

U.S. Managed Care Industry

Charles Boorady

Research Analyst

(212) 325-8999

Charles.Boorady@credit-suisse.com

*“No Lost Decade
for
Managed Care”*

January 2011

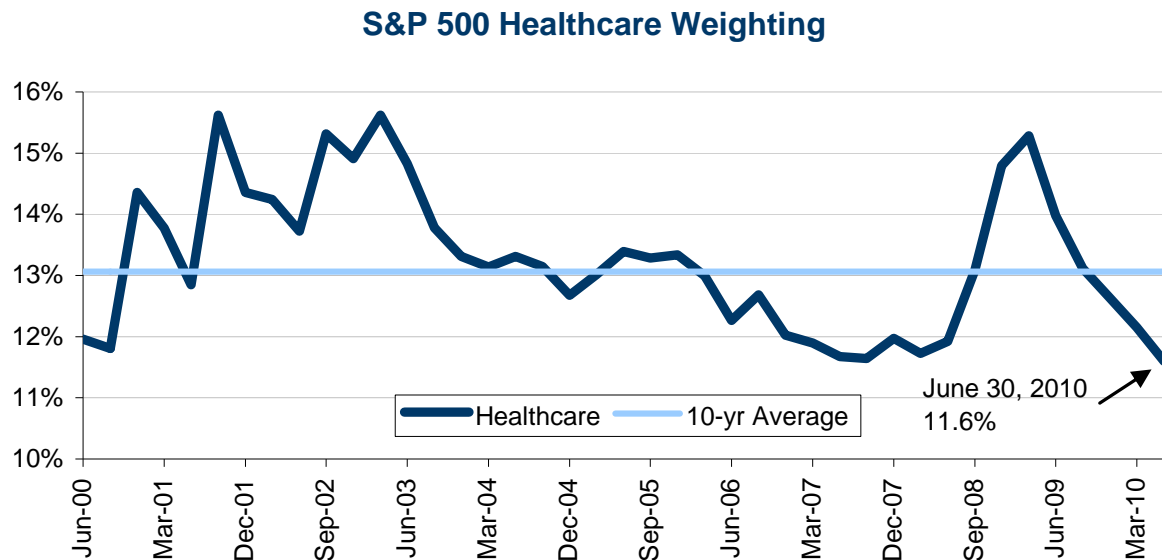
DISCLOSURE APPENDIX CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, INFORMATION ON TRADE ALERTS, ANALYST MODEL PORTFOLIOS AND THE STATUS OF NON-U.S ANALYSTS. FOR OTHER IMPORTANT DISCLOSURES, visit www.credit-suisse.com/researchdisclosures or call +1 (877) 291-2683. US Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Impact of Reform on Company Value

