equity Partners	4 years	n/a
	Urology America	28	83	Gauge Capital	4 years	n/a
	US Urology Partners	60+	150+	NMS Capital	6 years	n/a
	Unio Health Partners	54	182	Triton Pacific Capital Partners	3 years	n/a
Grand Totals		**825+**	**2,285+**	**Average Age**	**4.9**	

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

However, given that a number of these platforms were formed more than five years ago, it is not surprising that 2023 also saw the recapitalization of OneOncology by TPG and AmerisourceBergen Corporation. Additionally, in November 2023, it was announced that Verdi Oncology's practices in Tennessee and Indiana had become affiliated with The US Oncology Network. Verdi's third practice, Verdi Cancer and Research Center of Texas, officially closed in September 2023, four years after its initial launch in August 2019.

Silver Oak Services Partners' Integrated Oncology Network (ION) also saw practice growth in 2023. In September, ION announced High Desert Oncology of Victorville, California had joined California Cancer Associates for Research & Excellence (cCARE). cCARE experienced further growth with the opening of its newest clinic in Riverside, California in early December.

Similarly active were operators in the urology space. Gauge Capital's Urology America announced its partnership with Conrad Pearson Clinic in November while NMS Capital's US Urology Partners announced a partnership with Greater Boston Urology in December. Lee Equity Partners' Solaris Health appeared most active in 2023, having announced affiliations with UroPartners and LowCountry Urology in February; Spokane Urology in May; Urologic Specialists of Northwest Indiana in October; and Urologic Consultants of Grand Rapids, Michigan in December, bringing its total provider count to over 650 across 13 states.

Notable Deals

In June 2023, TPG and AmerisourceBergen Corporation closed the $2.1 billion acquisition of OneOncology, a network of oncology practices, from General Atlantic. TPG will acquire a majority interest in the company, and AmerisourceBergen will acquire a minority interest of approximately 35% for around $685 million in cash. As part of the transaction, TPG has a one-year put option effective on the third anniversary of the deal's close. If exercised, this option would require Amerisource Bergen to purchase the remaining interest in OneOncology at a price equal to 19x the company's adjusted EBITDA. AmerisourceBergen will also have a call option to purchase the remaining interest at the same price between the third and fifth anniversaries. In 2023, OneOncology added four practices and 143 providers to its platform, which now includes 19 practices in total across 15 states. OneOncology was founded in September 2018 with an initial growth investment from General Atlantic of $200 million.

In September 2023, AON and Digital Transformation Opportunities Corp. announced the completion of their business combination previously reported in November 2022. The transaction had an implied enterprise value of $497 million, with an implied TEV/Revenue multiple of 0.4x and an implied TEV/EBITDA multiple of 13.8x. Following the completion of the transaction, the newly combined company, American Oncology Network, Inc., was listed on the Nasdaq under the ticker symbol "AONC" and began trading on September 21, 2023. AON's platform now includes over 200 providers across 85 locations in 19 states and the District of Columbia.

In November 2023, American Shared Hospital Services (ASHS) announced that it had entered an Investment Purchase Agreement to purchase a 60% interest in the Southern New England Regional Cancer Center, LLC and Roger Williams Radiation Therapy, LLC, as well as certain payor contracts, from GenesisCare USA, Inc. for a purchase price of $2.85 million. GenesisCare is divesting the centers as part of its Chapter 11 bankruptcy process announced in June 2023.

Another transaction stemming from GenesisCare's bankruptcy is the acquisition of its Orange County radiation oncology centers by UCI Health for an undisclosed amount. The acquisition, originally announced in October 2023, is part of UCI's initiative to triple the size of its cancer services during 2024.

On January 2, 2024, it was announced that Carl Larson Cancer Center, based in Beckley, West Virginia, had been acquired by Vandalia Health System. The center has fourteen providers and delivers oncology, hematology, radiation therapy, chemotherapy, and diagnostic imaging and laboratory services. Per CON filings, the total deal value was $5.0 million, or 11.6x Year 1 projected EBITDA and 7.0x Year 2 projected EBITDA.

Reimbursement

On November 2, 2023, CMS released the final rule for the 2024 MPFS, which included several key changes that could have serious implications for oncology providers and practices in 2024 and beyond, including updated 2024 conversion factor, revised RVU valuation of office/outpatient visits, and reduction in direct scaling adjustments. The final rule reduced the physician conversion factor from $33.89 (2022) to $32.74, representing a 3.4% decrease.

In the CY 2021 MPFS final rule, CMS added a new code (G2211) for complex visits. At the time, CMS expected that 90% of hematology/oncology visits would utilize the new code. On December 27, 2020, however, Congress passed the Consolidated Appropriations Act of 2021, which stopped CMS from making payments for G2211. The hold on G2211 is set to expire at the end of 2023 and the revised expectation is that the code will now only be added to 38% of all office/outpatient visits. This is impactful to hematology and oncology specifically, as this code cannot be utilized for visits where there is a drug administered on the same day. This is also important because it has no impact on specialties and services that bill globally, such as surgeries or radiation treatment.

> "Reimbursement for office/outpatient visits will decrease an average of 2% in 2024, except when adding G2211, which will increase total reimbursement for a visit between 7.3% to 69%, depending on the level of service."
>
> **American Society of Clinical Oncology Press Release**
> ASCO Practice Impact Analysis of 2024 Medicare Physician Fee Schedule Proposed Rule

Pre-pandemic, the direct scaling adjustment to the Medicare allowable rate calculation remained constant between 0.57–0.59. Given the rising inflation following the public health emergency, certain practice expenses have skyrocketed, and the direct scaling adjustment has continued to decrease from 0.5094 (2022) to 0.5010 (2023) and is expected to be 0.4639 in 2024. In an inflationary environment, there is additional pressure on providers to manage other direct costs or risk losing profitability. Based on these final rule changes, the expected impact is presented below by subspecialty, place of service, and state of incorporation.

Oncology specialties are expected to experience the following decreases in Medicare allowable rates:
- Hematology/Oncology: 0.2% decrease
- Radiation Oncology: 3.6% decrease
- Gynecologic Oncology: 0.7% decrease
- Surgical Oncology: 2.9% decrease

For hematology/oncology, all outpatient settings are expected to benefit from G2211; however, this benefit does not carry over to radiation oncology as most office/OP visits are bundled into a global payment for multiple services during treatment. Presented below are the expected reimbursement changes from 2023 to 2024 for hematology/oncology and radiation therapy by place of service.

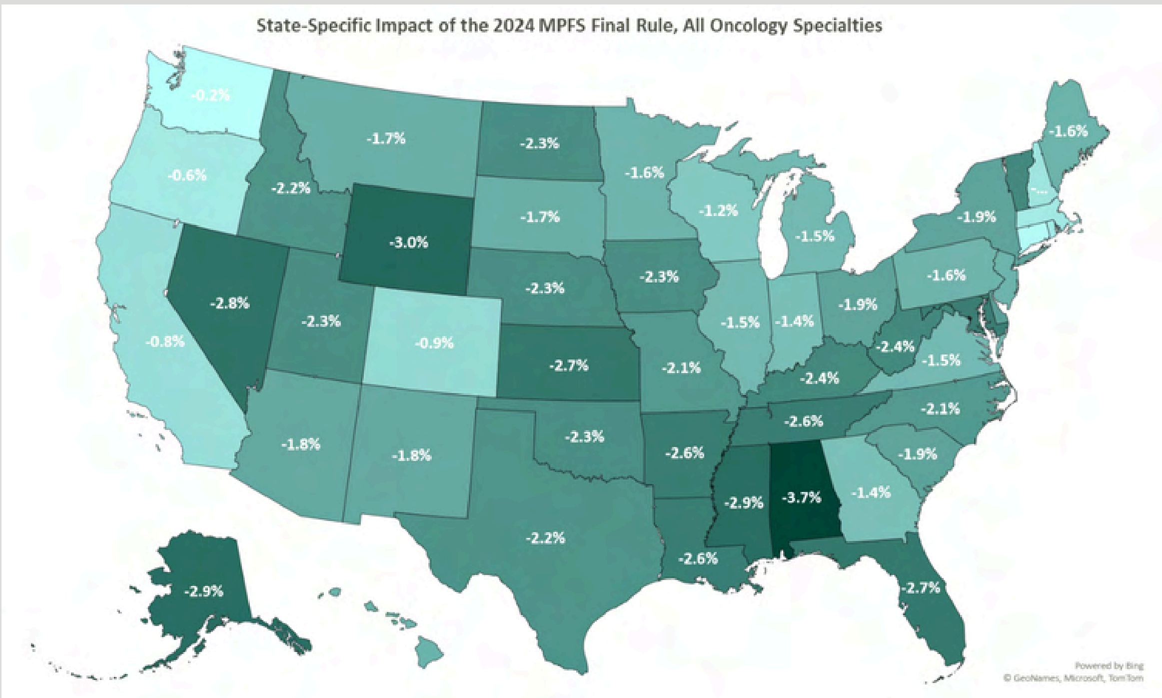
Hematology/Oncology

Place of Service *(in millions)*	**% Chg**
Inpatient Hospital	(4.0%)
Off-Campus Outpatient Hospital	2.9%
Office	(0.4%)
On-Campus Outpatient Hospital	2.5%
Other Place of Service	1.3%

Radiation Oncology

Place of Service *(in millions)*	**% Chg**
Inpatient Hospital	(4.2%)
Off-Campus Outpatient Hospital	(3.5%)
Office	(3.6%)
On-Campus Outpatient Hospital	(3.6%)
Other Place of Service	(3.0%)

When considering all oncology specialties, all states are expected to see a decline in reimbursement ranging from (3.7%) in Alabama to (0.2%) in Washington (darker equates to larger decline).



340B

On November 3, 2023, in the ruling of Genesis Healthcare, Inc. v. Becerra, Chief Judge R. Bryan Harwell of the U.S. District Court for the District of South Carolina ruled in favor of expanding the term “patient” and who is eligible to receive a 340B drug. The new ruling does not require “a covered entity to have initiated a healthcare service resulting in a prescription filled with a 340B discounted drug.” Currently, the decision and its impact are limited to the South Carolina-based health center Genesis Healthcare, but it could have broad, national implications in the future based on the new precedent set by Chief Judge R. Bryan Harwell.

