

Surgery Partners, Inc

Quick takes from the call, raising ests

Reiterate Rating: BUY | PO: 44.00 USD | Price: 33.04 USD

Shoulders/Ankles the next shift to outpatient

Total Shoulder and Ankle surgeries can now be done in Medicare, opening new cases as well as new doctors for SGRY to try to recruit. SGRY noted the knock-on effect of adding more procedures to the list of cases that can be done in an ASC. 8% CAGR in orthopedic cases as orthopods brought hips/knees, but also other procedures with them. We are raising our 2024/25 EBITDA ests and rolling out 2026. Our PO of \$44 represents 17.1x 2024E EBITDA less NCI (vs 17.2x prior). We reaffirm our Buy rating.

Rates driven by acuity, margins to improve

Rates benefiting from recruiting doctors with total joints (now in over 35% of facilities). 50% increase in total joints in 2023. Majority of de novos and deals have an ortho focus which should drive rate growth at/above LT targets of 2-3%. Cost discipline, acuity mix, and enhanced pricing helped margins (50bps on supplies and SWB) and will see run rate benefits in 2024. Margins also get a benefit from the growth in non-consolidated assets (which only show up as equity in earnings on the P&L).

Strong deal pipeline, 10 de novos/year

Spent \$165m on 15 deals at multiples under 8x pre-synergies (synergies lower multiple 1x within 18 months). \$165m is below its \$200m target, but it closed another \$60m in early January. Focused on deploying another \$200m in 2024 beyond the \$60m in Jan. Strong deal pipeline (over \$200m of deals under Letters of Intent). 8 de novos in 2023, 12 under development for 2024/early 2025, with goal of opening 10/year. These de novos includes consolidated and unconsolidated as well as 2-way and 3-way JVs.

Balance sheet improvement despite 1x items

Refinanced the term loan to 2030, increased revolver to \$700m. 3.5x credit agreement leverage (change in the calc lowered the ratio by 0.4x). Expects to continue to lower leverage, may not be a straight line depending on deals timing. First year of positive FCF in 2023 (\$110m) with the \$30m shortfall vs guide due to timing of collections due to cyberthreat in '23 (moved to paper billing for a period) and slowdowns in state supplemental payments which will settle in '24/'25. EBITDA growth to drive \$150m of FCF in '24. \$320m of 10% bonds callable in April could create interest rate savings.

Estimates(Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.05	1.00	1.04	1.19	1.48
GAAP EPS	(0.58)	(0.09)	0.28	0.41	0.70
EPS Change (YoY)	NM	NM	4.0%	14.4%	24.4%
Consensus EPS (Bloomberg)	0.10	0.92	1.07	1.23	1.63
Valuation (Dec)					
P/E	660.8x	33.0x	31.8x	27.8x	22.3x
GAAP P/E	NM	NM	118.0x	80.6x	47.2x
EV / EBITDA*	19.8x	17.2x	15.2x	13.8x	12.5x
Free Cash Flow Yield*	1.9%	4.9%	7.5%	8.1%	9.3%

* For full definitions of *IQmethod*SM measures, see page 4.

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Timestamp: 26 February 2024 11:58AM EST

26 February 2024

Equity

Key Changes

(US\$)	Previous	Current
2026E Rev (m)	NA	3,615.8
2024E EBITDA (m)	490.0	495.0
2025E EBITDA (m)	542.2	547.2
2026E EBITDA (m)	NA	603.8

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Stock Data

Price	33.04 USD
Price Objective	44.00 USD
Date Established	7-Nov-2023
Investment Opinion	C-1-9
52-Week Range	22.05 USD - 45.79 USD
Mkt Val (mn) / Shares Out (mn)	4,209 USD / 127.4
Free Float	59.4%
Average Daily Value (mn)	27.49 USD
BofA Ticker / Exchange	SGRY / NAS
Bloomberg / Reuters	SGRY US / SGRY.OQ
ROE (2024E)	4.3%
Net Dbt to Eqty (Dec-2023A)	76.7%
ESGMeter TM	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

