Modern Healthcare

Medicare Advantage Market Shows Signs of Valuation Bubble Ready to Burst

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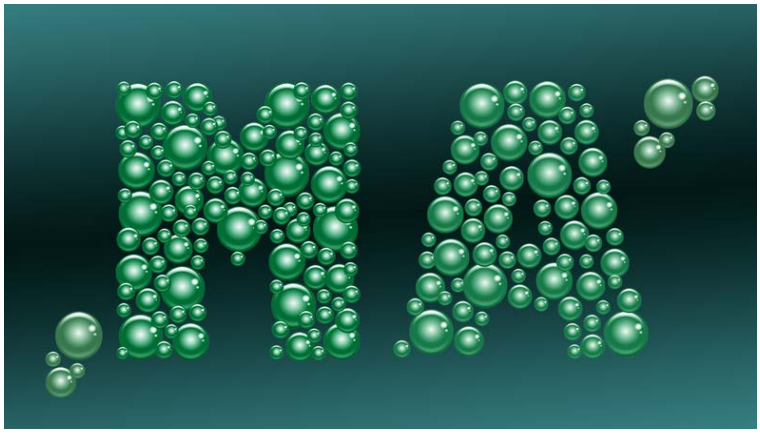


The past several years have seen headline after headline about investors buying up Medicare Advantage-focused providers for huge sums of money and throwing cash behind startup insurers that promise to disrupt the $350 billion market. Meanwhile, there's been an eye-popping number of new ventures seeking to capture a corner of the growing patient population.

This all prompts the question: Is the MA market in a bubble? If it is, some of the companies that are flying high today could run the risk of having their valuations tank if they run afoul of future regulations or get saddled with substantial fines after government audits. This fate has already befallen some startups that entered the public market with hot valuations but whose stock price has since cooled.

"If you believe the valuations at their peak, our country was bankrupt," said Ari Gottlieb, a principal at A2 Strategy Group. "Because the amount of money we would have spent on healthcare to justify these valuations was ludicrous."

Whatever happens, capitalism promises winners and losers, and not all companies are destined for success in this crowded market, said Alignment Healthcare CEO John Kao. Although Alignment's stock has dropped nearly 21% since the MA-insurtech's public debut in March, the startup has retained the most value out of all the other young insurers and many of the value-based care providers that went public this year.

"We do expect there to be a shake-up, and that's already started. The wheat is separating itself from the chaff, so to speak," Kao said, adding: "It's kind of like, if the bubble is gonna burst more next year, then I don't know how much lower this stuff can get."

Consider Miami-based Cano Health, an MA and Medicaid-focused primary-care provider that was valued at $4.4 billion when it went public via a special purpose acquisition company over the summer. The company, which declined to comment, lost 37% of its share value between its stock market debut and Dec. 10. Nonetheless, Cano has been on a buying spree in South Florida, nabbing University Health Care for $600 million and then Doctors Medical Center for $300 million.

Another example is Clover Health, an MA-focused insurtech whose stock has, as of Dec. 10, dropped nearly 72% since the startup went public via a $3.7 billion special purpose acquisition company at the start of the year. The memestock startup, which is backed by social media investor Chamath Palihapitiya, aims to differentiate itself

through its wide network approach, claiming its Clover AI Assistant tech platform can guarantee patients high quality and low costs at any doctor they visit. More than 60,000 practitioners are in Clover's network. The company offers the technology free for contracted clinicians to use and pays doctors an average of $200 for every visit that they use the tech.

“We want the doctors to focus on accuracy; there’s no incentive we give them to code up or down,” Clover Health President Andrew Toy said.

At the same time, the company is banking on the Centers for Medicare and Medicaid Services’ Direct Contracting program, which enlists private insurers to manage the care for traditional Medicare enrollees. Clover generates more than half of its revenue through the program, which Toy said is the future of Medicare. CMS barred new entrants from participating in Medicare Advantage earlier this year.

Critics have said Clover’s ultimate strategy is to leverage the program to turn traditional Medicare enrollees to members of its privatized preferred provider organization, and alleged that its tech automatically upcodes every patient condition and recommends physicians order unnecessary tests.

