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PRVA.OQ - Q2 2023 Privia Health Group, Inc. Earnings Call

EVENT DATE/TIME: AUGUST 03, 2023 / 8:30AM ET

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Privia Second Quarter 2023 Conference Call. (Operator Instructions). Please be advised that today's conference is being recorded.

I'd now like to hand the conference over to your speaker today, Robert Borchert, SVP, Investor and Corporate Communications.

Robert P. Borchert - Privia Health Group, Inc. - SVP of IR & Corporate Communications

Thank you, Amanda, and good morning, everyone. Joining me today are Parth Mehrotra, our Chief Executive Officer; and David Mountcastle, our Chief Financial Officer. This call is being webcast and can be accessed through the Investor Relations section of priviahealth.com.

Today's financial press release and slide presentation are posted on the Investor Relations page of priviahealth.com. Following our prepared comments, we'll open the line for questions. Please limit yourself to one question only and return to the queue if you have a follow up, so we get to as many questions as possible today.

The financial results reported today and in the press release are preliminary and are not final until our Form 10-Q for the second quarter and 6 months ended June 30, 2023 is filed at Securities Exchange Commission.

Some of the statements we'll make today are forward-looking in nature based on our current expectations and view of our business as of August 3, 2023. Such statements including those related to our future financial and operating performance and future business plans and objectives are subject to risks and uncertainties that may cause the actual results to differ materially. As a result these statements should be considered in conjunction with the cautionary statements in today's press release and the risk factors described in our company's most recent SEC filings.

Finally, we may refer to certain non-GAAP financial measures on the call and reconciliation of these measures to comparable GAAP measures are included in our press release and the accompanying slide presentation posted on our website. Now, I'd like to turn the call over to Parth.

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Thank you, Robert, and good morning, everyone. Privia Health delivered another solid quarter as we moved into the second half of 2023. We continue to execute on our strategy and remain focused on building one of the largest ambulatory care delivery networks in the nation.

This morning, I'll highlight a number of business and company updates, then David will discuss our recent financial performance and our 2023 guidance outlook before we take your questions.

Privia Health continues to gain market share and momentum with our broad provider partnership and operating model. We executed at a very high level during the second quarter, which resulted in Practice Collections increasing almost 14% year-over-year. Adjusted EBITDA was up more than 24%, which demonstrates the very strong operating leverage of our model as we continue to increase our number of provider partners and invest in our new markets.

Our results were driven by continued same-store and new provider growth as well as strong performance in our value-based arrangements in aggregate. Based on our performance year-to-date, we have updated our 2023 guidance and are raising most of the metrics to the mid to high end of our initial ranges.

Earlier this week, we announced a definitive agreement to enter Washington, our 13th state in partnership with Walla Walla Clinic, a multispecialty practice with more than 50 providers caring for patients in 3 locations. It was essential for us to find the right partner who shares our vision to help build a scale provider network in Washington, while improving access to an affordability of care in the local communities.

Walla Walla Clinic has a highly successful history over its decades of operation, and we look forward to continuing to build on its rich heritage of delivering high-quality care in the community. We expect the transaction to close in the third quarter, with Walla Walla Clinic being fully implemented on the Privia Platform by the end of 2023.

Turning to some other company news. On May 8, we completed a secondary offering of 42.6 million shares of common stock or more than 34% of our total fully diluted shares outstanding. This entirely eliminated Goldman Sachs and Pamplona Capital's ownership in the company as well as the Privia shareholder agreement provisions with the private equity sponsors.

We are excited to welcome a number of new long-term oriented investors, and look forward to continuing to create shareholder value in the years to come.

In addition, the Privia Health Board has continued to broaden the capabilities and expertise of our Board members. Adam Boehler, Managing Partner of Rubicon Founders, joined our Board on July 1. He brings deep domain experience as the former Senior Advisor for Value-based Transformation and Innovation at the Department of Health and Human Services, and also previously served as Director of CMMI, the Innovation Center at CMS.

Dave Wichmann and Pam Kimmet joined our Board on August 1. Dave's distinguished career with United Health will bring unique insights to our Board across the health care industry landscape. Pam is a proven leader with broad corporate experience and human capital expertise both in and outside the health care sector. We look forward to the important insights and valuable contributions from each of these new board members as Privia continues to execute on its vision.