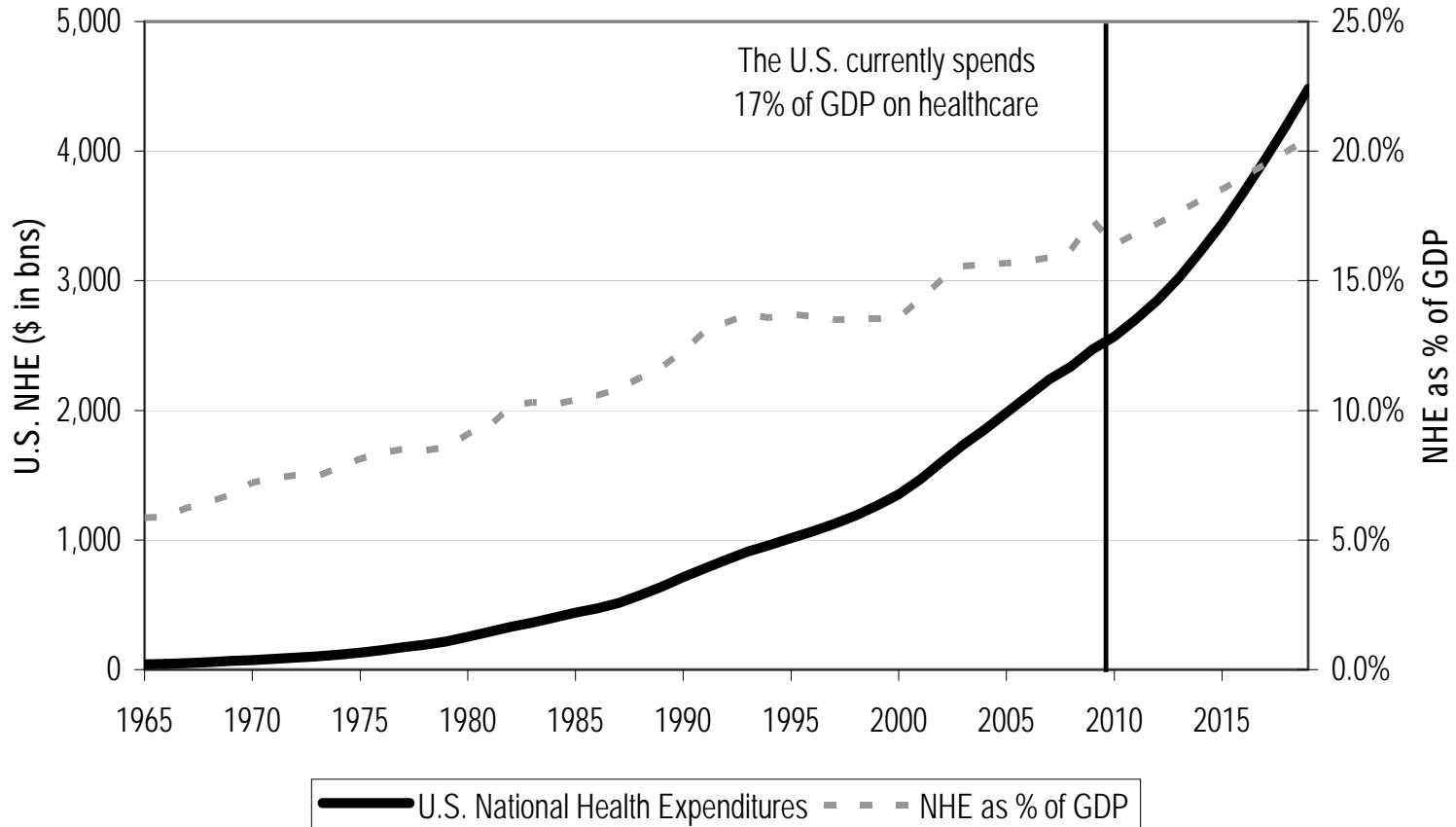
- Company Value = All Future Cash Generated, Discounted
- How we Model the Impact of Healthcare Reform?:
 - Changes expected cash generation
 - Increases the discount rate on future cash generated, due to higher uncertainty
 - Increases borrowing costs
 - Even non-profits would pay more to access capital

Healthcare Stocks At a Low as % of Market Index

- EPS Shortfalls in healthcare as high out-of-pocket costs and a tight consumer wallet reduce demand
- Negative general sentiment toward healthcare, and concern over the impact of reform



Health Spending Growth is Robust



Source: Bureau of Economic Analysis, CBO, Credit Suisse estimates

Intermediaries in \$2.5 Trillion/Yr U.S. Market

Buyers

Employers: \$924bn

- 175mn persons
- \$324bn addressable by managed care (excludes \$600bn in ASO, OOP spend)

Out-of-Pocket: \$280bn

Individuals: \$40bn

- 19mn persons

Uninsured: \$171bn potential

- ~50mn persons; \$171bn opp not in total

Medicare: \$530bn

- \$510bn Medicare + \$20bn MedSupp
- 46mn ages 65+ and disabled

Medicaid, CHIP: \$650bn

- 50mn total – 6.5mn duals; 11mn CHIP; Federal + State

Military: \$50bn

- 8mn+ Military (TRICARE); 4mn Veterans (VA)

Managed Care & PBMS

Providers

Facilities: \$948bn

- In&out-patient, long-term care, rehab

Physician & Clinical: \$509bn

Lab, Imaging, Dental, Vision, Other: \$654bn

Rx Retail & Institutional: \$267bn

Manufacturers

Equipment & Devices: \$250bn

- Imaging - \$40bn
- Cardio - \$25bn
- Ortho - \$20bn
- Other - \$165bn

Healthcare Distribution

Healthcare IT

Source: CMS, CS ests

Middle Men May Gain Share: Penetration just 40%

Payors	2009 NHE (\$bn)	Elim. of ASO, OOP	Addressable Mkt.	Managed Care		Growth Opportunity			
				2010E % Share	2010E \$ Share	Existing Mkt.	PF Reform	Total Mkt Opp	% of Mkt Opp
Medicare	\$510		\$510	25%	\$128	\$383		\$383	34%
MedSupp	\$20		\$20	100%	\$20	\$0		\$0	0%
Medicaid, CHIP	\$650		\$650	18%	\$119	\$531	\$66	\$597	53%
Military	\$50	(\$11)	\$39	10%	\$4	\$35		\$35	3%
Total Government	\$1,230	(\$11)	\$1,219	22%	\$270	\$949	\$66	\$1,014	91%
Employer	\$924	(\$600)	\$324	100%	\$324	\$0		\$0	0%
Out of Pocket	\$280	(\$280)	\$0	0%	\$0	\$0		\$0	0%
Individual	\$40		\$40	100%	\$40	\$0		\$0	0%
Exchange	\$0		\$0	0%	\$0	\$0	\$106	\$106	9%
Total Private	\$1,244	(\$880)	\$364	100%	\$364	\$0	\$106	\$106	9%
Total HC Spend	\$2,474	(\$891)	\$1,583	40%	\$634	\$949	\$171	\$1,120	100%

↑
The U.S. spends \$2.5T/yr on HC...

