Mesirow

Healthcare sector report

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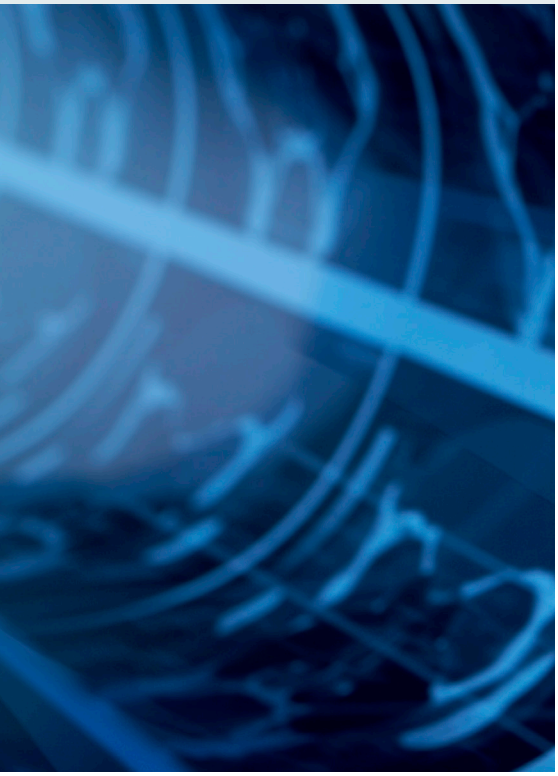
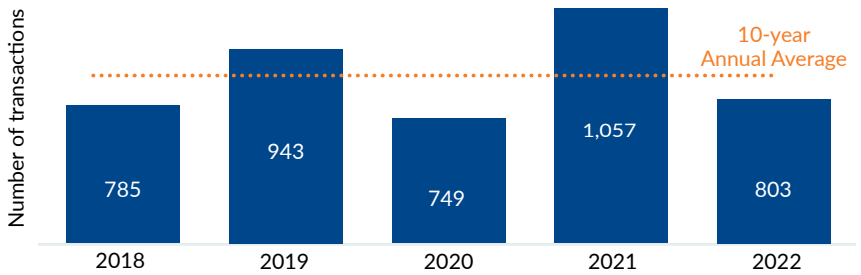


2022 Year-end update

The number of healthcare services M&A transactions declined by 24% in 2022 when compared to 2021's record year as investors continued evaluating COVID and its effect on the marketplace, and concerns grew about higher interest rates, rising inflation and slowing economic growth. Despite this decline, the number of transactions was far from weak when compared with the average annual performance over the last ten years. While concerns loom over economic headwinds (e.g., labor shortages, supply chain disruptions, rising interest rates) and potential recessionary fears, we expect M&A activity in the healthcare services sector to continue as many markets remain highly fragmented and both strategics and sponsors will continue utilizing M&A to add new locations / geographies, expand service lines and leverage synergies. Public acquiror valuations still remain strong and private equity's appetite for the healthcare services sector has not let up. Additionally, strategic partners, investors and acquirors are sitting on large amounts of dry powder and have indicated both the capability and willingness to structure deals that could better fit in today's economic environment. All of these factors suggest the healthcare services M&A market should remain strong for the remainder of the year.

CHART 1: **HEALTHCARE SERVICES M&A ACTIVITY**



Includes closed U.S. transactions that were announced between January 1, 2018 and December 31, 2022 | Data as of 12.31.2022. Source: S&P Capital IQ.

One of the predominant themes we are seeing in healthcare services is the push to drive care to lower cost settings (emergency department → urgent care → retail walk-in clinic → telehealth) and the consumerization of healthcare delivery. Firms as diverse as CVS (MinuteClinic), Amazon (One Medical), Walmart and Walgreens are all trying to merge medical treatment with retail philosophies like convenience, value and efficient use of time. We touch on part of this initiative in this sector spotlight on the urgent care space.

Sector Spotlight: The evolving Urgent Care Center (UCC) landscape

The last four decades have seen a revolution in the way people seek medical treatment for lower acuity situations – long gone are the days when doctors would make house calls. Those who have needed urgent medical attention since the 80s had little choice but to go to emergency departments (EDs). However, that has proved an imperfect solution for several reasons. EDs are tasked with dealing with all manner of emergencies, from heart attacks to gunshot wounds to allergic reactions. For those seeking treatment for acute but not immediately life-threatening conditions, getting treatment in a timely manner at an ED can be luck of the draw.

