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Agilon Health, Inc. (AGL)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the agilon health Second Quarter 2023 Earnings Conference. My name is Terry, and I am the conference operator for today's call. [Operator Instructions]

I would now like to hand the call over to Matthew Gillmor, Vice President of Investor Relations to begin. Please go ahead.

Matthew Dale Gillmor

Vice President-Investor Relations, Agilon Health, Inc.

Thank you, operator. Good afternoon and welcome to the call. With me is our CEO, Steve Sell; and our CFO, Tim Bensley.

Before we begin, I'd like to remind you that our remarks and responses to questions may include forward-looking statements. Actual results may differ materially from those stated or implied by forward-looking statements due to risks and uncertainties associated with our business. These risks and uncertainties are discussed in our SEC filings. Please note that we assume no obligation to update any forward-looking statements.

Additionally, certain financial measures we will discuss in this call are non-GAAP. We believe that providing these measures helps investors gain a better and more complete understanding of our financial results and is consistent with how management views our financial results. A reconciliation of these non-GAAP financial measures to the most comparable GAAP measure is available in the earnings press release and Form 8-K filed with the SEC.

Following prepared remarks from Steve and Tim, we will conduct a Q&A session. During the Q&A session, we would ask everyone to please limit themselves to one question so we can get through the full queue in a timely fashion.

With that, I'll turn the call over to Steve.

Steven J. Sell

Chief Executive Officer, President & Director, Agilon Health, Inc.

Thanks, Matt. Good evening, everyone, and thank you for joining us. We've had a very successful first half of 2023, and we continue to make rapid progress against our vision: to transform healthcare in 100-plus communities by empowering primary care doctors. Our progress is made possible because of the trust our growing network of partners have placed on agilon. I want to thank our 2,700-plus physician partners, and I want to thank my colleagues for their hard work and dedication to supporting our partners and their patients.

I'll start with a few highlights from the quarter and year-to-date performance. Our overall momentum remains strong. Performance across our key financial metrics was in line or above our guidance ranges and further demonstrates the unique power of our model to inflect profitability while driving significant growth in membership and revenue.

During the quarter, our MA membership grew 57% to 409,000 members, and revenues grew 71% to $1.15 billion. This was above our guidance and was once again supported by the successful onboarding of new PCPs and faster pull-through of members in new markets.

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Even with our impressive membership growth, our profitability continues to inflect, with adjusted EBITDA up sixfold on a year-to-date basis and coming in above the high end of our outlook for the quarter. This quarter's EBITDA performance was driven by the strength of our Medicare business across Medicare Advantage and ACO REACH.

For MA, medical margins increased 69% to $138 million, while ACO REACH was even stronger with medical margins increasing 82% to $39 million. It should be noted that our medical margin for MA included a net $7 million headwind from prior year claims and revenue, with about half of this flowing to adjusted EBITDA, making our profitability gains even more outsized on an underlying basis.

The quarter and year-to-date results also reflect our growing confidence with the ACO REACH program in terms of the predictability of agilon's relative and absolute performance. Now, in its third year, the program has reached a frequency and consistency of the data provided to better calculate and understand performance. This level of transparency is new as of 2023 and has confirmed that agilon has differentially managed utilization.

Our cost performance in REACH is more than 300 basis points better year-to-date versus the national benchmark, which all participants are measured against. Now, looking forward, from a guidance perspective, we have raised our membership, revenue and adjusted EBITDA outlook for 2023.

Importantly, the magnitude of the outperformance within REACH and underlying margin progressing across our partner MA markets has allowed us to both absorb the negative prior year adjustment from 2022 and strengthen our MA reserving approach in 2023. This will set a strong foundation for our performance in 2024 and is intentionally reflected in our updated medical margin outlook for MA.

One theme I would like to drive home, given all of the speculation on utilization trends is that different models will yield different outcomes. agilon's model is distinctively different and more durable and predictable in driving cost and quality results compared to the broad fee-for-service system, which predominates across healthcare today.

Let me highlight how we are producing such strong and predictable results and what drives our forward confidence in the business. First, at agilon, we only take risk on patients that have an aligned long-term relationship with a PCP, who has both the resources to positively impact total cost and quality of care. We do not take risk on a broad set of patients in an unmanaged fee-for-service system.

Our high-touch PCP-led model allows partner physicians to actively manage the health of a discrete set of senior patients they have often known for decades, while our platform provides doctors with a consistent set of clinical resources, like care managers, social workers and pharmacists, supported by technology and data insights.

This allows our network to deliver consistent results across 500,000 attributed senior patients while our physician partners focus on the most complex 20% of patients that are driving 70% to 80% of total costs. We believe this high-touch approach has prevented a pent-up demand for care and insulated agilon from any associated spikes in utilization.

Second point on differentiation. For our members, our year-to-date composite utilization trend is in line or better than our expectations. Year-to-date, we have driven very moderate ER and inpatient trends, with utilization flat to down in the mid-single digit range, while primary care and outpatient utilization is up in the mid to high-single digit range. Given that we manage the full premium dollar in a Total Care relationship, we focus on the composite utilization trend and are comfortable and actively encouraging this mix shift.

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All of the clinical programs we shared with you at our Investor Day are oriented towards moving care closer to primary care while significantly reducing unnecessary ER and hospital utilization, and they are tracking ahead of our expectations year-to-date.

Third, our model has natural advantages in terms of leading indicators and visibility. From an operational standpoint, we are not just receivers of macro utilization trends; our teams are actively managing utilization on the ground every day. This includes transition of care nurses, post discharge follow-up visits, and high risk case managers.

