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Weaver Insights: Health Care Valuation

2022 Year in Review

February
2023

Introduction

This collection of articles offers a chance to read and reflect on Weaver's health care valuation insights from 2022. As professionals who work with health care stakeholders across the industry, we look forward to navigating the future with you.

By the end of December 2022, health care services transaction volume had declined significantly, as buyers and sellers could not coalesce around the effects of increased labor costs and scarce availability on the future businesses of the seller. In 2023 and beyond, we expect health systems and private equity-backed platforms to continue consolidating to achieve more scale, and to re-invest in digital technology and alternate sites of care. However, due to increased cost and reduced availability of capital, we expect that buyers will be more selective and transactions will reflect a flight to quality.

In the short run, health care segments negatively affected by staff inflation and availability will struggle. In the long run, however, demographic and technological trends will have a positive impact. Natural demand driven by aging demographics, growth in underserved segments such as mental health, and a favorable regulatory and reimbursement environment should all contribute to long-term positive outcomes.

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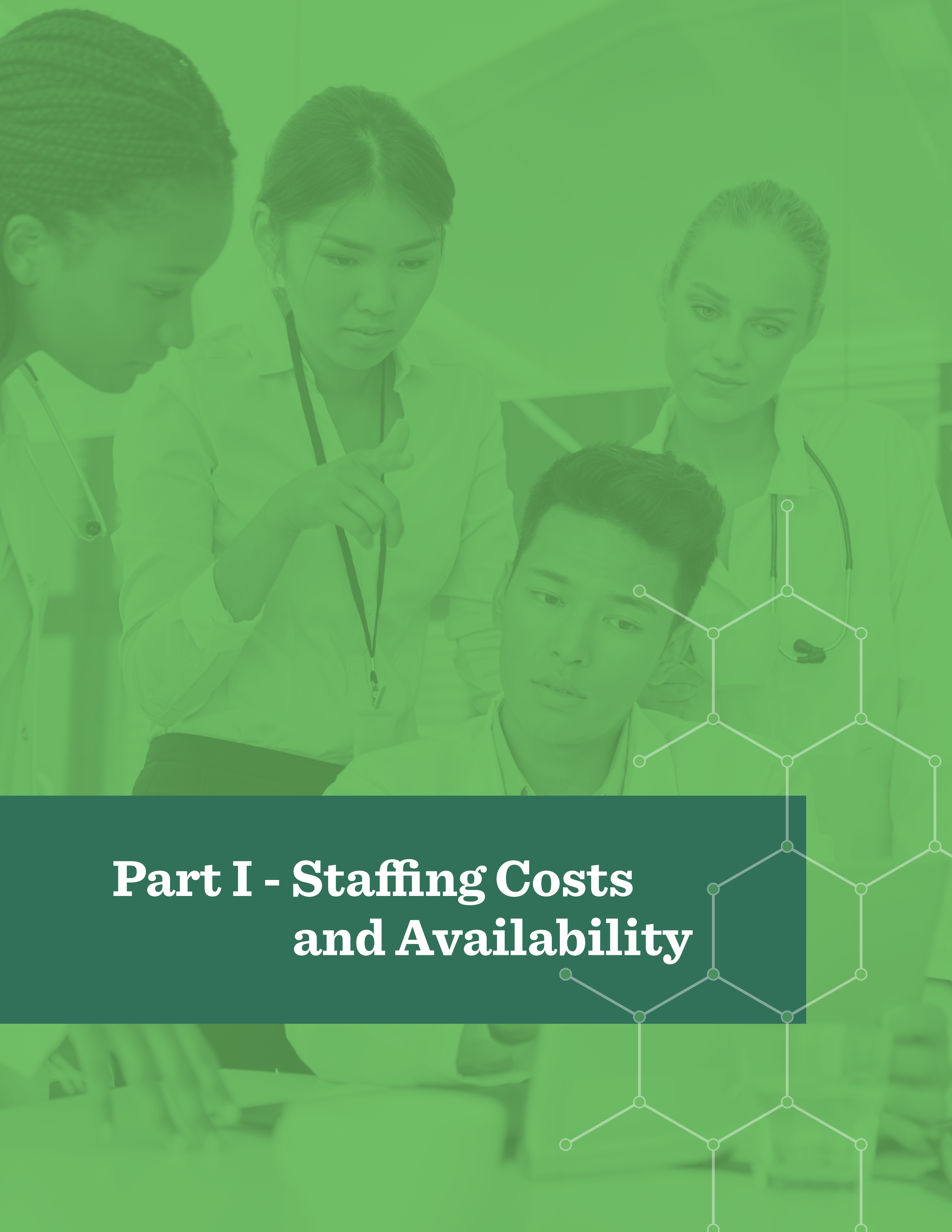


Part I - Staffing Costs and Availability

Health Care Services Transaction Volume Declines Below Pre-Pandemic Levels

January 18, 2023

Periods of Market Transition May Create Price Dislocation and Fair Market Value Considerations

Health care services transaction volume decreased significantly in 2022, decelerating from a blistering pace in 2021. The transaction data, published by Scope Research., may illustrate growing market dislocation between buyer and seller **"willingness and ability"** to transact. The most recent data in Q4 2022 show transaction volume settling slightly below pre-pandemic baseline levels.

By the Numbers

Healthcare Services Transaction Volume

Q1 2019 - Q4 2022

The chart above, developed based on data from Scope Research shows:

- Using Q1 2019 as the baseline (0%), health care services transaction volume experienced normal and moderate volatility until the beginning of the pandemic, or Q2 2020.
- Transaction volume plummeted during the pandemic in Q2 2020, down nearly 40% from the baseline.
- By Q4 2020, transaction volume surged, ranging between 40% and 60% above the baseline, partially a function of delayed, rather than canceled, transactions originally scheduled for Q2 2020.
- Q4 2021 transaction volume accelerated to close to 80% above baseline, a blistering pace of deals hovering well above normal and sustainable levels.
- Transaction volume though Q3 2022 declined each quarter towards the pre-pandemic baseline, and fell below pre-pandemic baseline in Q4 2022. The data is clearly illustrating characteristics of mean reversion.