SGRY = Surgery Partners, MCO = Managed care organization, LT = Long-term, HSD = High single digit, LDD = Low double digit, ASC = Ambulatory surgery center

iQprofileSM Surgery Partners, Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	4.6%	4.7%	6.3%	6.7%	14.9%
Return on Equity	0.2%	4.3%	4.3%	4.7%	11.4%
Operating Margin	13.6%	12.0%	15.4%	15.9%	16.4%
Free Cash Flow	78	205	317	342	391

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	34.3x	2.3x	3.1x	3.0x	2.7x
Asset Replacement Ratio	0.7x	0.8x	0.8x	0.8x	0.8x
Tax Rate	21.1%	NM	11.4%	11.4%	11.4%
Net Debt-to-Equity Ratio	71.2%	76.7%	76.0%	74.9%	NA
Interest Cover	1.5x	1.7x	2.3x	2.4x	2.6x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	2,539	2,743	3,018	3,304	3,616
% Change	14.1%	8.0%	10.0%	9.5%	9.5%
Gross Profit	1,830	1,998	2,197	2,405	2,632
% Change	15.2%	9.2%	9.9%	9.5%	9.5%
EBITDA	380	438	495	547	604
% Change	12.0%	15.2%	13.0%	10.5%	10.4%
Net Interest & Other Income	(235)	(193)	(203)	(223)	(227)
Net Income (Adjusted)	5	127	132	152	190
% Change	NM	NM	4.2%	14.9%	24.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(55)	(12)	36	53	90
Depreciation & Amortization	115	118	129	137	145
Change in Working Capital	(161)	(108)	(255)	(262)	(267)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	259	296	505	521	541
Capital Expenditure	(81)	(89)	(98)	(107)	(118)
Free Cash Flow	78	205	317	342	391
% Change	165.1%	162.1%	54.5%	7.9%	14.5%
Share / Issue Repurchase	0	0	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	(644)	43	79	73	43

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	283	196	196	196	0
Trade Receivables	456	500	558	612	0
Other Current Assets	182	199	221	241	0
Property, Plant & Equipment	877	960	1,057	1,165	0
Other Non-Current Assets	4,885	5,022	5,222	5,422	0
Total Assets	6,682	6,877	7,254	7,636	0
Short-Term Debt	63	73	73	73	0
Other Current Liabilities	431	523	551	578	0
Long-Term Debt	2,559	2,702	2,781	2,853	0
Other Non-Current Liabilities	347	217	352	484	0
Total Liabilities	3,399	3,515	3,758	3,989	0
Total Equity	3,283	3,362	3,496	3,646	0
Total Equity & Liabilities	6,682	6,877	7,254	7,636	0

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Medical Specialty

Company Description

SGRY operates one of the largest networks of outpatient surgery facilities in the US, consisting of 113 ambulatory surgery centers and 15 surgical hospitals in 31 states. SGRY also has ancillary services comprised of a diagnostic lab, multi-specialty physician practices, urgent care facilities, anesthesia services, and optical services.

Investment Rationale

We like the long-term fundamentals of the business, given ambulatory surgery centers' (ASCs) positioning as the low cost setting for care, which should drive organic growth. Also, ASCs are less exposed to labor than inpatient settings. Finally, we expect the company to supplement growth with acquisitions.

Stock Data

Average Daily Volume 831,909

Quarterly Earnings Estimates

	2023	2024
Q1	0.09A	0.07E
Q2	0.28A	0.17E
Q3	0.19A	0.21E
Q4	0.44A	0.60E

Price objective basis & risk

Surgery Partners, Inc (SGRY)

Our \$44 PO is based on a multiple of 17.1x our 2024E EBITDA-NCI estimate, a premium to the company's historical avg multiple of 13.1x since 2015 and above the 3-year average of 17x. We think the premium to the historical average is justified by the acceleration in the shift to the outpatient settings driving above-average long-term organic growth. In addition to the strong organic growth, we expect a robust M&A. The multiple is adjusted for the dilution of convertible preferred equity shares.

Downside risks are 1) worse-than-expected organic growth, 2) failure of physician recruitment investments to come online on time, 3) potential rate pressure from Medicare or commercial payors, and 4) deal integration risks. SGRY also has above-average leverage, although improving.

