

## Apollo Medical

# Upgrading to Buy as embedded earnings begin to show up in results

Rating Change: BUY | PO: 55.00 USD | Price: 38.75 USD

## Now see 40% upside, estimates above consensus

We are upgrading AMEH to Buy on what we see as an inflection point in the growth story, with a high confidence path to sustaining 30-40%+ revenue and 20%+ EBITDA growth through at least 2026. As a result, we are raising our estimates above the Street, with 2024E-2026E Adj. EBITDA now 7-13% above consensus. Additionally, we are lifting our PO from \$44 to \$55 which now represents 42% upside (same 15x multiple on higher 2025E Adjusted EBITDA forecast).

## Path to double revenue without geographic expansion

AMEH manages ~\$3.2b of medical spend, but only recognizes \$1.4b of it as revenue because \$1.8b of spend is housed 'off balance sheet' in either partial risk or MSO arrangements. However, the company is in process of converting almost all of that into full-risk revenue through its new RKK (license to take full risk in California) as well as the acquisition of a provider group (CFC) which will insource its largest MSO customer. If the transition is completed by 2026 (management guiding to a couple of years), this would more than double revenue and implies a nearly 40% revenue CAGR from 2023 before taking into account growth beyond its existing geographic footprint.

## High confidence building blocks in earnings acceleration

While only a portion of the converted revenue is expected to translate into profitability, there are a number of other discrete tailwinds building: 1) New organic contract wins, including one from a provider group that had exclusively relied on a large competitor (PRVA), highlights the durability of AMEH's market share in California, 2) Pipeline of accretive tuck-in M&A continues to get realized, 3) A legal restructuring leading to a sizable reduction of its corporate tax rate expands FCF conversion, 4) the loss of a \$20m-\$30m NextGen ACO payment in 2022, and \$5-\$10m of annual new market entry costs in 2023 are now built into the run-rate, and 5) End of Medicaid redeterminations (its largest customer segment) in 2024 will support same store growth. The only headwind appears to be the new risk adjustment model phase in from 2024-2026, which is a negative for VBC companies. However, particularly in CA, most large MA plans have already started cutting benefits ([which is why ALHC is growing nearly 50%](#)). If AMEH is right that it codes less than average, the benefit cuts should offset most of the impact.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	1.63	1.08	1.25	2.04	2.35
EPS Change (YoY)	61.4%	-33.7%	15.7%	63.2%	15.2%
Consensus EPS (Bloomberg)			1.19	1.40	1.65
DPS	0.69	0.31	0.08	0.12	0.14
Valuation (Dec)					
P/E	23.8x	35.9x	31.0x	19.0x	16.5x
Dividend Yield	1.8%	0.8%	0.2%	0.3%	0.4%
EV / EBITDA*	16.9x	16.1x	15.3x	12.7x	10.6x
Free Cash Flow Yield*	2.3%	2.6%	2.0%	4.3%	5.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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Timestamp: 22 February 2024 06:00AM EST

22 February 2024

### Equity

#### Key Changes

(US\$)	Previous	Current
Inv. Opinion	C-2-7	C-1-7
Inv. Rating	NEUTRAL	BUY
Price Obj.	44.00	55.00

**Adam Ron**  
Research Analyst  
BofAS  
+1 646 743 2020  
[adam.ron@bofa.com](mailto:adam.ron@bofa.com)

**Kevin Fischbeck, CFA**  
Research Analyst  
BofAS  
+1 646 855 5948  
[kevin.fischbeck@bofa.com](mailto:kevin.fischbeck@bofa.com)

### Stock Data

Price	38.75 USD
Price Objective	55.00 USD
Date Established	22-Feb-2024
Investment Opinion	C-1-7
52-Week Range	28.87 USD - 40.81 USD
Mkt Val (mn) / Shares Out (mn)	2,258 USD / 58.3
Free Float	77.8%
Average Daily Value (mn)	5.88 USD
BofA Ticker / Exchange	AMEH / NAS
Bloomberg / Reuters	AMEH US / AMEH.OQ
ROE (2023E)	10.3%
Net Dbt to Eqty (Dec-2022A)	-14.8%
ESGMeter <sup>TM</sup>	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".**