Why it Matters

- Steep transaction volume declines may signify market price dislocation as the willingness and ability of the buyer and seller to complete the transaction diverge, resulting in many delayed or canceled transactions.

- Sellers may be less able to demonstrate earnings growth and durability given recent financial performance challenges (i.e. inflation, staffing, etc.), and less willing to accept a lower price (despite recent headwinds) because they are still anchored to yesterday's price.

- Buyers may be less willing to take risk at historical pricing levels depending on their view of the future and less able to finance high prices with more expensive and scarce debt capital, given interest rate increases.

Health Care Valuation Takeaways

- High quality companies with sustainable competitive advantages will continue to be attractive to well capitalized buyers. In a selective environment, it is important for the valuator to understand seller earnings durability and sustainability when assessing appropriate company risk factors. Current market deal activity will skew transaction volume towards resilient and high quality assets, reflecting a "flight to quality". The valuator must thoroughly assess qualitative risk factors of the seller and not place an over reliance on recent performance metrics.

- Periods of market dislocation can be challenging for the valuation professional. The valuator should be cautious about using recent transaction volume trends as a comparable transaction guide. They should make adjustments (when appropriate) to account for the higher cost and availability of capital in addition to the impact of cost inflation on seller earnings potential. Booms and busts occur in every industry, and health care services is no exception. The valuator should use caution relying on valuation assumptions including "boom time" data. Taking a long-term sober view of the transaction environment will yield a higher quality valuation conclusion.

- It is unclear whether 2023 transaction volumes will stabilize around baseline levels or continue to decline.

- Professionals involved in health care transaction advisory services will experience lower revenue as transaction volume reverts to historical means. They are likely to experience more competition from new participants who took on the transaction advisory role to exploit elevated market transaction volume.

Dig Deeper | Healthcare Valuation Multiples - Scope Research

Hospital Expense Statistics Illustrate Significant Labor Pressures

September 22, 2022

What This Means for Fair Market Value Considerations Moving Forward

In most communities, hospital systems are still dealing with the effects of the pandemic on hospital staff and communities as a whole. According to Kaufman Hall's August 2022 Flash Report (which reflects July data), hospital operating margins remain significantly lower than pre-pandemic levels due to historically high expenses even as recent monthly trends show some slight moderation.

Inflation and labor shortages are contributing to a dramatic increase in total costs. Meanwhile, statistics indicate that hospital management is pulling every lever to control expenses. For example, total expense per adjusted discharge dropped 3.6% in July compared to May, and labor expense per adjusted discharge dropped 6.7% in July compared to May.

Per industry discussions, there has been an intense focus on reducing contract labor and hiring full-time and PRN staff. Hiring new staff often involves greater costs in the short-term with sign-on and referral bonuses becoming the new norm, in addition to overlap pay to contract labor while new staff is trained. The Kaufman Hall data indicates health care providers are finally beginning to see the results of their conversion away from contract labor.

These statistics illustrate hospital management's ability to effect change and quickly implement cost reduction measures. They also show the difficulty in finding and retaining staff as labor expense growth remains sticky and is the leading negative variance to budget.

By the Numbers

National Expense Results

Expenses % Change	Budget Variance	Month-Over-Month	Year-Over-Year	Year-Over-Year 2020
Total Expense	3.6%	-1.3%	7.5%	16.1%
Total Labor Expense	4.8%	-2.4%	12.1%	21.4%
Total Non-Labor Expense	2.7%	0.8%	3.0%	12.7%
Supply Expense	4.7%	4.6%	3.3%	18.2%
Drugs Expense	-3.9%	6.6%	1.0%	19.4%
Purchased Service Expense	5.6%	0.4%	6.4%	18.8%
Total Expense per Adjusted Discharge	2.6%	-3.6%	6.1%	5.2%
Labor Expense per Adjusted Discharge	3.4%	-6.7%	9.1%	7.4%
FTEs per AOB	-6.5%	-4.8%	-0.9%	-9.7%
Non-Labor Expense per Adjusted Discharge	-1.2%	-1.6%	3.2%	1.8%
Supply Expense per Adjusted Discharge	1.2%	0.3%	1.6%	5.7%
Drug Expense per Adjusted Discharge	-9.2%	4.1%	-4.1%	4.9%
Purchased Service Expense per Adjusted Discharge	0.5%	-3.8%	-1.0%	8.4%

Unless noted, figures are actuals and medians are expressed as percentage change. **Source: Kaufman Hall, Inc.**

Key statistical takeaways from the Kaufmann Hall Flash Report include the following:

- Total labor expenses were up 12.1% year-over-year and 4.8% above budget, while total expenses were up 7.5% year-over-year and 3.6% over budget.
- Conversely, non-labor expenses were up a modest 3.0% year-over-year and 3.2% per adjusted discharge.
- Total expenses per adjusted discharge, a measure of volume adjusted expense management, is up 6.1% year-over-year, significantly below the total labor expense per adjusted discharge increase of 9.1% year-over-year.

Why it Matters

- Total labor expenses are significantly elevated year-over-year and against budget, but other expense categories have grown more modestly. Examples of categories with modest growth include drug and administration costs. Elevated expenses will yield lower operating margins, which will affect hospital systems' long-term reinvestment into their facilities and communities and make hospital systems more susceptible to future financial stresses.
- Hospital operating margins are deteriorating and have yet to stabilize. Even after abnormally high contract labor expenses subside, labor-pricing levels could permanently adjust to elevated levels, affecting costs and operating margins in the long-term.
- There are levers that hospital management can pull to adjust to the current cost escalation labor trends. However, hospitals face the difficult task of keeping existing employees and filling essential roles while lowering costs. In many markets, there are few candidates to replace departing workers.
- Commercial payor rates for 2023 and beyond may at least reflect some inflationary costs and provide some much-needed relief to stabilize operating margins.