Additionally, while MA claims data has some lag, our REACH claims data is very current through May, which is more than 90% complete. We have not seen any meaningful change in our expected cost trend, including outpatient procedures.

Lastly, our 50-50 surplus sharing not only creates strong alignment in driving long-term positive patient outcomes, but it also buffers our financial results up and down. As a result, we are able to guide to relatively tight ranges on medical margin and adjusted EBITDA and absorb puts and takes that may arise during a given period.

Ultimately, the durability and predictability of our model has enabled agilon to raise our adjusted EBITDA outlook during 2023 and set a strong foundation for 2024, even as some health plans with broad fee-for-service networks are seeing pockets of higher costs. Our success in 2023 sets the table for strong performance in 2024, which should be another year of meaningful step-up in profitability.

As we have discussed previously, we operate in a very forward-looking model and our visibility on the key levers for driving next year's performance is quite high. As an example, the Class of 2024 implementation of six new partners and 100,000-plus MA patients is going extremely well, and we will have another year of record membership growth, with at least 145,000 new MA patients and 25,000 new REACH patients.

This class will benefit from multiple advantages as they come on our platform, including a 12-month implementation period, our newly acquired Minerva platform that shortens the period for integrating multiple EMRs, and the local value-based care infrastructure we have already built in multiple existing markets and states that several of these partners will leverage immediately. As a result, this class should have a higher starting point for medical margins in both Medicare Advantage and REACH and contribute to our adjusted EBITDA when we go live in January.

Looking further ahead, we are making strong progress with the Class of 2025 pipeline, with several partners already signed and beginning implementation and others progressing well. This class promises to be another strong mix of diverse physician organization types across both new and existing markets.

Our confidence in 2024 is also bolstered by the combined strength of our run rate medical margin performance across MA and REACH in 2023. This is inclusive of the adjustment to our MA reserving approach, which was a proactive decision on our part and supported by the magnitude of the upside we are seeing in REACH. On a combined basis, our underlying margins for MA and REACH are tracking slightly better than our expectations. This is, obviously, important as you think about the stepping off point for 2024.

Finally, we are increasingly confident in our ability to manage the new risk adjustment model starting next year. This is a function of our implementation work over the past few months and recent conversations with our health

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plan partners. We now expect most health plans in our markets will be disciplined and moderate their supplemental benefit offerings in 2024, which, ultimately, impacts our cost profile.

This is not something we had previously factored into our calculus on our ability to successfully manage the new risk model changes, and this new information further underscores our confidence in 2024 and beyond.

With that, let me turn it over to Tim.

Timothy S. Bensley

Chief Financial Officer, Agilon Health, Inc.

Thanks, Steve, and good evening, everyone. I'll now review highlights from our second quarter results and our updated outlook for 2023.

Starting with our membership for the second quarter, total members live on the agilon platform increased to approximately 496,000, including both Medicare Advantage and ACO REACH. Our consolidated Medicare Advantage membership increased 57% to 409,000, driven by the addition of new partner geographies and 9% growth with our same geographies. Our same geography growth within our partner markets was 12%.

Revenues increased 71% on a year-over-year basis to $1.15 billion during the second quarter. Year-to-date, revenues increased 73% to $2.29 billion. Revenue growth was primarily driven by membership gains in new and existing geographies.

On a per member per month basis, or PMPM, revenue increased 11% during the second quarter. This was primarily driven by benchmark updates and membership mix, including higher benchmarks in several new markets.

Our Medicare Advantage medical margin increased 69% year-over-year to $138 million during the second quarter. Year-to-date, medical margin increased 78% to $300 million. Medical margin increased on a PMPM basis, driven by the ongoing maturation of our markets and member cohorts even while accounting for the dilution from our strong membership growth and negative prior year development.

During the second quarter, medical margin PMPM increased 9% to $113, compared to $103 last year. Year-to-date, medical margin for our year-two plus partners, which excludes the dilution from year-one markets, increased 60% on a dollar basis and by 42% on the PMPM basis to $166.

Our medical margin for the quarter included $7 million of net headwind from prior year claims and revenue, including $16 million from prior year claims, offset by $9 million of prior year revenue. The prior year revenue we recognized in the second quarter relates to final risk adjustment settlements across several payors.

Prior year claims were primarily driven by two payors, including one payor that changed how they processed post-acute claims last year, which resulted in a true-up during the second quarter of 2023. We are taking specific actions to minimize the risk of prior year claims development in 2024, which I will discuss in a few moments.

Platform support costs increased 29% to $47 million. On a year-to-date basis, platform support costs increased 35% to $95 million. Growth in our platform support cost continues to run well below our revenue growth. As a percentage of revenue, platform support costs declined to 4.1% during the second quarter, compared to 5.4% last year.

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Our adjusted EBITDA was $10.3 million in the quarter, compared with negative $2.7 million last year. On a year-to-date basis, adjusted EBITDA was $34.1 million, compared to $5.4 million last year. As a reminder, our adjusted EBITDA includes geography entry costs primarily associated with new partners that would generate revenue in 2024. The increase to adjusted EBITDA reflects the gain in medical margin, platform support leverage, and contributions from ACO REACH.

Adjusted EBITDA contribution from ACO REACH, which is included in other income on our P&L, was $11.2 million in the second quarter, compared to $6.2 million last year. Year-to-date, ACO REACH has contributed $14.5 million to adjusted EBITDA, compared to $9.4 million last year.

It's important to remember that the contribution from ACO REACH doesn't fully include allocation of corporate overhead, and our MA business drove approximately 70% of the year-over-year gain in adjusted EBITDA during the quarter and about 90% of our adjusted EBITDA gain year-to-date.