EDs are also the default destination of those who don't have health insurance because by law — the federal Emergency Medical Treatment and Active Labor Act of 1985 — EDs must treat everyone who requests service, and thus they became the de facto community care giver. This has led to overcrowding and long wait times.

Add to that the evolution of healthcare delivery to HMOs, PPOs and other network-organized health delivery platforms, which can make it prohibitively expensive to seek care out of network.

Clearly there was a need for a middle solution to fill the gap between a comprehensive service model that addressed acute problems provided by EDs and ongoing care from Medical Doctors (MDs) in clinical settings.

The rapid growth and impact of UCCs

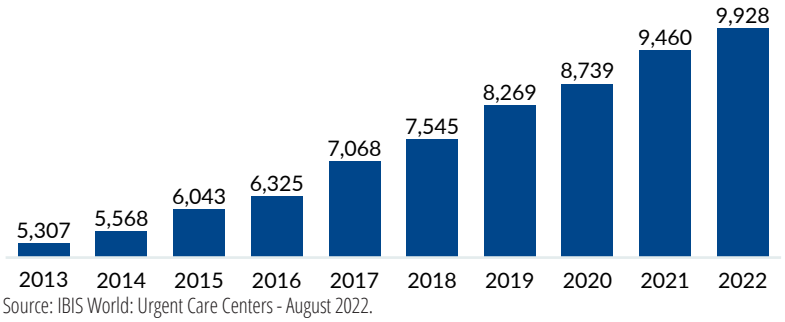
This desperate need for a treatment option for urgent but not life-threatening conditions has led to an explosion in UCCs in recent years and this growth has resulted in a transformation of how people seek urgent medical treatment.

- An open UCC in a ZIP code reduced the total number of ED visits by residents in that ZIP code by 17% ($P < 0.05$), due largely to decreases in visits for less emergent conditions. This effect was concentrated among visits to EDs with the longest wait times.
- UCCs reduced the total number of uninsured and Medicaid visits to the ED by 21% ($P < 0.05$) and 29% ($P < 0.05$), respectively, suggesting that during the hours they are open, UCCs appear to be treating patients who otherwise would have visited the ED.

Nearly all those visits appear to have been more convenient and affordable than a trip to the ER; the Urgent Care Association's 2018 Benchmarking Report found that more than 70% of patients waited less than 20 minutes to see a provider at an UCC, and nearly 94% were seen in less than 30 minutes. Overall, 85% of UCC patients were treated in less than an hour.

All this suggests that UCCs have the potential to reduce health care expenditures and deliver treatment more quickly than EDs. However, questions remain about their net cost impact and whether they can improve health care access, especially for communities who often experience barriers to receiving timely care.

CHART 2: **NUMBER OF URGENT CARE CENTERS IN THE U.S.**



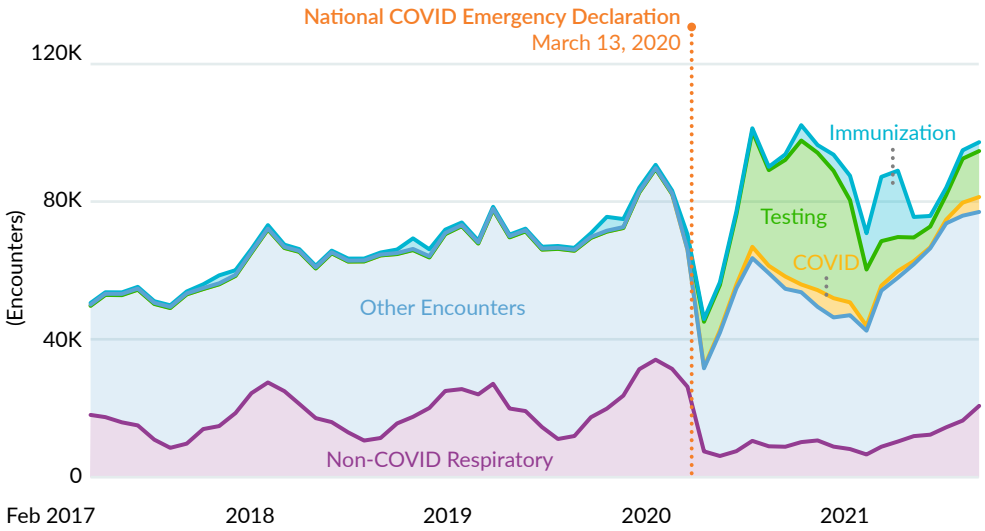
Source: IBIS World: Urgent Care Centers - August 2022.

Did COVID change the equation for UCCs?