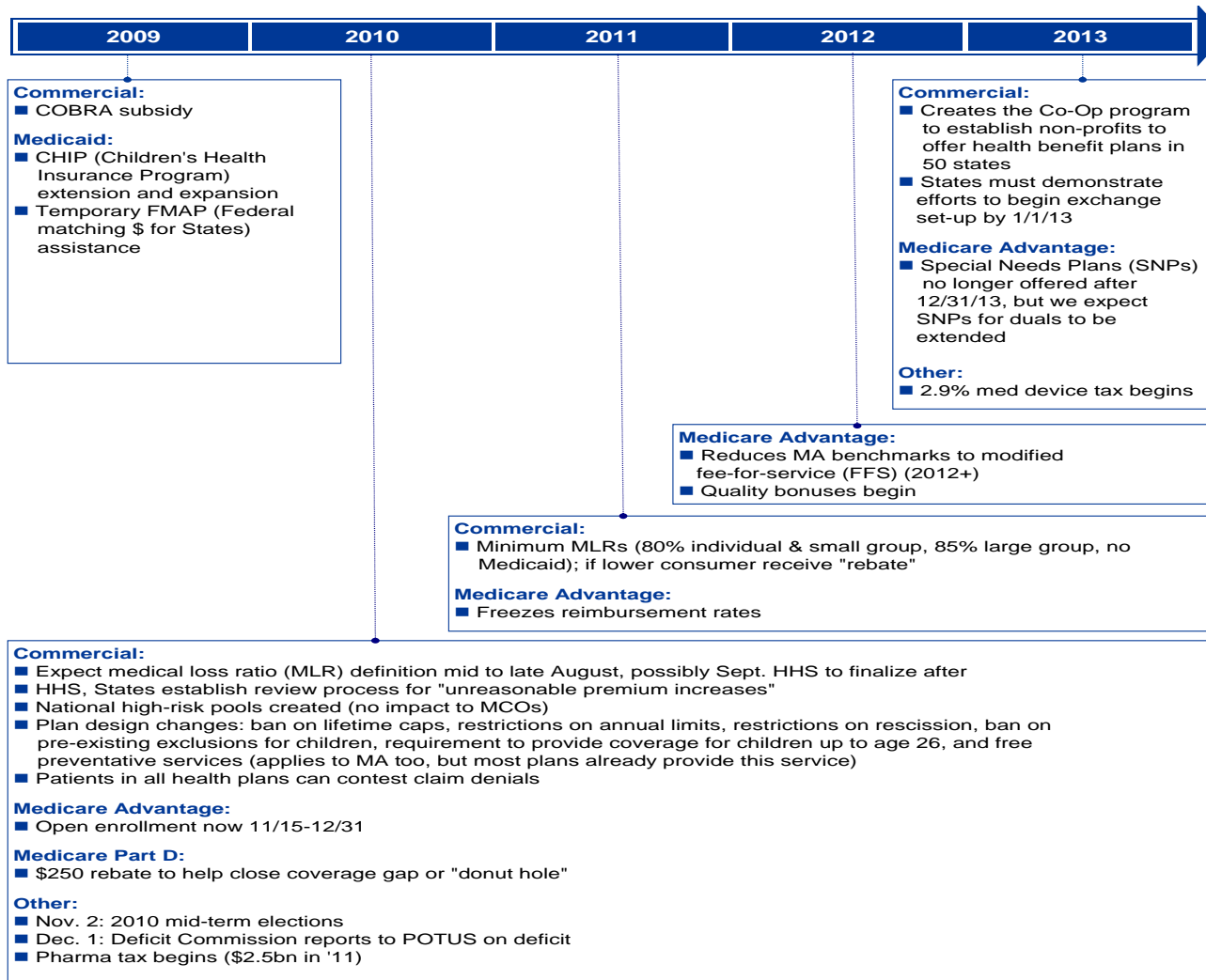
↑
...of which \$1.6T is addressable MCO revenue or about 40% penetrated

↑
Theoretically, there is more than 100% revenue growth potential post-reform if Medicare & Medicaid continue privatization

- \$1.6 trillion in US Healthcare spending addressable by private managed care organizations. Of that, only 40% is penetrated by managed care