As Steve referenced, we are very encouraged with the performance of our ACO REACH business. Our underlying cost performance continues to meaningfully beat the national benchmarks, and improved data sharing from CMS allows us to assess our performance in a much more predictable manner.

If you look at the combined performance of MA and REACH, which is how we operate the business, medical margin profitability is ahead of our internal expectations and roughly comparable on a PMPM basis. We are increasingly optimistic the strength and predictability of REACH will be sustainable on a go-forward basis, which is reflected in our updated 2023 guidance.

Before turning to our balance sheet, I wanted to discuss our reserving approach in MA and actions we are taking to minimize the possibility of negative development in 2024. A key driver in prior year development we have recognized this year has been associated with the breadth and complexity of our health plan relationships.

As we mentioned last call, we currently work with 30 health plans across approximately 100 different contracts, and this will continue to increase in future years. Our ability to work with these payors and meet them where they are is very strategic and allows us to unlock historically unmanaged markets as a first-mover.

To support our growing scale, we are making proactive investments and we recently hired a new SVP of Data Solutions. This role will enhance our data capabilities and improve how we utilize data to support our operations and financial reporting.

Additionally, with the support of stronger REACH performance, we are strengthening our IBNR reserves on a go-forward basis, which will significantly reduce the potential of negative claims development next year.

We are very pleased that the strength and durability of our business model has enabled us to both improve our adjusted EBITDA outlook for 2023 and set a strong foundation for performance in future years.

Turning to our balance sheet and cash flow. As of June 30, agilon had approximately $590 million of cash and marketable securities and total debt of $41 million. Cash flow from operations was negative $21 million for the quarter, which was in line with our expectations. As a reminder, our cash flow generally lags adjusted EBITDA because of the timing of final settlements with payors, which are typically nine to 12 months after the year-end.

agilon remains extremely well capitalized, and we do not anticipate needing any external capital to drive our future growth.

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During the second quarter, agilon repurchased approximately 9.6 million shares for $200 million in conjunction with the secondary offering by our founding equity sponsor. We were pleased to complete the transaction, which creates strong long-term alignment between our key stakeholders.

Turning now to our updated outlook for full year 2023. We have raised our membership and revenue ranges, as well as our adjusted EBITDA outlook, to a range of $0 to $23 million. At the same time, we have moderated our medical margin outlook by approximately $30 million to a range of $500 million to $530 million.

Our updated outlook reflects our decision to strengthen our MA reserves in 2023 while embedding a range of scenarios on utilization and cost trend. This was more than offset by stronger ACO REACH results and performance in our partner markets, and we expect our updated approach to MA reserving will support our performance in future years.

We now project ACO REACH will contribute $30 million to $35 million to our adjusted EBITDA in 2023, up from $5 million to $10 million previously. Full details on our third quarter and full year guidance can be found in the earnings press release.

With that, let me turn the call back to Steve.

Steven J. Sell

Chief Executive Officer, President & Director, Agilon Health, Inc.

Thanks, Tim. Before opening up the lines for Q&A, I want to emphasize three key points. First, the durability of our partnership model is driving predictable performance in terms of patient care, reinvestment in our partners, and earnings to agilon. Second, our year-to-date performance is in line or ahead for our partner markets in MA and ACO REACH which has enabled us to improve our outlook for adjusted EBITDA in 2023, while setting a strong foundation for 2024. And third, we remain very confident in the sustainable long-term trajectory of our business, including our execution against the key drivers for 2024 and beyond.

With that, we are now ready to take your questions. Operator, please start the Q&A session.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question on the line comes from Lisa Gill of JPMorgan. Your line is open. Please go ahead.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

[indiscernible] (00:23:05). Just a couple of clarifications. I just want to make sure I understand this. So first, when I heard, Tim, you talk about strengthening the reserves and if I think about your medical cost margin in the back half coming down on the revised guidance, how much of that do I think of that as being reserve versus your expectation for trend. I heard both you and Steve say multiple times that trend was in line with what your expectations were. So I just want to understand that one.

And then, just to clarify on the sustainability of the REACH's results. You said that it was – you expect a modest improvement in 2024-2025. Is that off of this new base? Are you thinking about the growth rate differently than that prior expectation that it would modestly improve in 2024-2025?

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. Lisa, this is Tim. That's a great question, and thanks. Just real directly on the first question. What we tried to do for the second half of the year is – and especially, by the way, related to your second question given the strength of our ACO REACH performance – is take the opportunity to essentially modify or moderate our medical margin outlook for the year by strengthening our reserves to sort of cover a range of potential outcomes. So rather than saying, hey, this percentage of this is for this or this is for that, we've looked at the range of potential outcomes that can happen in the second half. Want to make sure that we've got enough reserve to minimize the probability of any prior period development going into next year, and that would include things like being respectful of the fact that there could be a change, for instance, in utilization trends in the second half.

So I don't want to quantify it and break it out into components other than to say we've tried to increase the strength of the reserves to cover that sort of range of outcomes.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

And Lisa, I guess what I...

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

And then, on the ACO...

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

...yeah. So on the ACO REACH side, obviously really great results. This program is all about beating the in-year cost trends of that national benchmark. We're now 300-plus basis points better than that benchmark. Last time we talked to you, it was about 110 basis points. That's a function of our being able to maintain consistent utilization trends while that fee-for-service benchmark went up pretty appreciably over the course of the last quarter. I think it

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comes back to the really unique levers that we have with our primary care physicians and the ability to really impact those most complex patients like we talked about.

