Provident Perspectives: Consolidation & Investment Within Value-Based Primary Care

Adoption of value-based care is expected to continue driving merger and acquisition activity in the primary care and multispecialty market

Provident Healthcare Partners

An Evolving Value-Based Care Landscape Spurs Consolidation in Primary and Multispecialty Care

A nationwide push for adoption of value-based care has influenced a wave of consolidation among primary care and multispecialty physician groups with a record high of 41 transactions closing in 2020 and the market outpacing that already in 2021.

Value-based care (VBC) is a payment model that steps away from a traditional fee-for-service (FFS) model in which providers are not rewarded for volume of procedures but instead rewarded for quality care by measuring benchmarks of positive patient health outcomes. In September 2020, CMS issued guidance for states to accelerate the transition to VBC, largely driven by offering Medicare Advantage (MA) plans. Following the order, MA plans saw an increase a nearly 10% increase of 2.4 million new members in 2021. MA plans are offered through commercial payors but backed by CMS, utilizing capitation payments, a form of value-based reimbursement. The alternative payment models of VBC are designed to incentivize efficient care, holistic treatment, and improve outcomes at a lower cost. Investors recognize the opportunity for growth that comes with these at-risk contracts.

In 2020, the VBC market experienced robust M&A activity from both established and newer players, signaling that this spur of consolidation will continue.

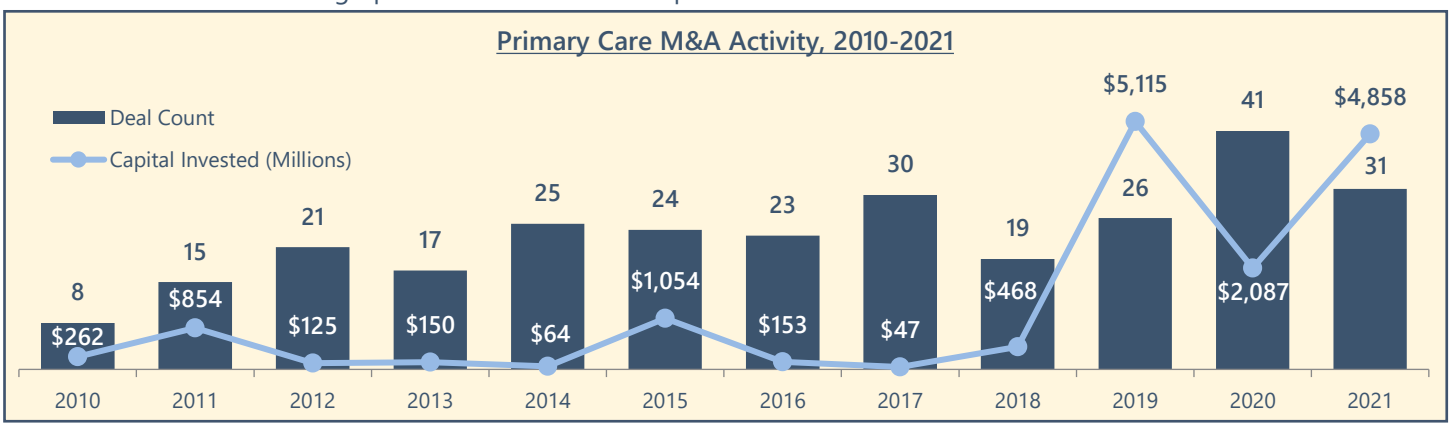
Traditional consolidators of primary care groups, such as large payors and health systems, hold the majority of Medicare Advantage market share, but private investors and the public market are quickly expanding their footprint in value-based care.

Payors are by far the most established players by means of their Medicare Advantage plans. UnitedHealth Group is the stand-out market leader with 27% market share as of March 2021. In fact, the largest ten MA insurers hold over 77% market share. By owning a large market share, payors can exercise influence over execution of VBC in real time.

Although new to the space, private equity and venture capital investors offer differentiated products through platform investments. These private investors now account for approximately 2% of Medicare Advantage lives.