AMEH = Apollo Medical  
MSO = Managed Services Organization  
RKK = Restricted Knox Keene  
CFC = Community Family Care  
PRVA = Privia Health  
ACO = Accountable Care Organization

MA = Medicare Advantage  
VBC = Value-Based Care  
ALHC = Alignment Health

# iQprofile<sup>SM</sup> Apollo Medical

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	8.7%	8.0%	9.2%	12.8%	13.4%
Return on Equity	18.7%	9.7%	10.3%	17.9%	19.1%
Operating Margin	12.7%	9.1%	7.8%	7.0%	6.7%
Free Cash Flow	51	59	46	97	117

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.0x	1.7x	1.2x	1.1x	1.1x
Asset Replacement Ratio	1.1x	1.3x	1.6x	1.4x	1.4x
Tax Rate	36.6%	41.7%	35.8%	35.0%	35.0%
Net Debt-to-Equity Ratio	-9.6%	-14.8%	-12.3%	-25.6%	-35.5%
Interest Cover	18.2x	13.2x	7.4x	8.3x	10.4x

## Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	774	1,144	1,379	1,897	2,465
% Change	12.6%	47.8%	20.5%	37.5%	30.0%
Gross Profit	178	199	229	273	314
% Change	20.1%	12.2%	14.8%	19.0%	15.3%
EBITDA	134	140	147	177	212
% Change	5.5%	4.9%	5.1%	20.1%	19.8%
Net Interest & Other Income	(20)	(18)	0	36	36
<b>Net Income (Adjusted)</b>	<b>74</b>	<b>49</b>	<b>59</b>	<b>109</b>	<b>131</b>
<b>% Change</b>	<b>95.1%</b>	<b>-33.6%</b>	<b>21.0%</b>	<b>84.2%</b>	<b>19.8%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	49	51	69	109	131
Depreciation & Amortization	18	18	17	18	18
Change in Working Capital	(20)	(10)	(30)	(26)	(28)
Deferred Taxation Charge	(6)	(8)	0	0	0
Other Adjustments, Net	30	31	17	20	21
Capital Expenditure	(19)	(23)	(28)	(25)	(25)
<b>Free Cash Flow</b>	<b>51</b>	<b>59</b>	<b>46</b>	<b>97</b>	<b>117</b>
<b>% Change</b>	<b>13.6%</b>	<b>15.8%</b>	<b>-21.9%</b>	<b>109.8%</b>	<b>20.7%</b>
Share / Issue Repurchase	43	(1)	(5)	0	0
Cost of Dividends Paid	(31)	(14)	(4)	(7)	(8)
Change in Debt	(58)	(1)	2	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	233	288	285	374	481
Trade Receivables	90	127	184	258	328
Other Current Assets	76	20	15	16	19
Property, Plant & Equipment	53	109	130	137	144
Other Non-Current Assets	400	420	468	468	468
<b>Total Assets</b>	<b>852</b>	<b>964</b>	<b>1,083</b>	<b>1,253</b>	<b>1,440</b>
Short-Term Debt	1	1	3	3	3
Other Current Liabilities	115	147	205	263	327
Long-Term Debt	183	203	206	206	206
Other Non-Current Liabilities	38	44	52	139	138
<b>Total Liabilities</b>	<b>336</b>	<b>395</b>	<b>466</b>	<b>611</b>	<b>675</b>
<b>Total Equity</b>	<b>516</b>	<b>569</b>	<b>617</b>	<b>642</b>	<b>765</b>
<b>Total Equity &amp; Liabilities</b>	<b>852</b>	<b>964</b>	<b>1,083</b>	<b>1,253</b>	<b>1,440</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Physician Practice Management

## Company Description

Apollo Medical (AMEH) is a physician enablement company that aims to streamline administrative functions for providers, and maximize practice economics by shifting the focus to value based care. What makes AMEH unique is its ability to work across all payers (vs peers who largely focus on Medicare products). Additionally, the company has a uniquely long track record (25+ years), and has proven its unit economics by generating target margins on a consolidated basis.

