FMVantage Point™
HealthCare Appraisers' Industry Insight

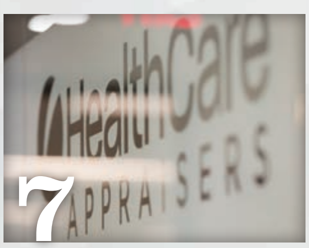
QUARTERLY INDUSTRY INSIGHTS

AT A GLANCE

HOME HEALTH FOCUS SHIFTING

SIGNIFICANT REIMBURSEMENT CHANGES COMING

POTENTIAL FOR REDUCED MEDICARE AND MEDICAID RATES

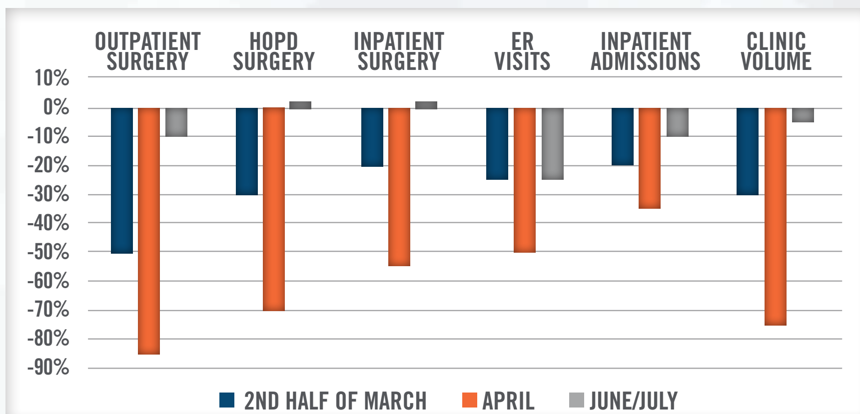


MEET THE EDITORS

Monitoring Industry Activity from Quarter 2 of 2020

As part of our ongoing monitoring of developments in the healthcare industry, HealthCare Appraisers follows reports from publicly-traded health systems, physician services providers, ambulatory surgical center management companies, and other healthcare service providers. This document summarizes important valuation-related takeaways from recent earnings calls and conference presentations, as well as supporting quotes[1] from publicly-traded operators. Similar to the first quarter earnings calls, second quarter calls were dominated by discussion surrounding COVID-19. Many operators and investment analysts focused on the near-term and longer-term impact that the pandemic is likely to have on the business models of the publicly-traded companies. **Figure 1** presents volume statistics from the various publicly-traded providers, illustrating that volumes improved substantially from the April lows as the quarter progressed. We discuss these volume trends and other second quarter takeaways in more detail below.

FIGURE 1: REBOUNDING PATIENT VOLUMES COMPARED TO EXPECTATIONS[2]



VOLUME RECOVERY, ACUITY, AND PAYOR MIX IN THE SECOND QUARTER

As illustrated in **Figure 1**, volumes improved throughout the second quarter, with April representing the nadir of patient activity, May showing improvement, and June volumes approaching, and in some cases exceeding, their pre-COVID-19 levels. In terms of specific services, publicly-traded operators indicated that higher acuity surgical procedures showed strong recovery in June and, in some cases, exceeded pre-COVID-19 levels as

[1] All quotes have been adapted from transcripts provided by S&P Capital IQ.

[2] Taken from the transcripts and earnings presentations from HCA Healthcare, Inc. Community Health Systems, Inc. Universal Health Systems, Inc., Tenet Healthcare Corporation; Mednax, Inc., Surgery Partners, Inc. and other public companies

VOLUME RECOVERY, ACUITY, AND PAYOR MIX IN THE SECOND QUARTER *(CONTINUED)*

delayed procedures were rescheduled and performed. Clinic visits and outpatient surgeries generally bounced back in June as well, with volumes down approximately 5 to 10 percent compared to pre-COVID-19 volumes. Certain medical specialties performed better than others, with cardiology, orthopedics and spine, and neurosurgery visits and cases getting rescheduled quicker, while other specialties, such as GI, lagged behind. Emergency room visits remained depressed throughout the quarter, as lower acuity patients stayed away from ERs due to their association with the pandemic. Other services, including dialysis clinics and cancer centers, were relatively unaffected by the pandemic, and telehealth visits continued to see significant growth and remained elevated after stay-at-home orders were lifted. Many operators indicated that July started off similar to June, although certain geographic markets with COVID-19 flareups saw volumes begin to decline in the second half of the month. Several companies benefited from higher net revenue per case or admission as the most acute patients were the first to reschedule once stay-at-home orders were lifted. In addition, many facilities benefited from improved payor mix as declines in Medicare patient volume were greater than declines in commercial patient volume due to the elderly opting to delay care and reduce risk of COVID-19 exposure. Longer-term, payor mix is expected to deteriorate due to higher levels of unemployment costing many individuals their employee sponsored health coverage.