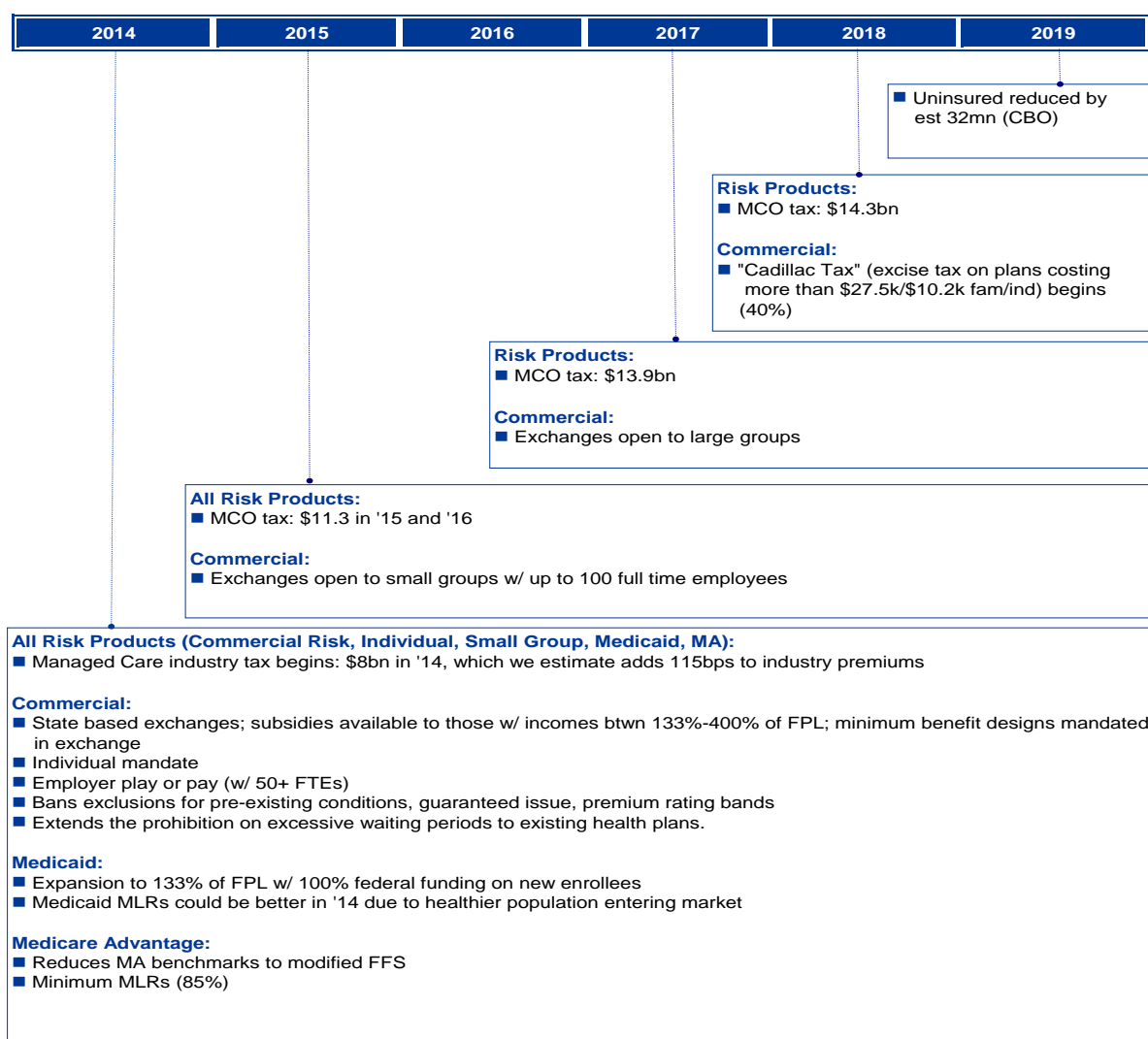
Source: CMS (National Health expenditure Data), Credit Suisse estimates

