Citron | RESEARCH

agilon health (AGL)

Citron Research Exposes the Document that agilon health was Hoping Shareholders Would Never See

Brief Background

Over the past 5 years, investors and private equity have jumped headfirst into any opportunity that could possibly extract profitability from the nation's new focus on Medicare Advantage and the shift to value-based care. As many have now realized, profits in the highly regulated healthcare space are not as easy as they looked in the investor deck and some business model might never reach profitability despite their lofty promises and valuations.

It is rare that a company will admit this weakness, let alone to the highest court of the land.

Agilon's physicians' enablement platform is a new yet saturated business model that by their own admission is under direct attack questioning their $7 billion valuation.

Before you read the report it is important to note that despite all the rhetoric and buzzwords of agilon "transforming healthcare" and "fixing America's broken healthcare system" is nothing more than a model created by private equity to put themselves in between the primary care physician and the insurance company.

What can go wrong there? Let agilon tell you.

Introduction

- As agilon reported a loss for the quarter and is on track to lose $70 million in 2022, Citron is compelled to break the bad news to shareholders. The best days of agilon are behind it as their business model unknowingly got torpedoed by the Supreme Court of the United States without Wall Street noticing.

- agilon's business model is to partner with primary care physicians (PCP) and generate profits shared from cutting costs and Medicare overpayments. While the company uses many bombastic phrases like reinventing healthcare, agilon is one of many companies in the category of "physicians' management services.“

- agilon does not own clinics, does not own practices, does not have long term contracts with payors. This unprofitable business is based on arrangements with physician groups to split additional profitability once uploaded on the agilon platform. The majority of these yet unrealized profits are to be generated through the increase of medical margin.

- If you believe agilon's projections, in the next 3.5 years they are taking this business from essentially 0 to over $500 million in EBIDTA.

Supreme Court Ruling on Overpayments

In what was widely referred to as a blow to value-based healthcare, the Supreme Court declined to hear United Healthcare's challenge to a federal rule stipulating insurers offering Medicare Advantage plans refund payments based on unsupported diagnoses in patients' medical records. This is referred to as **"overpayment."**

"UnitedHealth Rejected by High Court on Medicare Overpayments" – Bloomberg

"Supreme Court declines to hear UnitedHealth's lawsuit on Medicare Advantage overpayments rule" – Fierce Healthcare

"SCOTUS rejects UnitedHealth appeal of Medicare Advantage overpayment rule" – Healthcare Dive

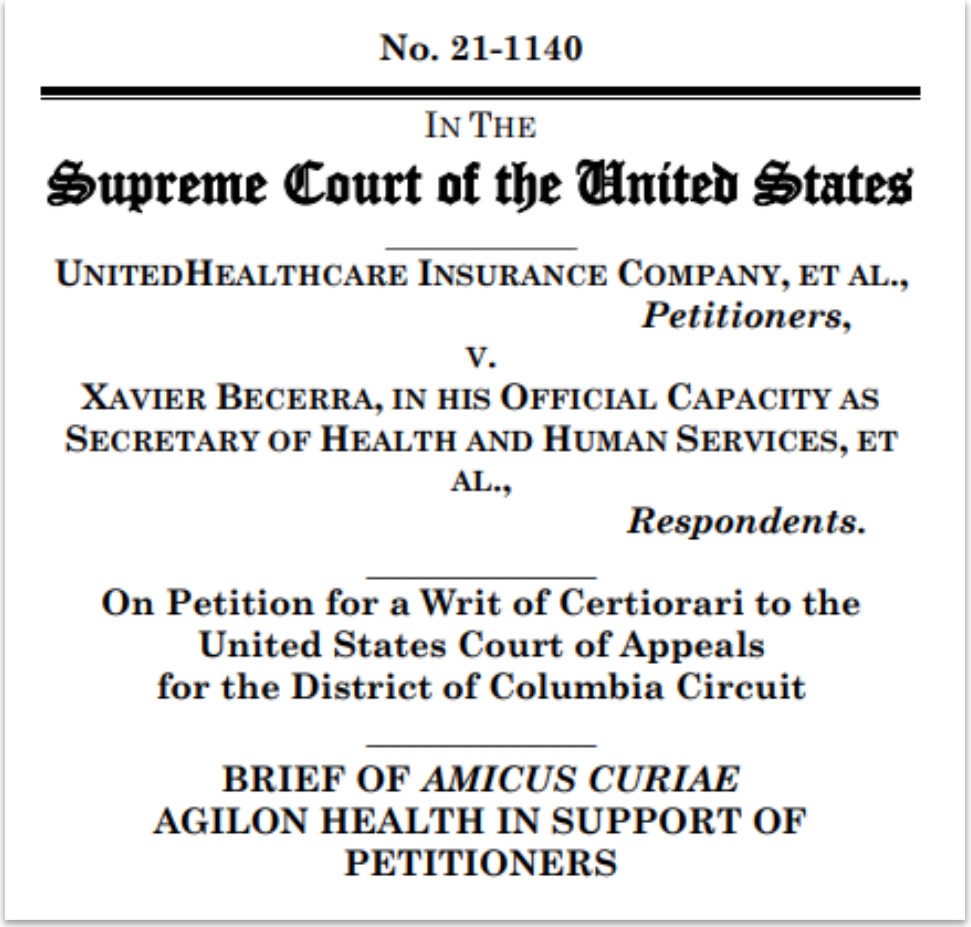
"Understanding the Medicare Overpayment Appeals Process" – Nelson Mullins