Enhancing Oncology Model

On July 1, 2023, the CMS Innovation Center kicked off its new Enhancing Oncology Model (EOM) in hopes of reducing cancer spending while improving overall quality of care. Similar to its predecessor, the Oncology Care Model (OCM), the EOM is a five-year, voluntary, episode-based payment model that is designed to place patients in the best setting of care while holding providers accountable for the cost of care. In essence, each practice will be assessed in six-month intervals where they can either earn performance-based bonuses or owe CMS a performance-based recoupment based on total episode expenditures and quality performance. During the six-year duration of the OCM (expired June 2022), the model involved more than 4,500 providers over 200 oncology practices across 33 states, and it was estimated to have touched one in four Medicare beneficiaries who received chemotherapy in that period. Upon expiration, it was concluded that the cost per treatment was significantly less than the cost outside OCM; however, these savings did not offset the incentive monthly payments paid by Medicare, resulting in a net loss.

CMS reported that EOM went live with 44 participating oncology practices across 37 states and included three commercial payers (Blue Cross Blue Shield (BCBS) of South Carolina, BCBS of Tennessee, and CVS Health/Aetna). This will greatly impact participating providers as the EOM "may help reducing reporting burdens, simplifying requirements, and offering potentially large bonus payments for lowering costs."

Conclusion

With increasing demand for cancer services, ongoing reimbursement pressures and a complex regulatory environment, the oncology sector remains poised for further consolidation. There will likely be a continuation of tuck-in acquisition activity by these major platforms 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.

More Oncology Thought Leadership

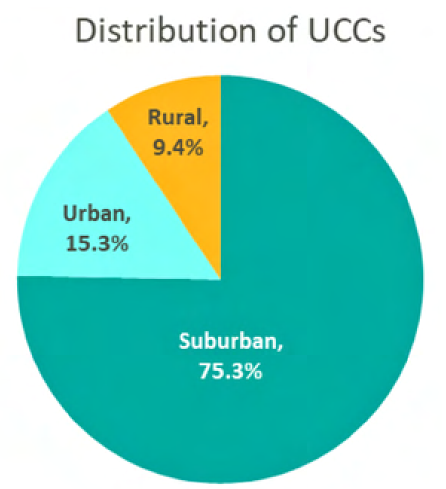
- Oncology: Private Equity and Corporate Investment in Cancer Care
- Managing Oncology Practice Revenue in the Face of Rising Healthcare Costs and Regulatory Burden

Urgent Care

Industry Overview

Key Stats

The number of urgent care centers (UCCs) in the U.S. has grown 9%, compounded annually from 6,100 UCCs in 2013 to 14,382 UCCs in 2023, with future industry growth estimates between 7.1% to over 11.5% through 2030. Market saturation in the UCC sector is most prevalent in large, suburban metro areas with suburban UCC operators representing approximately 75% of total UCCs. Approximately 89% of the U.S. population is within a 20-minute drive of a UCC, and 79% of the population is within a 10-minute drive.

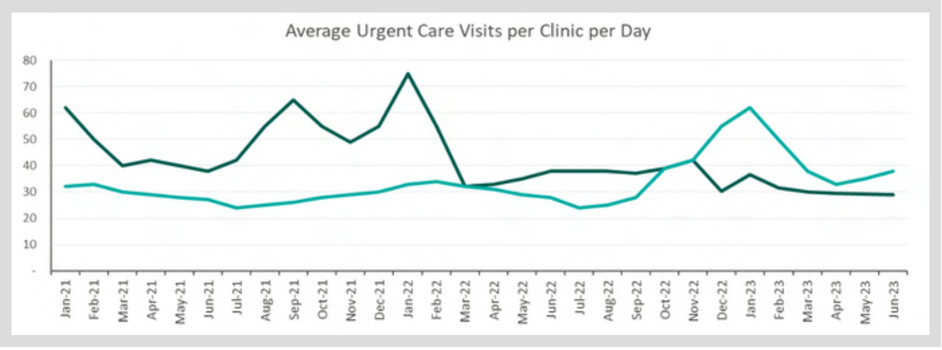


Increased demand for UCC services has been the main catalyst for growth in the market. Urgent care visit volumes continue to outpace other sites of service driven by several macro factors. First, consumers continue to demand accessible, on-demand health services. There is a rising shortage of primary care providers. The Association of American Medical Colleges expects a shortage of up to 50,000 primary care physicians over the next 10 years. Second, patients are bearing more monetary 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 (e.g., Apple, Amazon, etc.). Lastly, 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. The cost of an emergency room visit has led to the transition of patient volume from an emergency room (some freestanding) to an urgent care setting. Future industry growth is expected to continue for these reasons, along with a rising shortage of primary care providers.

Volume Volatility, Service Offerings Increase

During the pandemic, urgent care centers were the primary facilities where patients were evaluated for COVID-19. As such, UCCs experienced unprecedented levels of visit volume in 2020 and 2021, with 2022 volumes surpassing pre-COVID levels on an average patient-visits-per-day basis. During 2023, visit volume tracked lower than 2022 volumes and is trending toward pre-COVID levels.

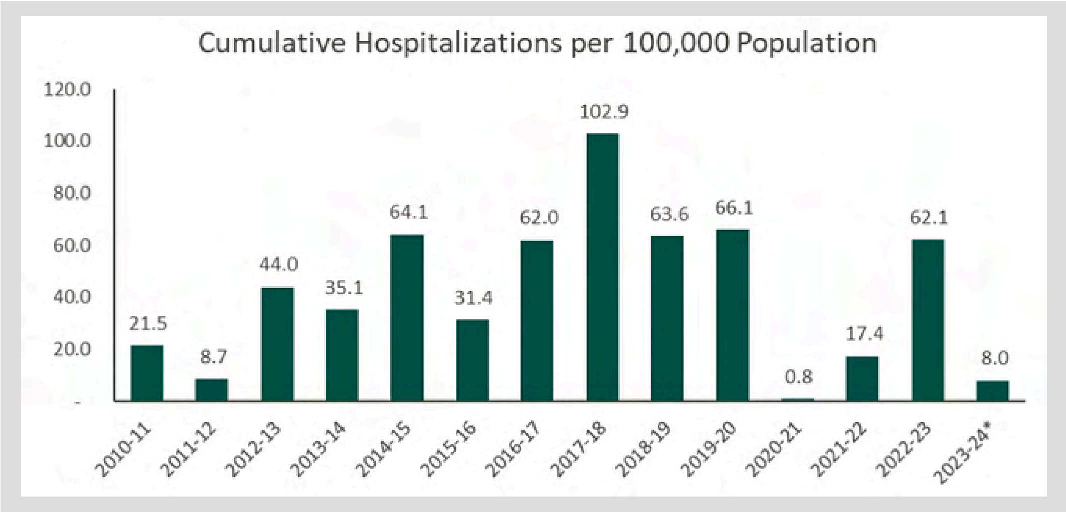
As of June 2023, the average visit volume was approximately 29 patient visits per day per location. This



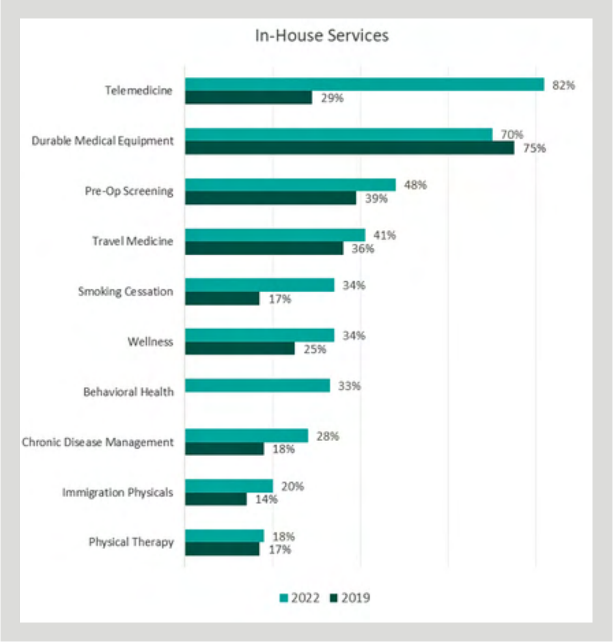
Experity Q2 Summer 2023 Urgent Care Quarterly Report, Figure D represents a 24% decrease to the average per-day visit volume of 38 for the previous three years (June 2020, June 2021, June 2022), which were impacted by elevated COVID volumes.

Impact of Flu Seasons

In addition to the normalization of COVID volumes, UCCs experience seasonality due to fluctuating flu volumes in the winter months. Historically, visit volume is higher during flu seasons and lower during summer months. The number of influenza-related hospitalizations is a measure of flu season severity; therefore, it is an indicator of flu season impact to UCCs. Hospitalizations increased dramatically during the 2022–2023 flu season as compared to 2020 and 2021. The 2022–2023 flu season also experienced elevated levels of COVID-19 and RSV cases, with the year dubbed as a “tripledemic.” Influenza hospitalizations are trending significantly lower in the 2023–2024 season, further contributing to volume declines in 2023 compared to 2022.



**Data through December 9, 2023 does not represent a full traditional flu season (October through April).*



Market Challenges vs. Future Volume Expectations

UCCs have mitigated the impact of lower patient volumes in 2023 by expanding in-house services offered. During the pandemic, UCCs began offering telemedicine services in addition to standard services. In a post-pandemic marketplace, UCCs have continued to provide telemedicine due to patient expectations and competition. Other expanded services offered by some UCCs include behavioral health and wellness services. The UCCs that adopted additional services, including expanded telehealth offerings, are positioned to maintain or increase average visit volumes.

Staffing and Inflationary Pressures

UCCs have experienced an increase in labor and supply costs. In 2023, medical supplies were approximately 15.2% of UCC expenses, compared to 5.4% of expenses in 2018. Additionally, labor costs have increased with inflation and staffing shortages. UCCs often offer X-ray testing and there is a current shortage of radiology technologists, which impacts UCC ability to provide patient care. UCCs compete for staff resources with higher levels of compensation, further increasing labor costs.

Payor Dynamics

The onset of the pandemic was labeled a public health emergency, and the federal government and other federally funded healthcare insurers were required to cover COVID-19 services, including copays, deductibles, and telehealth offerings, which were expanded for both Medicaid and Managed Medicaid plans. In May 2023, the public health emergency ended, and Medicaid pulled its requirements to fund COVID-19 services. The payor mix changes and impact to coverage could put UCC volumes at risk.