Several private investments have also graduated to the public markets debuting via IPO and SPAC. Most recently, Alignment Healthcare (NASDAQ:ALHC), a provider of privatized Medicare benefits, raised $489.6M through its IPO in March 2021. Public offerings by VBC and MA players Oscar Health, Clover Health, Oak Street Health, and Cano Health reached an aggregate valuation of $22.6 billion, signifying a large step for investors in the space.

Industry tailwinds such as an expansion in Medicare Advantage will continue to drive VBC implementation for the coming years. Due to the nature of a managed care model, primary care providers feel immediate, direct impacts of VBC trends. Smaller practices are not as easily able to realize the advantages directly tied to patient population size and sophisticated operations that are crucial to benefit from VBC models. Instead, smaller practices will battle higher fixed costs, fluctuating potential outcomes due to population instability, and overall operate in a riskier environment. These market pressures will cause primary care practices to leverage consolidation to remain competitive.



Sources: Mark Farrah Associates, Pitchbook

Shifting Primary Care Delivery Model Pushes for Alternative Market Opportunity

Patients are seeking healthcare at a lower cost, incentivizing primary care providers to shift to a value-based care model.

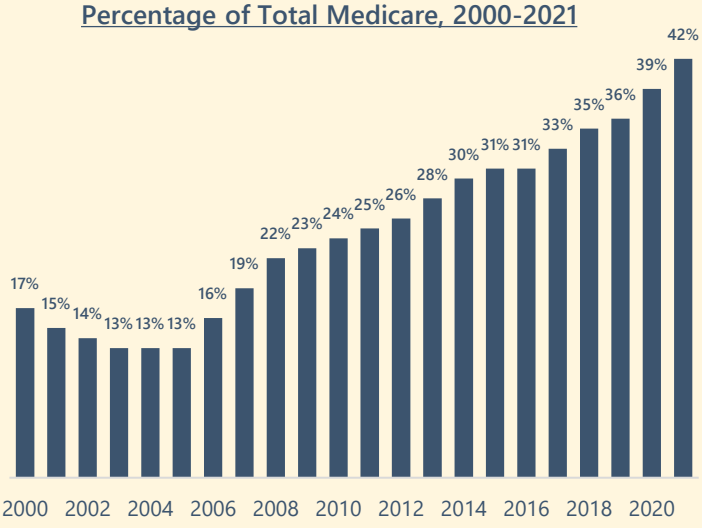
Stakeholders within the U.S. healthcare industry have and continue to be motivated to shift care and reimbursement models away from fee-for-service to value-based care. The primary care sector leads the march to more cost efficient and convenient models. Value-based primary care models aim to bring higher quality service and care to patients through vehicles such as Medicare Advantage, which is causing the expansion of MA plans. On July 1, Humana introduced a primary care value-based model aiming to improve quality care and health outcomes while also lowering the cost for such care. Humana's decision highlights the overall markets' shift to less expensive and more convenient healthcare models. There are several routes which patients are embracing to receive better, more efficient healthcare, including individual and retail models through Medicare Advantage, Medicare Managed Care, patient-centered medical home, and a few others.

Drivers such as higher accessibility to health insurance, an aging population, and a shortage of medical professionals are creating novice trends in the primary care industry.

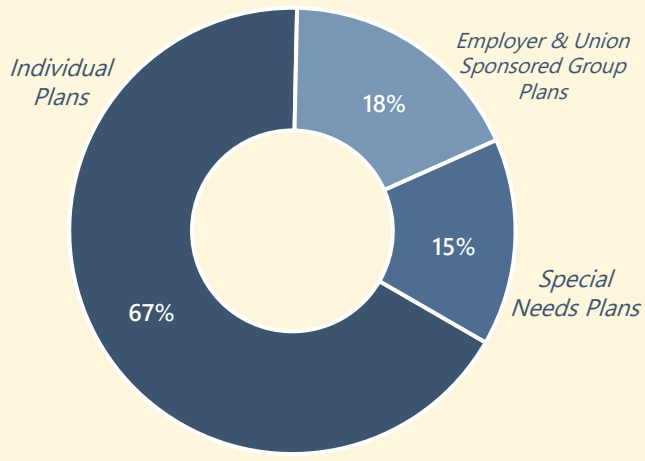
Since the introduction of the Affordable Care Act, the number of insured individuals has continued to rise. The supply of healthcare professionals has not been able to meet this increased demand, creating a large vacuum for retail platforms. The retail market includes services such as health centers and kiosks which address minor healthcare needs at patients' convenience. According to a report from Deloitte, between 14 and 27 percent of all emergency department visits could take place at a retail clinic or urgent care center, potentially saving the United States healthcare system $4.4 billion annually. The COVID-19 pandemic further exasperated the patient's demand for inexpensive, convenient care.