WHAT INDUSTRY LEADERS ARE SAYING ABOUT *VOLUME RECOVERY, ACUITY, AND PAYOR MIX IN THE SECOND QUARTER*

HOWARD BERGER – CEO OF RADNET, INC

"As I mentioned in last quarter's financial results call, our procedural volumes hit a trough during mid-April, whereby our procedural volume declined to about 28% of the pre-COVID per day volumes on a nationwide basis. We began to see a steady recovery in early May, which has continued to the present day. The week before last, our procedural volumes returned to about 90% of the pre-COVID per day procedures."

DANIEL CANCELMI – CFO OF TENET HEALTHCARE CORPORATION.

"In June, we recovered to about 90% of pre-COVID levels for hospital admissions and surgeries, and our USPI team grew its surgical cases back to about 90% of pre-COVID levels."

JASON GOREVIC – CEO OF TELADOC HEALTH, INC.

"We provided approximately 2.8 million visits in the second quarter, representing growth of over 200% compared to the second quarter of 2019 and a 35% increase sequentially over the first quarter, despite the second quarter historically being a seasonally slower quarter."

ERIC EVANS – CEO OF SURGERY PARTNERS, INC.

"Our same-store cases volumes, as a percentage of prior year totals, increased from 19% to 93% from April to June."

TIM HINGTGEN – COO OF COMMUNITY HEALTH SYSTEMS, INC.

"Admissions troughed with a 31% decline in April prior to the recovery in May and June, during which higher acuity inpatient admissions and surgeries returned to our hospitals. We finished June with a 5% decline versus the prior year month. On the surgery side, we were down almost 70% in April, but we were able to drive strong sequential growth the next two months, ending June at a positive 2%. Service lines, including cardiology, orthopedics and neuro services, contributed to this recovery. Similar to the reports across the industry, ER visits have recovered at a slower pace than other volume metrics. Our hospital ER visits were down 45% in April, and improved to a negative 20% by the end of June. We continue to see our ED volumes improve into July, now down approximately 15% versus the same period last year. Our ED visit declines are primarily due to lower acuity presentation. EMS traffic, representing what is typically higher acuity patient volume, returned to more historical levels leading into the third quarter. Physician practice volume is now higher than pre-pandemic levels, beating prior year visits in our clinics by 6% in June. Our physician practices and other access points are the top of the funnel for procedural and hospital volumes, so a leading indicator of future [hospital] utilization. Based on the visits we are now seeing in our practices, we believe we should see increased demand for medically necessary care across most specialties and hospital services in future months."

STEPHEN FARBER – CFO OF MEDNAX, INC.

"As we noted in our press release, our overall volumes fell to roughly 75% to 80% of pre-COVID levels during April, but have recovered to roughly 90% to 95% of normalized levels by the end of the quarter. On a preliminary basis, this recovery has persisted during the month of July with some geographic variations."

JOHN GALLINA – CFO OF ANTHEM, INC.

"Relative to our baseline financial expectations, aggregate utilization was 40% below expectations in April and 20% in May, as people nationwide adhered to shelter-in-place orders. Our June experience, while still early, suggest that utilization recovered to roughly 90% of baseline. Looking ahead, our guidance assumes the recent recovery and utilization persist, and second half utilization comes in slightly ahead of our pre-COVID-19 baseline expectations. All in, we expect this dynamic to increase our second half medical loss ratio by a couple hundred basis points, relative to what normal seasonality would have suggested."

ERIC PALMER – CFO OF CIGNA, INC.

"By month, compared to baseline expectations, utilization was 30% to 35% lower in April, 20% to 25% lower in May, and closer to normal in June at approximately 0% to 5% lower."