Health Care Valuation Takeaways

- The valuator should use caution when estimating future hospital operating margins. While labor is the largest and most important expense category, there are mitigating factors that can assist in operating margin stability. For example, commercial payor price increases, while delayed to 2023, may assist in operating margin stability.
- There is balance between finding staff savings and maintaining revenue. Lack of essential staff levels will affect the hospital's ability to accept new patients, accommodate physician surgical schedules and sustain quality. The valuator should determine whether management has been able to maintain revenue generation while cutting costs.
- Even if macro-inflation growth cools, elevated expenses may have reached new permanent shelf levels. More history is needed to determine the long-term persistence and impact of inflation. Some hospitals systems will be more successful than others at stabilizing operating margins.

Dig Deeper | National Hospital Flash Report - Kaufman Hall

Increased Contract Labor Costs May Lead to Valuation Revisions

May 17, 2022

Assessing the Durability and Longevity of Contract Labor Cost Increases

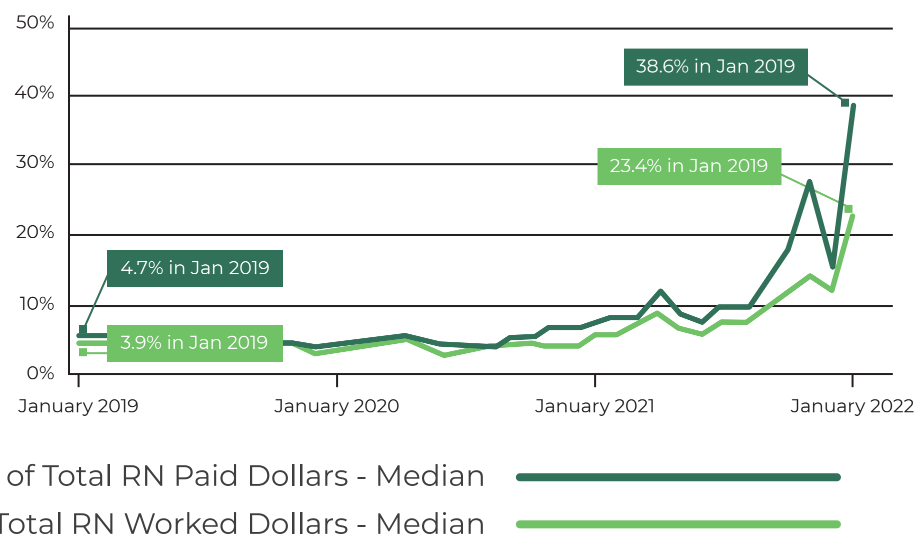
The pandemic has placed enormous strain on the nation's health care workforce. Labor costs account for more than half of the typical hospital's total expenses. Even a slight increase in labor costs can have a significant impact on a hospital's total expenses and EBITDA margins.

The combination of employee burnout, fewer available staff, and increased patient acuity has forced hospitals to turn to contract staffing firms to help address staffing shortages. Health care providers have long worked with contract staffing firms to bridge temporary gaps in staffing. The pandemic-driven-staffing-shortage has created an expanded reliance on contract staff, especially contract or travel registered nurses. According to a survey by AMN Healthcare, one of the nation's largest health care staffing agencies, 95% of health care facilities reported hiring nursing staff from contract labor firms during the pandemic.

By the Numbers

Figure #3

Contract RN as a % of Total RN Worked Hours and Paid Dollars



Analysis conducted by Syntellis Performance Solutions. Source: American Hospital Association

- Hours worked by contract or travel nurses as a percentage of total hours worked by nurses in hospitals has grown from 3.9% in January 2019 to 23.4% in January 2022.
- Illustrating the significant increase in contract labor RN rates, paid dollars increased at a much higher rate, from 4.7% in January 2019 to 38.6% in January 2022. The rise of the hourly rate has had a greater impact on cost than the amount of hours incurred.

Why It Matters

Health care providers may have difficulty returning to the contract labor percentages prior to the pandemic in the short time frame initially anticipated. The degree and speed of normalization of contract to permanent percentages will determine the rate and change of the structure of these businesses. Salary wages and benefits are likely to remain elevated for a long period.

- Public company hospital operators expect further improvement for the remainder of the year as they align the workforce appropriately by reducing the utilization of contract labor and the associated hourly rates. Numerous initiatives are underway around retention, recruitment, capacity management, new care models, and lower turnover.
- Hospitals are also adjusting base wages to be responsive to the market. Base wage adjustments will lower turnover and contract labor, but at a cost.
- Over time, hospitals hope to utilize payer contracts negotiations to get some relief from the wage inflation pressures.
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Dig Deeper | Costs of Caring

Health Care Valuation Takeaways

- Valuation during this post-pandemic time is very uncertain. The valuator needs to determine whether the contract labor is transitory or if the related base wage reflects more permanent wage inflation. Will the contract labor market revert to previous levels?
- Initiatives are under way to invest in recruiting and retention strategies and case management. Providers are hiring lower cost personnel to focus on non-surgical or non-clinical duties. Will these structural changes be effective?
- If the valuator believes that at least part of the contract labor increase will be enduring, then recent and future valuation multiples need to be reevaluated to account for lower structural profit margins for the industry.

The Future of US Health Care Profits

August 18, 2022

Key Assumptions and Valuation Impact for Providers

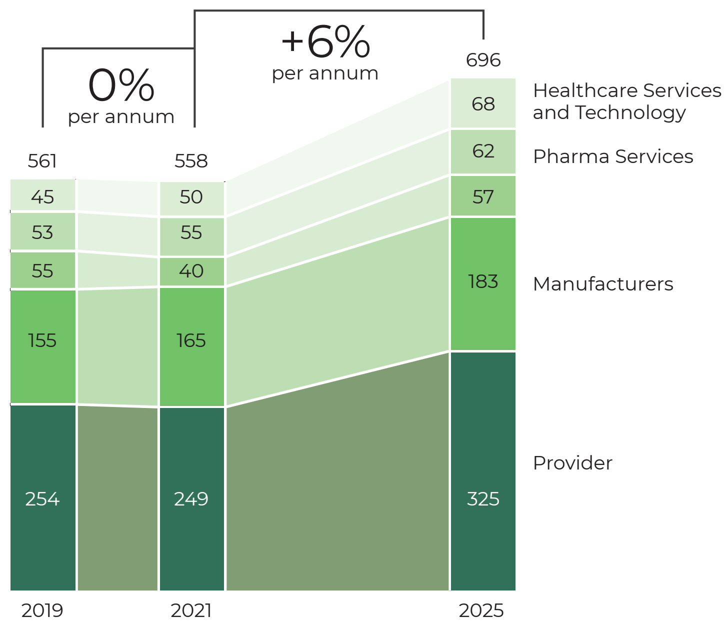
In The future of US healthcare: What's next for the industry post-COVID-19, published by McKinsey & Company on July 19, 2022, the authors analyze and predict the financial performance for five large segments within the health care industry over the next four years. Providers represented the largest category, with reported EBITDA of $249 billion in 2021.