The healthcare retail market, defined as health centers located within retail stores such as CVS and Walgreens, has risen in popularity over the past decade. This rise in the retail market is highlighted in the distribution of enrollment in Medicare Advantage. As consumers continue to take on a larger share of the healthcare cost burden, they are participating in the management of their health. In 2021, nearly two-thirds of Medicare Advantage enrollments are through an individual plan, rather than a group employment plan. Provident believes that this trend towards more efficient value-based primary care will cause significant M&A activity in the space.

Total Medicare Advantage Enrollment as a Percentage of Total Medicare, 2000-2021



Distribution of Medicare Advantage Enrollees by Plan Type, 2021



Sources: Humana, Deloitte Report

Obstacles Remain Before Widespread Adoption of Value-Based Care Becomes Standard

Even with its advantages, the transition from volume-based to value-based care comes with complex challenges.

High up-front costs and misaligned incentives are some of the most prominent issues regarding VBC implementation facing small, independent practices throughout the country.

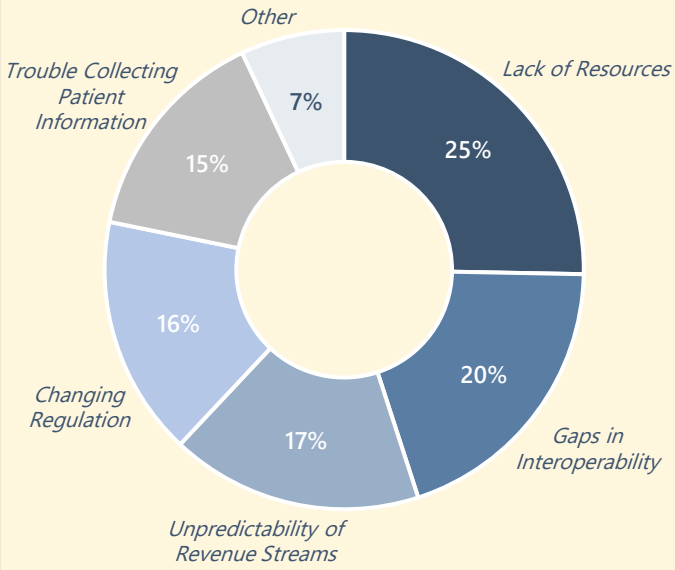
Many smaller primary care practices do not have the resources or infrastructure in place to immediately adopt VBC.

Since VBC relies on effective population management, significant investment in technology and data analytics is essential to coordinate care and track performance outcomes. According to a 2017 study conducted by Quest Diagnostics and Inovalon, 53% of health plan executives believe that providers have the healthcare IT tools for VBC, but only 43% of physicians agreed with the same statement. The ten-percentage point differential to already staggeringly low numbers indicates a large gap between expectations and realistic feasibility on the progress of implementing VBC. The integration of new systems such as EHR, advanced claims and billing software, and patient-gathered data platforms are costly and time-consuming, often prohibiting many practices to execute on their own.