Privia's national footprint continues to expand and now includes close to 3,900 Implemented Providers in our medical groups caring for more than 4.4 million patients in over 1,000 care center locations.

Our scale and diverse provider and payer partnerships are true differentiators. We are building one of the largest multi-specialty medical groups and ambulatory care delivery networks in the country that can improve patient outcomes and reduce costs. We continue to be ahead of our growth plan for adding new Implemented Providers in our recent new markets of Connecticut, North Carolina and Ohio.

While not highlighted on this slide, it is also noteworthy that our gross provider attrition rate in 2023 has been less than 1% year-to-date. This is one of the lowest in our company's history, and we continue to add providers on a net same-store basis.

Privia has one of the broadest, most balanced and diversified value-based care platforms in the industry. We serve close to 1.1 million attributed lives across more than 100 at-risk payer contracts in commercial and government programs. Total attributed lives increased almost 27% from 1 year ago.

There remains a significant embedded opportunity for us to move our Medicare Advantage lives into upside and downside risk arrangements over the next few years. However, we remain focused on thoughtfully moving to increased risk arrangements while continuing to provide significant opportunities for EBITDA and free cash flow growth.

Our strong performance in the current health care environment is a testament to Privia's proven ability to manage risk. Our book of business across a diverse set of fee-for-service and value-based contracts in Commercial, Medicare Advantage, the Medicaid Shared Savings Program and Medicaid allow us to uniquely balance risk while delivering significant shared savings, EBITDA and free cash flow growth across a cycle of varying utilization trends.

We leverage our clinical operations, performance management, health care economics and actuarial expertise to manage the transition to risk. Our close alignment with our physician is critically important in managing patient panels across the risk spectrum. This is accomplished through our physician-led governance structure in our homogenous single tax ID medical groups in each state, and the hands-on day-to-day work of our clinical and operations teams.

These differentiated fee-for-service and value-based care capabilities in the Privia model allow us to be a unique partner to physician practices across all specialties in any state serving all patients across all reimbursement models.

Now, I'll ask David to review our recent financial results and 2023 outlook.

David Mountcastle - Privia Health Group, Inc. - Executive VP, CFO & Principal Accounting Officer

Thank you, Parth. Privia Health's operational execution continued to deliver strong performance in the second quarter of 2023.

Our Implemented Provider count was 3,870 up 9.3% year-over-year. Solid ambulatory utilization trends and new implemented providers led to Practice Collections increasing 13.7% from Q2 1 year ago to reach $700 million.

Adjusted EBITDA was up 24.3% over Q2 last year to $19.3 million, highlighting our ability to continue to generate operating leverage as we expand and grow in existing and new markets.

Total value-based care comprised 37% of total GAAP revenue in the second quarter of 2023 compared to 29.6% in Q2 1 year ago, which highlights our thoughtful and prudent moves to at-risk contracts over time.

For the first half of 2023, Practice Collections increased 15.4% to almost $1.36 billion. Care margin was up 18.8% and adjusted EBITDA grew 19.3% to reach $36.2 million.

Our updated 2023 guidance highlights the strength and resiliency of our operating model and diversified book of business. Based on our year-to-date financial and operating performance, we are raising all of our 2023 guidance metrics to the mid to high end of our initial ranges, except Practice Collections and Attributed Lives. We expect Practice Collections to come in at the midpoint of the guidance as this includes the impact of the one paused capitated contract we discussed last quarter. We also expect the year-end Attributed Lives to be at the midpoint of our previous guidance.

As we've noted previously, our 2023 adjusted EBITDA guidance absorbs approximately $8 million to $10 million in new market entry and expansion investments. With 5 new States and 3 new ACOs in 2023, we plan to continue to invest across our business enterprise to support our significant expansion while continuing to grow EBITDA and free cash flow year-over-year. We expect our new markets to scale significantly in the coming years as we grow our provider base and attributed lives in these new States.