BRIAN KANE – CFO OF HUMANA, INC.

"In June, while utilization continued to rebound, on average, it was approximately 10% below normal levels, excluding COVID utilization. In July, the non-COVID in-patient utilization remained flat to June, but COVID testing and treatment costs were a bit higher than the modest cost we saw through June given the recent increase of cases in certain geographic hotspots. We expect non-COVID medical utilization to begin to approach normal levels as the year progresses and potentially run slightly above normal later in the year."

JOHN REX – CFO OF UNITEDHEALTH GROUP, INC.

"At the lowest point in April, in-patient care, inclusive of COVID-19-related care, was about 75% of baseline. In June, this recovered to nearly 95%. At the same lowest point, outpatient and physician services fell to roughly 60% of normal levels. As we exited June, they were also recovering, tracking above 90%. These national trends have continued thus far in July even as certain states are seeing short-term deferral of services where there are elevated levels of infection and hospitalization."

STEVE FILTON – CFO OF UNIVERSAL HEALTH SERVICES

"In terms of patient days, as an example, I would say, in mid-June, both our acute and behavioral patient days were averaging something like 95% of pre-COVID level. I think there were some days where we were even higher than that. Same thing with elective surgical and other procedures having climbed back to those levels. For ER visits, we're still probably 25% short of pre-COVID level. But then as we saw the second wave hit in the last maybe 10 days of June and into July, most of those metrics took a step back. I would say that, for instance, elective procedures, we're now running in the July time frame, maybe 85% to 90% of pre-COVID levels. Behavioral patient days, we're running, let's say, 90% to 95% of pre-COVID level. So, a bit of a step back from where we were but not that dramatic decline that we saw in the March-April time frame."

MARK TARR – CEO OF ENCOMPASS HEALTH CORPORATION

"At the end of June, inpatient rehabilitation census had rebounded to 95% of pre-pandemic levels, and home health starts of care had rebounded to pre-pandemic levels. These positive volume trends have continued in July."

WILLIAM RUTHERFORD – CFO OF HCA HEALTHCARE, INC.

"Same-facility inpatient surgeries declined 15.7% in the quarter, with April declining about 38%. May was down 12%, and June was up 3% over the prior year. Same-facility hospital-based outpatient surgeries were down about 27% in the quarter, with April down about 65%, May down about 19%, and June was up 4% from the prior year. Our outpatient surgeries in our ambulatory surgery centers were down about 40% in the quarter, with April down 85%, May down 32%, and June was up 1% over the prior year."

SAMUEL HAZEN – CEO OF HCA HEALTHCARE, INC.

"What we saw within surgery were orthopedic, spine, and general surgery recovered quicker and stronger. We also saw a slower recovery in our GI procedures in certain diagnostic categories, which started to ramp significantly at the end of June, which gives us a belief that downstream those diagnostic patients and encounters will ultimately require some level of therapy, whether it's surgery or something else. So we have some insights into it. We believe we'll need, through the third quarter and probably through the fourth quarter, to have a better sense of what the full recapture was of the cases that were, in fact, deferred. In cardiology, components of our cardiology business recovered really well, mainly electrophysiology and the procedures in that particular category."

HOME HEALTH FOCUS SHIFTING TO HIGHER ACUITY

Many of the largest operators in the home health space are increasingly interested in providing higher acuity services in the home, and the pandemic has served as a catalyst accelerating this shift. With much of the COVID-19 impact being felt in institutions like long-term care and skilled nursing facilities, patients and physicians are seeking alternatives and providing home health operators an opportunity to gain market share in the post-acute setting. Home health providers that have typically focused on primary care and certain types of chronic care management are now offering "skilled nursing facility-at-home" services, and emergency room levels of care, to patients in the home setting. In addition to higher levels of patient interest, another factor that could contribute to this shift toward higher acuity at home services is the overall drive to reduce cost within the healthcare system, as home health services cost a fraction of what institutional care costs at long-term care or skilled nursing facilities. There are also digital health tools and telemedicine capabilities that can be utilized alongside home health to reduce costs of post-operative or post-acute care.[3]

WHAT INDUSTRY LEADERS ARE SAYING ABOUT *HOME HEALTH FOCUS SHIFTING TO HIGHER ACUITY*

PAUL KUSSEROW – CEO OF AMEDISYS, INC.