“We truly see ourselves as a Medicare company, not MA,” Toy said. “We help Medicare eligibles. We use the Clover Assistant, we use the same approach. A lot of other MA companies haven’t done that because when you take a narrow-network strategy, it’s very hard to translate that to fee-for-service original Medicare. Because we already were taking a wide network strategy, it worked out for us. It’s not exactly the same, but there’s more organic growth to move into fee-for-service.”

More enforcement to come

A chief question in this debate is whether these companies actually deliver better care to seniors for less money. To that end, there have been discouraging signs.

A recent report from Health and Human Services’ Office of Inspector General noted that 20 MA insurers accounted for more than half of the $9.2 billion in federal government payments for care that beneficiaries may not have needed or received in 2016. UnitedHealthcare enrolled 22% of MA enrollees and generated 40% of its payments that year by listing conditions that weren’t verified in medical claims, federal investigators said.

The U.S. Justice Department has been intervening in whistleblower lawsuits related to MA programs, including those run by Independent Health and Kaiser Permanente. OIG’s audits have accused Anthem and Humana of misrepresenting their members’ illness to bilk the government out of billions.

“What it looks like is people have become really good at gaming the system,” said Greg Hagood, senior managing director with SOLIC Capital Advisors.

Medicare payments to MA plans were 104% more than traditional Medicare in 2021, according to the Medicare Payment Advisory Commission.

Some MA providers argue that’s because their patients are disproportionately sicker, lower income and more likely to be members of minority groups compared with fee-for-service Medicare. A recent Commonwealth Fund report disputed that assertion, finding that MA enrollees do not differ significantly from those in traditional Medicare with respect to race, income or chronic conditions. The same report found that members of both programs visited hospitals and emergency departments at the same frequency, despite MA members receiving more care management services.

The similarities in patient outcomes and profiles raise the question of why MA plans cost the government more than fee-for-service Medicare, Gretchen Jacobson, the Commonwealth Fund's vice president for Medicare and the report's author, told Modern Healthcare in October.

"How valuable are those extra services if the outcomes are the same?" Jacobson said. "It's really important for the government and policymakers to evaluate this, given Medicare Advantage plans right now are paid more than what it would cost to provide the same care to people in traditional Medicare."

Other MA providers argue that if MA didn't offer an attractive proposition to patients, the number of older adults enrolling in the program would not be increasing.

One thing is for sure: MA's popularity, combined with pressure from insurers, could be preventing lawmakers from making big changes to the program. More than a dozen U.S. senators from both parties wrote to CMS in October that they "stand ready" to protect Medicare Advantage from payment cuts.

"Changing Medicare Advantage is probably one of the hardest things to do because it involves really big money with really big business," Hagood said, "and they use the retired population as a bargaining chip."

Since there's not enough political will to regulate MA through the "front door"—broad-scale legislative changes—it's going to happen through the "back door": audits and small regulatory tweaks, said Eric Klein, a partner at Sheppard Mullin who leads its national healthcare practice.

"We're going to see a lot more enforcement activity," he said. "We're also going to see a lot more regulatory changes. It's going to be incremental. They're going to take it bit by bit."

For his part, Klein disagrees that the segment is in a bubble. Rather, he thinks it's just catching up with a bottleneck in supply that's existed for years, especially since the Affordable Care Act and subsequent presidential administrations have shifted the focus to value-based care. Regardless, he expects some of the new entrants to fail.

Mike Pykosz, CEO of Oak Street Health, said he thinks the influx of new MA players is "really exciting." His company's roughly 100 clinics can't realistically handle the more than 60 million Medicare patients out there.

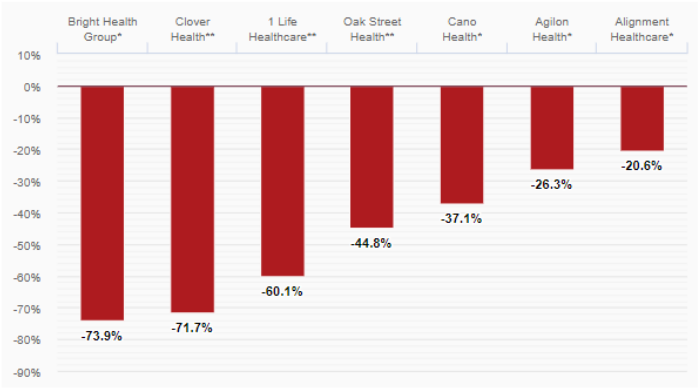
"Some will be successful—I'm very confident Oak Street will be one—some may not," Pykosz said. "But we need that. We need that level of innovation. It's great for the country. Ten years from now, we're going to be much better off for older adults and the care they're receiving and we'll be much better off in the country because of it."