Our balance sheet and capital position continue to be very strong with cash of approximately $318 million and no debt. Given our capital efficient partnership model with annual capital expenditures of less than $1 million, we continue to expect 80% to 90% of our adjusted EBITDA to convert to free cash flow on an annual basis. We remain focused on building Privia Health and one of the largest ambulatory care delivery networks in the nation and investing to support this growth as we build our national footprint.

We are now ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Jailendra Singh from Truist Securities.

Jailendra Singh - Truist Securities, Inc., Research Division - Analyst

Congrats on a strong quarter. So, actually, I wanted to get more color around utilization trends in the quarter. How did those compare with your expectations and maybe what are you assuming for the rest of the year there? And for the quarter, in particular, were there any pockets where utilizations were higher or lower than your expectations and impact on your business -- various business lines?

And kind of related, there was a $3 million unfilled PYD in the quarter. Can you provide some color, what drove that?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

I'll tackle the first half and then David will comment on the $3 million prior period adjustment. So, generally speaking, on the utilization trends, one broad comment, if you look at the last 3 or 4 years, 2019 through 2022, pre-COVID, acute during the COVID and then coming out of COVID. We've had ebbs and flow in utilization to a pretty extreme level. And the strength of our model just speaks for itself where we've each year grown both our fee-for-service book and our value-based book from both the top line and an EBITDA perspective. So, I think it's important to take that slightly longer-term view as we look at utilization.

The second point I'll make is, as we've said previously, it's important to distinguish between ambulatory utilization and then surgical or, in or outpatient utilization trends. On the ambulatory side, we continue to see a higher plateau coming out of COVID. We've seen pretty strong tailwinds.

That in our minds is good utilization with people seeing their primary care provider, pediatrician, OB-GYN, and that bodes well for our fee-for-service book and also is good for the value-based book.

I think if you see some spikes in surgical utilization both in an outpatient, that obviously impacts the Medicare Advantage book. But despite that, our other value-based books, both commercial and the Medicare Shared Savings Program act as a very natural hedge. So I think, obviously, we are downstream from the payers. We've all seen the same commentary that you've read. And overall, on balance, we performed really well in aggregate across both fee-for-service and value-based book.

David Mountcastle - Privia Health Group, Inc. - Executive VP, CFO & Principal Accounting Officer

Yes. And Jailendra, on the $3 million that you see out there, it is not related to the paused capitation contract that we did last quarter. So, I kind of wanted to make that point to start with. We received some payer data relative to retroactive 2022 adjustments. So, the $3 million prior period claims increase was not actually a loss, but it was offset by approximately the same amount of revenue booked in Q2 of 2023. And even with that, our financial performance remains strong, as reflected in our Q2 results and updated 2023 financial guidance to the mid to high ranges.

Operator

Our next question comes from Lisa Gill from JPMorgan.

Lisa Gill - JPMorgan Chase & Co, Research Division - Analyst

I just wanted to dig in a little deeper on the ramp in the new markets adding North Carolina, Connecticut, Ohio. How do I think about the trend that you're seeing, how quickly you're getting positioned to come on to the platform? And would we expect an impact as we go towards the back half of this year? And I understand that Washington will close in the third quarter. So, I think of that is more of a 2024 opportunity, but I'm just curious as to how the ramp is going versus your expectations?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, we're really pleased with how we've started in each of those markets. As we stated in our prepared remarks, we are running ahead of our expectations in new provider sales in each of those States, and we continue to see pretty good opportunities to build very large medical groups over the next 4 years to 5 years, which is always our thesis when we enter these new States.

I think this year, as we've experienced one of the strongest in-market sales years in the history of the company, that's reflected in our updated guidance of mid to high end on the implemented providers for the end of the year.

And then again, Washington is a new state that was not disclosed earlier, and we're really pleased with that partnership. They'll be implemented before the end of the year, but you'll see the financial impact for the full year going into '24. So, I think all of that leads us to have pretty good momentum closing out this year and then entering into next year, and that's reflected in the guidance we've provided today.