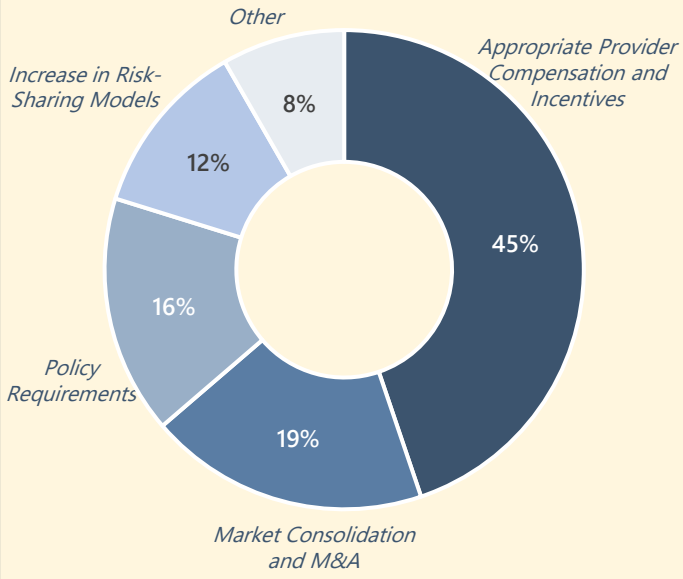
Another critical hurdle is realigning incentives from a FFS to a VBC model. In a FFS model, physicians are usually compensated based on number of procedures performed and payors reimburse on a per claim basis. With the evolution to VBC, practices need to align both physicians and payors to performance-based incentives. In 2020, 97% of physicians still relied on FFS or a flat salary compensation with only 36% having some component of value-based bonuses. Physician compensation plans in VBC should reorient physicians to provide the most effective care by tying a larger piece of compensation directly to VBC indicators. A large reason for the delay in reallocating physician compensation packages is the untimely performance payouts owed from payors to practices. Alignment with payors is equally as important. Providers and payors should collaborate in navigating newly structured terms and benchmarks of a VBC contract to maintain clarity throughout the reimbursement process. Larger practices are in a stronger position to transform both compensation structure and payor relationships with the stability and weight of a substantial patient population backing negotiations.

Many primary care providers have sought consolidation to confront these obstacles while maintaining quality care and consumer experience.

Healthcare Leaders' Largest Barriers to VBC



Factors Accelerating VBC Adoption



Sources: Medical Economics, Deloitte, McKinsey, Quest Diagnostics, Medscape, Definitive Healthcare

Evidence: Shift to Value-Based Medicare Advantage Care

The state of Florida and, more specifically, Miami-Dade County, provides a case study on how the plan has successfully developed and the takeaways to deliver to new markets.

As highlighted earlier, the rising age of the population could be impactful on the health care delivery model in the United States. Florida's demographics exemplify the future demographics of the entire United States; a large, elderly population needing increasingly more health care. As of October 2020, the total Medicare Advantage enrollment across the state reached nearly two million people, approximately 1 in 10 Floridians. A report from the mid 1990s stated that Miami-Dade, the most populous county in the State of Florida, had a very robust and highly penetrable Medicare Advantage market. With this reliance on Medicare Advantage, Miami-Dade's average monthly premium in 2021 is $13 as opposed to $495 across the country. Florida's successful model proves that enrollment into Medicare Advantage plans incentivizing value-based care is a delivery model that the rest of the United States should look to emulate.