Analyst Certification

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US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Acadia Healthcare	ACHC	ACHC US	Kevin Fischbeck, CFA
	Addus HomeCare	ADUS	ADUS US	Joanna Gajuk
	Agilon Health	AGL	AGL US	Adam Ron
	Astrana Health Inc	ASTH	ASTH US	Adam Ron
	BrightSpring Health Services	BTSG	BTSG US	Joanna Gajuk
	Chemed Corporation	CHE	CHE US	Joanna Gajuk
	Elevance Health Inc	ELV	ELV US	Kevin Fischbeck, CFA
	Encompass Health	EHC	EHC US	Kevin Fischbeck, CFA
	HCA	HCA	HCA US	Kevin Fischbeck, CFA
	Humana Inc	HUM	HUM US	Kevin Fischbeck, CFA
	Option Care Health	OPCH	OPCH US	Joanna Gajuk
	Oscar Health	OSCR	OSCR US	Adam Ron
	Select Medical Corp.	SEM	SEM US	Kevin Fischbeck, CFA
	Service Corp.	SCI	SCI US	Joanna Gajuk
	Surgery Partners, Inc	SGRY	SGRY US	Kevin Fischbeck, CFA
	Tenet Healthcare	THC	THC US	Kevin Fischbeck, CFA
	The Cigna Group	CI	CI US	Kevin Fischbeck, CFA
	UnitedHealth Group	UNH	UNH US	Kevin Fischbeck, CFA
	Universal Health Services	UHS	UHS US	Kevin Fischbeck, CFA
	US Physical Therapy	USPH	USPH US	Joanna Gajuk
NEUTRAL				
	Alignment Healthcare	ALHC	ALHC US	Adam Ron
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	Brookdale	BKD	BKD US	Joanna Gajuk
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA
	Privia Health	PRVA	PRVA US	Adam Ron
UNDERPERFORM				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	Cross Country Healthcare	CCRN	CCRN US	Kevin Fischbeck, CFA
	DaVita Inc	DVA	DVA US	Kevin Fischbeck, CFA



US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Enhabit Home Health & Hospice	EHAB	EHAB US	Joanna Gajuk
	Pediatric Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	$\text{Cash Flow From Operations} - \text{Total Capex}$	N/A
Quality of Earnings	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	$\text{Cash Flow From Operations} - \text{Total Capex}$	$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	$\text{Basic EBIT} + \text{Depreciation} + \text{Amortization}$

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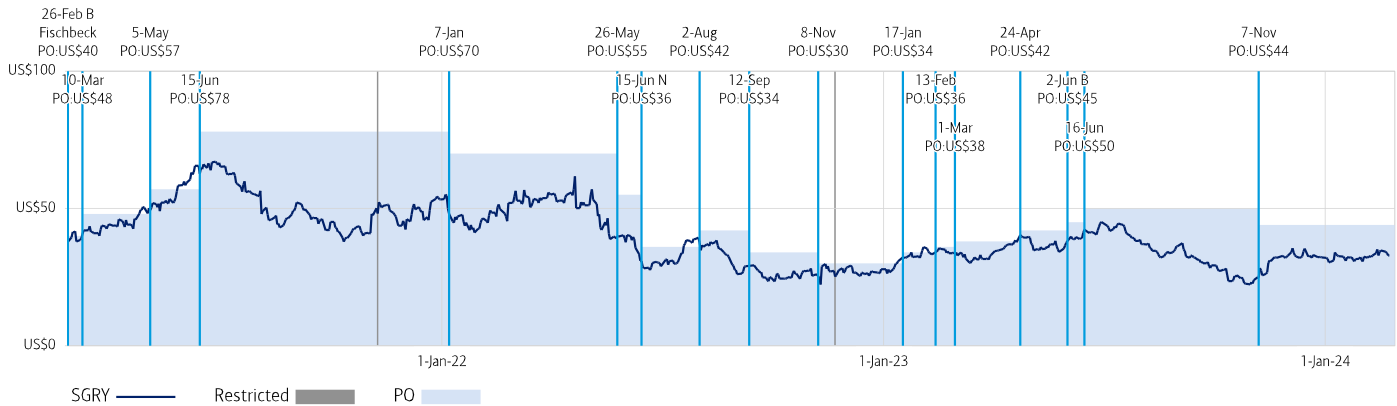
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Surgery Partners (SGRY) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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