Lisa Gill - JPMorgan Chase & Co, Research Division - Analyst

And Parth, any early thoughts on like health system pipeline partnerships for '24? How do you feel about that versus what we've seen in the last few years? Just given your success, are you seeing more interest, the same interest? Just curious if there's a way to quantify how to think about that pipeline going into '24?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes, sure. I mean, we've seen really strong momentum. If you see our performance since going public a couple of years ago, we've accelerated the opening of new states. We've entered now 5 States in pretty short order here in the last 12 months. And when we went public, we said expect us to enter one state a year and we're clearly exceeding that. Our pipeline continues to be broad. We're having multiple discussions with medical groups, ACO entities, health systems. Again, the timing of when these hit is always uncertain. These are very strategic partnerships, very long-term oriented, and we are very careful in who we choose as a partner. So, obviously, as those hit, we'll update you as we've been doing, but we feel really good about going into the next couple of years and the momentum of the business.

Operator

Our next question comes from Elizabeth Anderson from Evercore.

Sameer Patel - Evercore ISI, Research Division - Equity Associate

This is Sameer Patel. So, we're upwards of $900 on PMPMs for capitated revenues for the quarter, assuming no major change in lives. Should we expect something in this range going forward or is it kind of -- just trying to understand the range that it could potentially fall over the rest of the year?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes, Sameer. So, I think that's a fair range to look at. Obviously, we are downstream from the payers on the cap book. So, it's 85% of premium. And then in some risk pools, we are not taking the full 100% risk across all buckets of spend. So, it just depends on the mix of business and the risk pool we are in and how much risk we are sharing with the payers. So, we'll typically be slightly lower than the average PMPM that you usually see in the industry compared to 100% risk contract.

Operator

Our next question comes from Richard Close.

Richard Close - Canaccord Genuity Corp., Research Division - MD & Senior Analyst

I was wondering if you could just talk a little bit about Washington. The difference in that deal is maybe compared to, let's call it, BASS in California. And then, when do you expect to see, I guess, growth off of that in terms of bringing in new physicians?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, the fundamental difference is, we will own the tax ID, own the MSO entity, the ACO entity in Washington, so all 3 entities. That's not always the case in some of our partnerships. But in this state, we would own all 3 entities. So, you'll see us consolidate results on a GAAP revenue basis and that will happen from the date of the closing of the transaction.

The full year impact from an earnings standpoint will happen likely starting 2024 as Walla Walla Clinic gets implemented towards the end of this year, similar to the 5 months to 7 month ramp that we have in implementing providers.

And then we'll start our work again. The thesis is very similar to other states. This is a 4, 5 year journey for us to add providers. And I think our differentiated model is really -- should be welcomed in that state. I think there's a real need for providers to have an alternative in the Privia model to be autonomous and remain in their ownership structure while aligning with somebody like us. So, we're really excited. It's a big dam in that state, and we feel really excited to enter that state.

Operator

Our next question comes from Taji Phillips from Jefferies.

Taji Phillips - Jefferies LLC, Research Division - Equity Associate

So, looking at the value-based Attributed Lives growth mainly concentrated in commercial and then on the government side, MA. So, I'm just curious, as we go through the year and there's a lot of -- you could say messiness or a lot of shifting in terms of enrollment with redeterminations and exchanges. How are you thinking about the impact on your business? And then Parth, you had talked about still seeing a lot of embedded opportunity in Medicare Advantage. I guess what would kind of trigger that unlock, right, for you to see more growth in that part of the business?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, obviously, the one key differentiator for Privia is our book of business is very balanced, as you noted, between commercial and government programs, and within government programs in MSSP, MA and Medicaid. I think that puts and takes in each one of those.

Our view is as we grow our provider base, as we get more patients on the platform, we are looking to increase the number of attributed lives across all of these buckets. And I think we see great tailwinds across our states in continuing to add attributed lives and then increasing the yield per life as we enter into these programs, both for our physician partners and delivering low-cost care and adding value for the payers. I think that differentiates us very meaningfully even in the commercial book.

So, I think you'll continue to see growth in each of those buckets. Obviously, they are -- there's movement within the year. If you take our 2 largest buckets, commercial, MSSP, they are more open-access PPO like products. In the early half of the year you sometimes see employers change their insurance carrier. So there can be some shifting of lives as they need to come and see their PCP again before being attributed in the new plan, and we are downstream from that.

It's very unlikely that the patient actually leaves the doctor. So, I think you'll see some movement in the first couple of quarters, but overall, as we increase the number of providers, you should see growth in lives.