Commercial payors typically mirror CMS in raising reimbursement to align with cost increases or other annual changes. However, many UCCs have received low or static reimbursement rate adjustments from commercial payors over the past few years, creating a financial strain when combined with current labor and inflationary pressures. WellNow Urgent Care, a UCC operator with over 200 locations across the country, and Excellus Blue Cross Blue Shield failed to renegotiate contract terms before a January 1, 2024 deadline. Therefore, the UCC operator will go out-of-network with its 13 locations across Western and Central New York. WellNow Urgent Care cited increased costs and proposed stagnant reimbursement increases from Excellus Blue Cross Blue Shield as the reason for failed negotiations. Excellus Blue Cross Blue Shield covered approximately 300,000 WellNow visits in New York in 2023. Many UCC operators across the country are beginning to feel similar reimbursement pressures and challenges with commercial insurance payors. These payor dynamics could challenge future visit volume should patients choose to visit locations in network; they may also challenge UCC margins should reimbursement rates inadequately cover the costs of services.

Several large retailers are making significant investments in the primary care space, expanding services and 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
	CVS	Walgreens	Walmart	Urgent Care
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**

While there are many opportunities for UCCs' visit volume growth, the future remains uncertain. The urgent care landscape is evolving, and UCCs are increasingly integrating with primary care and specialist services, offering a wider range of care options and potentially influencing visit patterns.

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, private equity groups, and other buyers were active participants in UCC transactions during 2023. For health systems, UCCs offer a convenient access point into the health system. Typically, UCCs 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 operators accounting for approximately 20% of total UCC locations. As of December 2023, Concentra (subsidiary of Select Medical Corp.) was the largest independent UCC operator with 522 locations, an increase from approximately 300 locations in 2015, which represents a 10% compound annual growth rate. The largest hospital-owned UCC entity is HCA Healthcare Urgent Care, with 333 total locations as of December 2023.

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, combating current labor challenges. For financial and strategic buyers, optimizing the staffing model with lower-cost, mid-level providers is the most commonly pursued operational change. 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, their appetite for continued growth through acquisitions, and their appetite for growing accessibility for patients and health systems across the country:

> "It will provide convenient outpatient care options when and where [patients] need it. It also will help seamlessly connect these patients to our broader healthcare network when a higher level of care or specialty service is needed."
>
> **Erol Akdamar, President of American Group of Nashville, Tennessee-based HCA Healthcare**

Private Equity and Urgent Care

Private equity investors were actively involved in UCC transactions in 2023, 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, many are currently backed by a PE firm whose hold period currently exceeds the typical three- to seven-year investment window (vintage), indicating a potential exit opportunity in the near future.

Urgent Care Chain	Locations (Dec 2023)	Type	PE Firm	Vintage
Concentra	522	Health System	Select Medical Corp; WCAS	9
CareNow (HCA)	359	Health System	n/a	n/a
American Family Care	348	Franchise	n/a	n/a
GoHealth	266	Private Equity	TPG Capital	10
Fast Pace	255	Private Equity	Revelstoke Capital Partners	7.5
CityMD	191	Private Equity	Wallgreens / VillageMD	1.5
MedExpress	188	Payor	n/a	n/a
WellNow Urgent Care	154	Private Equity	SV Life Sciences, Petra Capital, River Cities	12
Blue Cross Blue Shield	130	Payor	n/a	n/a
NextCare	129	Private Equity	Enhanced Capital Partners	13
Well Street Urgent Care	99	Private Equity	FFL Partners	12
Patient First	78	Independent	n/a	n/a
CRH Healthcare	70	Private Equity	Freeman Spogli & Co.	5
PM Pediatrics	69	Private Equity	Comvest Capital Partners	4.5
Urgent Team	61	Private Equity	Petra Capital, River Cities	8

Private equity buyers were highly active in 2015, with several large platform transactions occurring. In addition, private equity investors deployed capital for new urgent care platforms during recent years. Since PE firms typically hold their investments for three to seven years, it is possible that increased M&A activity fueled by PE exits is on the horizon.

For example, Arby Partners' initial investment in FastMed Urgent Care was in 2015. The platform grew through a combination of de novo locations and acquisitions. In December 2020, FastMed announced the acquisition of Tenet Healthcare's 87 MedPost and CareSpot locations, bringing the total number of FastMed platform locations to over 190. In 2023, Arby Partner's investment horizon was approximately eight years, and FastMed announced a series of divestitures to a combination of strategic and health system buyers: HCA acquired the 41 Texas locations, Honor Health bought out FastMed's joint venture interest in their Arizona locations, andBlue Cross Blue Shield of North Carolina announced the acquisition of the North Carolina locations.

Private equity is still actively investing in the urgent care space. PM Pediatrics, a leader in the delivery of pediatric care in an urgent care setting, raised $50 million in Series E equity capital this year, led by Scopia Capital and Jefferson River Capital. Investors look to capitalize on the potential growth in the urgent care industry:

> "PM Pediatric Care continues to be poised for significant growth. We're proud to support the company as it works to change how pediatric medicine is delivered in our country, making access to specialized physical and mental health care convenient and affordable."
>
> Matthew Sirovich, Managing Parter of Scopia Capital.

> "We have never been more confident in the future of PM Pediatric Care. Now more than ever, quality urgent care, behavioral health, and other outpatient services are crucial for the welfare of our children and young adults. We are committed to delivering on the growing needs of our communities and innovating to help keep our youth healthy."
>
> Steve Katz, Co-Founder and Co-CEO of PM Pediatric Care

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

Notable Transactions

Health systems were the dominant player in the transaction space for UCCs in 2023. These transactions involved outright acquisitions of facilities and joint ventures with strategic operators. PE and strategic acquisitions continued to play a significant role in the transaction space for UCCs. Lastly, partnerships between two prominent health systems saw traction, primarily to leverage each other's existing network of patients, resources, and to increase patient outreach in markets that had not been served previously.

Health System Buyers

In May 2023, HCA announced its agreement to acquire 41 urgent care centers Texas from FastMed. The transaction expands HCA's total number of urgent care locations to over 300. The Company acquired FastMed's locations in cities such as Dallas, San Antonio, Austin, Houston, and El Paso.

In Central Texas, St. David's announced that it had acquired nine FastMed and one MedPost urgent care centers in San Marcos. St. David's looks to leverage this acquisition to bridge the gap between its primary care physicians and hospital emergency rooms. HCA outlined the importance of transitioning care to an outpatient setting with lower costs, higher quality of care, and patient convenience as motivating factors for these transactions.

In 2023, Scottsdale-based HonorHealth agreed to purchase its remaining interest in over 20 FastMed UCCs in the area. Originally, these UCCs were part of a joint venture between both organizations. Specifics of the deal were not confirmed; however, the transaction closed in the summer of 2023. HonorHealth looks to use the acquisition of the UCCs as a way of aligning and integrating with its current acute-care hospitals, physician practices, and other in-network services.

Originally named Urgent Care of Connecticut, PhysicianOne has sold 18 UCCs to Yale New Haven Health System. Sites include cities such as Groton to Enfield. The acquisition also includes sites located in Massachusetts and New York.

Private Equity and Strategic Buyers

Blue Cross Blue Shield of North Carolina acquired all FastMed UCCs and family medicine practices in North Carolina. The transaction includes 55 locations spread across the state. A key detail of the deal includes terms in which the facilities will operate independently from its nonprofit Blue Cross NC; however, no further terms were disclosed.

In 2023, UCG has acquired ParkMed Urgent Care. ParkMed has been a leader in providing urgent care services in the greater Knoxville area. UCG believes this acquisition complements the partnership between itself and Covenant Health. UCG will now offer services in Georgia, Missouri, and the Carolinas. Terms of the deal were not disclosed.

PM Pediatrics has announced that it has secured $50 million in Series E financing, led by Scopia Capital and Jefferson River Capital. The Company has raised more than $140 million of capital since its inception. PM looks to use most of the capital raise to add new business lines, such as primary care and behavioral health, expanding its number of UCCs in current markets like Chicago, LAOC, and Dallas. The company will look to transition from a fee-for-service business model to a value-based care business model.

Baylor Scott & White and NextCare have agreed to joint venture 41 of NextCare's UCCs across Texas. Fourteen of the 41 locations are in the Dallas-Fort Worth area. The joint venture will expand Baylor Scott's presence beyond North Texas to areas such as Abilene, Houston, and San Antonio.

Peachtree Immediate Care and Emory Healthcare Network have agreed to extend their collaborative relationship in a new, long-term agreement that will allow Peachtree Immediate Care to remain the sole urgent care provider for Emory Healthcare. A partnership dating back to 2016, Peachtree Immediate Care became a member of the Emory Healthcare Network and has since grown to over 50 locations across Atlanta and other nearby regions.

In September 2023, PM and Ann & Robert H. Lurie Children's Hospital of Chicago agreed to partner and serve families with urgent care services for children and young adults. This partnership will allow both organizations to provide services at three existing sites in the greater Chicago area.

Reimbursement

Medicare reimburses UCCs according to the MPFS. On November 2, 2023, CMS released the CY 2024 MPFS final rule, setting the CY 2024 Medicare conversion factor to $32.7442. The CY 2024 conversion factor is a 3.4% reduction from the CY 2023 conversion factor of $33.8872, which previously included a 2.5% increase provided by the 2023 Consolidated Appropriations Act (CAA). The CY 2024 conversion factor reduction is reflective of the expiration of the 2.5% CAA statutory payment increase, a 1.25% CAA statutory payment increase, and a 2.2% downward budget net neutrality adjustment.

Regulatory

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

The urgent care industry is not as heavily regulated or faced with restrictions that other healthcare entities are presented with. Instead, UCCs are typically licensed under an individual physician's license or an affiliated hospital. Most states do not require a facility-specific license for UCCs. No states require a certificate of need (CON) to open an UCC. Without the need for a CON or any roadblock from other types of regulations related to the saturation of a particular market, it has been easier for platform operators to achieve growth through opening de novo clinics. This has led to increased UCC market fragmentation in many suburban areas.