PPACA "Reform" Timeline: Margins Regulated 2011+



Source: Government data, Credit Suisse estimates

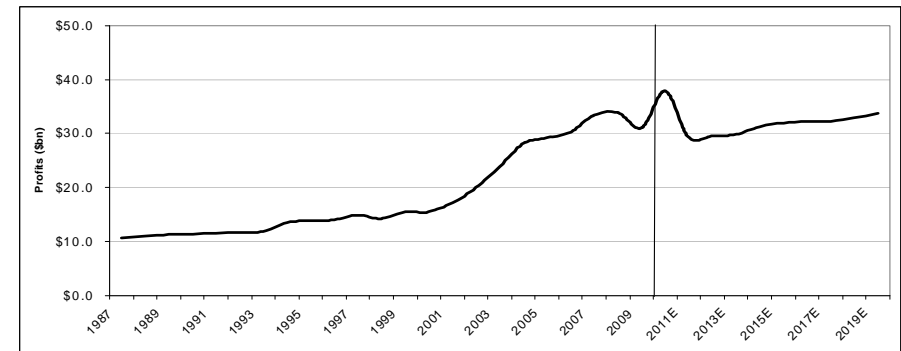
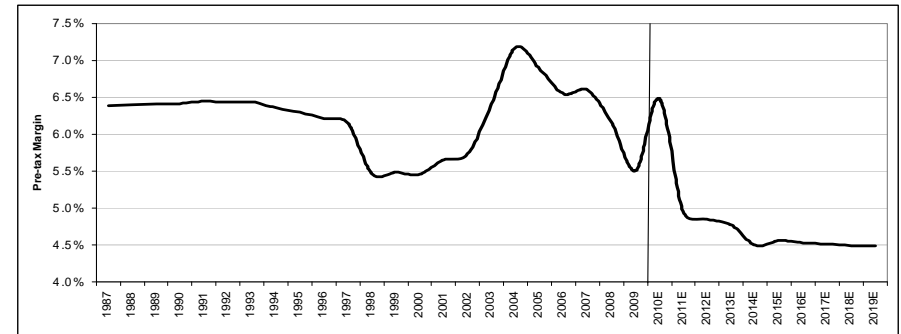
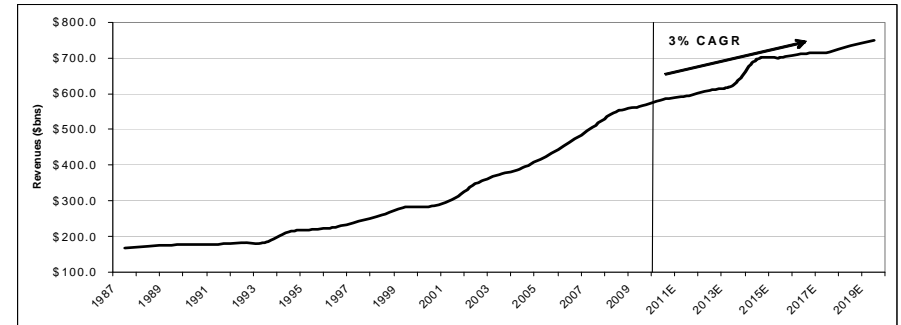
Timeline 2014+ coverage expansion, guaranteed issue



Source: Government data, Credit Suisse estimates

Our 10 Year Model

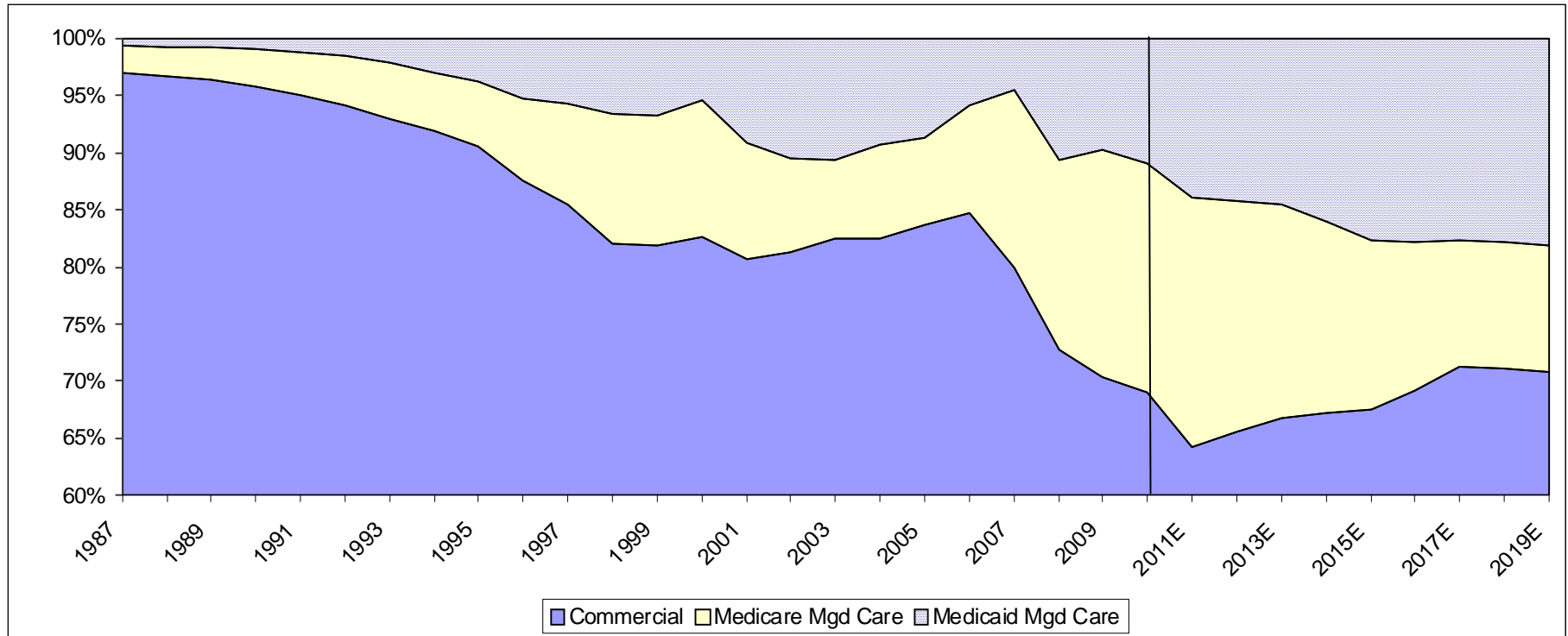
Revenue Growth
X
Margin Contraction
=
Flat Profits; But
Survivors Will Gain
Share