## Investment Rationale

Having proven the model in Southern California, AMEH is already generating ample free cash today, with enough local scale to have built a defensible moat around the core earnings base. Meanwhile, there is a large embedded opportunity to double its revenue in core markets over then next couple of years by expanding its existing contractual relationship with insurer and fee based customers, which supports a meaningful earnings acceleration with minimal execution risk.

## Stock Data

Average Daily Volume 151,765

## Quarterly Earnings Estimates

	2022	2023
Q1	0.31A	0.31A
Q2	0.25A	0.28A
Q3	0.56A	0.47E
Q4	-0.06A	0.19E

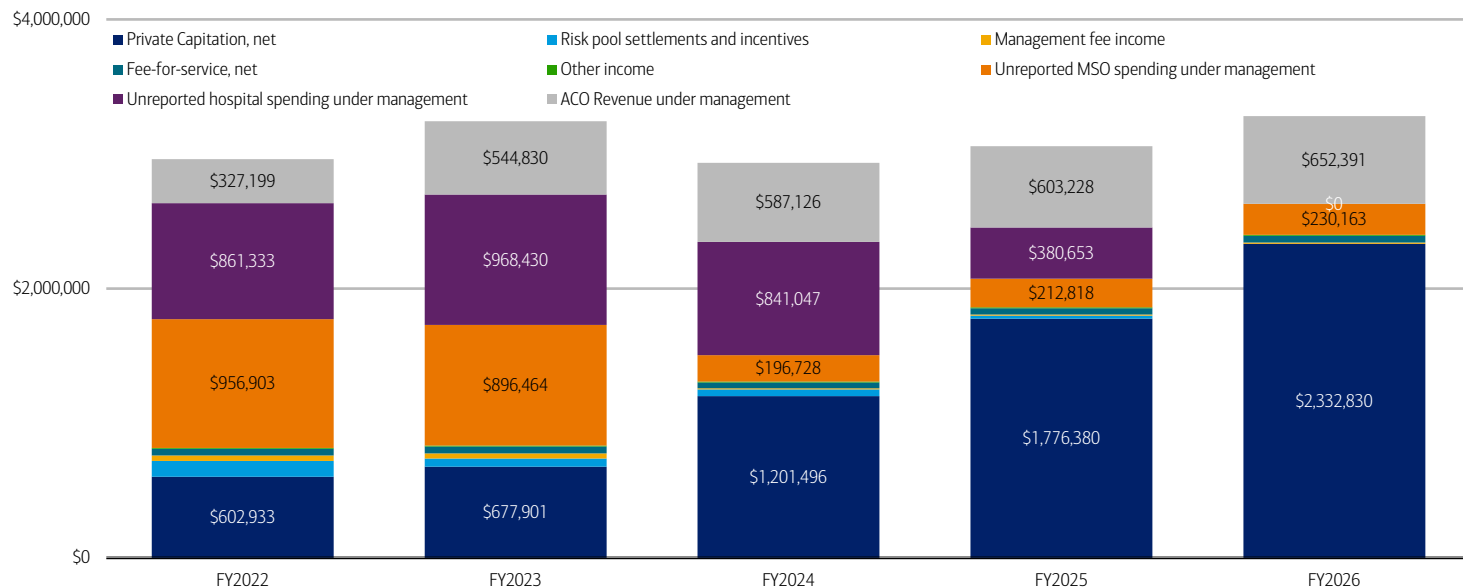
## Insourcing off-balance sheet revenues

One nuance worth explaining in more detail is that because AMEH's customers are value based care providers in California, they require a special 'Restricted Knox-Keene' license to assume full-risk value based on a member. Since AMEH's customers don't have this license, the revenue they report is only a fraction of THEIR spending under management (generally about 35% of the 85% capitation rate or 41% of spending managed). Additionally some of its customers are in MSO (managed services) arrangements which simply pay a flat fee to manage a member in value based care, which has lower dollars margins and don't allow AMEH to book the full revenue either.

