agilon health (AGL)

A Business Model Designed for Abuse. Exploiting short-term loopholes in Medicare /Primary Care…and still can't make money…..Target Price $5

Last week, Amazon entered the primary care market by purchasing provider 1Life Healthcare (ONEM). As the nation transforms from fee-for-service to value-based Medicare, investors must decipher between the pretenders and the disruptors.

It is the opinion of Citron Research that agilon health (AGL) is the most vulnerable healthcare stock in the market because they have:

- A business model designed for abuse (someone please answer the $270 mil question)
- A business with a history of abuse
- A nosebleed valuation relative to competitors
- Their most exploited "loophole" just got smaller last week thanks to CMS

agilon health's tagline is "Transforming Primary Care in America". Pretty broad statement. To be more precise, agilon is a healthcare company established by Private Equity Firm Clayton Dubilier & Rice to help primary care physicians transition their business to more value-based medicine using a proprietary "platform". agilon is one of many private and nonprofit entities (each with its own platform) finding ways to insert themselves into the transaction between physicians and Medicare.

Business Model Designed for Abuse

agilon's business model was built on the controversial and now revised practice of direct contracting. While this is NOT the cornerstone of the "short case," it is part of the mosaic. By signing up an Accountable Care Organization (ACO) to its platform, agilon can switch a senior citizen's level of healthcare without their permission. A practice that has caused a stir in the US healthcare system.

This loophole has opened the door for private equity to try and arbitrage the health benefits of America's seniors and has been referred to as "the biggest threat to Medicare you've never even heard of".

https://thehill.com/blogs/congress-blog/healthcare/585103-the-biggest-threat-to-medicare-youve-never-even-heard-of/

Unlike most of its competitors who have opened physical clinics, bought physician groups, or provide software and services, agilon does not own anything. Instead, they sign up doctors for its "platform" and share the profits between what Medicare pays them and what they spend on patient care... what can go wrong here?

These thoughts are not the ramblings of a short seller and we are not going to opine on the Medicare system as direct contracting, and its successor REACH are already under scrutiny from:

- The Office of Inspector General
- The Centers for Medicare and Medicaid Services
- The Brookings Institution
- Department of Justice
- American Hospital Association
- Multiple Members of Congress and Senate

"The Direct Contracting model seems to have ignored the lessons learned from the experience of MA and its predecessors at a cost to CMS and taxpayers of hundreds of billions of dollars"

– The first director of CMMI and the administrator of CMS under Obama

"Our findings raise concerns about the extent to which certain MA companies may have inappropriately leveraged both chart reviews and HRAs to maximize risk-adjusted payments"

– The Office of Inspector General

"Private equity investment in health care is driven by financial incentives for both the private equity buyers and the health care sellers… the more recent interest in physician practice investments may be driven by revenue opportunities amplified

by certain payment loopholes, Medicare Advantage policies, and value-based payment models, among other factors."

– The USC-Brookings Schaeffer Initiative for Health Policy

https://www.healthaffairs.org/do/10.1377/forefront.20210927.6239/full/
https://www.healthaffairs.org/do/10.1377/forefront.20210928.795755/full/
https://oig.hhs.gov/oei/reports/OEI-03-17-00474.pdf
https://www.brookings.edu/wp-content/uploads/2021/10/Private-Equity-Investment-As-A-Divining-Rod-For-Market-Failure-14.pdf

We are not going to include all of the criticisms here, but this is the gist of the abuses of this business model or, as Senator Warren states with a blunt tongue:

"President Biden should not permit Medicare to be handed over to corporate profiteers. Doing so is going to increase costs and put more strain on the hospital insurance trust fund"

https://www.fiercehealthcare.com/payers/warren-warren-calls-end-direct-contracting-reforms-medicare-advantage-risk-adjustment

The DOJ is well aware that a company like agilon, whose only customer is Medicare can make money only two ways:

1. Up code patients to extract more money from Medicare, an illegal policy that was of prime concern to the OIG
2. Issue excessive denial of coverage or necessary care to generate more profits, a practice which chased agilon out of their home state of California

The $270 Million Question

Imagine being a senior citizen and waking up to find that your Medicare has switched from fee-for-service to value-based without your knowledge or permission. Now imagine this switch occurred because, unknown to you, a private equity firm gave your doctor millions of $$ in a pre-IPO stock.