"Our admissions would also suggest that we are starting to realize the trend of patients wanting to avoid admission into skilled nursing facilities and other facility-based settings. And as we continue to innovate as an aging-in-place company, we believe there is a compelling post-acute market share capture proposition from offering a SNF-at-home product and finding other ways to capture patients that historically would have received care in facilities."

BRUCE BROUSSARD – CEO OF HUMANA, INC.

"We believe consumer demand for high-quality home-based care models will continue to increase, and COVID has reinforced this belief as we see increased awareness and interest in home-based care models by consumers. Home-based models consistently demonstrate higher patient satisfaction, reporting Net Promoter Scores of 95 or higher, allowing for more personalized care and often demonstrate superior clinical outcomes. Heal will serve as our preferred home-based primary care model, which is inherently more capital-efficient and scalable, allowing Humana to offer high-quality, value-based primary care to more members than a clinic-based strategy. The ability to deliver emergency room- and hospital-level care in the home through partners like DispatchHealth is highly complementary and allows patients to recover in the safety and comfort of their home, reduces caregiver burden and avoids the risk of secondary infections and further health declines often experienced as a result of an inpatient hospital stay."

[3] *Telemedicine Journal; https://pubmed.ncbi.nlm.nih.gov/32907513/; Accessed September 2020*

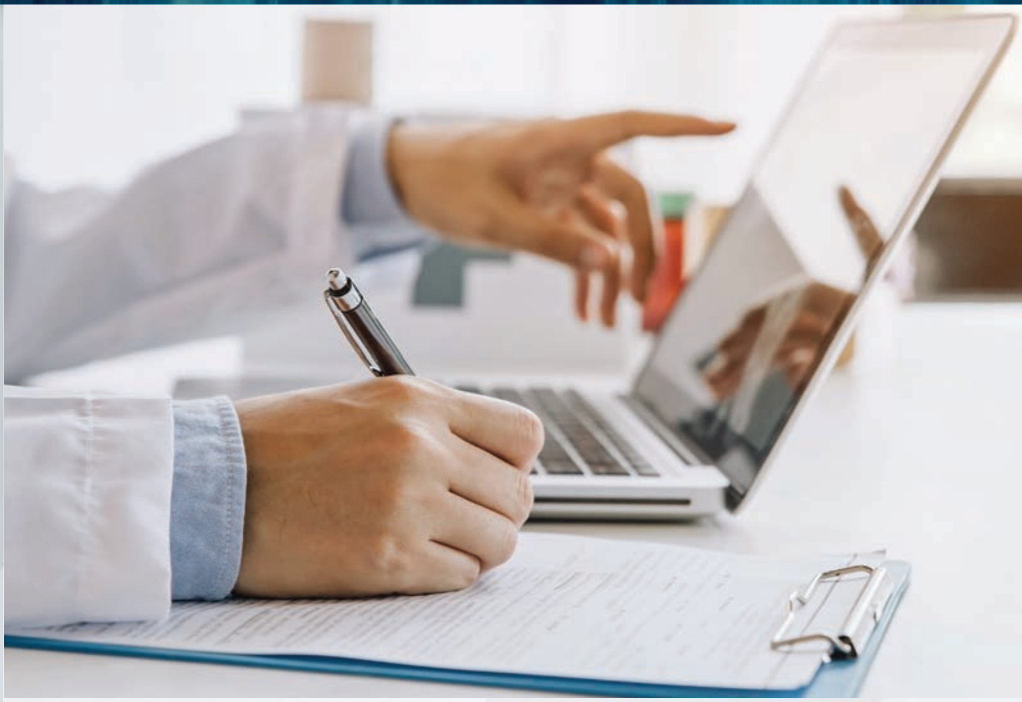
SIGNIFICANT REIMBURSEMENT CHANGES COMING IN RADIOLOGY

The largest operator of independent diagnostic testing facilities ("IDTF") expects to face an $11 million revenue headwind associated with cuts to reimbursement for diagnostic imaging procedures. The reimbursement cuts proposed by CMS are related to changes in the conversion factor that will likely be impacting many medical specialties in 2021. CMS has proposed significant increases in reimbursement for existing patient evaluation and management CPT Codes, and budget neutral provisions require that the increase in payments for these CPT Codes be offset by reductions in reimbursement for other CPT Codes. CMS is proposing to address this by reducing the conversion factor which is used to calculate reimbursement rates by 10.6%. The actual impact for a specific IDTF will depend heavily on that IDTFs modality mix, with the global rate cut for different modalities ranging from 1% to 15%. In addition, CMS is proposing to increase the practice expense RVU as a percentage of the total RVU. This will result in a greater portion of the negative impact to global reimbursement rates falling on the professional component. If implemented, this rule could impact business valuations as well as professional fees paid to radiologists.