Source: Company data, Credit Suisse estimates

Winners will have Medicare and Medicaid Experience

Percent of Industry Profits by Major End-Market



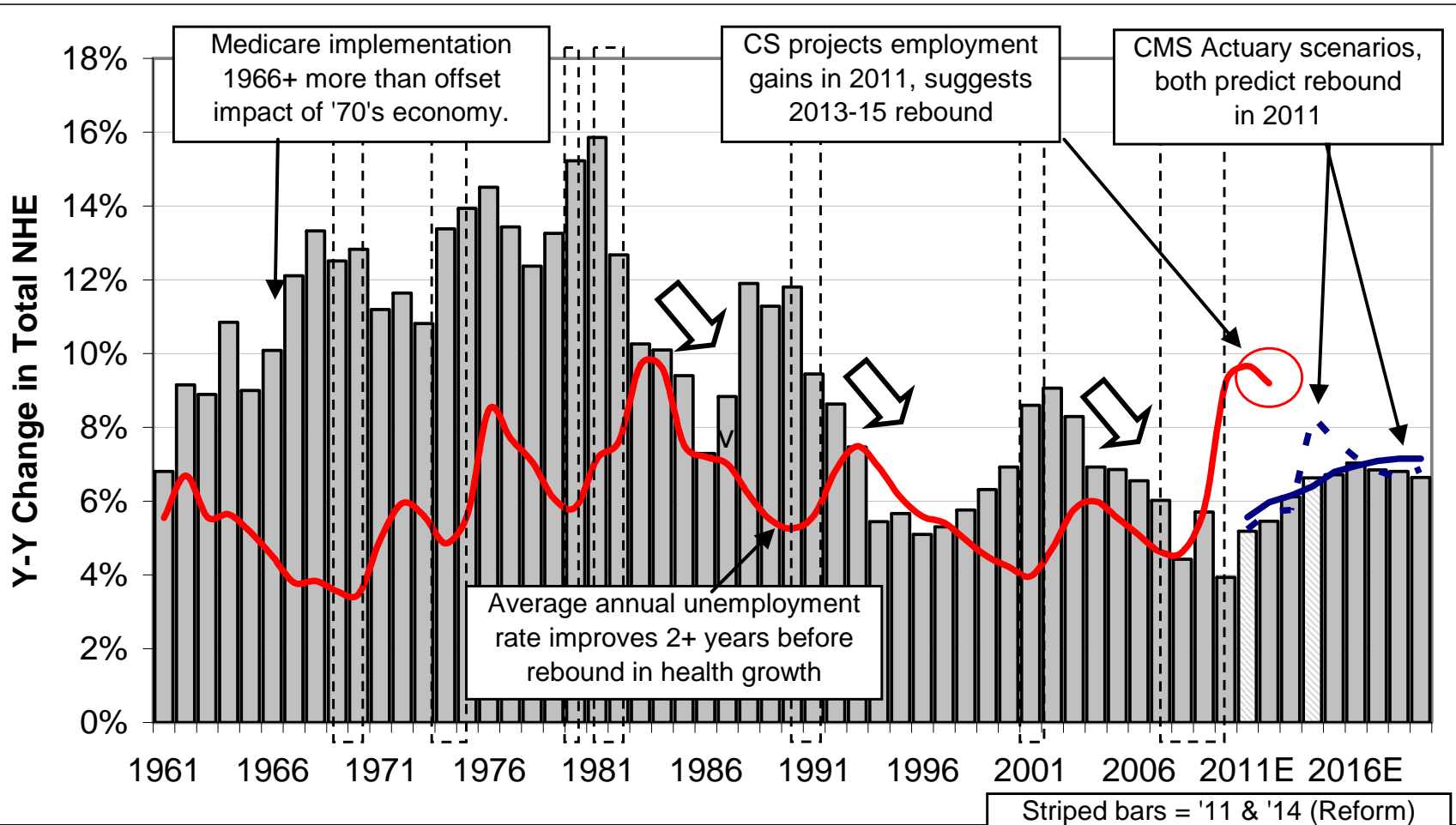
Source: CMS, Office of the Actuary, CBO, Company data and Credit Suisse estimates