Excerpt from AGL S-1:

"Between March 2018 and February 2021, we entered into partner physician group equity agreements pursuant to which our anchor physician partners are

entitled to receive shares of Common Stock conditioned on completion of this offering with a total value of approximately $269 million"

https://www.sec.gov/Archives/edgar/data/0001831097/000119312521085566/d10763ds1.htm

This $269 million stock incentive did not increase healthcare quality for anyone and most certainly did not decrease the cost for the government. This $269 million was not used to buy these physician groups, and by no means does it validate the agilon technology. Instead paying someone $269 million on the condition of a successful IPO turns your primary care physicians into default bankers and stock promoters.

Considering how serious anti-kickback laws are and that you cannot even give out gift cards to assistants, it would be interesting to explain this king's ransom.

A few questions that need to be asked:

1. Have the physicians disclosed this unique relationship to their patients as their performance under this coverage is the cornerstone of this massive payday?
2. Have the "partner physician groups" disclosed this incentive to bankers and investors pre-IPO as they continue to promote this business model of agilon?
3. How are they partners? If you pay someone $269 million as an incentive for your IPO, this not a regular partner
4. Is this even legal? What part of the Stark Law was this able to circumvent, and if so, why is agilon the only company to have done it?

agilon History of Abuse – Going Back to Cali!

To properly understand the vulnerabilities of agilon and understand how quickly this company could go away, just go back to their previous business model. In 2017, agilon was one of the leading Medicaid providers in California, with over 400k patients and over 9k physicians, a much larger footprint than the current company.

Every press release from agilon was filled with the same word vomit of about improved outcomes and savings blah blah blah. Read the release below as an example of the same rhetoric for Medicaid that we hear now for Medicare.

https://www.prnewswire.com/news-releases/agilon-health-a-new-healthcare-services-and-technology-company-formed-at-the-forefront-of-value-based-healthcare-300338505.html

While preparing for IPO with the "thriving" Medicaid business, agilon was hit with an investigation from the California Department of Managed Health Care about fraudulent claims and utilization management. Employees of agilon were accused of changing dates and hiding files from auditors and falsifying claims. Needless to say, management said they didn't know what was happening.

In a separate incident the same year, they were subject to a whistleblower lawsuit urging the government to investigate illegal and unethical conduct at agilon. The State of California claimed that amongst many accusations that "Senior management delays treatments for cancer patients without any regard of patient's well-being, to save their dollars."

https://www.latimes.com/business/la-fi-medicaid-denial-nurse-20181219-story.html

What is most important is not the accusations or the history of putting profits over care BUT when held accountable, agilon immediately unwound the California business and sold it less than 24 months later for a paltry $30 million. Meanwhile, none of the over 400k patients and 9k doctors had any benefits interruption as too many firms are willing to pick up the business.

As the DOJ has made increased scrutiny on Medicare Advantage a top priority, agilon is only one whistleblower away from facing the same problems they had in California.

As illustrated by California this "platform" is not key to the business of the physician. agilon does not own any patents, break out technology spending, or show any technology advantage over any competitor. On the contrary, their unique platform seems to be primarily based on data provided by Health Catalyst (HCAT).

https://www.healthcatalyst.com/wp-content/uploads/2021/05/Analytics-Improves-Population-Health-and-Drives-Efficiencies.pdf

Valuation – Yes It Finally Matters

Before doing the comparisons, it must be understood that agilon owns nothing proprietary that would give it a market premium.

Let's start with the most obvious. Let's compare agilon to aglion of summer 2020 when unprofitable companies were in vogue. To put the timeframe in perspective, 1Life Healthcare (ONEM) was trading at $30 vs. now just acquired for $18.

During the year, agilon sold millions of shares for $4.49 a share. 2020 was a year before their business model came under mass scrutiny and change from CMS, Congress, and the DOJ.

https://www.sec.gov/Archives/edgar/data/0001831097/000119312521266585/d189358ds1a.htm

AGL

Date	August 2020	Today
Price per share	$4.49	$26.00
Market cap ($ in mn)	$1,826	$10,575
# of lives (# in thousands)	131	342
Market cap per life	**$13,941**	**$30,921**

ONEM

Date	August 2020	Today
Price per share	$30.00	$18.00
Market cap ($ in mn)	$5,821	$3,493
# of lives (# in thousands)	549	767
Market cap per life	**$10,604**	**$4,554**

https://s27.q4cdn.com/807105172/files/doc_presentations/2022/agilon-Investor-Deck-6.pdf
https://investors.agilonhealth.com/news/news-details/2022/agilon-health-Reports-First-Quarter-2022-Results/default.aspx
https://investor.onemedical.com/news-releases/news-release-details/one-medical-announces-results-fourth-quarter-and-full-year-2020
https://investor.onemedical.com/news-releases/news-release-details/one-medical-announces-results-first-quarter-2022

While AGL and ONEM are not apples to apples, we would argue that ONEM is a premium offering with an actual footprint; here is a comparison of mkt cap per life of AGL vs. ONEM. We could argue that agilon is worth $3-4 a share on this comparison alone.