What is Overpayment and why is it so important to agilon?

UNH's argument to the Supreme Court was based on actuarial equivalence. Actuarial equivalence refers to the requirement that CMS pay the same amount based on risk factors for Medicare Advantage as it would for traditional Medicare. So, if a company like agilon claims their doctors practice quality over quantity of medicine with improved outcomes, they should keep the overpayment and be rewarded for practicing good medicine.

This Is Where It Gets Interesting

- The Supreme Court would not hear arguments to overturn the lower court decision that overpayments and actuarial equivalence are two different things.
- In the UNH pleading to the Supreme Court, only ONE company submitted an Amicus Brief pleading with the courts that overpayments are crucial to value-based care and the lifeline of their business. That single company is agilon health.
- Rarely does a company provide a smoking gun as to why they will never achieve scaled profitability. Still, in this case, agilon needed to throw a Hail Mary to the Supreme Court with the remote chance of saving their business model..



No. 21-1140

IN THE

Supreme Court of the United States

UNITEDHEALTHCARE INSURANCE COMPANY, ET AL.,
Petitioners,

v.

XAVIER BECERRA, IN HIS OFFICIAL CAPACITY AS SECRETARY OF HEALTH AND HUMAN SERVICES, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF *AMICUS CURIAE* AGILON HEALTH IN SUPPORT OF PETITIONERS

Source: *agilon's amicus brief to U.S. Supreme Court*

In agilon's Own Words

The following quotes from agilon's Amicus Brief to save overpayments could not be clearer about the impossibility of agilon ever achieving its self-stated guidance of $350 million in EBIDTA in 2026, after zero EBITDA this year.

Moreover, it questions if there is any value at all to this type of business model.

"By promulgating the Overpayment Rule, CMS has abandoned actuarial equivalence, and the undisputable result is that MAOs will see their reimbursement reduced to below Medicare FFS levels. **This reduction will be felt by agilon…**"

"MAOs typically base agilon's compensation on a defined percentage of the corresponding monthly premium payments which the MAO receives from the Centers for Medicare & Medicaid Services ("CMS") for the MAO's members who are attributed to agilon's partner physicians. Thus, **any changes to how CMS reimburses MAOs will impact agilon**."

Note the use of the term "will" is used. The use of future tense signals the impact of the decision has yet to be factored in Wall Street's current estimates for agilon.

Supreme Court's Final Say

In the quotes below, we see agilon attempted to plea to the court that if it can retain the overpayments, the money will go back into the system.

"Similarly, agilon's capitation reimbursement from MAOs will be reduced decreasing available funding for continued innovation, care management, care coordination, and patient-centered care."

Is this effective altruism? This omits the truth about corporate profits, private planes, private equity profits, and executive salaries. The Supreme Court obviously looked right past the charade.

Lastly, to influence the court and save any hope of future profitability, agilon unsuccessfully attempted to tie their fortunes to that of the whole value care system.

"The Overpayment Rule Undermines the Viability of Medicare Advantage's Reimbursement Model."

"The D.C. Circuit's ruling threatens the stability of value-based care arrangements and frustrates the development of innovative care delivery models by agilon and its physician partners."