Key Managed Care Themes

- **Healthcare Utilization and Price-cost spread**
- **Payor Provider Contracting Trends**
 - Horizontal and Vertical Integration, ACOs
 - **CMS Demonstrations**
- **M&A and Diversification**
 - UNH acquiring HCIT assets; HUM acquires Concentra
- **Enforcement, RADV Audits, other**
- **Regulations**
 - **Exchange regulations, Will Employers Migrate to Exchanges?**
 - **MLR Regulations:** may promote outsourcing of Mail Rx or other specialty
 - **ACO**
- **Repeal Efforts -- Legislative & Judicial**
- **State Budgets – Impact on Medicaid and Medicare Advantage**

Utilization a Key Controversy for Investors Right Now:

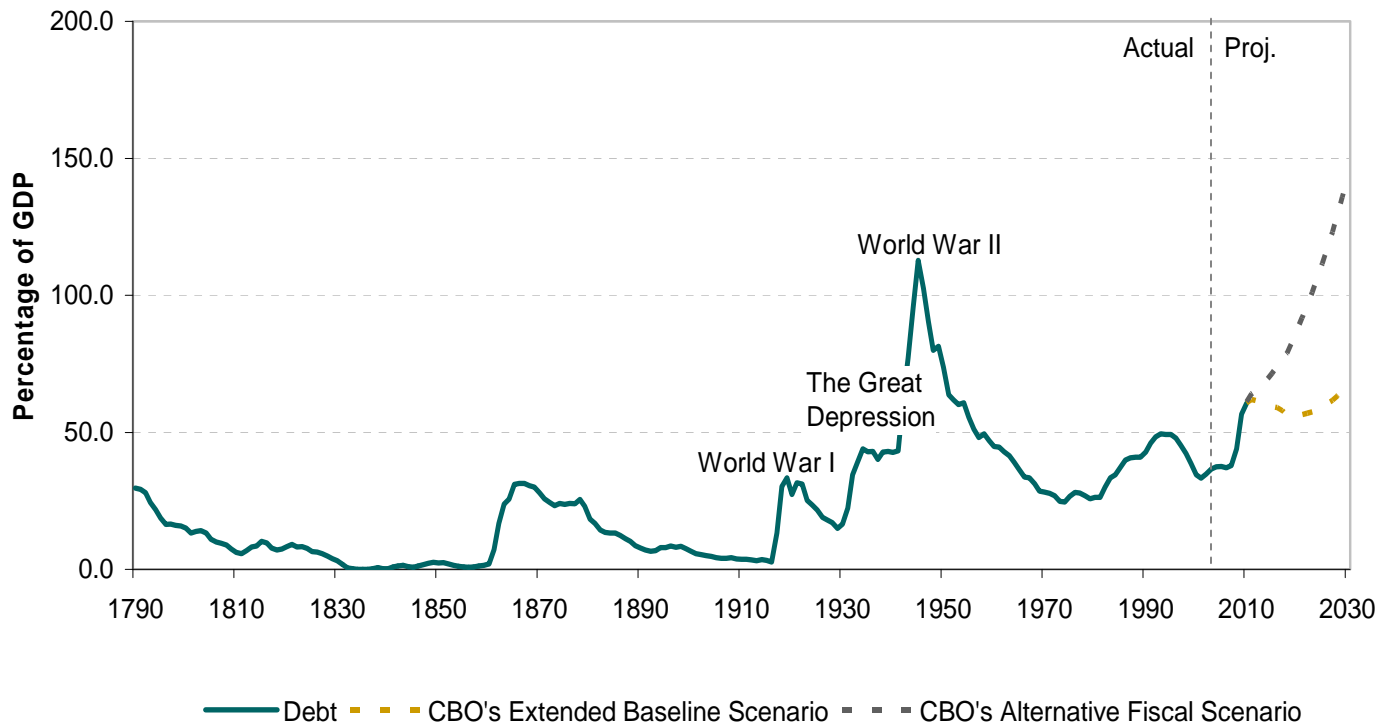
The CMS Office of the Actuary Models a Rebound in 2011 Medical Cost Growth; but We Model Continued Pressure



Source: CMS National Health Expenditures (1961-2009), CMS Office of Actuary (2010-2019), FactSet, Recessions are dotted boxes

Son of Reform – Investor Uncertainty over What’s Next

- Like Massachusetts, reform will drive faster growth in health spending.
- CBO Projects federal debt will approach 150% of GDP by 2030



