

Surgery Partners, Inc

Quick takes from the call, raising ests

Reiterate Rating: BUY | PO: 50.00 USD | Price: 36.21 USD

Guide raised, above average growth through 2023

SGRY raised the Adjusted EBITDA guidance by 1% despite the headwind from the cyber event, calling for at least 14% growth in 2023. Expects volume and rev/case to be above the LT outlook (2-3% vol, 2-3% pricing) due to physician recruiting and targeting higher acuity. Expects Q3 to be 24% of adjusted EBITDA and 24.5% of revenue. This implies that Q3 EBITDA is 1% below consensus and the implied Q4 is 2% above consensus. Finally, management was confident in its ability to grow adjusted EBITDA by mid-teens next year. Overall, the quarter was in-line with expectations with strong EBITDA growth and a modest beat/raise signaling that numbers continue to move up. We are raising our adjusted EBITDA ests. Our \$50 PO represents 18.7x our 2024E EBITDA less NCI vs 18.8x prior. We reaffirm our Buy rating.

Volume growth broad based

Reported same store case growth of 2.3% would be closer to 3% excluding the cyber event. Specialty case mix is where it was expected as all specialties have recovered since 2022. In particular, Mgmt continues to be bullish on the growth outlook for Ortho over the next few years, noting that total joints were up 73%. The company highlighted continued progress on physician recruiting. Finally, the company was bullish on its de novo pipeline within both consolidated and unconsolidated facilities.

Portfolio repositioning continues, growing unconsolidated

SGRY spent \$119m on M&A at multiples under 8x. Recent deals have skewed towards unconsolidated assets, which will accelerate over the next 12-18 months as de novos and deals with JV partners ramp. SGRY noted that when it buys a Minority interest in a facility it tends to be a lower multiple than avg but then sees two advantages, 1) SGRY gets a mgmt fee and benefits from the synergies it brings through its equity in earnings of affiliates, and 2) these deals add scale which it can leverage across the portfolio through things like better procurement. On the other end, SGRY continues to sell assets with less opportunity to grow - sold 5 facilities with another 2-4 sales over the next 6 months with proceeds redeployed accretively. So far, divestitures are over a \$100m rev headwind, but will replace that revenue through redeploying proceeds over time.

Estimates(Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	(0.12)	0.05	0.80	0.74	0.97
GAAP EPS	(1.24)	(0.58)	0.07	0.20	0.44
EPS Change (YoY)	94.3%	NM	NM	-7.5%	31.1%
Consensus EPS (Bloomberg)	(0.18)	0.09	0.60	0.83	1.05
Valuation (Dec)					
P/E	NM	724.2x	45.3x	48.9x	37.3x
GAAP P/E	NM	NM	517.3x	181.1x	82.3x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	22.8x	20.3x	17.8x	15.8x	14.3x
Free Cash Flow Yield*	0.6%	1.7%	3.3%	6.8%	7.8%

* For full definitions of *IQmethod*SM measures, see page 5.

01 August 2023

Equity

Key Changes

(US\$)	Previous	Current
2023E EBITDA (m)	430.0	435.0
2024E EBITDA (m)	485.0	490.0
2025E EBITDA (m)	535.2	540.2

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Stock Data

Price	36.21 USD
Price Objective	50.00 USD
Date Established	16-Jun-2023
Investment Opinion	C-1-9
52-Week Range	20.46 USD - 45.79 USD
Mrkt Val (mn) / Shares Out (mn)	4612 USD / 127.4
Average Daily Value (mn)	30.18 USD
BofA Ticker / Exchange	SGRY / NAS
Bloomberg / Reuters	SGRY US / SGRY.OQ
ROE (2023E)	3.4%
Net Dbt to Eqty (Dec-2022A)	71.2%
ESGMeter™	Medium

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SGRY = Surgery Partners

LT = Long-term

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Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 01 August 2023 10:33AM EDT

iQprofileSM Surgery Partners, Inc

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	5.0%	4.6%	5.2%	5.4%	5.8%
Return on Equity	-0.5%	0.2%	3.4%	3.1%	3.8%
Operating Margin	13.6%	13.6%	13.1%	14.6%	15.2%
Free Cash Flow	30	78	152	315	361

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	NM	34.3x	2.4x	4.4x	3.7x
Asset Replacement Ratio	0.6x	0.7x	0.7x	0.6x	0.7x
Tax Rate	12.9%	21.1%	8.7%	20.0%	20.0%
Net Debt-to-Equity Ratio	110.8%	71.2%	74.1%	73.1%	70.8%
Interest Cover	1.4x	1.5x	1.9x	2.3x	2.6x