And then to your last point on Medicaid, again, you'll see some redetermination effect on that pool, but we are hoping that we capture those lives back in the commercial bucket over time. And then in the MA book, we'll continue to, as we've noted in our prepared remarks, thoughtfully increase the level of risk we are taking on that book of business. There's a lot of embedded opportunity, but you need to do it very thoughtfully as we have been doing with a focus on maximizing the earnings power for the level of risk we take.

Operator

Our next question comes from Jamie Perse from Goldman Sachs.

Jamie Perse - Goldman Sachs Group, Inc., Research Division - Associate

2 quick financial questions. First, can you help us with the bridge on care management fees from 1Q to 2Q? It seems like a bigger step-up than usual. So, I'm wondering if there's incremental services being offered on new partnerships there that are driving that?

And then just on second half guidance. I mean it feels like there's a lot of momentum coming out of the second quarter. Your implied second half really isn't changing too much across most metrics. I'm wondering if there's any incremental headwinds you're assuming for the second half or just any specific assumptions we should be thinking about?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, on the first question, look, again, you see the great operating leverage in our business where if we get great top line growth and perform well in value-based arrangements, there's embedded operating leverage that you can see flow through into EBITDA and then free cash flow. So, I think there are quarters where you see that play out very significantly. We also saw that in all of 2022, where we grew top line close to 50%, EBITDA close to 50%, free cash flow close to 50%. So, I think, again, we differentiate from that perspective in our book of business and with the unit economics working, and you're seeing some of that play out in Q2.

And for the rest of the year, look, we'll try to be prudent with our guidance. We see a lot of good momentum. We're also investing in 5 new markets, as David noted. So, I think it's a balance between continuing to invest and get future growth versus profitability in the current year. So, I think we feel really good about the guidance we've given. And as the year goes, we'll update guidance going into Q3 and Q4.

Operator

Our next question comes from Jeff Garro.

Jeffrey Garro - Stephens Inc., Research Division - MD & Analyst

So, I'll ask about investments in new markets, and you've mentioned the success ramping markets like North Carolina, Ohio and Connecticut. So, curious how new market investment spend is tracking year-to-date? And then maybe also you could help us think about growth in new market investments going forward versus what you've detailed for the current year, and specifically how the types of markets and agreements like what you've disclosed in Washington and whatever else is in the pipeline, might impact that?

David Mountcastle - Privia Health Group, Inc. - Executive VP, CFO & Principal Accounting Officer

Yes. So, I would say, as we've been tracking with our results in those markets, so, we have the investments in those markets. So, I would say the investments are on track and maybe even a little bit ahead of schedule for the ones that we've done in the past.

On a go-forward basis, obviously, we have an expectation of investment each time we enter one of these markets. And so, we're expecting to invest in Washington starting, obviously, as soon as we close. So, we'll have some of that impact this year. But obviously, that's reflected in our increased guidance that we provided for the year.

And again, on a go-forward basis, as we continue to enter new markets, we expect those operating costs as we get into those market not to really be much different from that in the past, being -- the larger the market, maybe a little bit larger cost, a smaller to market, maybe a little bit smaller. But at the end of the day, we are going to make -- we are going to need to make an investment in any of those markets as we enter them, but we see great long-term results from making those investments.

Operator

Our next question comes from Andrew Mok from UBS.

Andrew Mok - UBS Investment Bank, Research Division - Analyst

I just wanted to follow up on the utilization conversation. You held the midpoint of your Practice Collections outlook constant despite strong performance in the quarter, the low attrition rate you cited and your comments around strong trends in the ambulatory segment. Can you help quantify the impact of the pause capitated contract and expectations for this year? And is there anything else you would call out why the higher utilization isn't necessarily flowing through to higher Practice Collections revenue?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, obviously, if you look at the implemented lives that are not capitated, if we hadn't had that contract paused, you can imply that we would have been closer to the mid to high end of our original guidance even on Practice Collections. Obviously, the reason for pausing that contract was preserving the earnings power and given the unique situation in that one particular contract.

It's not impacted our bottom line results, and that was the objective here. So, again, you can see the top line impact is not resulting in any bottom line metric. And with the momentum we've had, had it not meant for that, we would have been mid to high end of that guidance as well.