Interestingly, the article highlighted significant improvement in expectations for provider financial performance. In particular, it forecasts provider EBITDA to grow at an approximate 7.0% compounded annual growth rate over the next four years, from $249 billion in 2021 to $325 billion in 2025. It also predicted consistent shifts in payers and sites of care.

Key Assumptions

Healthcare Profit Pools are Expected to Show a Strong Recovery Post-COVID-19, with Payer and Services Segments Growing Fastest.

Projected Healthcare EBITDA[1] Across segments, 2019-25, $ Billion



[1]Earnings before interest, taxes, depreciation, and amortization.
Source: McKinsey Profit Pools Model

Expectations of elevated provider profit pools after the post-2021 recovery are driven by several factors and key assumptions, including:

- Overall patient volumes are expected to increase, spurred by the aging U.S. population. The number of people over 65 is expected to grow three percent annually from 2021 to 2025 compared with about .5% for the U.S. population as a whole.
- Payer categories will shift. Many aging workers will move from commercial plans to Medicare, resulting in lower overall reimbursement; however, this shift will be balanced (in part) by the movement from Medicaid into commercial payers as the economy improves.
- There will be a shift to non-acute sites that have lower costs and two to three times higher profit margins compared to the acute setting. This is expected to drive the industry towards higher overall provider profits on a lower revenue base.
- The accelerated adoption of value-based care will deliver lower costs, better outcomes, and higher profits (margins of more than 15 percent) in primary care and specialty business models.

Yes, But...

Changes to key assumptions in the article could paint a different view.

- The authors did not address the potential for continued significant cost inflation; however, they did acknowledge persistent inflation could dent the outlook. Since the pandemic, personnel and supply cost inflation has continued to have a negative effect on provider profits across the spectrum.
- Changes to payer mix (however slight) have a large impact on profits and are difficult to predict on a yearly basis. If the assumed shift of patients from commercial payers into Medicare is underestimated and / or the assumed shift from Medicaid payers into commercial is overestimated, provider profits would have more severe negative pressures than anticipated.
- While EBITDA margins are higher in the non-acute setting, the absolute dollar amount of revenue and EBITDA are lower, with all else being equal. The article implicitly assumes that strong utilization growth in the non-acute setting will overcome the absolute EBITDA loss in the acute setting. Countervailing forces to increased utilization include continued technological disruption and value-based activities.
- Value-based care has yet to materially affect industry provider profits in a meaningful way. While exceptions apply, providers have not traditionally been successful managing value-based care initiatives over the long run.

Health Care Valuation Takeaways

- Many of the variables outlined in the article (payer mix changes, site-of-care changes, population growth) will continue to be relevant factors that influence the direction of provider EBITDA.
- The estimates contained in the article represent a positive macroeconomic outlook for providers in the aggregate; however, some providers are anticipated to benefit more than others.
- The valuator should closely follow changes to key variables in the macro and microenvironment in order to develop an informed forecast of future profits, thereby leading to a more supportable fair market value opinion.

Dig Deeper | Future of US healthcare post-COVID-19 - McKinsey

Part II - Innovation And Demographic Trends

Hospital Earnings Supported by Fewer Uninsured Patients

October 27, 2022

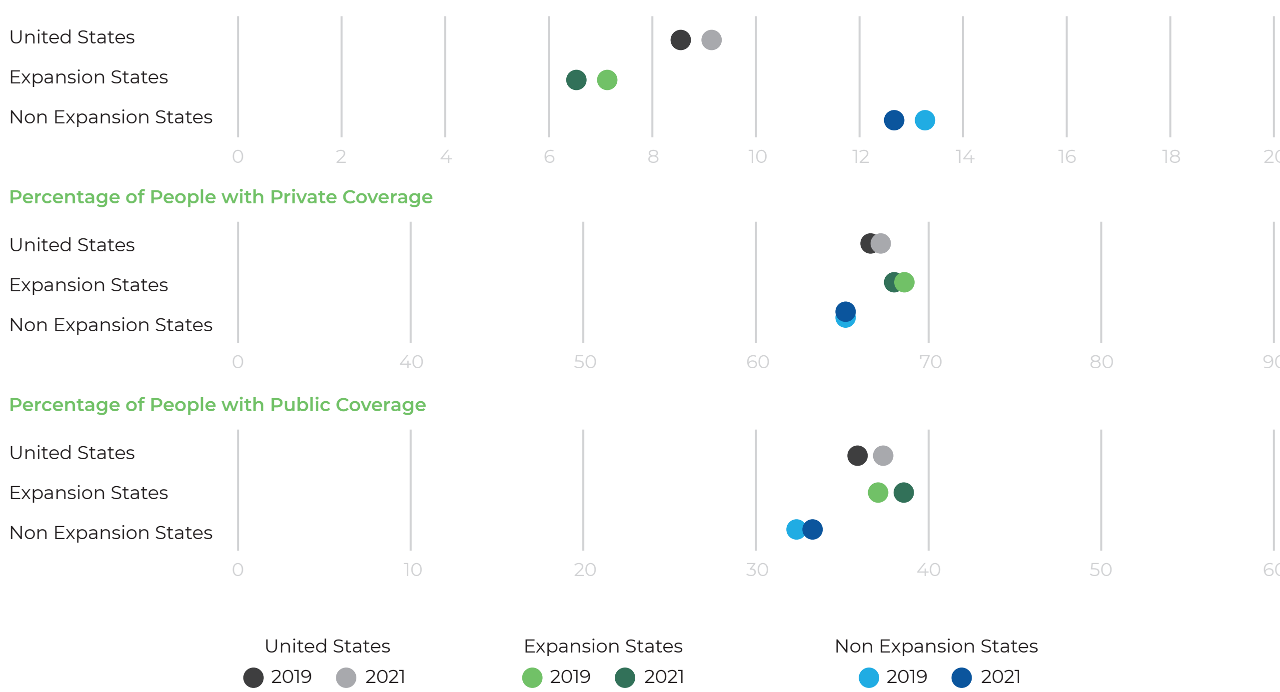
The Persistence of Recent Payer Mix Shifts Have Resulting Valuation Implications