Below, we estimate the total amount of medical spending that AMEH is responsible for over time, and note that by 2026 the conversion of a major MSO customer to full risk (CFC) should lower the management fee income, but increase private capitation by insourcing most of the previously unreported 'MSO spending under management'. Similarly, by moving to full risk on the RKK license, the 'unreported hospital spending under management' should also convert into private capitation revenue.

### Exhibit 1: GAAP revenue will be 2-3x higher as AMEH recognizes 'off balance sheet' spend, a portion of which will flow into earnings

Breaking down components of GAAP revenue, as well as implied 'off balance sheet' revenue driving the economics



Source: BofA Global Research, Company Filings

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## Price objective basis & risk

### Apollo Medical (AMEH)

We value AMEH using 15x EV/EBITDA on our 2025 estimate to arrive at \$55 (1.3x GAAP revenues), which we see as justified as it is in-line with its historical 5YR average multiple of 15.5x.

This PO is also supported by a 10YR DCF assuming a discount rate and exit multiple. For the DCF we use the free cash flow numbers from 2023-2031 outlined above, but back out interest expense and stock compensation, apply an 'Exit Multiple' EBITDA multiple of 14x on 2032 EBITDA and a discount rate of 10%.

Upside risks are better than expected ramp of new markets and ACO REACH while downside risks are Medicaid redeterminations and risk model revision changes.

## Analyst Certification

I, Adam Ron, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Acadia Healthcare	ACHC	ACHC US	Kevin Fischbeck, CFA
	Addus HomeCare	ADUS	ADUS US	Joanna Gajuk
	Agilon Health	AGL	AGL US	Adam Ron
	Apollo Medical	AMEH	AMEH US	Adam Ron
	BrightSpring Health Services	BTSB	BTSB 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
<b>NEUTRAL</b>				
	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
<b>UNDERPERFORM</b>				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	Cross Country Healthcare	CCRN	CCRN US	Kevin Fischbeck, CFA
	DaVita Inc	DVA	DVA US	Kevin Fischbeck, CFA
	Enhabit Home Health & Hospice	EHAB	EHAB US	Joanna Gajuk
	Pediatrix Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

### Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

### Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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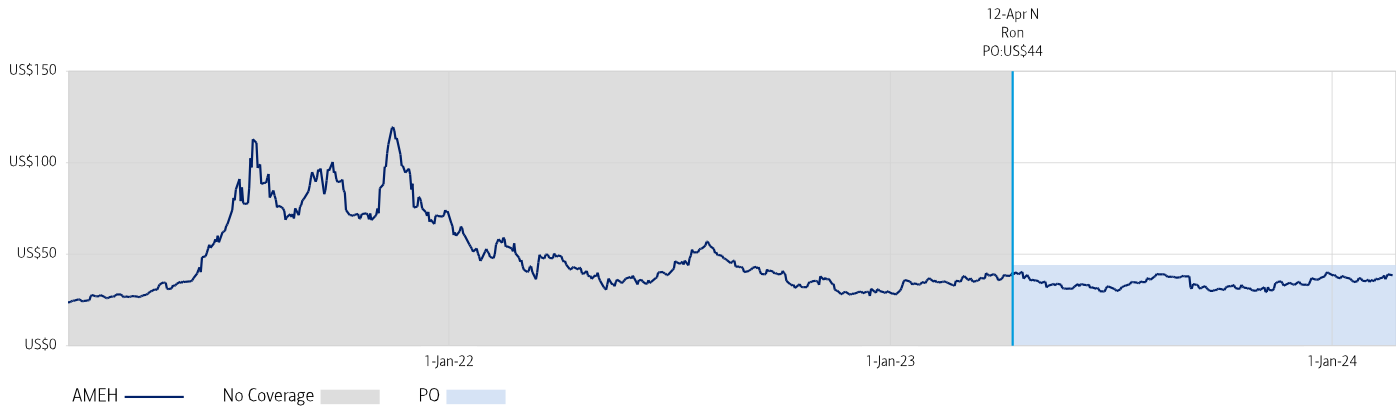
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### Apollo Medical (AMEH) Price Chart



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 <sup>R1</sup>	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 <sup>R1</sup>	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%

<sup>R1</sup> 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 <sup>R2</sup>
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> 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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