Operator

Our next question comes from David Larsen from BTIG.

David Larsen - BTIG, LLC, Research Division - MD and Senior Healthcare IT & Digital Health Analyst

Can you maybe talk a little bit about the nature of the conversations that you're having with the health plans? Are they willing and ready and have been able to get into risk deals? Sometimes they want to avoid risk deals. Are you seeing more success on the Medicare or Medicaid side?

And then just any thoughts around the CMS proposed rule for '24. There's going to be some headwinds for the conversion factor, but an increase in risk. Just any color there would be helpful.

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, in general, look, we work really closely with all of our health plan partners. It's a longer-term discussion than a very immediate discussion. We look at different risk pools. We look at density of lives, density of duals and decide when to dial up risk.

Look, our approach has been to be very prudent. We can't be more explicit than have a slide in our earnings call with the subheading that says, it's called risk for a reason. Our philosophy has been to have very close alignment both with the payer partner as well as our physicians. Having all 3 entities participate in that risk, we think that leads to very -- better aligned outcomes and we'll continue to follow the same philosophy.

Obviously, there can be in a period of time where everybody is chasing MA utilization -- sorry, MA attribution. You can have population growth or Attributed Lives growth which can be a little bit unnatural if everybody is chasing that from the payer side and we are downstream from the payers.

So, we have tried to avoid adverse selection and things of that nature. So, having that alignment is very important. So, I think we continue to have those discussions in every -- each one of our states. We thoughtfully move into risk. We really like the CMS, MSSP program as you noted. It's a big part of our business.

CMS takes about 25% share of the shared savings in the Enhanced Track. And I think most of the changes that they proposed further will spend in the program and will be favorable in general to us. Around the assignment process, whether it's a benchmark risk adjustment methodology, quality reporting and then potentially the ability for ACOs like us to take more risk than the Enhanced Track.

I would say though, these will -- the financial impact will likely be more gradual than some onetime spike here, as we've seen in the past with CMS, adjusting the program, but we continue to think that this is one of the best, most broadly applicable value-based programs in the country, and then we feel really good about it.

Operator

Our next question is from Jessica Tassan from Piper Sandler.

Jessica Tassan - Piper Sandler & Co., Research Division - VP & Senior Research Analyst

So, I was hoping you could maybe talk a little bit about the performance of some of your more mature MSSP ACOs? And I'm specifically curious to know if ACOs like the Mid-Atlantic are still growing new providers and new lives 9 years after inception, and kind of when an ACO is that sophisticated or mature? How do you think about bringing new providers into the fold without diluting the savings rate for existing providers?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes. Look, we've continued to grow all of our ACOs over the years. We continue to add new providers even in mature markets like Mid-Atlantic. There are a lot of late adopters. We see a lot of momentum. We still, despite being in this market for more than 8 years or 9 years, have pretty low market share relatively. We barely approach double-digits even in mature markets with very large medical groups. And I think that speaks to the strength of this business model where the TAM is really large for us, and we continue to get more attributed lives enter into increased risk arrangements.

So, moving from track1, 2, 3 or ABC as they were in the past into more Enhanced Track, and then increase the savings rate. So, I think you're going to see a double whammy on the shared savings and the EBITDA progression on these ACOs. And our hope is to continue to keep delivering on that. Obviously, the more mature the market, you start to see some stabilization of results, but we think we have a pretty good line of sight in the next few years to keep growing some of our ACOs and continuing to deliver.

Operator

Our next question comes from Whit Mayo.

Whit Mayo - Leerink Partners, Research Division - Analyst

Parth, you guys acquired that ACO in Connecticut a few months ago. And I'm just wondering, is that a strategy that you guys think you might plan on exploring further? I mean, I guess that the question is, are you finding more inroads conversations after that transaction? Just how willing you are to maybe put capital to work to move into new markets? I mean, you'll probably have over $400 million of cash by year end. So, just kind of curious, as you think about capital deployment and growth, how willing you are to maybe pursue that as a strategy?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes. So, the uniqueness of our business model is, as you well know, we are forming medical groups, risk or ACO entities, and then a full management services entity in every state.