Conclusion

The urgent care industry was positively impacted by the rise of COVID-19 testing volumes throughout 2021 and 2022. During 2023, volumes declined as COVID-19 volumes normalized and flu volumes were lower than previous years. In addition, the UCC industry is not immune to other risks facing the healthcare industry and U.S. economy, such as the current labor market, reimbursement pressures, 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. Technological advancements (e.g., adoption of telehealth capabilities), and specialization of services (e.g., behavioral health and wellness services) 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 remain 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. UCC operators that adapt to these market dynamics with service offerings, sophisticated telemedicine capabilities, COVID-19 testing and treatment capabilities, and other changes in patient visit types will be popular acquisition targets in the future.

Dialysis

Industry Overview

Overall, in 2023, reports out of the dialysis industry have been overwhelmingly positive. Growth in treatment volume and operating income have been bolstered by underlying patient demographic and health diagnosis trends that serve as tailwinds for the industry—namely, the continued increase in chronic kidney disease (CKD), driven by an aging population and increased prevalence of diabetes and hypertension. Underlying this steady growth in performance, however, are shifting industry themes that will continue to shape the industry in 2024 and beyond. This shifting landscape is propelled by legislative directives prioritizing care outside of traditional dialysis facilities, a growing number of consolidators on the nephrology practice side, the emergence of new pharmaceuticals, and the continued introduction and adoption of alternative payment models within renal care.

Although gradual, the shift away from traditional, in-center hemodialysis is becoming apparent. As of October 2023, The Centers for Medicare & Medicaid Services (CMS) published data showing that there were approximately 7,638 Medicare-registered dialysis centers in the United States. The number of centers has grown at a compound annual growth rate of 3.5% over the last 13 years and grew from 5,413 dialysis facilities in 2010. More recently, however, this historical growth has reversed. There was a 0.2% decline in the number of licensed dialysis centers from 2020 to 2023 following modest growth of 1.5% from 2017 to 2020. Although traditional, in-center hemodialysis remains the dominant care protocol, within the last 10 years, the percentage of patients receiving home dialysis treatments has doubled.

Large dialysis facility operators have continued to invest in opportunities and services that will contribute to growth in home dialysis. Although DaVita, Inc. did not provide figures for the incremental growth in home dialysis treatments in its Q3 2023 10-Q and earnings call, they stated that home dialysis accounts for approximately 15.0% of overall treatment volume, which has been stable, although the dropout rate on home dialysis has remained high. DaVita indicated in their Q3 2023 10-Q that increases in home dialysis have incurred higher-than-normal charges for center capacity closures. On April 1, 2023, DaVita and medical device company, Medtronic, closed an agreement to form a new company, Mozarc Medical, to develop new kidney care technologies with a specific focus on at-home treatments. Fresenius Medical Care indicated that home dialysis treatments accounted for approximately 16.0% of overall treatment volumes during Q3 2023. This percentage is up slightly year over year compared to 15.4% of overall treatment volume in Q3 2022. Although the percentage of overall treatments occurring at home has continued to increase, the percentage has stabilized, as Fresenius stated during its Q3 2023 earnings call that it remains stable at approximately 16.0%, consistent with last quarter.

Volume Trends

DaVita stated in its Q3 2023 earnings call that new patient admissions have been up for three sequential quarters of year-over-year growth for the first time since the COVID-19 pandemic, aided by a continued decline in trailing 12-month mortality rate. Volume has been in line with their expectations, and they expect 2024 "to be a year of positive growth in volume and adjusted operating income." Fresenius notes in its Q3 2023 earnings call that same-market treatment growth in the U.S. continued to be stable. Volume is expected to be up 1.0% in FY 2023, with continued improvement expected in FY 2024. Both Fresenius and DaVita noted in their Q3 2023 earnings calls that the core drivers of their medium- and long-term business prospects remain unchanged, with commentary on the anticipation that GLP-1 drugs will not impact their long-term growth plans. GLP-1 and related pharmaceuticals are a topic of much discussion as they relate to their long-term impact on dialysis operators. Currently, predictive studies do not provide definitive outcome expectations.

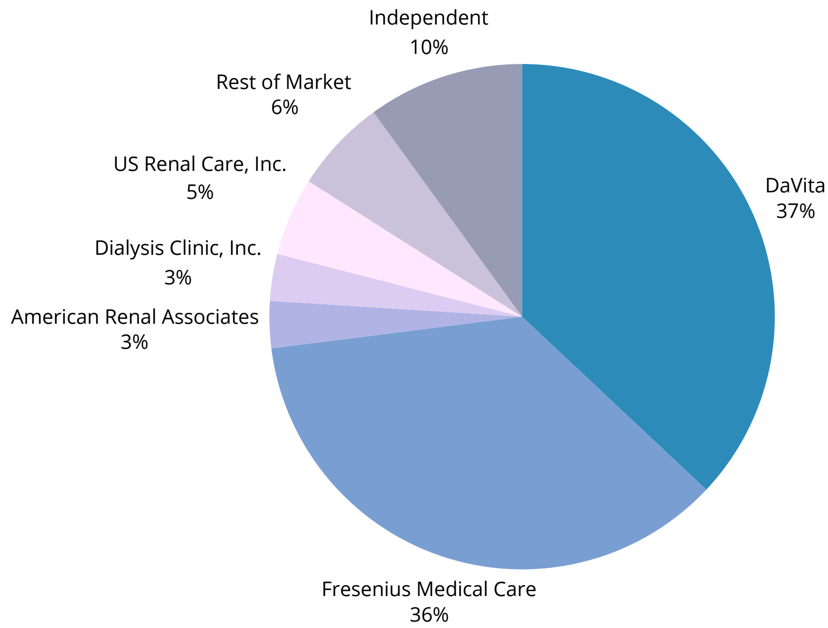
Impact of Increasing Labor Expenses

During the third quarter of 2023, economic conditions and political and regulatory developments have added additional volatility and uncertainty to staffing in an already challenging labor market. Companies are facing rising general labor costs, hiring difficulties, supply chain pressures, and elevated inflation rates. These problems continue to increase labor expenses and supply chain costs and are exacerbated by the nationwide shortage of skilled clinical personnel. DaVita stated that they have experienced slight improvements in wage levels compared to Q2; however, they continue to experience higher levels of compensation in the year-to-date period compared to 2022. These elevated staffing and labor costs are expected to persist due to increased training costs and recent legislative changes, including the implementation of the provisions of Senate Bill 525 in California, which impacts minimum-wage requirements for healthcare workers. Fresenius also noted in their Q3 2023 earnings call that, while elevated labor expenses continue, there have been improvements compared to the prior year. The dialysis industry has experienced difficulties with an increase in union organizing activities and staffing shortages. 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 adversely impact clinical operations, and may otherwise have a material, adverse impact on dialysis facilities' ability to provide services or meet the cost of providing those services.

Operator Composition

In comparison to most other healthcare verticals, the dialysis industry is highly consolidated and is dominated by two large dialysis operators: DaVita and Fresenius. When combined, the two operate approximately 5,637 Medicare-registered U.S. dialysis facilities, representing 73.8% of the overall market. Excluding DaVita and Fresenius, the next three largest operators combine to account for only 11% of the remaining market in the U.S., with each operating approximately 3%–5% of total U.S. dialysis facilities. These include US Renal Care (372 facilities), American Renal Associates (228 facilities), and Dialysis Clinic Inc., which operates approximately 246 facilities and is the largest non-profit operator of its kind.

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



The rest of the U.S. market is comprised of 425 single-site or smallermulti-site chains and 730 independent operators, which accounts for the remaining 16.0% of outpatient dialysis facilities combined.

> "In our U.S. dialysis business, we continue to face intense competition from large and medium-sized providers, among others, which compete directly with us for limited acquisition targets, for individual patients . . . and to engage physicians qualified to provide required medical director services."
>
> **DaVita**
> 2024 Form 10-k

Reimbursement Trends

On October 27, 2023, CMS issued a final rule that revises the end-stage renal disease (ESRD) Prospective Payment System (PPS) base rate for CY 2024, updates the payment rate for acute kidney injury (AKI) services for individuals in ESRD facilities, and makes changes to the ESRD Quality Incentive Program (QIP) requirement, and the Treatment Choices Model. CMS is increasing the ESRD PPS base rate by approximately 2.1%, based on the ESRD market basket increase factor of 2.1%, decreased by a multifactor adjustment of less than 0.1%. The final adjustment increases total payments to all ESRD facilities by $5.45 to $271.02. For hospital-based ESRD facilities, CMS projects an increase in total payments of 3.1% and an increase in total payments of 2% for freestanding ESRD facilities. Additionally, the final ruling updates the AKI dialysis payment rate for CY 2024 to equal the CY 2024 ESRD PPS base rate and to apply the CY 2024 wage index. In response to this final rule, dialysis operators have expressed their frustration.

> "...The net rate update finalized for 2024 was only 2.1%, which is still below what we believe is appropriate given continued forecasting errors, current inflation and other rising costs."
>
> Joel Ackerman, CFO and Treasurer, DaVita

Earlier in the year, CMS proposed and later finalized their ruling to update the QIP and revise the definition of the minimum Total Performance Score (mTPS) to better reflect the calculation of national ESRD facility performance on reporting measures. The proposal suggests setting a proxy median of zero for new reporting measures when there is initially insufficient data available. This strategic approach aims to provide facilities with increased predictability and transparency in the calculation of the mTPS for a given payment year. The ruling also addresses various policies related to measuring adoption, retention, and removal to align ESRD QIP regulations with those of other quality reporting programs.

Value-based care, shared savings arrangements, and ACOs have become more prevalent among many types of healthcare providers in recent years, and ESRD care providers can participate and potentially benefit through the Kidney Care Choices (KCC) model. There are four KCC model options. The Kidney Care First (KCF) option is open to participating nephrologists, nephrology professionals, and nephrology practices and allows participants to receive adjusted capitation payments for managing aligned beneficiaries' care with CKD stage 4 or 5 (a precursor to ESRD), and for those 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 plus transplant bonus payments, like the capitation payments under the KCF option. KCEs, however, take responsibility for the total cost and quality of care for their patients, and in exchange, can receive a portion or all of the Medicare savings they achieve. The first cohort of KCC model participants began their participation in the model performance period on January 1, 2022.