According to the latest U.S. Census data, the percentage of the U.S. population without health insurance is at record lows. During the past two years, Congress passed emergency measures to improve access to public and private coverage during the COVID-19 health emergency. These policies improved access to and affordability of health care and significantly decreased the uninsured population. All other factors being equal, an increase in the insured population lifts earnings for providers that have historically served uninsured segments of the population.

Acute care hospitals treat patients regardless of their insurance status, and they have benefited from a certain percentage of these uninsured patients obtaining some form of insurance. Alternatively, providers that focus exclusively on privately insured patients may be negatively affected by some of their commercial patients transferring to a lower-paying insurance product. Nevertheless, recent gains could be reversed in the near future as government programs and conomic trends wane.

By the Numbers

Percentage of People Without Health Insurance Coverage by State and State Medicaid Expansion Status: 2019 and 2021



Source: U.S. Census Bureau

Key statistical takeaways from the Kaufmann Hall Flash Report include the following:

- Overall patient volumes are expected to increase, spurred by the aging U.S. population. The number of people over 65 is expected to grow three percent annually from 2021 to 2025 compared with about .5% for the U.S. population as a whole.
- Payer categories will shift. Many aging workers will move from commercial plans to Medicare, resulting in lower overall reimbursement; however, this shift will be balanced (in part) by the movement from Medicaid into commercial payers as the economy improves.
- There will be a shift to non-acute sites that have lower costs and two to three times higher profit margins compared to the acute setting. This is expected to drive the industry towards higher overall provider profits on a lower revenue base.
- The accelerated adoption of value-based care will deliver lower costs, better outcomes, and higher profits (margins of more than 15 percent) in primary care and specialty business models.

The Big Picture

- The Families First Coronavirus Response Act provided 17 million eligible adults and children with insurance coverage. Continuous enrollment will end as soon as the public health emergency ends, resulting in an estimated 5.3 million to 14 million losing insurance coverage.
- The American Rescue Plan Act of 2021 expanded access to the Affordable Care Act's insurance marketplace by enhancing tax credits, essentially eliminating the subsidy cliff. This resulted in a 21% increase in ACA marketplace enrollment from 2021.
- The Inflation Reduction Act added funding to extend these tax credits but will expire in three years.
- "Our health insurance exchange growth grew 20% to 25% in a given period. I do think that was primarily attributable to the increase in enrollment that I think is attributable to enhanced subsidies." William Rutherford, CFO, HCA Healthcare, Inc., Earnings Conference Call, Second Quarter 2022
- "Our managed care book for the quarter was up about 2.6% compared to overall admissions. That was partly driven, if not mostly driven, by the health insurance exchange volume. We continue to see that. We've talked about good enrollment going into that." William Rutherford, CFO, HCA Healthcare, Inc., Earnings Conference Call, Fourth Quarter 2021

What They're Saying

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William Rutherford, CFO, HCA Healthcare, Inc. Earnings Conference Call, Fourth Quarter 2021

Health Care Valuation Takeaways

- The valuator should understand how uninsured rates could change depending on economic and political environments. These dynamics should be reflected in the subject company's financial projections and valuation risk factors.
- While certain providers have benefited from the positive payer mix shift toward public plans, there are numerous other factors that should also be understood when projecting revenue. These include reimbursement rate increases and federal or state subsidy levels.
- Businesses that focus solely on insured patients (such as Ambulatory Surgery Centers and Outpatient Imaging Centers) may experience minimal effects from a decrease in the uninsured population; however, they are exposed to insurance mix shifts from high reimbursement commercial plans into lower paying public plans.

Dig Deeper | Uninsured Rate Declined in 28 States 2019-2021

Behavioral Telehealth Growth May Mean Opportunities for Inpatient Operators

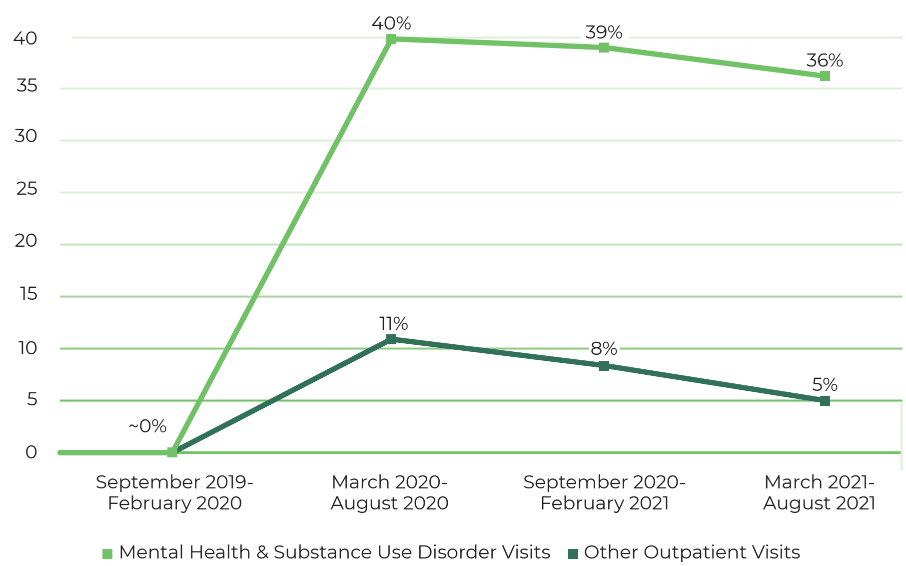
July 26, 2022

Beginning in February 2020, telehealth use increased exponentially in all outpatient categories as patients and providers were brought together by necessity during the pandemic. As the pandemic has receded, traditional medicine has largely returned to in–person delivery; however, telehealth continues to play a significant role in treating patients with mental illness.