It's a very integrated type model across fee-for-service and value-based care. The way we enter each market or grow a market after we enter can be acquiring either of those 3 types of entities. And we've done that in the past, as you've seen with different entries in different states with and putting small amounts of capital to work. I think you should continue to expect that we'll keep doing that.

Entering Washington is another example. We bought the medical group entity there. And I think we're on the lookout for more such opportunities to either enter into new states or expand and increase our density in existing states. And I think that's a great use of capital for us to keep growing our business. And so, I think you should continue to expect us to do that in the future.

Operator

Our next question comes from Gary Taylor from Cowen.

Ryan Langston - TD Cowen, Research Division - Analyst

This is Ryan Langston in for Gary Taylor. It looks like AR jumped up quite a bit sequentially into the second quarter. DSO looks like it's up about 10 days, but this is pretty similar to what we saw last year. Can you just remind us what is driving this? And also, it looks like on the cash flow statement there was a $5 million repurchase of NCI. Can you just maybe give us some context on what that refers to?

David Mountcastle - Privia Health Group, Inc. - Executive VP, CFO & Principal Accounting Officer

Yes, on the accounts receivable, so it was partially related to our new capitation related approvals in '23. We've got some new contracts that increased revenue. But remember, on our value-based care side of the business, with the typical 1 year annual payment in Q3 or Q4 of each year, AR builds in Q1 and Q2 each year.

So, unlike fee-for-service that you get sort of more of a normal DSO churn, for the value-based care stuff, it grows throughout the year and then we get a payment in Q3 or Q4, AR goes back down and then it continues to grow back from there. So -- and again, as you mentioned, very similar same pattern as our past couple of years. So, we expect this and -- this is what we expect.

On the $5 million on the cash flow, we purchased the remaining minority stake in an MSO that we own the majority stake in. So, it was just a small additional investment to own 100% of an MSO in one of our markets.

Operator

Our next question comes from Sandy Draper from Guggenheim Partners.

Sandy Draper - Guggenheim Securities, Research Division - Analyst

A lot of the questions have been asked and answered. Maybe just a quick housekeeping question. I think, David, you mentioned -- you gave the percentages of fee-for-service and value-based care versus as a percentage of Practice Collections. If that's true, could you just repeat that?

And I guess my broader question, I know you guys don't specifically comment on capitated margins and where you are, but just in light of all -- what's out there and it's sort of been talked about, how you're progressing in terms of -- you feel like you're progressing on your capitated revenue in terms of the margins? And again, how you think about the long-term trajectory about where eventual scale is there and targeted margins?

David Mountcastle - Privia Health Group, Inc. - Executive VP, CFO & Principal Accounting Officer

So, value-based care represents 37% of GAAP revenue in '23 compared to $29.6 million in Q2 of '22 and Practice Collections, value-based care was 24.9% in Q3 '23 versus 21.8% in Q2 '22.

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

And Sandy, I appreciate the question. On the capitated book, look, our view is, you take increased level of risk if there's significant earnings opportunity for taking that risk and us getting compensated and our doctors getting compensated.

So, I think with close to 150,000 MA lives, the embedded opportunity is pretty huge for us to dial up risk. We're just taking downside risk on about 23% of those lives today. Over time, you should expect to see that number increase.

Obviously, we try to do this very prudently, working with our payers, understanding where we've got the right density, making sure our providers are aligned. They share the risk with us upside and downside. We don't backstop risk, as you know. And we think that's the right long-term model to get all 3 entities aligned in such an environment.

So, I think while our approach has been more prudent than many other players, I think there's been a lot of focus on taking more risk in the recent years than managing risk. We think managing risk should be as important, if not more important than taking risk, especially as you go through some of these utilization trends that the payers have been commenting on. We as provider entities taking risk are downstream from that. And I think, again, you'll continue to see us being very thoughtful.

Over time, over the long run, you should see pretty significant opportunity for us to increase the earnings power of this business as we take more risk in that particular segment and drive future EBITDA and free cash flow growth.

Operator

Our next question comes from Ryan Daniels from William Blair.