And in terms of the sustainability, there's a new level of transparency around the information that we're getting particularly around this retro trend adjustment. We always knew what our trend was. We didn't know what that national benchmark was. But now, every month, Tim and the team are getting that, which gives us a lot of confidence. The way the mechanics work in the program is that basically your baseline savings that we will end 2023 with, kind of, carry forward. And then what happens in 2024 is if you're in line with the benchmark, you probably deliver about the same performance you did in 2023. If you're better than the benchmark, those numbers would go up.

So I think you do have a meaningful step-up in terms of the baseline performance in REACH that has allowed us to raise our guide for 2023 and take the reserving actions that Tim talked about for any sort of adverse consequences, which gives us that really strong run rate as we step [ph] in 2024 (00:26:41).

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

That's very helpful. Thank you.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

Thanks, Lisa. Operator, why don't we go to the next one?

Operator: The next question comes from Ryan Daniels of William Blair. Please go ahead. Your line is open.

Jack Senft
Analyst, William Blair & Co. LLC

Q

Yeah. Hey, guys. This is Jack Senft on for Ryan Daniels. Congrats on the quarter. I just kind of want to go back to something previously, and this is actually from one of the partnership announcements that you guys had. But for one of the partnerships that you mentioned in 2024, previously, you noted that there was going to be 32 physician groups. And the most recent one, it looked like there was 31 physician groups. I just want to make sure I'm reading that right. Is there anything to call out with the loss of that one group? Like, did a physician group just kind of get...

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

Jack, the...

Jack Senft
Analyst, William Blair & Co. LLC

Q

...this up to – yeah.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

I think you might be confusing physician groups with geographies. What we've announced is still 32 physician groups. We've never lost a partner group.

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Jack Senft
Analyst, William Blair & Co. LLC

Q

Okay.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Yeah. And of the six groups that we've announced, it's the 100,000 incremental patients for next year. So that's very much in line. I think what we're seeing for the Class of 2024 and for this pipeline in the Class of 2025 is that our differentiated performance on cost and quality is making us that much more attractive to groups who are thinking about making the move to value.

One data point I'll just give you about the Class of 2025 is, I believe, this is the first class in which we have signed up a partner medical group that previously was aligned with what we would consider to be a competitor. And what we heard from them was they were not getting the performance via that relationship and so they decided to end it.

And so, I think all of this ties together back to this flywheel, the better we perform, the better our partners do, the more other physicians want to join. So it's in line with what we've communicated before, and the pipeline is getting stronger based on that dynamic.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

And Steve, the only thing that I would add, just to make sure we're perfectly clear, is the six new partners, going to 32 partners, and 100,000 at least members coming from those new partners, are total membership projection. We're going to add like 145,000 members next year when [ph] you understand (00:29:02) geography growth, and that will be our largest new class, if you want to look at that combined.

And just to tag on real quickly because it relates to this question and back to Lisa's question, in addition to that, one of the reasons why we really continue to be more bullish on ACO REACH is we're also going to increase our ACO REACH membership next year for the first time. So [indiscernible] (00:29:22) bring in several new ACO REACH markets as well with at least 25,000 new ACO REACH members coming in. So between the two of those, next year is a really big year for membership.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right. Thanks for the question. Operator, why don't we move on?

Operator: The next question on the line comes from Jailendra Singh of Truist Securities. Please go ahead.

Jailendra Singh
Analyst, Truist Securities, Inc.

Q

Thank you, and thanks for taking my questions. I want to go back to the medical margin guidance change topic. Just want to better understand, like, how are you going about updating these estimates on this new reserve. Just trying to get your comfort around the reserves if it's [indiscernible] (00:30:00). Is it all driven by your ACO REACH experience, which gives you good visibility and have you captured some other data points? And as we think about 2024 and any potential prolonged utilization uptick, what levers do you have to go back to payor contracts to renegotiate? Anything there would be helpful.

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Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Yeah. Well, let me start on the guide and Tim can come in on that. I mean, I think the objectives we are trying to achieve is that we wanted to beat our 2023 adjusted EBITDA, and we are highly confident about that. That is driven both from the REACH outperformance that we've talked about in which we are meaningfully beating that national benchmark and the differences in our model. But then, two, Jailendra, our partner MA markets, ex-PPD, are performing extremely well.

And so, that is really a powerful part of what we're trying to do. As we talk about sort of the strengthening of reserves that Tim laid out, there's kind of three things that I think we look at this year that we want to make sure we accounted for in any sort of adverse scenario.

One is the PPD. We want to eliminate the likelihood of that in 2024. And so, that was our first objective. Second is the supplemental benefits from payors is an area where we have seen higher costs than what we projected and what our payor partners had projected.

We know from our conversations, those are going to correct for 2024. But we want to make sure in the back half of 2023, before they go away or substantially reduce, they were covered around that. And then, the one area that we see the type of elevated utilization that some of the health plans have talked about is in our one non-partner market of Hawaii, which is a broad fee-for-service network, and we are seeing higher utilization.

So we wanted to make sure that we covered all of that from a guide perspective. And then, I think you asked just about 2024. What we try to communicate is our confidence on 2024 is even higher than the last time that we talked to you. One is this run rate performance that we laid out. Two is, our clinical programs that are driving these results, were in a third of our existing MA markets, were in two-thirds of our existing REACH markets. So we have a lot further to go.

By the end of 2024, we'll have a full suite of clinical programs in every single one of our markets from the class of 2024 and earlier. That should provide a meaningful step up in terms of cost and quality management. The benefit changes, that's new information for us that we were not previously factoring.

And then, finally, this implementation on the Class of 2024 is going extremely well. This is the first class that's able to leverage that Minerva platform that we talked about earlier as part of our acquisition. And so, all of that leads to us to feel very good about 2024, and then the forward application from that.