Why has the company not addressed this issue to Wall Street? Why have the analysts not factored the potential impact of the overpayment rule?

Can agilon Management Maneuver Its Way Out of this Problem? No RAC'n Way

The days of upcoding and gaming the system are over. It would be too easy to list the multiple articles from the government and media on fraud in Medicare Advantage. Last month, the New York Times did a thorough job discussing the widespread fraud with the MSO's.

- According to that times article, "the most common allegation is that the insurers did not correct potentially invalid diagnoses after becoming aware of them."
- That is the key to the overpayment that agilon is so desperately trying to keep.
- Between audits, whistleblowers increased compliance with MSOs, it will be possible for agilon to expand its medical margin and stay compliant with the false claims act simultaneously.

'The Cash Monster Was Insatiable': How Insurers Exploited Medicare for Billions

By next year, half of Medicare beneficiaries will have a private Medicare Advantage plan. Most large insurers in the program have been accused in court of fraud.

Source: The New York Times

The Impossibility of agilon's Business

Beyond the Overpayment Rule, agilon is under constant scrutiny from their customers over their profits and processes. Citron spoke to a former agilon executive, and he mentioned that the most vulnerable part of the business is that most of agilon's contracts with the MSO's are for only one year.

As interpreted by the law firm of Friar Levitt:

"The regulatory pressure placed on MAOs by CMS as a result of this ruling may drive MAOs to more scrupulously audit the Dx codes submitted by contracted practices in an effort to deflect responsibility for poor RADV audit results away from the carriers." – **source: Friar Levitt**

Three MSO's, UNH, Aetna, and Humana, account for close to 60% of agilon's business. The healthcare giants are under constant scrutiny and hold all the cards. They insist on razor thin margins and will renegotiate any contract IF they see agilon every making any sizable profits.

"Contracts with MCOs are relatively concentrated and could become less favorable to agilon over time, or MCOs may adopt different approaches to value-based care including greater utilization of their own physician assets."

Inflated “Medical Margin” Excludes “Other Medical Expenses”

- The most important metric agilon wants Wall Street to focus on is medical margin.
- **agilon inflates its medical margin by including a line item titled "other medical expenses."**
- Agilon defines medical margin as "the amount earned from medical services revenue after medical services expenses are deducted. Medical services expense represents costs incurred for medical services provided to our members."
- According to agilon's filings, "Other medical expenses consist of physician compensation expense related to surplus sharing and other direct medical expenses incurred to improve care for our members."
  - So, the surplus money paid to physicians is NOT part of the medical margin? That is their whole business. As agilon wants to keep Wall St focused on this created metric and NOT profitability, we see this is easily manipulated and an accurate sign of their performance.
  - In our view, these expenses, which are up to management's description, should be included in the reported medical margin as they represent costs incurred for medical services provided to members.
- As mentioned in the first report, the metric that should be used is network contribution.
  - Management mentioned medical margin 27 times on the Q3 2022 earnings call vs. mentioning network contribution only 5 times.
  - No analyst asked about network contribution metrics on the call.

UnitedHealth Provides Insight to Weakening Profitability

UnitedHealthcare Investor Day – November 29th,2022

"Obviously, for the last couple of years, there is been a lot of focus on the effect of COVID as you think about impacts on medical cost trend," CEO Andrew Witty told investors in October. "There is now a blend of possibly a little bit of COVID effect in the system, but cost of living effects, things like inflation, things like capacity constraints as the labor market tightness has affected different parts of the system at different moments."

"So, I think this whole issue has become actually more complicated in some ways because there is more influences on what you need to think through going forward," he added.

Valuation: What is agilon Worth???

- The bulls will argue by not owning physicians or clinics, agilon is an asset-light business model designed for scalability. The "asset light" has become its vulnerability as the model relies on retaining overpayments and splitting with the PCP and not owning the practice.
- Bulls would argue that agilon should trade a premium to peers because of the focus on Medicare Advantage. Still, with the Supreme Court rulings on Actuarial Equivalence and overpayments, a Medicare Advantage value-based care life should have the same value as a fee-for-service (FFS) life.
- **No matter how you choose to analyze agilon, the stock is crazy expensive, considering its business model is unproven and, by their admission, is under attack from regulation.**
- On the following slide we have two charts. The first compares the landscape of all primary care operations and the second is just physician management firms. It is conclusive that agilon belongs in the single digits.
- The analysts who cover agilon are still living in 2021 as they look at EV/Sales without considering revenue recognition compared to peers. This is negligent and lazy.