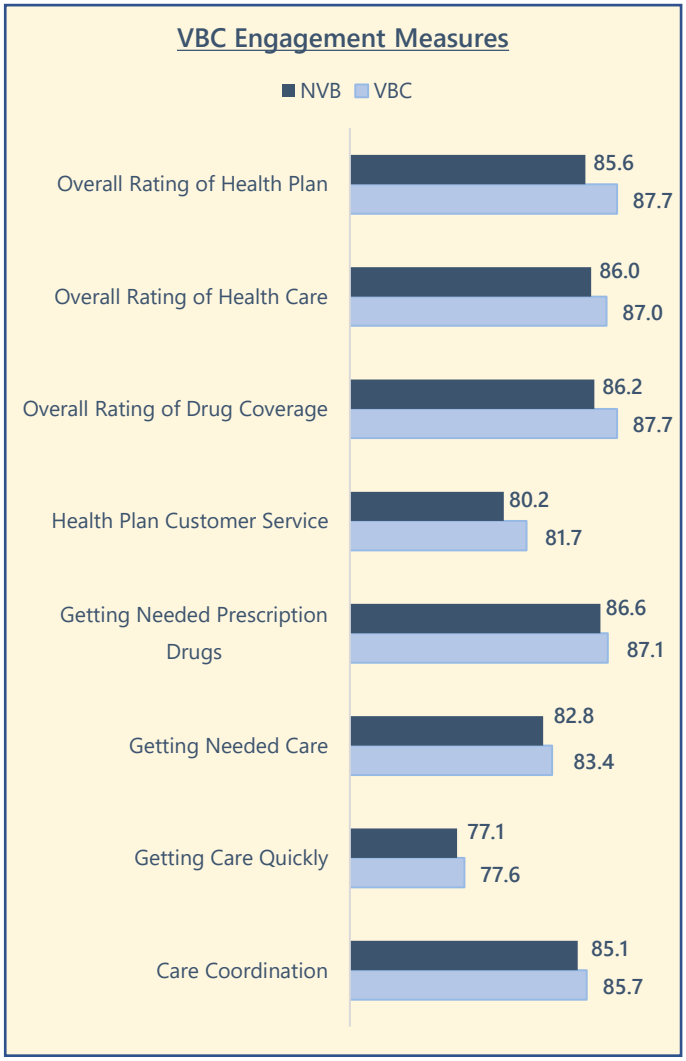
Miami-Dade County MA Profile

478k *Eligible*	348k *Enrolled*	72.8% *Penetration*
90 *Plans Available*	$13.17 *Avg. Premium*	$110.80 *Avg. Deductible*

enrollees has reached over forty percent in nineteen states, including in Florida and some of the largest states in the country such as California, Texas, Colorado, and Arizona. According to a report, Texas's monthly average premium is declining, including a drop from $12.43 in 2020 to $11.42 in 2021. Enrollment into Medicare Advantage plans is proving to successfully lower premiums and costs to patients. In addition to a statistical analysis on the shift to value-based care through Medicare Advantage on the state-level, investments into healthcare companies also highlight this shift.

Multiple high-level investments are underscoring the shift to value-based plans in the United States.

Clover Health Investments Corp., a Medicare Advantage insurer, announced in the middle of the COVID-19 pandemic that it would enter the public markets through a SPAC, Social Capital Hedosophia Holdings Corp. III. The deal, valued at nearly $4 billion, helped to jumpstart the fastest-growing Medicare Advantage insurer in the United States. Furthermore, Cano Health, a value-based healthcare provider, announced on November 12, 2020, that Jaws Acquisition will take the company public via a SPAC transaction. Both investments indicate the acceleration toward value-based delivery models.



Sources: Value Penguin, The Street, Medicare Advantage

The Future of Value-Based Care

Although CMS embraced the concept of VBC in 2008, the onset of the COVID-19 pandemic exposed a significant lag in adoption in the market. With the sharp and sudden drop in demand, healthcare providers quickly realized how reliant their FFS models were on constant utilization.

The healthcare system is now observing a fresh optimism towards implementing VBC as a method to avoid demand vulnerability and run a sustainable practice.

The VBC market has many different growth sectors by which it can progress into the future.

The pediatric sector is often excluded when discussing value-based care, but it will be integral to the dynamic of the larger healthcare system. Research shows that expanding the scope of care beyond the medical system can have tangible health impacts on a person's life. The Abecedarian Preschool Project was a 35+ year study on early childhood intervention and ultimately calculated a 13% return on investment (ROI) on an individual's health. Treating a patient on a holistic level from a young age can prevent a multitude of health problems later in life, thus achieving the goals of VBC. Patients will need fewer healthcare visits and, consequently, providers expend fewer costs. With pediatric medicine already making up 21% of the primary care market, practices that can capitalize on the opportunities within pediatric VBC will realize large returns in alternative payment models over time.

As VBC is adopted more widely, practices should also look to assume more advanced, risk-bearing arrangements to be competitive in the marketplace. While accepting risk aligns practices and payors, it can be daunting for smaller physician groups. This is especially true for primary care and multispecialty practices. Value-based care plans prioritize the role of PCPs as the center of a managed care plan.

Large physician groups will be best positioned to take on risk with the benefits of economies of scale and leveraging power with payors.

A study done by researchers at Stanford and Princeton found that patients that switched from a small to a large physician organization reduced overall healthcare spending by 16%, primarily driven by 13% reduction in primary care visits and 21% fewer inpatient admissions per year. Large primary care groups specifically are poised to gain market share and quickly dominate the inevitable VBC market, a trend already catching the attention of private equity investors.