Pykosz counts himself in the no bubble camp. In fact, when it comes to Oak Street, he thinks it's undervalued. Nonetheless, the company's stock had shed almost 45% of its value in 2021 as of Dec. 10.

VALUATION CHANGES IN VALUE-BASED STARTUPS

Stock prices of startups focused on value-based care, particularly Medicare Advantage, fell over the course of 2021. Investors will likely be more cautious with their cash come 2022, experts say.

The chart below is interactive: click or touch to see more.



Notes

Initial value is price at closing on the day of the IPO.
Comparison of stock results as of Dec. 10, with start dates as noted:
* IPO during 2021
** Price beginning Jan. 4, 2021
1 Life Healthcare (One Medical) announced acquisition of Iora Healthcare in June 2021.
Source: Modern Healthcare reporting

The company's disclosure during the third quarter that regulators were investigating its business threw the entire MA industry into a tailspin, because it signaled to investors how easily these companies could violate regulations, A2 Strategy's Gottlieb said. He said investors were distracted by the size of the MA market and, during the first six months of 2021 threw cash indiscriminately at every startup that promised to disrupt the system.

After watching stock prices fall during the second half of the year, Gottlieb said he expects investors to be more skeptical come 2022.

"There is a fundamental issue that investors at the peak did not recognize, which was they believed the value that these companies were creating could be created in perpetuity and could be expanded to take all the excess spending out of the system," he said. "That just was never the case because the road gets re-baselined. The more successful they are, the harder it is for them in the future at some point."

Companies emphasize their differences

Getty Images

MEDICARE ADVANTAGE MARKET VALUE:
$350
BILLION

In interviews, MA providers and payers are quick to differentiate themselves from their peers. They caution against lumping these companies together, as they all have unique approaches to care delivery.

For example, Iora Health, the MA-focused primary-care provider that recently became part of One Medical, has experience on its side, said Dr. Rushika Fernandopulle, the company's founder and now One Medical's chief innovation officer. Iora and One Medical have been in business for almost 20 years, he said.

"When we started, this was not cool," Fernandopulle said. "People thought we were crazy, actually. The opposite of cool."

But that longevity hasn't prevented One Medical's stock from suffering the same fate as other MA providers this year. One Medical stock lost 60% of its value in 2021 as of Dec. 10.

Another Medicare Advantage-focused company, Agilon Health, is unique in that it doesn't have clinics and its providers don't operate under the Agilon brand. That's because Agilon is a so-called physician enablement company, meaning it partners with independent primary-care practices and adds its staff and technology to help them better manage care for their MA patients.

"This is allowing them to move into the new world of value-based care," said Steve Sell, Agilon's CEO. "There's not really a great alternative to do that right now other than selling your practice to an Optum Care or a hospital."

Agilon's shares lost about 26% of their value between its initial public offering in April and Dec. 10. Sell declined to comment publicly on the company's valuation.

Part of what's driven the initial valuations so high is massive buy-in from private equity and venture capital, for whom value-based care is the investment fad du jour. When the global private equity firm Sun Capital Partners bought Miami Beach Medical Group, the $500 million price tag was more than a dozen times the company's earnings.

“If you look at the overall demographics, I think you’re seeing a perspective that there really is a ton of growth that is embedded into this marketplace,” said Pete Magas, a partner with BPOC, a healthcare private equity firm focused on the middle market. “And where there is growth, there is opportunity."

It’s not just senior-focused value-based care that investors are interested in, it’s also primary care, which many believe has long been undervalued, Magas said.

Iora’s Fernandopulle thinks his company’s model of changing how people get primary care—adding health coaches and social workers and supplementing care through emails and texts—sets it apart.

“Our core proposition is if you‘re not changing how actual people get actual care, it’s a waste of time,” Fernandopulle said. “In general, the only way to really add value in the big picture is to actually make people healthier.”

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