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HEALTHCARE MANAGEMENT ADVISORS

Urgent Care: Understanding Value to Manage Transaction Expectations

Danielle Bangs, Manager, Veralon   **Jordan Klein**, Associate, Veralon

Urgent care is in the investor spotlight. Private equity, venture capital, health insurers, and health systems all want a piece of it, and transaction activity in the industry is high.

Despite this flurry of activity, the industry remains largely fragmented, and the size and nature of urgent care companies varies dramatically. This variation, as well as differences across buyers, has translated into a wide range of urgent care transaction multiples; between our own valuation work and data on other urgent care transactions, Veralon has seen sale prices in the industry ranging from 2x to 19x EBITDA.

Understanding what drives value – and variation in transaction prices – is crucial for managing expectations in a transaction, and ensuring that both parties are satisfied with what they received for their investment.

While all urgent care entities and transactions are unique, company value is largely a function of:

- Buyer’s standard of value
- Center-level profitability
- Size and scale
- Growth history and plans

BUYER’S STANDARD OF VALUE

Healthcare providers and private equity firms are not on an equal playing field for the type of value they can consider in arriving at a transaction price for an urgent care acquisition or investment. While most healthcare entities are restricted to consideration of the fair market value of the urgent care entity, PE firms and other non-provider entities are able to consider the strategic value of the entity and transaction.

CENTER-LEVEL PROFITABILITY

Patient Volume: Due to a largely fixed cost structure, once an urgent care center reaches breakeven, incremental volume largely feeds the bottom line. As a result, urgent care operators build their strategy around maximizing patient volume, by prioritizing location, visibility, and patient convenience.

Reimbursement Rates: While reimbursement rates for urgent care visits are relatively similar across markets, many factors can influence actual average reimbursement (payer mix, service offerings/mix, fee-for-service vs. global visit reimbursement), which in turn affects breakeven volume levels.

Urgent care centers that offer occupational medicine services experience lower average reimbursement, as reimbursement for these services is lower than that for typical urgent care visits. Concentra, for example, has a heavy occupational medicine service line and a lower valuation, on an EBITDA multiple basis, than other similarly sized urgent care companies.

Cost Structure Consideration – Provider Staffing: Provider costs are the most significant operating expense for most urgent care centers. All else being equal, centers that effectively leverage lower-cost clinicians are more profitable than those that rely exclusively on physicians.

SIZE AND SCALE

Size and scale allow urgent care companies to share overhead costs, thereby increasing profitability.

In addition, the number of centers a company has in operation is still correlated with higher sale prices, on an EBITDA multiple basis. A company with 20+ centers that each average $2M in EBITDA per year might sell at 10-12X EBITDA, but a company with 3 centers that each average $2M EBITDA per year might sell at 5-6X EBITDA.

One factor contributing to this is that private equity firms are more interested in bigger (10+ center) urgent care companies, which PE firms perceive as offering the growth platform they desire. Prices paid by private equity tend to be higher, for reasons previously discussed, than in transactions with a healthcare provider buyer.

GROWTH HISTORY AND PLANS

Recent Growth: An entity's growth track record speaks to its relative stability and/or risk. If a company were to have 10 centers in operation, but 7 were opened in the past year, there is start-up "risk" associated with the company, and a realization risk associated with projected volume and financial performance. This would require that the valuation include application of a higher company-specific "risk factor" for the purposes of discounting projected future cash flows.

Growth Plans: The degree to which growth plans are incorporated into a company's valuation, and the "risk factor" selected for those future growth plans, requires consideration of:

- Company track record: How many centers have they opened? Over what time period? How quickly did the centers "ramp-up," and how successful have they been?
- Substantiation of specific growth plans: Does the company have detailed business plans for additional centers, executed leases for new locations, or other tangible "proof" of future growth?
- Market capacity and saturation: Do the company's growth plans make sense in light of market capacity and current urgent care saturation?

An understanding of the factors influencing urgent care transaction prices and value allows for appropriate expectation setting on both sides of the table, ultimately contributing to positive transaction discussions and sound decision-making.

877.676.3600 www.veralon.com info@veralon.com