It is not clear whether or how much downstream inpatient behavioral health providers will benefit from telehealth and digital outreach. The increased utilization since the pandemic began sheds light on a severely underserved sector that presents significant opportunities across the board.

By the Numbers

Share of Outpatient Visits Delivered by Telehealth, 2019-2021



Source: KFF Research

Based on the information above, we make the following observations:

- Utilization of telehealth was relatively low prior to 2020, accounting for less than 1% of outpatient visits.
- Telehealth for mental health and substance abuse diagnosis rose significantly during the pandemic. As a percentage of total outpatient mental health visits, the increase in behavioral health and substance abuse telehealth was greater than for other types of outpatient visits.
- After the initial boom, behavioral health and substance abuse telehealth usage decreased slightly, while the percentage of other general outpatient usage of telehealth decreased significantly (over 50%).

Importantly, it is currently unclear how Medicaid and commercial payers will structure reimbursement for behavioral telehealth services in the future. As in other healthcare segments, changes to reimbursement structure could have an impact (positive or negative) on utilization.

Health Care Valuation Takeaways

- Telehealth has evolved as an important entry point and access platform for existing and new patients, many of whom did not historically seek care. This growth will directly or indirectly benefit all mental health providers in the industry.
- Inpatient behavioral health providers will need to be an integral part of the digital behavioral health ecosystem in order to (i) gain access to potential new patients (many of whom may become recurring visitors) and (ii) effectively support their various integrated outpatient programs post patient discharge. These efforts can include implementing digital telehealth programs or partnering with innovative providers.
- To support the valuation of an inpatient behavioral provider, the valuator should evaluate the impact of investment (or partnership) in telehealth infrastructure along with other outpatient programs.

What They're Saying

Management for Acadia, Inc., the largest pure play operator of inpatient behavioral health with 49 acute care facilities, addressed digital telehealth access growth in recent company conference calls:

"And while I don't think it will ultimately be a replacement for inpatient care, I think there will be opportunity for us to continue to look at innovation. Any opportunity to leverage technology for the benefit of improving our health outcomes is something we will look at."

Christopher Hunter, CEO Acadia, Inc. – Q1 2022 earnings call

"Recent studies have indicated nearly half of adults report negative mental health impacts. They need to be able to access someone who can help them. And so we are part of the digital access efforts, but I also think it is happening across the industry."

Q2 2021 earnings call

Dig Deeper | Telehealth Has Played an Outsized Role Meeting Mental Health Needs During the COVID-19 Pandemic - KFF

Surgery Outmigration Driving Elevated Valuation Multiples in the ASC Segment

April 26, 2022

Surgery Outmigration Driving Elevated Valuation Multiples in the ASC Segment

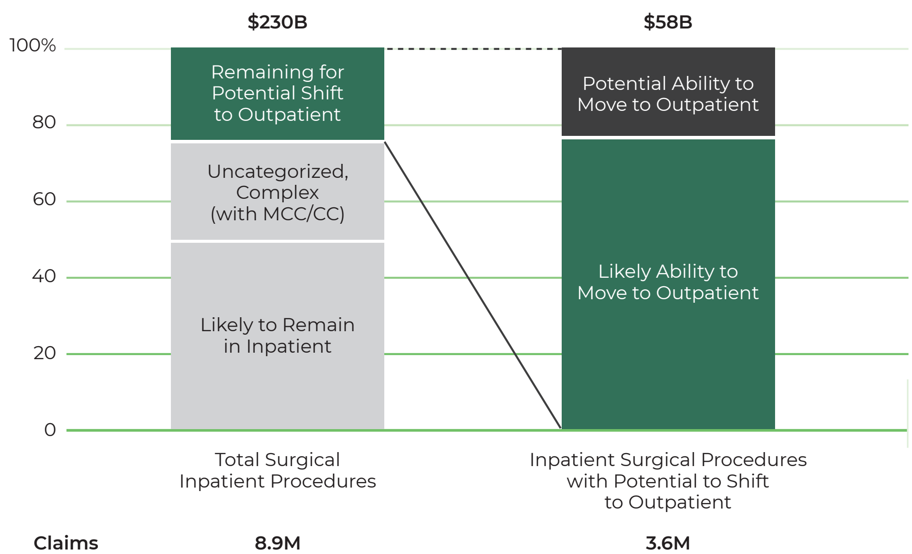
In 2021, the bellwether transaction in the ambulatory surgery centers (ASC) segment was the purchase by United Surgical Partners International (USPI) of nearly all of the SurgCenter Development (SCD) ambulatory surgery centers, adding 86 mature and de novo centers primarily focused on musculoskeletal surgical cases. Tenet Healthcare management estimates the purchase will add $275 million in fully ramped adjusted EBITDA by years three and four.

According to Scope Research, the SCD transaction was priced at 10.8x of year one EBITDA less non-controlling interest. USPI's willingness to apply this multiple to future EBITDA reflects confidence in their ability to execute on growth initiatives given their differential management capability and negotiating strength with payers. More importantly, the valuation multiple implicitly expresses their confidence in the industry's outlook regarding the outmigration of surgical cases.

By the Numbers

Payments for Surgical Inpatient Procedures (2018)

As illustrated in the chart, estimate of future outpatient surgery migration suggest that ASC industry revenue and profits could significantly increase in the future.



Source: Surgery Partners Inc. Investor Presentation – January 2022

- As of 2018, Surgery Partners Inc. (SGRY) estimated that $58 billion (or 25%) of the $230 billion payments for surgical inpatient procedures have the potential or likely ability to shift to the outpatient setting. These payments are associated with 3.6 million (or 40%) of 2018 inpatient procedures.
- Of the $58 billion inpatient payments that could potentially migrate to the outpatient setting, SGRY estimates 75% as likely to move and 25% as having potential to move in the near future.

Yes, But...