Notable Transactions

As it relates to major operators, DaVita continues to open new centers at a slowing pace in favor of setting up programs that are home-dialysis focused or expanding existing sites to accommodate home dialysis. DaVita stated in its Q3 2023 10-Q that it 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, with DaVita acquiring 13 centers in 2018 and five in 2022 within the U.S. By the end of Q3 2023, DaVita has not acquired any centers this year. They developed 18 centers in the nine months ended September 30, 2023, down from 33 in the same period of 2022. Center closures have decreased year-over-year, with 51 closed or sold and closed centers in the year-to-date (YTD) 2023 period compared to 76 centers closed or sold and closed in the YTD 2022 period, per DaVita’s Q3 2023 10-Q. The distinction between a closed-and-sold and a closed center is the retention of most patients in existing outpatient dialysis centers in the case of closed centers, which represents most closures.

Oak Street Health, a value-cased primary care provider, and Interwell Health, a kidney care management company, launched a joint venture to offer primary care to ESRD patients directly within dialysis centers. The goal of the venture, called OakWell, is to reduce hospitalizations, increase kidney transplantations, and lower the total cost of care. Coordinated primary care, in partnership with nephrologists, will help patients avoid attending additional, separate medical appointments by leveraging patients’ time in dialysis centers. OakWell will begin offering services in Chicago, Houston, and Dallas-Fort Worth dialysis centers in Q3 2023. As described in this report last year, InterWell Health, originally formed in 2019 between 1,100 physician investors and Fresenius, merged with Cricket Health to create a physician-centric joint venture that 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 combines Fresenius Health Partners’ kidney care expertise with InterWell’s clinical care models and network of 1,600 nephrologists 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 at inception, operates under the InterWell Health brand and is fully consolidated by Fresenius Medical Care as the majority owner.

Panoramic Health, the leading physician-integrated, value-based kidney care platform with 800 nephrology providers across 19 states, announced in January 2023 that they have partnered with WellSky, a leading health and community care technology company. This partnership will allow Panoramic Health to gain access to a national network of providers using WellSky solutions for acute and post-acute transition of care workflows, and will allow access to new capabilities that will enable nephrologists to keep patients out of the hospital. Additionally, Panoramic Health has announced several strategic nephrology partnerships to expand in Texas this year, including San Antonio Kidney Disease Center, Kidney Specialists of South Texas, Southwest Nephrology Associates, LLP, The Kidney Institute, Renal Associates P.A., Renal Specialists of Houston, and Permian Basin Kidney Center.

Strive Health, a digital health company that is focused on value-based kidney care, closed a $166 million Series C funding round from investors, including CVS Health Ventures, on May 31, 2023. This funding will fuel their continued growth in a slowing venture capital market. Strive Health eases the work of existing primary care physicians and nephrologists by using predictive analytics, telehealth services, and kidney health and treatment education. They claim that their value-based care approach has led to a “20% reduction in the cost of kidney care and a 42% reduction in hospitalizations.”

Monogram Health, a value-based specialty provider of in-home, evidence-based care and benefit management services for patients living with polychronic conditions, including CKD and ESRD, closed on $375 million of funding. In addition to new and existing financial investors, this funding round included investments from CVS Health, Cigna Ventures, Humana, Memorial Hermann Health System, and SCAN. Monogram will use the funding to support the rapid deployment of the company’s technology-driven, evidence-based clinical services and in-home kidney and polychronic care delivery models. The clinical services they provide include complex case and disease management, utilization management, and medication therapy management, which can improve patient outcomes and experiences while reducing medical costs.

As of August 11, 2023, Novartis AG completed its acquisition of Chinook Therapeutics, Inc. for $3.5 billion. Chinook Therapeutics is a Seattle-based biopharmaceutical company that focuses on the production, development, and research of precision medicines for kidney diseases. This acquisition will allow Novartis to apply substantial resources to pursue broader development efforts for severe CKD programs.

On April 1, 2023, Medtronic, Inc. and DaVita closed on the agreement they had previously entered to form a new, independent, kidney care-focused medical device company. This new company, Mozarc Medical Holding LLC, was formed through a deconsolidating partial interest sale from Medtronic to DaVita. Mozarcwill focus on developing products for at-home treatments, leveraging technology to allow patients to continue home therapy longer and improve patient experience. DaVita and Medtronic each hold 50% voting equity interest, and both companies provided $200 million in cash investments to launch the company.

Conclusion

The dialysis industry maintained stable growth in 2023 through the rising prevalence of CKD and demographic shifts—namely the aging population. The impact of these tailwinds on operating income, however, has been tempered by expense inflation that has outpaced growth in reimbursement. M&A activity in the dialysis sector has been increasingly focused on building vertical scale to accommodate alternative payment models and manage risk. The two largest dialysis operators, jointly accounting for nearly the entirety of the total market, have made significant investments in introducing home-based services and have embraced the novel, value-based care models. However, the adoption of home dialysis programs has been slow after the initial surge. It is vital to observe the many changes occurring to the nephrology practice side, as there is a growing number of consolidators. These emerging companies, supported by substantial private equity and venture funding, aim to unify a fragmented industry and intend to harness technology, analytics, and scale to accelerate the implementation of value-based care and shared-risk models.

More Dialysis Thought Leadership

- Dialysis Medical Director Compensation Arrangement

Laboratories

Industry Overview

Laboratory tests and procedures are generally used by hospitals, physicians, and other healthcare providers and commercial clients to 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 consists primarily of three types of providers: hospital-based, independent clinical, and physician-office laboratories. Hospital-based laboratories are segmented by type of testing and staffed by trained specialists. Some 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 both an attending or consulting physician's office and a hospital that meets at least the requirements to qualify as an emergency hospital. The independent laboratory market includes the nation's largest commercial laboratory companies, Quest Diagnostics 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 for performing diagnostic tests in connection with the physician practice.

As mentioned above, the two largest commercial laboratory companies in the United States are Quest and LabCorp. Combined, they account for over 15% of test volume in the industry but make up less than 1% of all laboratory testing locations in the United States. To increase their market share, both have been very active with acquisitions over the past several decades. In fact, over 50% of LabCorp and Quest's revenue growth from the past 25 years has been linked to acquisitions.

M&A Trends

According to reports by Irving Levin, laboratory M&A deal volume has increased approximately 26% through the first three quarters of 2023 compared to YTD 2022. Although there have been increases in overall transaction volume, full-scale acquisitions have returned to pre-pandemic levels due to uncertainty around the overall macroeconomic picture. Although the COVID-19 pandemic has slowed down full-scale acquisitions, lab companies have amplified their focus on acquiring hospital outreach laboratories, which allow them to continue advancing their hospital and health system strategies by establishing and expanding strategic collaborations. This relationship is mutually beneficial, as hospitals and health systems that are struggling in the current economic environment with reimbursement pressures and rising wages receive much-needed assistance with large commercial labs' additional capital and management expertise. This is noted in Quest Diagnostics Q3 earnings call regarding the overall push to focus on hospital outreach businesses and smaller independent levels.

> "Acquisitions remain a key driver of our growth with an emphasis on accretive hospital outreach purchases as well as smaller independent labs."
>
> **James E. Davis, Chairman, CEO & President, Quest**
> Q3 2023 Earnings Call

Notable Transactions

As mentioned previously, LabCorp and Quest dominate the independent laboratory space and have attributed over 50% of their revenue growth from the past two and a half decades to acquisitions. Below is a snapshot of key acquisitions that were announced through the third quarter of 2023.

Acquirer	Target	Announcement Date	Description
LabCorp	Baystate Health	10/4/2023	Acquisition of outreach laboratory business and select operating assets, including laboratory service centers
LabCorp	Tufts Medicine	8/3/2023	Acquisition of outreach laboratory business and select operating assets
LabCorp	Legacy Health	7/11/2023	Acquisition of outreach laboratory business and select operating assets, along with managing Legacy's inpatient hospital laboratories through a long-term agreement
LabCorp	Providence Health & Services Oregon	5/16/2023	Acquisition of select operating assets
LabCorp	Jefferson Health	5/3/2023	Acquisition of select operating assets
LabCorp	Enzo's Clinical Laboratory division	3/16/2023	Acquisition of substantially all operating assets
Quest	Haystack Oncology	4/27/2023	Acquisition of outreach laboratory business and select operating assets
Quest	Northern Light Laboratory	12/8/2022	Acquisition of outreach laboratory business and select operating assets

> "LabCorp's capabilities, coupled with Legacy's longstanding history in the region, will bring expanded offerings to communities throughout Oregon and Southwest Washington. Legacy continuously seeks to improve both the quality of care and the health of the communities they serve, and this relationship will allow LabCorp to bring our world-class diagnostics and capabilities to patients across legacy's service area."
>
> **Rajat Mehta, Senior Vice President, Laboratory Corporation of America**
> Q3 2023 Press Release

Reimbursement

CMS reimbursement for laboratory services has held steady over the past four years despite regulatory pressures to decrease rates. In 2014, the Protecting Access to Medicare Act (PAMA) was passed to slowly phase in cuts to the Clinical Laboratory Fee Schedules (CLFS). PAMA's goal 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 would slowly phase in cuts to the CLFS over five years. Initially, these cuts were (10%) each year from 2018 through 2020 and were expected to continue. Originally, the COVID-19 pandemic halted and delayed these cuts in 2020 and 2021; however, they have not been reimplemented since. Further, 2024 brought the second consecutive year where the delay in reimbursement cuts was not announced until December. There is still significant uncertainty around the reimbursement landscape for lab services, and there have been regulatory pushes to ensure these cuts do not get reimplemented. This was noted in the Quest Q4 earnings call as a key item:

> "While we are pleased with the delay, we continue to work closely with our trade association to seek a permanent fix to PAMA through SALSA, the saving access to Laboratory Services Act. ACLA's highest priority this year is to secure passage of SALSA."
>
> **James E. Davis, Chairman, CEO & President, Quest Diagnostics**
> Q4 2023 Earnings Call

Regulatory

In 2022, the Saving Access to Laboratory Act (SALSA) was introduced in Congress and remains in the legislative process in the beginning of 2024. SALSA's initial goal was to reform PAMA and minimize the cuts to the CLFS. This act would delay reductions and reform how data was collected from commercial payors. Advocates of the bill believed the initial data reporting process in PAMA was flawed, which led to historical and proposed cuts that will be unsustainable 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 set toan appropriate reimbursement level. The law did not pass during 2022 and again throughout 2023, but it continues to be a priority going into 2024.