Jailendra Singh
Analyst, Truist Securities, Inc.

Q

Thanks a lot.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right, Jailendra. Thanks very much.

Operator: The next question comes from Stephen Baxter of Wells Fargo Securities. Please go ahead.

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Stephen Baxter
Analyst, Wells Fargo Securities LLC

Q

Yeah, hi. Thanks. I was hoping that you could maybe be as specific as possible about what your level of claims visibility is for the second quarter. I guess, first, how closely does ACO REACH claims data track with your actual MA claims experience. I guess, how complete would you judge the ACO claims data to be for April and May at this point?

And just to make sure I understand the actual guidance change for medical margin, is your underlying estimate before making this reserve change changing in any way? Or would you say the entire change in your medical margin guidance, ex the prior year item, is related to your reserving change, whether that's assuming a higher margin for adverse development or something of that nature? Thank you.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Yeah. I'll start on visibility and Tim – he can talk about reserves. So I think our visibility is extremely strong, Stephen, and we have high confidence. I think it's a function of our model, which is very different, right? We are on the ground with PCPs every day. We are managing those most complex patients. And so, we're trying to better identify them and make sure the PCP and the care teams are aware of them, and then make sure that they are engaged in our clinical programs.

The data that we are receiving is, in particular, focused on those highest cost settings like inpatient and ER. And we put that together, we're able to drive the type of results that I talked about with inpatient down in the flat to down in the mid-single digit range.

From a claims perspective, to specifically answer your question, we are 90% complete on our May year-to-date REACH claims. And so, there is incredibly high visibility. There is a lag on the MA claims, and Tim talked about the actions we're taking from a reserving perspective to protect ourselves on a go-forward basis, but same markets, same doctors, same clinical programs. We're able to correlate these clinical programs and indicators with claims, and so we feel like we have an incredible level of visibility on that.

And I think the last thing I would just say is I think we've demonstrated that our model really stands out in higher utilization periods that broader fee-for-service markets are seeing. Our ACO REACH performance being 300 basis points better. What we're seeing in our partner markets versus our Hawaii market, our medical margins are 3x greater in our partner markets than we're finding in Hawaii. And, so I think the power of that model is really driving exceptional results.

And the last data point I'll give you is just we walked a lot through our clinical programs at our Investor Day. But one of the ones we talked about was the importance of our high risk patients and the two-day follow-up when they're discharged from the hospital. Year-to-date, we have seen a 28% increase in the two-day discharge visit back with the PCP versus where we were at last year. It substantially reduced the readmit rate, and that has substantially led to that inpatient trend, which is flat to down in that mid-single digit range.

So I think this is an area where we feel like we have incredible confidence. The REACH comparison set gives us great visibility on the claims side that matches up with those operational indicators.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

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Yeah. That's right, Steve. So the only other thing I would say about ACO REACH to lead into how we're handling MA is, on the ACO REACH side, CMS has always been our best payor in terms of currency and accuracy of the claims data they give us. And since the beginning of the program, we've always been very tight and a very good shape on our IBNR claims estimation for the DC, now ACO REACH business.

The issue in ACO REACH has always been around the revenue side, and CMS has been tremendously helpful now in providing us better information over the last six to nine months and how we're looking at that. The combination of those two things give us tremendous confidence in our projections for ACO REACH going forward.

How that applies back to MA; of course, on the MA side, it's a much more complex situation of payors. We talked about those statistics a couple of times already on this call. And so, that complexity makes it more difficult to do your IBNR estimation. Some of the blind spots that have come out of that have, of course, resulted in some prior period development that we talked about this year, both on the revenue positively and on the claims side negatively. Those are the things that we want to eliminate.

So we have taken a couple of actions that we talked about. One is we brought in some incremental expertise, a new Senior Vice President of Data Solutions that has a lot of experience in this area that's going to help us both work with the payors to eliminate some of those blind spots, as well as just work with the data we're getting to better understanding where we should be reserving.

And when we talk about then the strengthening of our reserves that are in our guidance, we've essentially said, hey, with the understanding that our reserve should probably be stronger in terms of the range of potential reserves that we could build, both because of those potential blind spots and also just to cover for the possibility and be respectful of the fact that there may be some change and utilization in the back half of the year.

We feel like the strengthening of the reserves that we built into Q2 and into the balance of year guidance are adequate to cover really that range of outcomes of – be a little bit stronger in terms of any blind spots that we may not see that – make sure that we're not getting prior period development, as well as cover the possibility of any possible increase in – or some possible increase in utilization.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

All right, Steve. Thanks very much. We appreciate it. Operator, can we move to the next one?

Operator: The next question comes from Gary Taylor of Cowen. Please go ahead. Your line is open.

Gary Taylor
Analyst, TD Cowen
Q

Hi, good evening. I'm just going to continue to work on the ACO REACH for a moment. I think that's the piece we're all trying just to understand.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.
A

Sure.

Gary Taylor
Analyst, TD Cowen
Q

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My two questions are – if we look at the Q, the ACO MLR was down about 600 basis points year-over-year. So I just wondered if there was any reserve release out of ACO REACH in the quarter.

And then, my second one is, just trying to understand, I know – I think originally going back to IPO, I thought we were looking at maybe $60 million of EBITDA and $25 million from ACO. But at the March Investor Day, you cut that in half. And now, we're a few months later, now we're going to do that number – or the high end would be doing that number in 2023. So just trying to understand like what has happened in the last few months that has changed that outlook fairly quickly?