While UCCs have been an option for a few years, they have not become a go-to for many people. However, the COVID pandemic may have changed that. After dropping in the first couple months of the pandemic, urgent care visits rebounded with a dramatic increase in infectious disease testing and immunizations helped to drive an increase in urgent care visits in 2021.

The story hidden in the data is how visit volume first contracted then expanded throughout 2020.

CHART 3: **WEEKLY URGENT CARE VOLUMES**
February 2017 – May 2021 | n=3,500,269

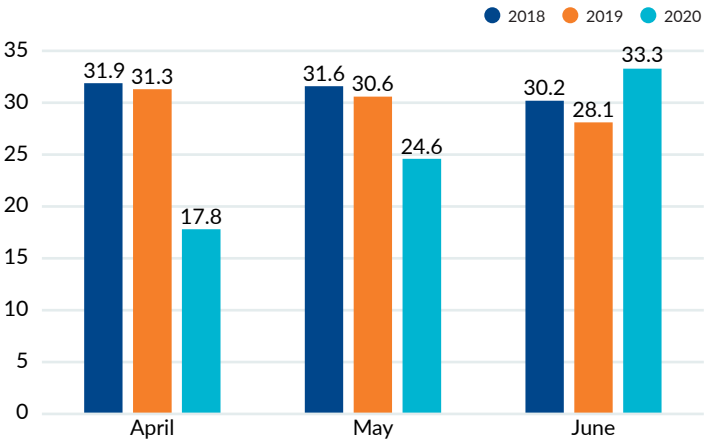


Source: "Weekly Urgent Care Volumes," 2021. Epic Health Research Network (EHRN.org).

How the pandemic influenced UCC visits

The net result may indicate increased comfort with an adoption of UCCs as a trusted community resource. The question is whether that increase will become permanent going forward. For example, potential investors are asking if a UCC went from $3 million to $8 million of EBITDA because of COVID testing, what is the true normalized state of that UCC? Urgent care operators have tried to isolate the revenue from COVID testing and how that compares to the norm. However, COVID mitigations have also reduced flu infections and UCC visits to treat them, creating uncertainty around the level of activity that can be considered "normal."

CHART 4: **AVERAGE VISITS PER CLINIC PER DAY**
YoY 2018–2020



Source: Experity Health.

The Urgent Care space is a fertile ground for M&A activity

The consumerization of the UCC space is a classic example of a sector poised for rapid expansion and change. It has all the hallmarks: rapid growth (discussed above), fragmentation, established need and no clear leaders.

Fragmentation

There is no nationwide chain of UCCs. Some of the largest U.S. urgent care operators are regional entities and include:

- American Family Care
- City MD
- Concentra
- Fast Med
- GoHealth
- HCA CareNow
- MedPost
- NextCare
- Patient First
- U.S. Healthworks

Established need

As Laurel Stoimenoff, CEO of the Urgent Care Association points out, "The year-over-year growth in UCCs across the country shows the importance of urgent care in today's healthcare marketplace, as today's patients seek affordable healthcare options, shorter wait times and more convenient access to care."

Typically, a visit to the UCC is a money-saver for patients. A 2016 study in the Annals of Emergency Medicine found that ER treatment costs were ~10x more (an average of about $2,200) than those in an UCC (~$168) — even for patients with the same diagnosis.

Younger patients in particular are more likely to use a convenient care approach. Nearly one-quarter of millennials haven't visited a primary care physician (PCP) in five years or more, per a 2019 Harmony Healthcare IT survey .

No clear leaders

While community-based acute care facilities are becoming a part of the medical landscape, how they will evolve is open to debate. Currently, there is no set staffing model for UCCs. Henry Schein Medical cites three major approaches:

- **Physician Only:** The most expensive model that uses no mid-level practitioners. However, it could be the most cost-effective option for new centers building their patient base.
- **Mixed Model:** A balance of physicians, physician assistants, and nurse practitioners for centers increasing in patient volume.
- **Mid-Level Model:** Centers staffed entirely by mid-level staff. This option is suitable for low acuity cases but may not be equipped to handle more complex patient needs.