After an announcement in October 2023, another major regulatory change looms. The Food and Drug Administration (FDA) has proposed a rule to regulate lab-developed tests (LDTs) as medical devices. LDTs burst into the spotlight during the COVID-19 pandemic as labs used an all-hands approach to fight the pandemic. This approach proved beneficial by accelerating test development and deployment. Presently, while LDTs are subject to certain standards, they operate under considerably less oversight compared to FDA-regulated devices. With the pandemic's pace slowing down, there is a growing call for increased regulatory scrutiny, as many medical decisions are based on LDT results. Testing manufacturers must now submit tests to the FDA for approval prior to the distribution to the market. This rule is expected to take effect in April 2024. Time will tell how this impacts M&A activity in the lab market space. LabCorp CEO Adam Schechter noted in their Q3 earnings call that this rule would have minimal effect on their business due to the internal processes they currently have in play.

> "If it's fairly done, meaning that all laboratory-developed tests have to do the same thing across big labs, small labs and everything else, as long as they can get the filings done quickly so that people have access to new innovations in a timely manner like they do today, we believe that it will be a minimal impact to us in terms of the amount of money or spend because we do a lot of that work anyway."
>
> **Adam Schechter, CEO, Laboratory Corporation of America**
> Q3 2023 Earnings Call

Conclusion

Consolidations of laboratories continued throughout 2023, although full-scale acquisitions slowed down due to economic factors and the minimized impact of COVID-19. Businesses were very active in acquiring both hospitals' outreach labs. Further uncertainty existed regarding the laboratory industries in the regulatory and reimbursement throughout 2023 and will continue in 2024, with the current delay of PAMA cuts and the failure to pass lasting reform legislation to PAMA. Furthermore, updated FDA guidelines for LDTs may influence strategic decisions, requiring companies to align with evolving compliance standards. As a result, the lab industry will continue to work through their acquisition pipeline throughout 2024 while uncertainty in the reimbursement and regulatory industry continues.

More Laboratory Thought Leadership

- Health System Outreach Lab Benchmarking and Valuation

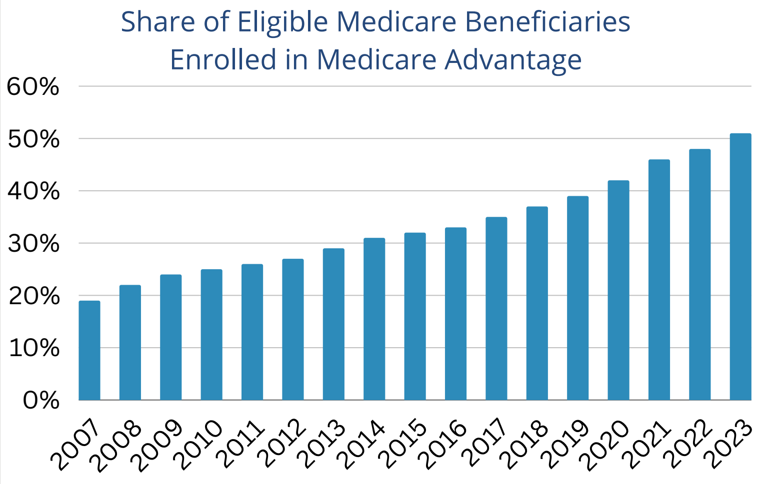
Value-Based Care & Risk-Bearing Organizations

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 10% annually from 2021 to 2025, compared to the 1% growth in the overall insured population. The current participants in the VBC space span a wide range of verticals, including payors, health systems, provider groups, technology-enabled primary care platforms, retailers, and financial investors. Given the variety of participants in the VBC space, this emerging market remains highly fragmented and poised for continued transaction activity.

M&A Trends

The shift toward VBC has been in discussion for many years, most notably when the CMS Innovation Center was established in 2010 as a part of the Affordable Care Act (ACA). Since then, CMS has continued to push the containment of healthcare costs through the movement of lives from traditional fee-for-service Medicare to Medicare Advantage. Over the past decade, Medicare Advantage enrollment has nearly doubled as a percentage of eligible Medicare beneficiaries because of these efforts. This percentage is expected to increase further over the next decade, making Medicare Advantage a fast-growing portion of the overall market due to aging demographics. Further, CMS established a goal to have 100% of Medicare beneficiaries in an accountable care relationship by 2030. As a result, companies that can effectively manage these lives can 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 towards the reallocation of risk and the containment of healthcare costs across the spectrum of lives, including Medicare, primarily through the Medicare Shared Savings Program (MSSP), and commercial payors.

Commercial payors (i.e., insurance providers and insurer-owned companies), have shown a particular interest in the VBC space. Since the ACA took effect, insurance companies have been required to spend at least 80% to 85% of premium dollars on medical care. As a result, many of these companies are seeking vertical consolidation strategies as an opportunity to unlock additional profits. Their focus in the VBC sector has been primarily on Medicare Advantage, which is unsurprising given that there is a concentration of Medicare Advantage enrollment among a few key players, such as UnitedHealth Group, Inc. and Humana Inc. According to the Kaiser

Family Foundation, United and Humana accounted for approximately half (47%) of all Medicare Advantage enrollees nationwide in 2023.

Recently, several market participants have begun touting 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' objectives are to leverage technology in the shift toward VBC. While there was high interest in these innovative companies, the market began to cool in late 2021 and stock prices began to decline. Despite the initial excitement, many of these companies were unable to acquire lives as quickly as expected and execute on shared savings rates and medical loss ratio targets. As a result, expectations were readjusted. Over the past few years, the technology-enabled primary care platforms that emerged from this volatile time have continued to refine their strategies, particularly in the primary care portion of the market. In the last year, these entities have been active in adding partnerships to their core markets and continue to evaluate opportunities in new markets across the U.S.

In recent years, non-traditional players, such the retailers Amazon and Walgreens, have made major investments in the VBC space. These non-traditional players identified opportunities to leverage their national reach and existing operations with the goal of improving outcomes and reducing costs for primary care patients—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.

> **Given the number of well-capitalized players and the fragmentation of a market that benefits from scale, market activity in this sector is expected to remain elevated throughout 2024.**

Notable Transactions

Payors and Retailers

On February 8, 2023, CVS Health completed its $10.5 billion acquisition of Oak Street Health, representing a purchase price of $9.7 billion plus $1.03 of assumed debt and less $201 million of assumed cash. Based on available information, the valuation implied a revenue multiple of 4.9x. Oak Street Health boasts a primary care network with 600 providers across 169 medical centers. Despite Oak Street's current operational losses, CVS sees a substantial opportunity, projecting over 300 centers by 2026, each potentially contributing $7 million to Oak Street's adjusted EBITDA at maturity. This transaction followed the announcement of CVS' 2022 acquisition of Signify Health, which closed on March 29, 2023. CVS Health acquired Signify Health for $30.50 per share, or approximately $8 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 its technology and analytics platform. Signify Health expanded in the value-based care space in March 2022 with its acquisition of Caravan Health, which partners with providers who participate in accountable care organizations (ACOs). Of note, Pak Street, Signify Health, and Caravan Health are held within CVS' health services business, which has been recently rebranded as CVS Healthspire.

On February 22, 2023, Amazon closed its acquisition of One Medical, a membership-based, technology-enabled primary care organization for $3.9 billion, an implied revenue multiple of 3.6x. One Medical has an established clinical footprint of over 220 offices and continues to grow. Since the transaction closed, One Medical has announced partnerships with CommonSpirit Health's Virginia Mason Franciscan Health (November 9, 2023) and Hackensack Meridian Health (November 14, 2023).

On September 26, 2023, Cano Health, Inc. announced that it substantially sold all its assets associated with the operations of its senior-focused primary care centers in Nevada and Texas to CenterWell Senior Primary Care for approximately $66.7 million. The consideration consisted of approximately $35.4 million in cash plus certain liabilities owed by Cano. The primary care centers in Nevada and Texas represented approximately 15,200 members. CenterWell, along with Conviva Care Center, comprises Humana's primary care business. Before the transaction, Humana's primary care business delivered care to approximately 266,000 seniors across 12 states.

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 3x 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. On March 3, 2023, VillageMD announced the acquisition of Starling Physicians, a primary care and multispecialty group in Connecticut. The terms of the deal were not disclosed.

Throughout 2023, Optum, an information and technology-enabled health service subsidiary of United, continued to execute on its historical trend of buying primary care operations and utilizing these entities as platforms to execute its risk-based contracting strategies. Over the course of the year, it is estimated that Optum added 20,000 employed and affiliated physicians. Effective February 22, 2023, Optum acquired Crystal Run Healthcare, a Middletown, New York-based primary care and multispecialty group comprised of over 400 physicians. Later that year in December, Optum filed a notice of its intention to acquire Corvallis Clinic, a large primary care and multispecialty group in mid-Willamette Valley, Oregon. In addition to the primary care and multispecialty physician acquisitions, Optum also closed a multimillion-dollar deal to acquire LHC group, a home health and hospice company, and announced plans to merge with Amedisys, another home health and hospice provider. It is understood that one of the driving factors for these movements in the post-acute sector is Optum's value-based care strategy as it seeks to shift care to the most appropriate and lowest-cost setting.

On November 1, 2023, agilon health, inc. announced the sale of MDX Hawaii to a private buyer. MDX Hawaii, acquired by agilon in 2016, is a provider network comprised of approximately 600 physicians serving 36,000 members with fully delegated risk contracts and management services organization capabilities. The sale of MDX Hawaii allows agilon to focus on its core partner markets in the continental U.S. Throughout the year, agilon continued to announce partnerships with many health systems and providers, including The Center for Primary Care in the Central Savannah River Area, Catalyst Health Network in Texas, Holland PHO in West Michigan, Premier Health in Southwest Ohio, Family Practice Center in Central Pennsylvania, and Lexington Clinic in Central Kentucky. agilon plans to assist these health systems, clinics, and providers with implementing VBC models to provide high-quality, cost-effective care for the senior populations in their communities.

On March 7, 2023, Privia Health Group, Inc., a technology-driven, physician enablement company announced a partnership with OhioHealth, a not-for-profit health system based in Columbus, Ohio. The partnership will support

OhioHealth's existing clinically integrated network (CIN). On August 1, 2023, Privia announced a partnership with Walla Walla Clinic, a multispecialty practice with more than 50 providers in the state of Washington. The Walla Walla Clinic marks Privia's entrance into the state of Washington.