Provident Healthcare Partners Case Study: Family Care Partners

In May 2021, Provident Healthcare Partners advised Family Care Partners (FCP) on its partnership with InnovaCare Health, a portfolio company of Summit Partners. Family Care Partners is one of the largest primary care providers in northern Florida with 5 practice locations, over 44 providers, and approximately 140,000 patient visits annually.

InnovaCare is a leader in value-based care with a top 10 ranking for Medicare Advantage. With a unique focus on physician leadership and investment in data analytics, the Company is well positioned to succeed under value-based care contracts. InnovaCare currently manages over 330,000 lives with 1,800 PCPs and 30 clinics throughout four states.

Sources: Xtelligent Healthcare Media, Change Healthcare, Health Economics, IBIS World

Private Equity Investments Explained

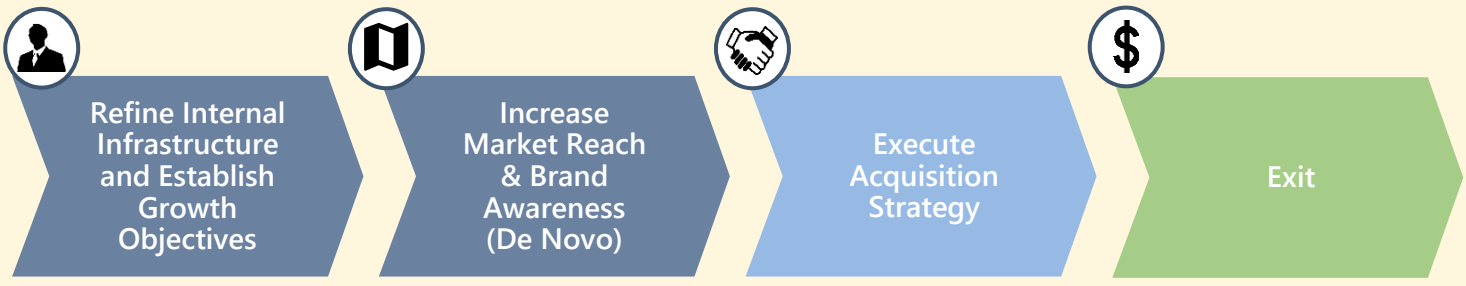
Private equity (PE) refers to investors and funds of capital that seek to make direct equity investments in privately-owned businesses. General Partners (GP) invest the fund's capital in businesses that align with their investment theses, seeking to exit their investments typically within three to seven years for substantial returns. Upon investment, or a recapitalization, a private equity firm will acquire a stake in a private business, providing the shareholders with significant liquidity in the form of cash proceeds as well as retained equity in the newly recapitalized company. Post-transaction, private equity firms provide access to capital and expertise as they seek to improve their investments both financially and operationally by building out the infrastructure to provide a foundation for growth.

The type of growth initiative varies from model to model. In most cases private equity firms will infuse their portfolio companies with capital to increase geographic density organically through de novo initiatives and inorganically by executing add-on acquisitions to enter new geographies and increase market share. By expanding through acquisition, these investors create platforms used to integrate practices under one common management company.

In past decades, private equity investors sought to buy out practices entirely, accumulating all the profits created by providers. All physicians were paid a salary based on their production levels, which created a fair amount of unrest with their provider base. As the market evolved, general partners realized they needed to keep providers incentivized.

Today, when a practice partners with a private equity group, physician shareholders will be expected to rollover part of their ownership into the new company. This provides individuals with a large up-front payment, taxed at lower capital gains rates, along with equity ownership in the new company. This new business model allows each provider to share in the profitability of the practice as they expand through acquisition and de novo initiatives. After a three to seven year holding period, it is anticipated that the practice has grown, prompting the general partners to likely sell the platform to a larger private equity group. During this second transaction, physicians have the ability to roll additional equity into the newly formed company, providing shareholders with a second liquidity event, or lump-sum cash consideration.

The Four Stages of the Private Equity Investment



Concluding Thoughts

Provident expects consolidation within primary care to remain active. Due to favorable macroeconomic tailwinds such as a rise in the aging United States population and increased accessibility to health insurance paired with the industry's expansion of Medicare Advantage driving an adoption of VBC.

Recent SPAC transactions, targeting value-based care models as well as expansionary measures taken by primary payors highlight this trend in primary care.