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	2,225	2,539	2,750	3,026	3,298
% Change	19.6%	14.1%	8.3%	10.0%	9.0%
Gross Profit	1,589	1,830	1,993	2,194	2,394
% Change	20.2%	15.2%	8.9%	10.1%	9.1%
EBITDA	340	380	435	490	540
% Change	34.3%	12.0%	14.4%	12.6%	10.2%
Net Interest & Other Income	(221)	(235)	(190)	(191)	(191)
Net Income (Adjusted)	(9)	5	102	95	125
% Change	91.6%	NM	NM	-7.0%	31.6%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	(71)	(55)	9	26	56
Depreciation & Amortization	99	115	128	155	163
Change in Working Capital	(181)	(161)	(293)	(240)	(257)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	241	259	396	472	505
Capital Expenditure	(58)	(81)	(88)	(96)	(106)
Free Cash Flow	30	78	152	315	361
% Change	-87.2%	165.1%	94.8%	107.1%	14.4%

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	390	283	215	215	215
Trade Receivables	430	456	505	547	596
Other Current Assets	126	182	193	209	227
Property, Plant & Equipment	630	877	908	1,004	1,110
Other Non-Current Assets	4,542	4,885	4,992	5,192	5,392
Total Assets	6,118	6,682	6,813	7,167	7,540
Short-Term Debt	60	63	63	63	63
Other Current Liabilities	476	431	450	470	494
Long-Term Debt	2,878	2,559	2,655	2,715	2,745
Other Non-Current Liabilities	403	347	268	414	574
Total Liabilities	3,818	3,399	3,435	3,661	3,876
Total Equity	2,300	3,283	3,377	3,505	3,664
Total Equity & Liabilities	6,118	6,682	6,813	7,167	7,540

* For full definitions of iQmethodSM measures, see page 5.

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

833,499

Quarterly Earnings Estimates

	2022	2023
Q1	-0.09A	0.09A
Q2	-0.03A	0.28A
Q3	-0.02A	0.13E
Q4	0.20A	0.31E



Price objective basis & risk

Surgery Partners, Inc (SGRY)

Our \$50 PO is based on a multiple of 18.7x 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
	Alignment Healthcare	ALHC	ALHC US	Kevin Fischbeck, CFA
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	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
	Privia Health	PRVA	PRVA 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				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	Apollo Medical	AMEH	AMEH US	Adam Ron
	Community Health Systems	CYH	CYH US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA
	Oscar Health	OSCR	OSCR US	Kevin Fischbeck, CFA
UNDERPERFORM				
	Aveanna Healthcare	AVAH	AVAH US	Joanna Gajuk
	Bright Health Group	BHG	BHG US	Adam Ron
	Brookdale	BKD	BKD US	Joanna Gajuk
	Cano Health	CANO	CANO US	Adam Ron
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Clover Health	CLOV	CLOV US	Kevin Fischbeck, CFA
	Cross Country Healthcare	CCRN	CCRN US	Kevin Fischbeck, CFA

US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

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

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

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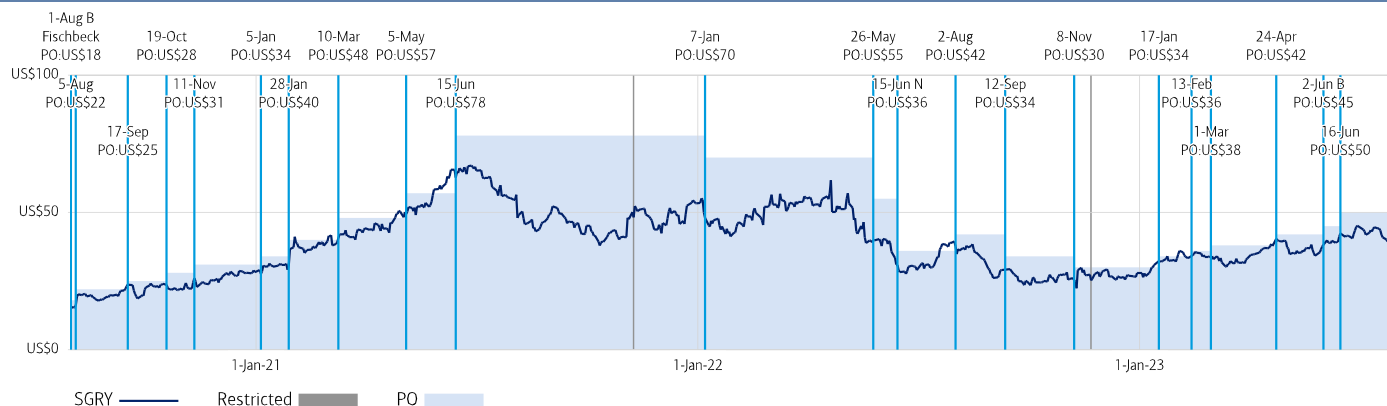
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Surgery Partners (SGRY) Price Chart



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 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	236	57.84%	Buy	105	44.49%
Hold	87	21.32%	Hold	38	43.68%
Sell	85	20.83%	Sell	22	25.88%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{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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