Other Players and Investors

On April 26, 2023, Kaiser Permanente announced a definitive agreement to acquire Geisinger Health, a health system based in Danville, Pennsylvania. Through the acquisition, Geisinger is the first to join Risant Health, a nonprofit organization created by Kaiser. As a part of the deal, Risant will make a minimum of $2 billion available to Geisinger through 2028 to support strategic and routine capital, as well as other assured funding related to Geisinger's health plan and research and education enterprises. Risant was formed with the goal of expanding and accelerating the adoption of VBC. Risant plans to acquire four or five more health systems over the next five years.

Reimbursement

In August 2023, CMS announced that MSSP saved more than $1.8 billion in 2022, marking the sixth consecutive year that MSSP has generated savings compared to spending targets. On November 2, 2023, CMS released the 2024 PFS final rule, which included changes to MSSP that aim to further advance CMS' overall VBC strategy. Per CMS, the changes to MSSP in the 2024 PFS final rule are expected to increase participation in MSSP by 10–20%.

Notable items from the ruling include changes to assignment methodologies and financial benchmarking. Changes to the assignment methodologies for beneficiaries aim to provide greater recognition to advanced practice providers in delivering primary care services. Modifications to the financial benchmarking methodology include adjustments to the regional risk adjustment to improve accuracy, encouraging participation in ACOs, and incentivizing ACOs to care for higher-risk beneficiaries.

Earlier in the year, CMS finalized the transition to a revised risk-adjustment model, the 2024 CMS-HCC Risk Adjustment Model, Version 28 (V28), which includes changes to the MA capitation rate and risk-adjustment methodologies. CMS plans a three-year phase-in for the revised model from the previous model, the 2020 CMS-HCC Risk Adjustment Model, Version 24 (V24). CMS implemented the model changes with a goal to reflect more recent utilization, coding, and expenditures patterns in fee-for-service Medicare. In application, it is expected that the change will decrease overall risk scores. Per the 2024 MA Capitation Rates and Part C and Part D Payment Policies Rate Announcement, the risk model revision and normalization are expected to have a (2.16%) impact on MA plan payments relative to 2023.

Medicare Shared Savings Program

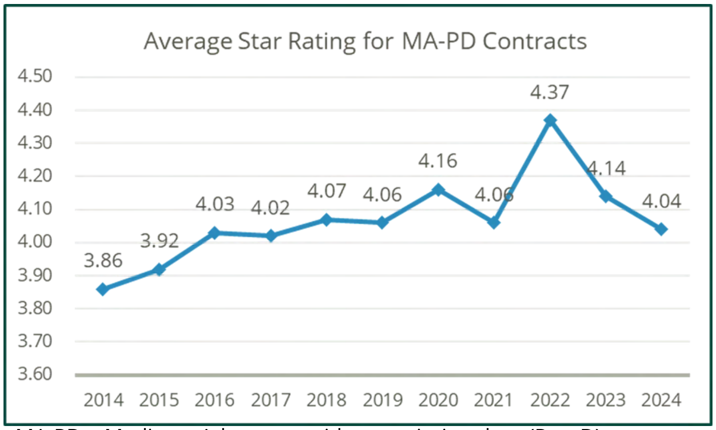
MSSP was launched in 2012 to evaluate VBC models in reducing costs and improving outcomes. As of January 2024, MSSP included 480 ACOs providing care to 10.8 million Medicare beneficiaries. The program offers different participation options that allow participating ACOs to assume various levels of risk. The ENHANCED track has the greatest level of downside financial risk. Despite the larger downside risk, the ENHANCED track continues to increase in adoption due to the greater shared savings rate (i.e., 75% vs. 50%). These shared savings opportunities continue to make the ENHANCED track a popular option for high-revenue or experienced ACOs.

ACO Tracks	1/1/2024	1/1/2023	1/1/2022	1/1/2021	1/1/2020
Number of ACOs					
One Sided	159	151	199	163	191
Two Sided	321	305	284	195	192
ENHANCED Track	*207*	*161*	*146*	*76*	*80*
Percentage					
One Sided	33.1%	33.1%	41.2%	45.5%	49.9%
Two Sided	66.9%	66.9%	58.8%	54.5%	50.1%
ENHANCED Track	*43.1%*	*35.3%*	*30.2%*	*21.2%*	*20.9%*

In recent periods, MSSP has developed an adjacent model that more specifically focuses on bringing health equity to underserved communities. 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. 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.

For 2024, the ACO REACH model has 122 ACOs, representing approximately 2.6 million beneficiaries. Early results from the ACO REACH model are neutral to positive. Based on a report released by CMS in September 2023, ACO REACH model participants scored statistically better on unplanned admissions for patients with multiple chronic conditions. On other measured metrics, such as all-condition readmission and timely follow-up after acute exacerbations of chronic conditions, ACO REACH model participants did not score statistically better or worse. Early results of the model's financial performance indicate a 7.7% reduction in Medicare spending compared to benchmarks, but it is important to note that savings in the first half of the year tend to be overstated due to seasonality.

During 2023, CMS published changes to the ACO REACH model with the goals of increasing predictability, protecting against inappropriate risk score growth, and advancing health equity. Notable changes directed at increasing predictability for model participants include a short-term reduction in the beneficiary alignment minimum, a 10% buffer allowing a temporary drop below the new beneficiary alignment minimum, an expansion of criteria for high-needs population ACOs, and a change in responsibility for retrospective trend adjustments beyond 4%.



MA-PD = Medicare Advantage with prescription drug (Part D) coverage

Medicare Advantage Star Ratings

CMS uses star ratings to measure the quality of MA and prescription drug (Part D) plans. In addition to helping consumers compare health plans, a plan's star rating can influence MA payments in the form of bonuses and rebates. Star ratings reached an all-time high in 2022, partially due to favorable provisions in response to impacts of the COVID-19 pandemic. Since then, star ratings have faced some downward pressure, as these provisions rolled off and changes to the determination of star ratings previously discussed went into effect.

As announced in previous rulings, beginning with the 2024 star ratings, CMS utilized Tukey outlier deletion, which involves the removal of outlier scores. The goal of this change in methodology was to increase the stability and predictability of the star-measure cut points. In application, this methodology resulted in the removal of primarily low-performing plans, shifting the cut points to a higher range.

Looking forward, the 2024 final rule announced some additional changes, including measure changes and a new reward system aimed at increasing health equity. These changes are expected to be implemented for 2026 and 2027 star ratings respectively.

Conclusion

Strong M&A activity in the VBC and risk-bearing entity space is expected to continue in 2024 as payors continue to pursue vertical integration strategies, technology-enabled providers optimize care coordination and management, and nontraditional players scale their services. Other healthcare organizations' participation in the market will likely increase as they recognize the need for innovative approaches to enhance patient outcomes and control costs. If 2023 was any indication, these organizations are likely to pursue strategic partnerships and collaborations with the active players in the VBC domain.

More Value-Based Care Thought Leadership

- Exploring the World of Value-Based Care: An Overview
- Structuring Value-Based Compensation Plans to Maximize Revenue Under Alternative Payment Models

Private Equity

Industry Overview

Over the last decade, private equity (PE) involvement within the healthcare industry has risen from 445 deals in 2017 to an estimated 788 deals in 2023, experiencing a high-water mark of 1,114 deals in 2021. The PE investment class offers qualifying individuals and entities with an alternative to public debt and equity investments, with the hope of providing outsized returns relative to those markets. Investment in healthcare services specifically represented nearly half of all PE investment in the healthcare industry, and roughly 11% of PE buyout and growth deals overall in the U.S. in 2023. The continued 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 overall economics (healthcare spend as a percentage of U.S. GDP and recession-resilient qualities).

The PE playbook often involves buying a company, achieving operational synergies through either investment or cost cutting, growing the business through both organic and inorganic strategies, and ultimately exiting the investment through a sale. The typical PE investment follows the J-Curve economic theory, whereby investments in companies are made in the first three years with the intention of improving the business and driving increased cash flow to the PE firm beginning in year three and continuing thereafter. As such, 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.

The recent trend observed in the healthcare services space illustrates how deal volumes have normalized back to pre-pandemic levels (649 in 2019) after having experienced rapid investment in 2021 and 2022 (1,114 and 940, respectively). Capital that has been committed to PE funds but not yet deployed by those funds (dry powder) allocated specifically to healthcare services by U.S.-based PE firms is estimated to approximate $100 billion. After considering the leverage that a PE firm will also utilize, this dry powder could equate to nearly $240 billion in total enterprise value.

PE firms investing in the healthcare industry face competition from a growing number of groups, such as traditional hospitals and health systems; vertically integrated payer-providers (UnitedHealth Group, Humana, CVS Health, etc.); and other PE firms who previously have not invested in healthcare. It seems, anecdotally, at least, that limited partners are increasingly asking their PE firms why they are not invested in the healthcare industry, driving those additional players into the sector.

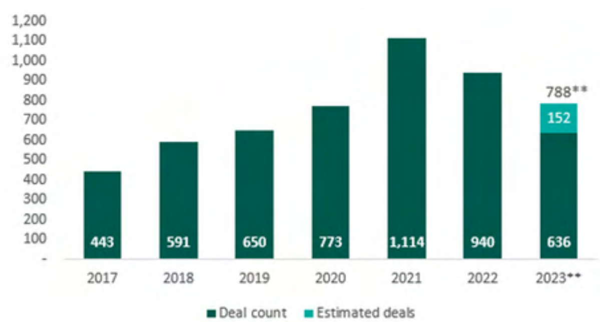
One other component to the increased valuation multiples observed throughout the last decade is PE firms' and other corporate acquirers' willingness to move further out on the acuity curve for physician practices. Historically, PE investment in the physician practice space has involved acquiring a medical specialty practice, building a platform, and adding additional 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 organic growth, multiple arbitrage, financial leverage, and other operational efficiencies resulting from achieving scale and professionalized management.

As PE firms have become more comfortable with the risks involved within the healthcare services space and have begun to search for additional returns, they have begun to apply this buy-and-build model to other provider services, such as cardiology, orthopedics, behavioral health, pain management, and women's health. 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. Additionally, PE continues to assess investment opportunities involving the implementation of value-based care arrangements and how those strategies may fit with their existing portfolio of companies.