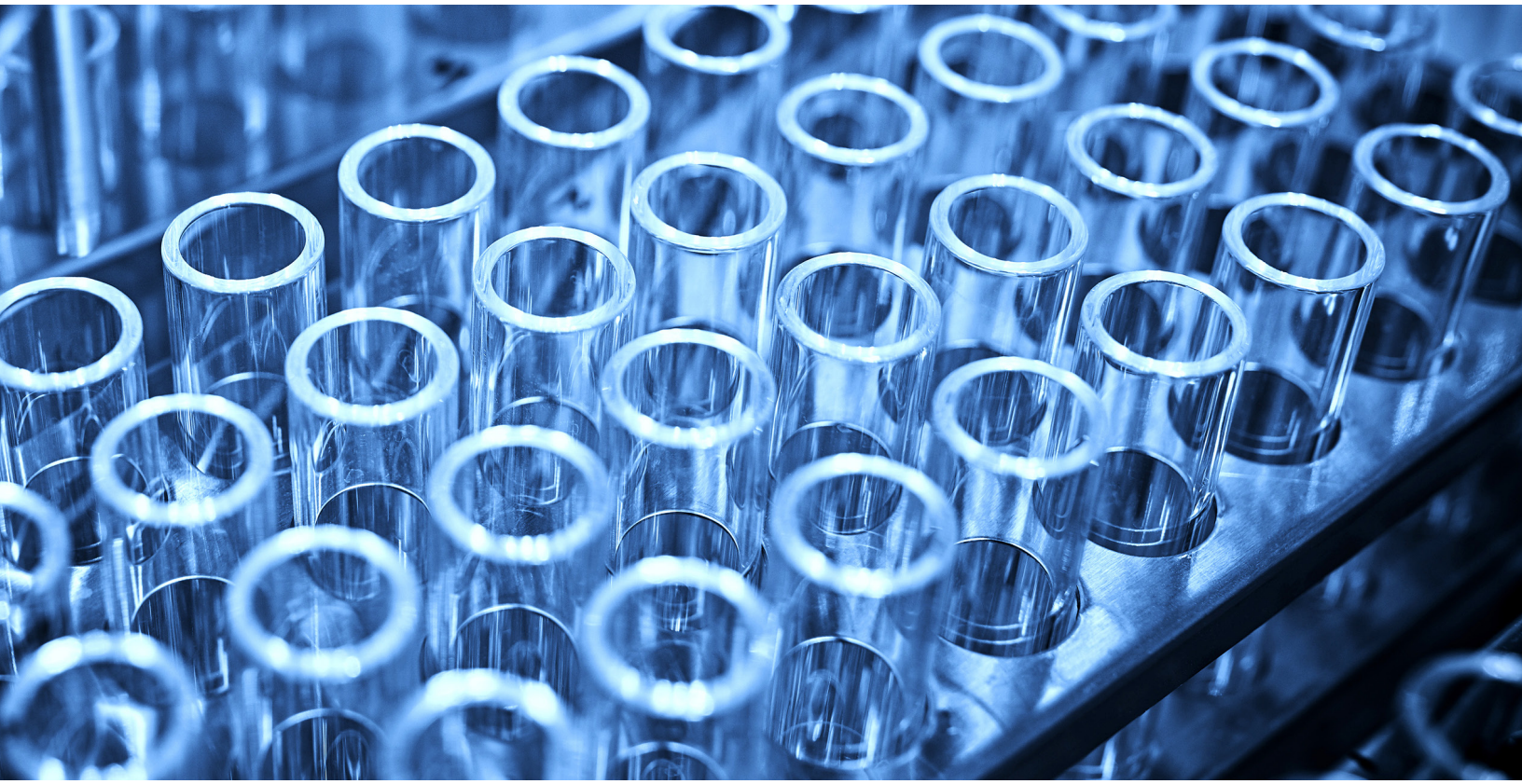
Some enterprise entities, like Walmart and Walgreens, are launching initiatives to create nationwide homogenous clinical settings, but both efforts are in their infancy. Walmart's model is closer to a traditional doctor's office, with labs, x-rays, diagnostics and counselling, while Walgreen's has partnered with UnitedHealth Group's MedExpress to create a true UCC model.

But currently, there's no "Starbucks" or "Whole Foods" of UCCs that has established a standard experience where people can know what they can expect regardless of where they live.

Uncertainty abounds, but so does opportunity

Several issues must be resolved for UCCs to reach their full potential to take healthcare delivery out of a higher cost setting to a lower cost setting. We've found that healthcare is a bit like politics in that it's extremely local and in some respects scale doesn't matter. Given that, how do UCCs interact with local hospitals and other healthcare providers? What population density is necessary for efficient deployment? How does the generational aspect figure into the equation?

But clearly, despite the uncertainties, an enormous opportunity awaits for investors who can solve that puzzle.



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- Facilities & Alternate Site
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- Home Health & Post-Acute Care
- Physician Practice Management

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