Primary Care Operations Landscape

	apollomed	PRIVIA HEALTH	agilon health	CanoHealth	P3 Health Partners	OAK STREET HEALTH	one medical
Business Model[1]	Affiliate-provider model	Affiliate-provider model	Affiliate-provider model	Staff / Clinic Model	Affiliate-provider model	Staff / Clinic Model	Staff / Clinic Model
Members Served	1.2M	856k[2]	356k[3]	282k[4]	102k[5]	145k[6]	815k[7]
Serves All Patient Types[1, 8]	✓	✓	✗	✓	✗	✗	✗
Market Capitalization[9]	$2.0B	$4.0B	$8.2B	$1.6B	$1.3B	$5.0B	$3.5B
2022E Revenue[10]	$1,095M - $1,115M[11]	$1,262.5M[2]	$2,678.5M[3]	$2,875M[4]	$1,050M[5]	$2,152.5M[6]	N/A[7]
2022E Adj. EBITDA[10]	$136M - $166M[12]	$58.5M[2]	$4.5M[3]	$200M[4]	($72.5M)[5]	($290M)[6]	N/A[7]

Source: ApolloMed November 2022 Investor Presentation

Overvalued Relative to Physician Management Peers

	Agilon (AGL)	Privia (PRVA)	Apollo Med (AMEH)
Enterprise value ($bn)	$6.5bn	$2.5bn	$1.7bn
Members	356k	846k	1.2m
Enterprise Value per member	**$18.2k**	**$2.9k**	**$1.4k**
AGL premium vs. peer		*6.2x*	*13.2x*
Physicians	1.6k	3.6k	10.6k
Enterprise Value per physician	**$4.1m**	**$690k**	**$157k**
AGL premium vs. peer		*5.9x*	*25.9x*

Market data as of 12/2/2022
Source: Citron analysis

Further Proof of an Inflated Valuation

- agilon has maintained an inflated valuation compared to other competitors in the physician's management space because of their focus on Medicare Advantage and the ability to capture the overpayments market. Now that we see that being eliminated forever, we expect them to trade on same metrics as competition.

Physician Enablement Platforms

As of 5/12/2022	agilon	PRIVIA HEALTH	P3 Health Partners	apollomed
Strategy / Model	Partnership / Affiliation	Partnership / Affiliation	Partnership / Affiliation	Partnership / Affiliation
Total Membership	342,000	786,000	67,000	1,200,000
Aligned Physicians	1,600	3,300	2,000	9,600
Enterprise Value ($mm)	5,643	1,864	1,351	1,392
2021 Revenue	1,833	966	642	861
2022E Revenue *(midpoint)*	2,548	1,282	975	1,070
3-Year Revenue CAGR	*47.5%*	*17.1%*	*86.6%*	*24.0%*
2021 Adj. EBITDA	(39)	41	(33)	174
2022E Adj. EBITDA *(midpoint)*	5	56	(65)	151
2022E Implied Margin	*0.2%*	*4.4%*	*n/a*	*14.1%*
EV / Membership	16499.1x	2371.9x	20165.1x	1159.7x
EV / 2022E Revenue	2.2x	1.5x	1.4x	1.3x
EV / 2022E EBITDA	1128.5x	33.3x	*n/a*	9.2x

Updated as of Q1 2022 guidance; sources include investor presentations and Q1 earnings releases

Hospitalogy

Source: Breaking Down Physician Enablement Care Platforms – Workweek (May 12, 2022)

Conclusion

Citron can write volumes on why this business model is not viable and how management is deceptive with Wall Street. We will save this for another report. Some of the topics that have not been discussed but should be addressed are:

- More on how agilon recognizes medical margin?
- The inefficiencies of Direct Contracting
- How agilon recognize total revenue?
- The conflicts and related party transactions of management
- Industry trends in the primary care market
- The non-reliance of clinical data from agilon from early cohorts

The current state of the stock market, deservedly so, is that nothing makes a difference if the company will never achieve profitability. In the case of agilon, this fate was sealed by the high court of the United States.

Cautious Investing to All

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