WHAT INDUSTRY LEADERS ARE SAYING ABOUT *REIMBURSEMENT CHANGES IN RADIOLOGY*

MARK STOLPER – CFO OF RADNET, INC.

"The way the cuts are proposed is that the conversion factor in the Medicare fee schedule is set to decline by 10.6%. I think it's a total of $3.83 [per RVU]. It's moving from $36 and change to $32 and change [on a per RVU basis]. And that conversion factor then gets applied to both the technical and professional RVUs to calculate reimbursement rates. In the case of radiology, what CMS is proposing is that the technical RVUs are actually going up so that the proportion of the technical RVUs to the total RVUS is higher and that ratio is used in the formulas that we have with our third-party affiliated medical groups to determine what portion of the revenue and cash collections go toward professional fees. So our professional groups are going to be absorbing a significant amount of this cut with us. The $11 million that I mentioned is net of the portion our physician groups are going to be absorbing. The technical RVUs going up was a function of Medicare reevaluating the cost of equipment, which it does from time to time, and they have talked about this, along with this E&M code cut really for the last several years."



NEW DATA SHARING AGREEMENT HIGHLIGHTS THE IMPORTANCE OF HEALTH DATA

Data sharing arrangements and transactions involving health data are becoming more common in the healthcare industry, and a recent agreement between RadNet and Hologic provides insight into how these arrangements are being utilized. Hologic, a medical equipment manufacturer, and RadNet, one of the largest imaging providers in the United States, entered into an arrangement whereby RadNet will share data with Hologic to help advance the companies artificial intelligence capabilities. More broadly, we have observed large sets of health data being utilized to help improve care management and population health management technology platforms, among others. Data licensing agreements are common in the care management space, as well as in the pharmaceutical space, and are certain to increase going forward. For additional insight, see our recent articles here and here on related topics.

WHAT INDUSTRY LEADERS ARE SAYING ABOUT *DATA SHARING AGREEMENTS*

HOWARD BERGER – CEO OF RADNET, INC.

"We announced a multifaceted collaboration agreement with Hologic, focused on improving women's health. Specifically, Hologic will contribute capabilities and insights behind its market-leading hardware and software, and RadNet will share data with Hologic produced by RadNet's fleet of high-resolution mammography systems, the largest in the nation. The data will be used to train and refine current and future products based on artificial intelligence."

POTENTIAL FOR REDUCED MEDICARE ADVANTAGE AND MANAGED MEDICAID RATES IN 2021

COVID-19 is causing added difficulties to the process of setting 2021 rates for Medicare Advantage and Managed Medicaid plans. There are several factors complicating the normal negotiating process between CMS and insurers that offer these plans to beneficiaries. In some cases, states are facing budget constraints which could potentially limit funds available. In addition, dramatically lower utilization of healthcare services in the first half of 2020 is adding complexity to the process of determining appropriate benchmark rates for 2021. While payors are optimistic that rates will be set in an actuarially sound method, certain risk sharing mechanisms could be implemented to mitigate the uncertainty caused by COVID-19.

WHAT INDUSTRY LEADERS ARE SAYING ABOUT *MEDICARE ADVANTAGE AND MANAGED MEDICAID RATES IN 2021*

MICHAEL NEIDORFF – CEO OF CENTENE CORPORATION

"With state budgets under constraint, the role of managed care companies like ours, which maximize member outcomes and cost savings, has never been more important. While we do expect some short-term pressure on rates, these rates have to be actuarially sound. Our 2020 guidance incorporates what we know at this time, and the majority of our conversations with states have been highly constructive...The states, initially, when they saw the reduced utilization, they assumed payors were saving all this money. Now they understand that utilization will come back in the second half of the year. And they also see, as we reported in July, while utilization may be down for elective procedures, that's being offset by COVID costs."

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