Ryan Daniels - William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Healthcare Technology and Services

Parth, one for you. You've talked a little bit about outpatient utilization. Obviously, the managed care companies are seeing a lot of pent-up demand and sustained outpatient surgery volume. You're in a pretty unique position here both with your surgery partnership and kind of your multi-specialty purview. Maybe help with -- I'm curious what you're seeing specifically there? And if you can move into more risk-based contracts or episodes of care on the outpatient surgery to help deal with that and drive your growth and value proposition?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes. I -- we would agree with your assessment. I think we are in a very unique position, and that's a great differentiator for us. We have 50-plus specialties on the platform. We are not very heavy on surgical specialties, but we have partnerships that are -- and in the markets where we have hospital partners, obviously, that's a bit more heavy.

But overall, we think the commercial book is going to continue to be a pretty important part of our business. It's 50% of the population. It's commercially insured. I think there's a big focus by the payers to move a lot of the surgical procedures in an outpatient setting from an inpatient setting. I think that bodes well for our business and the value a multi-specialty group like network can provide the payer partners. And we're having a lot of discussions in adding to our specialist network and moving a lot of those volumes to the outpatient setting.

So, again, it's a long-term strategy, but it adds a big tailwind to our business. And again, that diversification helps us continuing to grow both top line and EBITDA as I've mentioned earlier in one of the questions. If you look at the last 4 years, it's just played out where despite the ups and downs through the COVID years, we've continued to grow top line and bottom line with that kind of mix. And so, we feel pretty excited about our strategy, and it validates our approach in building big multi-specialty groups. 80% of the costs are downstream from the PCP, and it allows us to manage those costs in different arrangements as they come about over time.

Operator

Our next question comes from Adam Ron of Bank of America.

Adam Ron - BofA Securities, Research Division - Research Analyst

Coming back to the Washington market entry, I'm just trying to get a sense for how dilutive it would really be to enter, just because if you already have 50 providers, that could be like $30 million in revenue. And if you take 10% of that, that's like $3 million of incremental revenue to you when you talk about like low single-digit start-up costs in new markets. So, just wondering like why wouldn't that just be breakeven next year? And just trying to understand what scale you kind of need in the market to overcome the dilutive investments?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

So, your assessment is correct. If we get a head start like we are doing here with 50-plus providers, as you've seen, we've entered the market, and we've increased our guidance ranges on the bottom line metrics to the mid to high end. So, we are absorbing some of those costs within the year despite addition of one new market that we hadn't previously announced.

However, I think the TAM is pretty big. So, while we'll get a little bit of a head start here, these markets break even as we are looking to build very big medical groups, 200, 250 or 300 providers over the next few years.

There's pretty significant sales marketing, implementation costs that go in. We've commented on the $2 million to $3 million spend per new state, and that spend will happen in Washington as well, getting a head start with 50 providers held, but most of these markets take a couple of years just to hit breakeven.

Operator

And our last question comes from Sean Dodge of RBC Capital Markets.

Thomas Kelliher - RBC Capital, Research Division - Equity Associate

This is Thomas Kelliher in for Sean. I'll ask a higher level one here. How does virtual care fit into your current provider playbook or strategy? Is this an effective tool to improve overall economics, at least maybe on the value-based care side, or is it just more of a capability that certain patients kind of expect at this point?

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Yes. I think we've continued with our playbook where -- it's everything that you mentioned. I mean our job is to transform the practice once a provider joins us and optimize both their fee-for-service operations, take as many of the lives and move into value-based arrangements, streamline the expense structure and take on a lot of the admin burden.

So, we are focused on all of those aspects to increase at the end of the day the take home pay for our physician partners and the providers that join us. And that's our value proposition. It's a pretty big moat. A lot of hard work goes into it. We take a lot of the dirty work off of their plates and then increase both the top line and bottom line. And then our management fees are directly tied to the performance of the practice.

So, I think the interests are pretty aligned. So, I think we're going to focus on all 3 aspects of doing that and keep adding value to our provider groups, and that increases the stickiness as you're seeing with our business.

Operator

I'm showing no further questions at this time. I would now like to turn the conference back to Mr. Mehrotra for our closing remarks.

Parth Mehrotra - Privia Health Group, Inc. - CEO & Director

Thank you for listening to our call today. We appreciate your continued interest and support of our company and look forward to speaking with you again in the near future.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.