M&A Trends

Total deal activity in 2023 for PE firms investing in the healthcare services industry declined compared to 2022, as deal volumes continued their downward trend following a slowing pace of activity in the second half of 2022. The decline in PE-related transaction activity observed during 2023 is a direct result of several headwinds, including rising interest rates year-over-year, continued challenges recruiting and retaining staff, and an observed disconnect between what buyers are willing to pay versus what a seller believes their business to be worth.

Healthcare Services PE Deal Activity*



Data through December 31, 2023

As such, deal volumes for healthcare services involving PE declined from 940 in 2022 to an estimated 788 in 2023, representing a (16.2%) decline that is the result of quarterly declines throughout the year. This follows a (15.6%) decline in activity from 2021 to 2022, following the inverse relationship between deal activity and interest rates over the same time period.

Healthcare Services PE Deal Activity by Quarter

Source: Pitchbook research center

This should not be interpreted as private equity's unwillingness to invest in the industry. As noted previously, dry powder allocated to the industry has reached record highs. In our 2023 M&A Report, VMG Health detailed various factors that contributed to heightened transaction volumes in 2021 and 2022, including covenant-lite loans and enterprises that were valued based on pro forma earnings. As economic headwinds persisted—or, in some cases, escalated—deal activity contracted throughout the year and reverted to pre-pandemic levels.

Additionally, the creation and usage of continuation funds continues to play a role in transaction activity. Continuation funds are created by a PE firm and potential co-investors to purchase assets from the same PE firm's older fund. These funds are primarily used for two purposes: to increase the hold period for the PE firm for well-performing portfolio companies with remaining growth potential, or 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 has continued through 2023, as Beecken Petty O'Keefe & Company established their first continuation fund in April 2023 to transfer five healthcare portfolio companies from Fund IV into the new vehicle. Co-investors include investment funds affiliated with Apollo S3, Blackstone Strategic Partners, and Five Arrows.

Notable Transactions

PE firms looking to put their limited partners' capital to work will do so through two avenues at the onset: acquiring a sizable entity from which the platform will be built and 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, either by taking the platform public (IPO, reverse-merger, SPAC, etc.) or selling to another entity, whether private (PE firm, management buy-out, etc.) or public (publicly traded entities).

Secondary Buyouts

During 2023, transactions between PE and other institutions (secondary buyouts) slowed relative to activity observed in 2022, reflecting the trend within the broader deal environment. Secondary buyouts serve as important signals to healthcare providers contemplating partnering with PE. Traditional PE buyouts include provisions for sellers to retain a portion of their purchase price (or "roll") a portion of their proceeds into equity at the holding company, which then becomes monetized at the point of secondary sale. A strong secondary buyout market helps to provide those initial sellers with the confidence that they will get "a second bite of the apple." Below are a few examples of secondary buyouts that occurred in 2023:

In October 2023, BlueSprig Pediatrics purchased Trumpet Behavioral Health for an undisclosed amount. Trumpet Behavioral Health has 40 locations and provides behavioral health services, including ABA therapies, and was previously owned by Balance Point Capital, WindRose Health Investors. Blue Sprig Pediatrics is a portfolio company of KKR.

In August 2023, Cressey & Company acquired HealthDrive from Bain Capital Double Impact for an undisclosed fee. Headquartered in Framingham, Massachusetts, HealthDrive is a leading, multispecialty clinical services organization for patients residing in long-term care facilities, delivering coordinated care across six specialties. HealthDrive has grown to employ over 500 clinicians in over 3,800 facilities, serving more than 150,000 enrolled senior living residents.

In April 2023, General Atlantic First Cressey Ventures exited their investment in OneOncology through a sale valuing the group at $2.1 billion. OneOncology is a network of leading oncology practices, and will be acquired by TPG, AmerisourceBergen, and OneOncology's affiliated practices, physicians, and management team, which will form a new joint venture to complete the transaction. General Atlantic made their initial investment in OneOncology in 2018. The transaction includes a put option for TPG, whereby they may require AmerisourceBergen to purchase TPG's shares at a value of 19x adjusted EBITDA at that time. This put option can be exercised during the fourth year of ownership.

In April 2023, Novocardia, previously a portfolio company of Deerfield Management, merged with Cardiovascular Associates of America (CVAUSA), a portfolio company of Webster Equity Partners. Novocardia became the newest division under CVAUSA, focusing on the development, testing, and scalability of innovative care models and new, value-based and risk-based contracting models that improve quality care and efficiency while lowering costs. The Florida-based cardiology groups currently partnering with Novocardia, First Coast Heart and Vascular Center in the Jacksonville area and My Cardiologist in the Miami area, will immediately become partner groups within the CVAUSA network.

In May 2023, Ovation Fertility and US Fertility completed their previously announced merger to form an advanced fertility care network spanning over 90 locations and 28 laboratories. US Fertility will continue to operate as the practice MSO while Ovation Fertility will act as the laboratory MSO. Morgan Stanley Capital Partners were the previous sponsors of Ovation Fertility while US Fertility was sponsored by Amulet Capital Partners; both firms will continue as investors in the newly combined entity.

Noteworthy Areas of Investment

Cardiology

The previously mentioned merger between CVAUSA and Novocardia in April 2023 brought together two elite cardiovascular networks and positions CVAUSA as the preferred, value-based cardiovascular network for payers, risk-bearing providers, and self-insured employers. In June 2023, James River Cardiology, based in Richmond, VA, received a growth investment from RC Capital to create Aligned Cardiovascular Partners (AlignedCardio) in a platform creation event. The creation of AlignedCardio brought the number of PE-backed platforms in the cardiology space up to six after the merger mentioned above briefly brought that number down to five. Pitchbook research indicates that there have been 15 deals involving PE in the cardiology space through September 2023, matching the full year 2022 total. Investor appetite remains strong for these assets, as there is a strong investment thesis behind the specialty and limited supply of cardiologists who are involved in private practice (<20%).

MedSpa Consolidation

Previously an afterthought in dermatology roll-up strategies, Medspas have become a standalone investment thesis for PE firms, as the highly fragmented market offers many of the characteristics sought after by the industry. There were 17 platforms with PE-backing as of August 2023, with substantial add-on activity occurring throughout the year. Through September 2023, aesthetic dermatology transaction activity has already surpassed 2022's activity, a previous high-water mark for the subsector:

- MedSpa Partners (Persistence Capital Partners): four deals in 2023
- Advanced Medaesthetic Partners (Leon Capital Group): four deals in 2023
- Alpha Aesthetics Partners (Thurston Group): six deals in 2023
- Empower Aesthetics (Shore Capital): formed in July 2023, completed first acquisition in November 2023

Regulatory

Healthcare is one of the most regulated industries in the United States, and investors old and new must stay abreast of changes, both contemplated and enacted. Historically, PE investors utilized leverage more than health systems and other corporate entities in their acquisition activity, magnifying the impact of shifts in reimbursement rates and mechanisms and expense patterns. Two areas of recent regulation pose significant threats to revenue for healthcare entities: surprise billing legislation and price transparency. Uncertainty around the stability of revenues at current volumes can put significant strains on M&A activity, as sufficient, unlevered, free cash flow is required to meet the enterprise's debt obligations and capital expenditure needs on a go-forward basis.

The healthcare industry's staffing cost headwinds continued through 2023 following the FTC's proposed rule in January 2023 to ban non-compete 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." 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, such that previous owners would not be impacted by the rule.

> "A growing number of states are implementing laws restricting noncompete agreements generally, and some states specifically with respect to providers. These states include Alabama, California, Delaware, Minnesota, New York, North Dakota, Oklahoma, and Texas."
>
> **Matthew Brohm, Partner and Co-Chair of Healthcare Private Equity, Arnall Golden Gregory**
> Interview conducted by Rebecca Springer, Pitchbook's Lead Analyst in Healthcare

Anecdotally, VMG Health's clients have not altered their investment approach nor valuation practices to account for this potential regulatory shift.

Furthermore, the FTC announced in September 2023 that it sued Welsh, Carson, Anderson & Stowe-backed US Anesthesia Partners (USAP) on anticompetitive grounds. The USAP suit marks the first major instance of the federal agency taking aim at a roll-up strategy rather than a merger of equals with relative size.

California's Office of Health Care Affordability (OHCA) has published draft regulations on the healthcare transaction notice requirement that will become effective on April 1, 2024. Healthcare law firm McDermot, Will and Emory issued the following summary of the matter: "At a high level, SB 184 requires a 'health care entity' (defined as a provider, payor or fully integrated delivery system) entering into a transaction involving the sale or transfer of control of a material amount of its assets or operations to provide at least 90 days' prior written notice of the transaction to the OHCA. After the health care entity provides notice, the agency then has 60 days to either advise the health care entity of its determination to conduct a cost and market impact review (CMIR) or provide a written waiver from such review. OHCA will issue a preliminary report upon completion of the CMIR. Then, after allowing the parties and the public to provide input, the OHCA will issue its final report. No transaction going through the CMIR process may close until 60 days following the OHCA's issuance of the final report."

The incremental layer of scrutiny and potential reversal of a transaction on regulatory grounds will surely lead to additional considerations in the investment thesis for any PE acquisition activity in the State of California going forward, as each acquisition in a buy-and-build strategy with be subjected to the requirements, as will any potential sale of the portfolio company in the future. Due to the uncertainty around exit opportunities, some of VMG Health's contacts at lending institutions are currently avoiding investment opportunities in California until there is more clarity on the situation.

Conclusion

Overall, private equity's investment in healthcare services declined in 2023 relative to the record-high activity experienced in 2021 and a strong 2022. Private equity deal flow in the industry has seen a downward trend throughout the year, as economic uncertainty persisted due to elevated interest rates, labor challenges, and contracting reimbursement rates. However, there continues to be additional capital raised and allocated to healthcare for these PE firms, and we expect to see activity stabilize and demonstrate modest growth in 2024 relative to 2023. We expect PE investment to remain selective in the current lending environment, with capital deployed to quality assets with favorable geographic locations and density. Overall, early indications from VMG Health's clients point toward an increased level of transaction activity in Q1 2024 relative to Q4 –2023, with optimism for sustained deal flow throughout the next calendar year.

More Private Equity Thought Leadership

- The Rise of Hospital and Health System JVs with Private Equity
- Proceed with Caution: Five Key Considerations in Quality of Revenue Analysis
- Partnerships Are the Future: How Health Systems & Private Equity-Backed Platforms Can Fuel Mutual Growth
- Private Equity Investment in Ambulatory Surgery Centers

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