Apples to Apples:

While there is a level of differentiation across the Medicare services space, the one most similar to AGL is Privia Health (PRVA). This is the latest comparison valuation to covered lives:

	AGL	PRVA
Market cap ($ in mn)	$10,575	$3,920
# of lives (# in thousands)	342	848
Market cap per life	**$30,921**	**$4,623**

But to get more granular and intellectually honest on this comparison, we should look at the EV/Network Contribution so we can see each company's valuation vs. what they are earning in their ACO partnership agreements:

	AGL	PRVA
Enterprise Value ($ in mn)	$9,600	$3,675
2021 Network Contribution ($ in mn)	$85	$238
EV / Network Contribution	**113.5x**	**15.4x**

https://www.sec.gov/ix?doc=/Archives/edgar/data/1831097/000095017022002826/agl-20211231.htm#statements_of_operations
https://www.sec.gov/ix?doc=/Archives/edgar/data/1759655/000175965522000032/prva-20211231.htm#ia06b611f2d754c3e981e0e6e2eedc487_97

This most defined comparison would put agilon stock today at $5-6, including cash.

Consider this – this company has not been able to make money under the best-case scenario with low doctor visits and a loose regulatory environment. How are they going to make money now let alone have a premium valuation?

agilon's Key Loophole is Closing

To agilon's credit, they have one differentiating factor in their business model compared to the many other companies providing services to ACOs in the transition to value-based treatment.

In return for sharing 50% of the savings of the physicians, agilon will cover any of the losses that the doctors might incur in the early stages of the transition from fee-for-service to value-based Medicare, a concern for practices in rural and underserved areas. This risk-sharing agreement has been crucial to agilon's strategy.

Their investor presentation shows that 43% of their partners fall in this category.

5. HOW HAS THE AGILON HEALTH PARTNERSHIP HELPED YOUR PRACTICE REACH UNDERSERVED COMMUNITIES AND ACHIEVE HEALTH EQUITY?

Dr. Keisha Jarrett, a family medicine physician with Wilmington Health in North Carolina, shared some interesting stats: 59 million people in the United States live in areas where there is a shortage of healthcare providers, and 43% of the agilon health partner practices are in some of those areas. "We are constantly growing," she says, noting the increasing retiree population in the area. "We're providing a lot of after-hours care" and are "trying to reach as many of those patients as we can."

Medicare Innovation Giveth and Taketh Away…

This month CMS enacted modifications for next year in the Advanced Shared Savings Program that will address this concern for rural ACO's deal without having the primary care provider not have to give up 50% of their income to agilon.

The proposed revision goes directly to the core of agilon's business. As shown in the 2023 proposed rules from Health Affairs July 21, 2022:

"In the recent Calendar Year 2023 Physician Fee Schedule proposed rule, CMS proposed a number of changes to address these barriers in the Shared Savings Program. First, the agency proposed creation of new incentive payments for smaller ACOs to provide upfront capital to build the infrastructure necessary to succeed in the program and better address the social- determinants-of-health needs of underserved people with Medicare in rural communities"

https://www.healthaffairs.org/content/forefront/medicare-value-based-care-strategy-alignment-growth-and-equity

To be more exact as described by CMS:

"Building on lessons learned from the Center for Medicare & Medicaid Innovation (CMMI) ACO Investment Model, CMS proposes providing advance shared savings payments to new ACOs (i.e., not renewing or reentering ACOs) serving rural and other underserved populations."

"As proposed, eligible ACOs would receive a one-time fixed payment of $250,000 and quarterly payments for the first two years of their five-year agreement period."

https://www.morganlewis.com/pubs/2022/07/cms-releases-physician-fee-schedule-proposed-rule-continuing-emphasis-on-equity-and-value-based-care

While this is still in the comment period, Citron has done calls to confirm at high level that the government wants to provide more direct support to new ACOs (i.e., removing the competitive edge of AGL).

Conclusion

Find us a company created by private equity and whose only customer is Medicare, and we will find the abuse. Citron believes this multi-billion-dollar loophole company will either not exist or be a fraction of itself five years from now as the government dynamically changes Medicare law and increases enforcement on these middlemen. While the verdict is still out on the benefits of value-based medicine vs. practice-based medicine, one thing is sure, private equity-based medicine is not a great idea for the seniors or the fragile Medicare system.

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