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. I think for the first part of the question, which is why is our MLR improvement – or what's driving the MLR improvement, both particularly in the second quarter, but now also year-to-date. When we entered the year, and this is one of the reasons why we talked about ACO REACH the way we did during Investor Day, was we are being very cautious on the components [ph] set built (00:41:09) to revenue for ACO REACH.

So it's not really about claims release or about the IBNR side. We've been very tight on that for really the first three years or two-and-a-half years now with the program. But it was really around – being cautious around how is the – primarily that retro trend adjustment going to work and what's the real trend going to be. We stayed pretty conservative on that in Q1. We are getting more and more data now as we move through the year, and we're seeing that retro spend adjustment be more positive. We've now built that into our year-to-date results as well as projected it forward.

So I think our increasing confidence in what that revenue number is going to be and are increasing now visibility to the fact that we are significantly beating that fee-for-service benchmark that's driving that revenue number with our own costs is how we built that number back up to now $30 million to $35 million for the year. So I think it's the removal of some of that very high level of conservatives that we had going into the year now that we're seeing how the model is actually working.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

And Gary, what I would just reiterate is, the big change is not so much in our visibility to our trend; it's in this monthly update on the national trend. And so, as you've been on the calls, people have talked about fee-for-service utilization trending up. That's what's happened in this national reference population, and that's where we're seeing the gap between what we're managing to and what's happening with that growing, and that's the way the program really rewards you.

So I think going back to sort of the unique levers in our business and the fact that the clinical programs that we shared in March being ahead of where we expected them to be, we are really effectively managing that inpatient, that ER and the gap relative to the benchmark is growing, which is driving the strong result.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right, Gary.

Gary Taylor
Analyst, TD Cowen

Q

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Okay. Thanks.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

Thanks very much. Operator, why don't we move to the next question, please?

Operator: Of, course. The next question comes from Whit Mayo of Leerink Partners. Please go ahead. Your line is open.

Whit Mayo
Analyst, Leerink Partners LLC
Q

Hey, thanks. As you guys look at 2024, you've mentioned a lot of optimism around your ability to grow. Are there any operational or clinical changes you're thinking about for next year, either how you're approaching coding, engaging with the panel, changing the panel, the physician workflow, just anything as you kind of look out over the next three years with the risk adjustment changes. And I hear you a lot on the clinical programs having a positive impact, but just maybe operationally how you're modifying things for next year? Thanks.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.
A

Yeah. So thanks, Whit. So operationally, everything we do – we think about burden of illness, which is determining the acuity of the patient as a clinical program. It feeds our quality programs, it feeds our clinical programs. And so, we are doing a much better job of identifying those most complex patients. The acquisition that we made of this Minerva platform, that we shared with you back in March, allows us to get data to our partners earlier about those patients and to get them enrolled in those programs. So that's really meaningful on the cost and on the quality side.

I think what we're finding in terms of our implementation of the new risk model is that that is executing very well. Our metrics are tracking well. Our centralized physician medical record review is reviewing more of those charts and better providing almost a peer review basis for our physicians, as they are having those assessment visits with their patients.

And so, all of that is telling us it's very manageable from the risk model change. The payor conversations on the benefit change is something we had not factored before. And then, being ahead on the clinical program and getting more patients identified with the changes that I talked about should flow through very well. And so, as we look at 2024, the expansion of those programs, the better the identification, I think we are quite confident about it.

Whit Mayo
Analyst, Leerink Partners LLC
Q

All right. Thank you.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

All right. Whit, thanks very much. Operator, why don't we move to the next question, please?

Operator: We have a question from Adam Ron of Bank of America. Please go ahead.

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Adam Ron
Analyst, Bank of America

Q

Hey. Thanks for taking the question. I think at one point you mentioned that you think because of the new implementation cycle that you're seeing on the 2024 cohort, you think that they would have a higher starting point at medical margin PMPM.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

That's right.

Adam Ron
Analyst, Bank of America

Q

And I think at the Investor Day, the number you pointed to for 2023 was $46. So would it be upside to that specifically? And like any help understanding like the quantification of how significant it could be?

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. Adam, that's a great question. Thanks. So you're exactly correct. Typically, during the year, our new class comes in somewhere between $30 and $60 MA medical margin PMPM. This year is probably right around the middle of that. By the way, the middle of that range is about where we breakeven in the first year from an adjusted EBITDA standpoint.

Next year, we actually expect that the new class will come in at average, actually, above the $60 range. So that's really positive for us, particularly in the year with the advanced notice coming in where it is. We've got a really big class, a really strong class and that they're going to come in probably in the first year above that $60 range, which means they are going to be generating positive EBITDA as a new class in the first year in 2024.

Adam Ron
Analyst, Bank of America

Q

And do you think that would be...

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

Adam, thanks for the question.

Adam Ron
Analyst, Bank of America

Q

...sustainable going forward?

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Sustainable like in classes in the future?

Adam Ron
Analyst, Bank of America

Q

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Yeah. Like [indiscernible] (00:47:26) as a starting point.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Each year is going to be different, depending on the mix. So we're pretty well along with the Class of 2025. We'll know in the next few months what we think that might look like. One of the keys to doing this is how quickly can we get the new partners signed up; and therefore, how long of an implementation cycle we have. We're in really good shape with the Class of 2024. Some of the larger partners have actually been implementing for more than a full year or will have been implementing for more than a full year. Class of 2025 is looking pretty good. So I don't want to guide to a number specifically, but I think we'll get the benefit of the long implementation cycle for that as well.

The second thing is we just made this investment in mphrX, which allows us to more quickly integrate with the EMRs and our new partners, which is where a lot of the data comes from that helps us drive the year-zero performance that will get us into that first year. So new tools and capability, continue to sign partners on early to get a long implementation cycle, should all point to us being able to perform better in year-one medical margin PMPM, short of actually giving guidance for 2025 or 2026 on this yet.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right. Thanks, Adam. Operator, why don't we move to the next question, please?

