AdaptHealth Corp.

Medicare rate risk for Diabetes could be material but few years out

Maintain Rating: UNDERPERFORM | PO: 6.50 USD | Price: 7.85 USD

Rate risk for CGMs material but few years out

Recently, the Office of Inspector General (OIG) said that it will look at Medicare payments for Continuous Glucose Monitors (CGMs), with a summary report expected in 2025. In the worst-case scenario (Medicare uses rates paid under the commercial pharmacy benefit), it would be an 11% cut to AHCO's Adj EBITDA before any offsets. However, the more likely scenario is that the rate cut is smaller given the service component and the tools available to make the rate changes (Congressional action required to move to the pharmacy benefit). The changes would likely take effect in 2027+. We maintain our Underperform rating given the uncertainties regarding the long-term organic growth profile.

Estimate every 1% cut to Medicare CGM rates is 0.4% to EBITDA

Given the shift into the lower gross margin pharmacy benefit in commercial, AHCO has focused more on the government payors, such as Medicare, Medicaid, and Veterans' Affairs, by utilizing its existing sales force to reach to new referral sources. Assuming that CGMs represent 80% of AHCO's Diabetes segment (the rest is pumps, strips, supplies) and 50% is paid under Medicare, we estimate that every 1% cut to Medicare equates to a $3m cut to revenues and falls through to the bottom line, translating to a 0.4% cut EBITDA before offsets.

Worst-case 11% cut to EBITDA before offsets

If Medicare were to match the rates paid by commercial plans under the pharmacy benefit, it would be a 30% cut to rates (see BofA Global Research Medtech's report). This implies an $86m or 2% cut to AHCO's total revenues or 11% to Adj EBITDA before any offsets. There could be an offset from more volumes given a lower co-pay and potential expansion of coverage to non-insulin patients over time. We view this scenario as less likely as a shift from Medicare Part B to Part D (pharmacy) would require Congressional action. We think that a more likely scenario is that CMS reduces rates by less than that, as it would continue to cover services (training/support). We estimate that a 15% cut would be 6% to AHCO's EBITDA before any offsets.

CMS could cut rates or add CGM to competitive bidding

The OIG will compare Medicare payments to prices available to consumers and supplier acquisition costs. If it finds that Medicare rates "greatly exceed" their acquisition costs, it believes that CMS has the authority to adjust rates by either 1) cutting rates (using the Inherent Reasonable authority has been controversial) or 2) adding CGMs to the competitive bidding (CB) program. The prior CB cycles resulted in 30-40% price cuts.

Rate changes few years away

The latest round of CB was deferred because CMS did not see savings for those categories, and the biggest risk has been that CB will be expanded to new categories. The CB is now on hold for 2024, and CMS has stated that it will go through a comment and rulemaking process to re-establish a new CB program, which means that it would take at least 9 months before rolling it out. If the OIG report comes out in mid-2025, the CB rates would likely be effective for 2027 or later. In a positive, if this were to play out the way the earlier rounds of CB did, it could result in smaller players dropping out, creating share gains that could mitigate the impact to AHCO.

Refer to important disclosures on page 3 to 5. Analyst Certification on page 2. Price Objective Basis/Risk on page 2. 12639010

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Equity

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Stock Data

Price	7.85 USD
Price Objective	6.50 USD
Date Established	8-Nov-2023
Investment Opinion	C-3-9
52-Week Range	6.37 USD - 22.94 USD
Mrkt Val (mn) / Shares Out (mn)	1,060 USD / 135.0
Free Float	57.7%
Average Daily Value (mn)	10.01 USD
BofA Ticker / Exchange	AHCO / NAS
Bloomberg / Reuters	AHCO US / AHCO.OQ
ROE (2023E)	-20.2%
Net Dbt to Eqty (Dec-2022A)	104.1%
ESGMeter™	Medium

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CMS = Centers for Medicare and Medicaid Services

Price objective basis & risk

AdaptHealth Corp. (AHCO)

Our $6.50 PO is based on 8.3x our 2024E Adj EBITDA less capex, discount to the current multiple of home health peer (9x) as AHCO as weight-loss drugs pose a risk to its long-term organic growth profile, while Diabetes business growth decelerates.

Downside risks to our PO: 1) Organic growth is lower than expected. 2) Medicare reimbursement is worse than expected. 3) Deal integration issues arise. 4) Competitive risk from distributors and new technologies is worse than expected. 5) GLP1 headwind materializes faster.

Upside risks: 1) Organic growth is faster than expected, 2) The company executes better on cost cutting. 3) The headwinds to Diabetes business dissipate.

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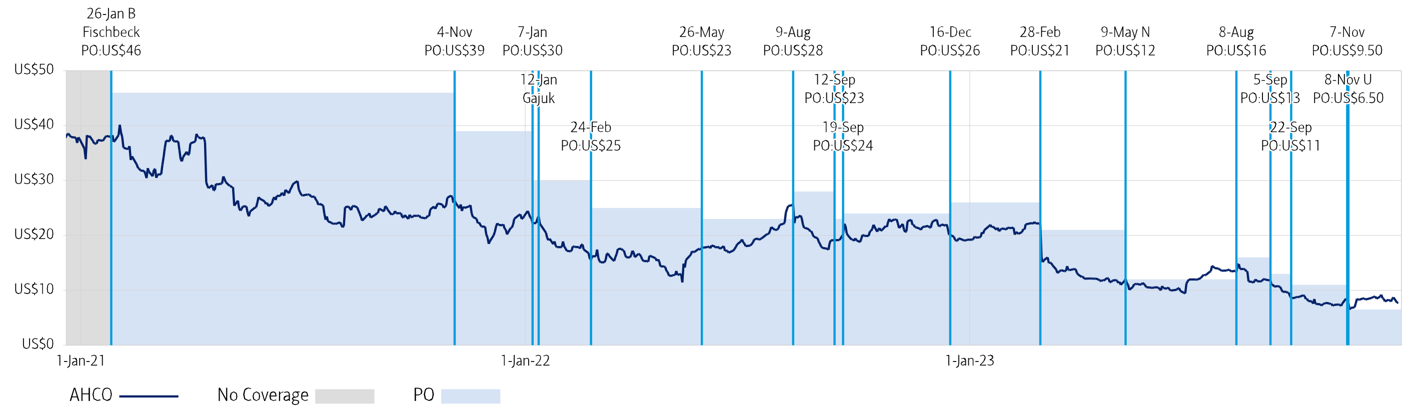
AdaptHealth Corp. (AHCO) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
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Hold	83	21.45%	Hold	33	39.76%
Sell	71	18.35%	Sell	25	35.21%

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