With the significant potential for future surgical migration to the outpatient setting, the high valuation multiples observed in bellwether transactions may be justified. However, not all independent ASCs will benefit from these headwinds to the degree of the larger operators.

- Available and independent surgeons required to take advantage of the outmigration trends are scarce. Their training and skillsets will be in high demand for all existing and future ASC partnerships. Securing and collaborating with the right specialties in the right locations to take advantage of the outmigration trends may be operationally challenging for ASC operators.
- Staunch competition will exist for these cases from health systems. Because outmigration is inevitable, health systems will continue to move quickly to employ or affiliate with physicians and staff with the unique training and skillset to perform these cases. These cases will then be directed to ASCs where health systems have an ownership stake.
- Due to the finite nature of surgeries in general, large ASC operators may face cannibalization (and political) issues of growing within market at the expense of other alignments.

Health Care Valuation Takeaways

- The outmigration trend is an extraordinary future growth opportunity for the ASC industry. This trend will lead to higher volume, revenue, and profits for the industry and helps justify elevated transaction multiples in the space.
- Individual ASCs may not have the ability or the specialized knowledge and training to take advantage of these opportunities. Their valuations will likely be based on historical status quo performance, with resulting EBITDA multiple implications.
- Regardless of the favorable outmigration trends, significant headwinds continue to exist in the industry related to ASC partnership succession, given the lower availability of independent physicians.

Dig Deeper | ASC Partnerships Face Succession Challenges

Part III - Enduring Topics In Health Care Valuation

Revenue Growth and EBITDA Multiple Expansion Drove Historical Health Care Investment Returns

June 7, 2022

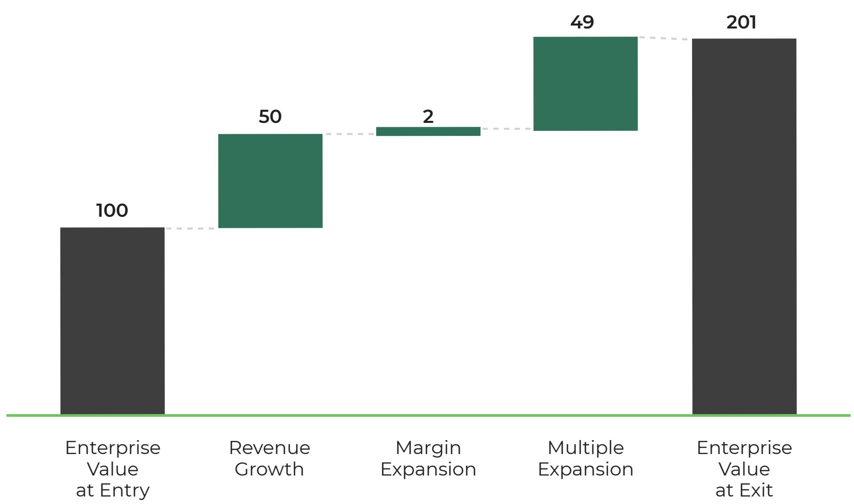
Will Future Return Components Mirror the Last Decade?

During 2021, private equity funds and strategic buyers deployed a record amount of capital into health care businesses. Investors' perception of stable profit margins and a recession-resistant profile encouraged new participants to enter the space, pushing up valuations and intensifying competition.

To understand investor interest and strategy, it is important to understand the underlying drivers of return generation. Over the last decade, transactions of health care private equity portfolio companies have occurred in a very strong market with expectations of revenue growth and EBITDA multiple expansion, which, somewhat circularly, is encouraged by past performance and achievements.

By the Numbers

Healthcare Median Value creation, Entry years 2010-21 (Indexed)



Multiple on EV at Entry	0.50	0.02	0.49	
Percentage of Value Created	49%	2%	49%	

Source: Bain Capital, DealEdge

As illustrated in the chart by Bain Capital, revenue growth and EBITDA multiple expansion have contributed equally to expansion of enterprise value at exit over the last decade (2010-2021) as relates to health care enterprises. According to Bain Capital, the resulting median compound annual revenue growth rate for health care was 11.1% compared to 7.6% for all other industries. Changes to EBITDA margins was neither a positive nor negative contributor to value creation over this period, as this metric largely held stable.

Why it Matters

In the next ten years, factors affecting investor returns in health care may be different compared to the prior decade. Going forward, investor expectations will be influenced, in part, by the following:

- Rapidly rising labor and supply costs combined with tepid pricing growth expectations will likely negatively affect the margin expansion return component and the multiple expansion component.

- Exit EBITDA multiple growth may be harder to achieve in the future as enterprise value at entry continues to rise while profit margins contract.

Health Care Valuation Takeaways

- Health care companies are finding new streams of revenue through geographic expansion, new technologies and consolidation. There is high likelihood that revenue growth will continue due to the continued consolidation of a highly fragmented health care market.

- As deals become more competitive and entry multiples rise further, it is likely that revenue growth component will become the most important – and perhaps the only - source of investment return value.

- If we expect margin contraction due to higher and enduring labor costs, lower profit margins may become a negative return component. Contracting margins may also negatively influence the multiple expansion component, once again leaving only revenue growth as the sole component to value creation over the next decade.

- The valuator needs to determine if the transaction return components from the last decade will mirror those of the next decade and, if necessary, make appropriate adjustments to valuation assumptions.

Dig Deeper | Healthcare Private Equity Deal Returns: Look to Revenues and Multiples | Bain & Company

Expanding Supply of Urgent Care Centers Create FMV Considerations

June 28, 2022

Accelerated Facility Count Growth Illustrates Relative Low Barriers to Entry

Urgent care operators (especially those well capitalized by private equity funds) have invested a record amount of capital to open new (de novo) sites in 2022. This influx of new supply represents the industry's reaction to significant historical and anticipated patient demand. New center growth is evident in every ownership category, but private national and regional operators with 10+ sites represent the most active category over the last year and a half.