Operator: Of course. The next question comes from George Hill of Deutsche Bank. Please go ahead. Your line is open.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys. And I appreciate you taking the question. Steve, you kind of touched on this a couple times about orders. And if I could get you to dive in a little more detail where you're expecting a lot of your payor partners to rationalize supplemental benefits in 2024 as a result of reimbursement changes and plan changes. I imagine that's going to lower your cost to serve your beneficiaries. I guess, can you talk about the moving pieces there kind of where you expect it to, I guess, most frequently impact costs on your side?

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Yeah, George. So we have a great relationship with our payors. We're now working with north of 30 payors. We work with five nationals and have really in-depth joint operating committee discussions. And I guess I would start by saying the tone and tenor of those is as productive as I've ever heard them. And I think that the value that we are providing to these payors is really enhanced in an era in which fee-for-service utilization is up. And so, maybe they're challenged across a broad fee-for-service network. They'd like to get more patients into a model like the agilon partnership. And the risk model changes are making things tougher.

And so, the fact that we're able to deliver four-plus star quality in all of our year-two plus markets, the fact that we're able to really better identify these patients and sign them with [indiscernible] (00:50:26), I think, is really important to them. And so, that is really an opportunity that we see.

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In terms of the specifics, each one of them is tweaking different benefits. We have great sight line, and they do too, in terms of how some of these benefits are running. I think, in particular, some of these cash cards associated with dental or OTC are probably the areas where you're seeing some of the benefits going away altogether are dramatically sort of reducing those as we go towards next year. But it really is in a variety of areas that you're going to see the MACVAT come down, in some cases, pretty meaningfully.

So George, hopefully, that gives you context on kind of where we're at. But we're encouraged by it. We were not factoring this as we thought about 2024. We knew there would be some changes, but we just sort of held it constant until we got to the place where we had good visibility, and that's been encouraging.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

All right, George. Thanks very much. We appreciate it.

George Hill
Analyst, Deutsche Bank Securities, Inc.
Q

[indiscernible] (00:51:35).

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

Thanks. Operator, why don't we move to the next one, please?

Operator: The next question comes from Justin Lake of Wolfe Research. Please go ahead. Your line is open.

Austin Gerlach
Analyst, Wolfe Research LLC
Q

Hey, guys. This is Austin on for Justin. Just to follow up on George's question there. Just thinking through the magnitude of the impacts to 2024, do you feel like the reception from the payors on the supplemental benefits is enough to offset like almost totally any risk model impact? Or how should we be thinking of that stepping into next year? Thanks.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.
A

Yeah. I mean, I'm not sure I would characterize it that way. I think we've sort of said, hey, it's very manageable for us in that kind of before any sort of supplemental changes in that kind of 2% to 3% range. I think that there is some relief coming from that. And I think as we've done implementation, maybe that there's some modification around that. But it kind of varies by payor and it kind of – it varies based on their market strategy and sort of the relative changes they're looking at. But I guess my point is on the composite, there will be some relief.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

All right, Austin. Thanks very much. Operator, why don't we move to the next one, please?

Operator: The next question comes from Sandy Draper of Guggenheim Securities. Please go ahead.

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Sandy Draper
Analyst, Guggenheim Securities LLC

Q

Thanks so much for taking the question. Tim, just trying to – I think I understand the higher reserves impacting the MLR for the back half of the year. But I was just trying to think about the cash flow. I noticed that there was a step-up in other working capital items. Was there any impact in the second quarter in that in terms of any true up? And I guess maybe the simple thing I'm trying to ask is, as you basically have these higher, more conservative reserves going forward, does that lower your conversion rate of EBITDA to free cash flow? Or is there sort of a one-time catch-up and then it normalizes? Thanks.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. I think it would be more – to answer the second part of your question first, the way the math would work is the way you described it. It's more of a one-time catch-up, and then normalize going forward. You have to be a little bit careful looking at the big working capital metrics, realize that the way that – when you look at receivables and payables on our balance sheet, we don't pay the claims and we don't actually receive the full cash of the revenue. Ultimately, what we do is settle up – we get some payments as we move along, and then finally settle up nine to 12 months later for the full surplus between those two numbers, between the capitated revenue and the claims.

So when you look at our balance sheet and we are breaking it out and showing that virtual balance sheet of when you can look at days claims payable, as an example, or days sales outstanding, it's not – those numbers will move more based on the timing of information that we get from the payors about what claims have actually been paid, so we can count which ones are paid, versus really having a direct impact on our cash flow.

Now, having said that, if our medical margin, obviously, is going to be lower in the second half because we're shrank in our reserves, I mean that will have a one-time, obviously, impact on EBITDA and a one-time impact on cash flow. That will then be essentially stable after that. I don't know if that makes sense or not, but...

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right, Sandy. Thanks very much. We appreciate it. Operator, why don't we move to the next one, please?

Operator: The next question on the line comes from Jamie Perse of Goldman Sachs. Please go ahead.

Jamie Perse
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thank you. Good afternoon. So I think by year-end, the average time on the platform is going to be around 3.25 years or so. I guess just what is the typical progression for cohort at that level of maturity in terms of expense PMPM? I'm just trying to understand what the existing cohorts might look like from, again, the expense side in a typical progression from, call it, year-three to year-four, and then we can obviously layer on the new markets on top of that. Thank you.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. I don't – do you want to jump in first?