Value-based care aims to decrease costs, improve customer experiences, and create a more efficient healthcare system. The increase in insured patients associated with the Affordable Care Act has burdened more people with paying significant premiums and deductibles. With a focus on optimizing health care visits, patients are seeking delivery models which achieve the goal of more attentive care at a less expensive price. Medicare Part C, otherwise known as Medicare Advantage, provides a vehicle for patients to participate in value-based care. Traditional payors, such as Humana, have introduced value-based primary care models, highlighting the shift of the large healthcare payors and the whole market.

In addition to large payors expanding Medicare Advantage programs, investments into value-based primary care companies have accelerated over the past few years. Clover Health and Cano Health are two companies that have recently gone public using a SPAC with each company valued at nearly $4 billion. Both deals occurred during the pandemic, stressing that investments and acquisition activity into value-based platforms will continue.

Florida's demographics represent the future demographics of the United States. The Florida-based Medicare Advantage story provides an example for other states to robustly implement and incentivize value-based primary care. The strategy is being applied to 19 states with material MA enrollment, including California and Texas. Provident believes that the value-based models are the clear path forward in healthcare and expects investment in the space to grow beginning first with primary care.

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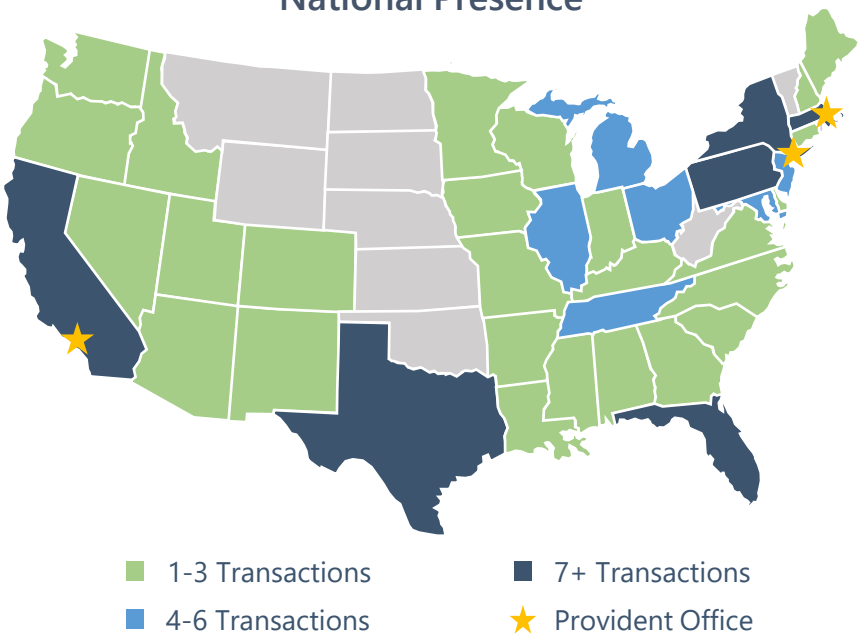
About Provident Healthcare Partners

Provident Healthcare Partner's investment banking team works with privately owned healthcare companies to provide advisory services related to mergers and acquisitions. Prior to formal engagement, Provident works with companies to provide the upfront education to shareholders necessary to understand the economics, structure, and motivation of a transaction. Following the education process, if formally engaged, Provident leverages their extensive knowledge of the buyer universe to find the most compatible partner and drive valuations for a company's previously illiquid stock. Driving the entire transaction process, Provident facilitates and assists with deal structuring, negotiations, exit planning/processing, counseling amongst shareholders, and due diligence.

National Presence



21+	Years of Healthcare Investment Banking
150+	Healthcare Deals Closed
12-15	Landmark Deals Per Year
27	Banking Professionals

Note: The above map represents states where Provident clients were headquartered. Provident has successfully closed transactions with clients operating in 45 states and Puerto Rico.

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Provident is the leading investment banking firm specializing in merger and acquisition advisory, strategic planning, and capital formation for middle-market and emerging growth healthcare companies.

The firm has a vast network of senior industry relationships, a thorough knowledge of market sectors and specialties, and unsurpassed experience and insight into the investment banking process.

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