By the Numbers

Annualized	2019	2020	2021	May 2022
Openings				
Private	736	698	895	1,195
Health System	620	601	478	658
Total	1,356	1,299	1,373	1,853
Growth	n/a	-4.2%	5.7%	34.9%
% Ownership				
Private	54%	54%	65%	65%
Health System	46%	46%	35%	35%
	100%	100%	100%	100%
10+ Site Operator				
New Openings	177	602	793	905
% of All Openings	13%	46%	58%	49%

Source: Weaver Analysisof National UC Realty Data

Based on the information above, we make the following observations:

- The ability for market participants to open so many sites on an annual basis is characteristic of an industry with low barriers to entry.
- There has clearly been a surge of new openings in 2022 as investors take opportunities to capture growing demand, but to a lesser extent, other factors also may be contributing to the increase. These include centers planned for 2021 openings that experienced construction delays during the pandemic.
- Health system openings have remained steady, but they represent a declining percentage of total openings in 2021 and 2022.
- National and regional operators with 10+ sites represented 50% of new openings so far in 2022, up from 13% of new openings in 2019. Growth for this cohort is clearly a function of their access to significant available capital.
- While the data does not capture urgent care closures or relocations, we know this number has been small over the last two years due to pandemic induced patient demand growth.

Yes, But...

- Those opening new sites, especially large operators, are betting accelerated patient demand for urgent care will continue beyond the foreseeable future. If actual demand is less than expected, the growth in new urgent care sites will be (in retrospect) an over-reaction and could cause an over-supply situation.
- The acceleration of new openings may increase competition for qualified health care workers, exacerbating existing shortages and rising labor costs. Combined with continued supply inflation, new (as well as existing) sites may need to achieve higher patient volumes than previous to maintain profitability levels.

Health Care Valuation Takeaways

- New center growth is clearly a vote of confidence in the industry as a whole, as evidenced by the significant investment in capital and management resources to grow site count.
- Valuators need to address the impact of new competition due to low barriers to entry. Successful urgent care centers may be tested, especially if patient visit volume declines within the respective market.
- The valuator needs to weigh a subject urgent care center's merits along with its exposure to potential or new competition.

Dig Deeper | National UC Realty

Essentials for Selling Your Health Care Business

November 30, 2022

Whether you are an individual, operator or health system looking to divest an entire business or service line, it is never too late to start planning. Selling a health care business takes preparation to ensure a satisfactory outcome. Even when a deal seems to be moving along smoothly, unanticipated events can occur. If you are considering this move, you should be taking these steps now.

Initial Steps

- **Develop Relationships and Contacts Early**
  For many health care businesses, the likely buyer pool includes local health systems, employee providers or other local or national buyers. You may have already identified potential buyers. Two or three years before officially launching a sale process, start preliminary conversations with these parties. What you learn can be invaluable in your planning.

- **Identify Your Team**
  Finding a team of partners you trust is essential to completing a successful transaction while mitigating risk and maximizing value. You will ultimately need to involve experts in law, accounting and finance to complete your transaction. You may also want to consider an investment bank to run the sale process.

- **Define Your Ongoing Role**
  For many individual owners, the question of lifestyle after sale is difficult to address. Do you want to retire completely? If you are an owner-operator, do you want to focus on providing service long-term without the administrative hassle? If you are a health system selling or joint venturing a service-line, what relationship do you want to have with the new owner in the market? Knowing what you really want from a sale is important to best align with the right buyer and potential future partner.

- **Keep Emotions in Balance**
  For individuals, the process of selling can be emotionally challenging after having invested so much time and energy in the business. Maintain your perspective and know what you want to accomplish without letting these emotions get in the way.

Financial Steps

- **Organize Information**
  For many operators, just organizing key information takes months to complete. Financial statements, billing records, contracts, asset lists, operating protocols and licensures should be readily available, accurate and complete. Buyers will want to explore operating metrics and ensure they review final, signed versions of contracts and documents.

- **Clean Up the Financial Statements**
  Know the story. Buyers will typically value a business based on a multiple of revenue or earnings before interest, taxes, depreciation and amortization (EBITDA). While the baseline revenue and EBITDA levels are important, potential buyers will want to understand the historical financial results to best project the future outlook of the business. That's why it is important to properly record and regu larly review

the financials of the business. In addition to reviewing your financial statements regularly, start keeping a list of potential one-time and/or non-recurring activity that may not accurately reflect the normal operations of the business (e.g. personal expenses, one-time legal events, etc.).

- **Consider Ordering a Valuation**
  A professional independent valuation may be beneficial for several reasons. These are just a few of the benefits to taking this proactive step: It can (1) require you to organize information (2) help provide reasonable expectations in the event of sale (3) shed light on areas of improvement prior to sale, and (4) provide a "dress rehearsal" for real conversations with potential buyers.

- **Understand Tax Implications of the Sale**
  There are many different ways to structure a transaction, each with different payout terms and tax implications. Differences in these terms can have a sizeable impact on the amount of cash you actually receive from the sale. Knowledgeable M&A tax advisors can help you understand the timing of payments to you and the tax impact of those payments.

- **Consider Estate Planning**
  For individual owners, selling a business can lead to significant proceeds. You may need to explore estate planning issues prior to sale.

Operating Steps

- Make Necessary Business Changes. Whether you need to switch billing companies, re-negotiate contracts, optimize staffing levels, or improve your brand, preparing to sell your business is no time for procrastination.

- Stay Focused on Business Operations. Preparing for sale is NOT a reason to let operations slip. The sale process can take months and buyers will be keen to notice declining business trends. It is easy to mentally move forward to life after a sale, but maintaining strong operations will be the key to a successful transaction. Continue operating the business as if the sale were not going to happen...because it may not.

- Keep Cybersecurity Top of Mind. As you prepare for a sale, it is even more important to ensure sound security controls remain in place and operating. Health care businesses are an attractive target of various hacks, and allowing your security controls to lapse may result in a breach that could make your business less attractive to buyers.

- Lock Down Financial Processes and Controls. Tie up the valuable package that is your business. A prospective sale event can significantly disrupt standard operating procedures that keep your business running efficiently, effectively and compliant with applicable requirements. As you prepare for a sale, make sure your core processes are firmed up, formalized and documented so that critical control activities continue prior to, during and following a sale event.

Taking these steps will improve your chances for a successful transaction.
For more information, contact Weaver's Health Care Advisory Services team.