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Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Well, I was going to say, I mean, we typically talk about it, Jamie, from a med margin PMPM because you have very different benchmarks and cost base lines depending upon the markets in which you operate. And so, I mean, you could have a difference between a baseline of $725 of cost to $850 cost. And so, it's really – to give you a number on the cost side, it's really the relationship between the revenue PMPM and the medical cost PMPM, and on year-three specifically.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. I was going to say that – exactly the same thing, which is, each market is going to look different in terms of what their mix of members look like from how they're risk-adjusted versus what their claims are. Hopefully, those things go together. That's the whole idea of risk adjustment. So medical margin, we think, is a much better number. Can't really quote a specific one or the other because they're going to be different for every market.

And I think the information that we put out at Investor Day that shows the progression of each of our market cohorts, over time, is really a good indicator of exactly where we expect them to be from a medical margin standpoint. And so, you can see each cohort and where each of them was at the three-year point since we show you the progression over time. There's going to be a little variability between them from market to market, but, generally speaking, they're pretty well progressing on the same curve. So...

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

And Jamie, I guess I'll just close by saying, I think we've demonstrated our ability to go to a diverse set of markets with a diverse set of physician group types and drive consistent performance across time. So I think what Tim talked about, in terms of referencing back to that, is a very good comparison set in terms of what that progression looks like, which will be a combination of how that revenue and costs are reflected.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right. Thanks, Jamie. We appreciate it. Operator, why don't you move to the next one, please?

Operator: The next question comes from Elizabeth Anderson of Evercore ISI. Please go ahead. Your line is open.

Elizabeth Anderson
Analyst, Evercore ISI

Q

Hi, guys. Thanks so much for the question. Going back to one of the earlier questions, I noticed you talked about sort of your first competitive win there. Does that kind of business come through at like a better initial MLR since they've had some improvement perhaps in there, but obviously not enough to cause them to stay with their prior arrangement?

And then, secondly, you hired the SVP of Data Solutions, so is that sort of – what's sort of his or – like sort of the focus of that new position in terms of is it sort of integration with claims data? Is there something else that you guys are working on in terms of how the offering and programs that you're offering to your doctors and patients as well? Thanks.

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Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

A

Yeah. Thanks for the question. I'll take the first one. Tim can take the second. I think that the reason that they made the change, at least what they're talking to us about, is they have not been able to sort of drive the performance that they were looking at previously. And so, how that translates over in terms of do they start in a better place than others, I'm not sure I would necessarily say that. I think the factors that are driving better year-one performance are the things that we've talked about, which is a longer implementation period that they'll get.

This Minerva platform that's going to get data earlier and the ability to identify those most complex patients and get them enrolled in clinical programs, which we should have in place as they go live, I think those things enable a better stepping-off point versus maybe what they were doing previously.

And then, on the new position, Tim, do you want to...

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. I think the idea was to bring in a very talented executive experience – an experienced executive and build a group underneath them that are really looking at the whole pipeline of data for us, beginning with what data are we getting from each payor, what's the quality of data, what's the timeliness of the data and how can we continue to work to improve that? How is that data ingested and conditioned? And then, how is that, ultimately, used both from an operational standpoint to drive performance as well as from a financial standpoint to drive our accruals in our financial reporting.

So it's a pretty holistic approach. I think it's a really important step for us to take given the size and breadth of the data and the number of payors that we're talking about. And so I think it will help us across all of those fronts. It should certainly help us in improving our ability to continue to sort of improve the quality of our reserves to make sure that we're not minimizing the probability of prior period development next year. But on a much bigger scale, it's also going to help us tremendously with how we use data to drive operational outcome.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.

A

All right. Thanks, Elizabeth. Operator, I think we've got one last question.

Operator: The final question comes from David Larsen of BTIG. Please go ahead. Your line is open.

David Larsen
Analyst, BTIG LLC

Q

Hi. Thanks very much for squeezing me in. Congrats on a good quarter. Can you provide an update on your expectations for fiscal 2026 EBITDA based on sort of the new methodology? I mean can we sort of estimate 150,000 new MA lives at $500 each? That's about $75 million of market entry cost, which means you should be at about, let's call it, at least $500 million of EBITDA for fiscal 2026. Thank you.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.

A

Yeah. So we haven't updated our guidance specifically for the new methodology. But the math that you're using, which is we would expect that geography entry costs would continue to be about $500 per member for the

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following year. So the idea is that the geography entry cost in 2026 will be about $500 a member for those members that we're adding in 2027. The geography entry costs in 2025 would be about $500 per member for those that we're adding in 2026. So just kind of be aware of that – those geography entry costs are kind of one-year offset from the member growth that they're driving.

But the underlying EBITDA performance that we projected before the change to include geography entry cost is – we're still very confident in those numbers. How we basically project that through – next time, we give an update, obviously, for our long-term plan, we'll include that. But the math and the logic that you're using is the right one.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

And Dave, you can obviously get some sense for our geography entry costs for this year? David, do you have a quick follow-up?

David Larsen
Analyst, BTIG LLC
Q

No. Just thanks. Congrats on a good quarter. Thank you.

Matthew Dale Gillmor
Vice President-Investor Relations, Agilon Health, Inc.
A

Thank you.

Timothy S. Bensley
Chief Financial Officer, Agilon Health, Inc.
A

Thanks, Dave.

Steven J. Sell
Chief Executive Officer, President & Director, Agilon Health, Inc.

All right. Thank you, everyone. We really appreciate your interests and your questions. And I think you can hear that we're excited about the progress we've made to-date and the future ahead. So look forward to updating you on future calls.

Thanks, everybody.

Operator: This concludes today's conference call. Thank you all for joining. You may now disconnect your lines.

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