Source: Bureau of Economic Analysis, CBO, Credit Suisse estimates

U.S. Has a Unit Cost Problem: Fragmented Buyers

Utilization Statistics in OECD Countries

Countries	Coronary Bypass	Angioplasty	Caesarean Section	Hip Replacement	Bone Marrow Transplant	Kidney Transplant	End-Stage Renal Failure
<i>Procedures per:</i>	<i>100,00 pop (inp.)</i>	<i>100,00 pop (inp.)</i>	<i>1,000 live births</i>	<i>100,00 pop (inp.)</i>	<i>100,00 pop (inp.)</i>	<i>100,00 pop (inp.)</i>	<i>100,00 pop (inp.)</i>
Australia	75.9	166.1	303.0	152.1	N/A	3.1	77.5
Belgium	135.4	435.1	177.6	236.4	7.1	4.6	103.9
Canada	72.7	135.9	262.7	119.7	5.0	3.8	103.6
Czech Republic	70.8	237.7	183.7	N/A	5.1	3.9	N/A
Denmark	78.6	189.6	204.4	200.5	N/A	3.2	79.5
Finland	66.2	152.2	160.0	191.2	6.0	4.0	72.6
Germany	129.1	536.1	277.8	270.4	5.6	3.4	111.3
Italy	72.8	383.1	397.2	154.2	9.1	2.9	N/A
New Zealand	74.4	100.8	239.2	132.0	3.7	2.3	77.0
Norway	81.0	249.9	159.1	197.1	N/A	4.5	N/A
United States	84.5	436.8	311.0	161.9	6.3	5.7	169.2
U.S. Rank of Selected Countries	3rd	2nd	2nd	6th	3rd	1st	1st

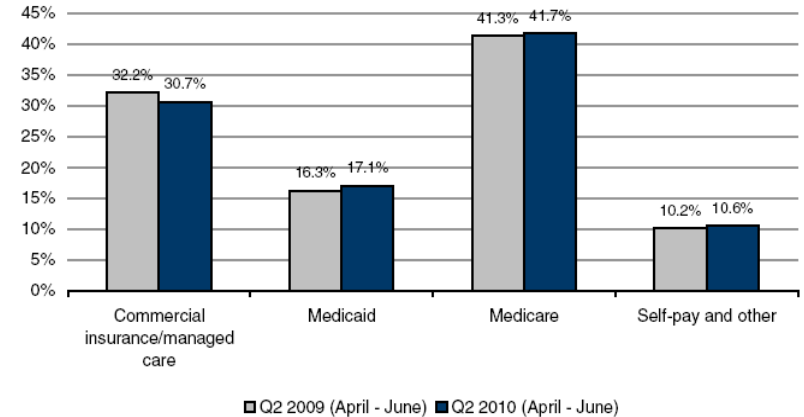
Fee Report – USA, Europe, Canada (International Federation of Health Plans)

Fee Type	Procedure	Canada	France	Germany	Netherlands	Spain	UK	USA Average		USA Medicare
								Low-end	High-end	
Scans and Imaging	CT Scan Abdomen	\$83/\$530	\$248	\$319	\$258	\$161	\$179	\$750	\$1,600	\$400
	CT Scan Head	\$41/\$530	\$212	\$319	\$258	\$161	\$179	\$950	\$1,800	\$300
	CT Scan Pelvis	\$83/\$530	\$248	\$319	\$258	\$161	\$179	\$950	\$1,700	\$300
	MRI Scan	\$824	\$436	\$839	\$567	\$235	\$179	\$1,200	\$1,500	\$500
Physician Fees	Well-Baby Office Visit	\$30	\$38	\$15	TBD	\$22		\$88	\$148	N/A
	Routine Office Visit	\$30	\$31	\$22	\$32	\$15	Primary care	\$59	\$151	\$72
	Normal Delivery	\$498	\$1,023	TBD	\$622	\$1,041	capitation	\$2,384	\$4,847	\$1,601
	C-Section	\$915	\$1,478	TBD	\$1,051	\$1,139	Specialty	\$2,618	\$6,094	\$1,812
	Appendectomy	\$313	\$114	\$376	\$494	\$285	salaries No Fees	\$629	\$1,803	\$600
	Cataract Surgery	\$392	\$573	\$302	\$496	\$653		\$530	\$1,731	\$600
Hip Replacement	\$727	\$126	\$587	TBD	\$1,554		\$1,269	\$3,935	\$1,400	
Hospital Charge	Avg. Cost/Hospital Day	\$837	\$1,050	\$550	\$502	\$579	--	\$3,181	\$12,708	\$2,200
	Avg. Cost/Hospital Stay	\$9,043	\$9,840	TBD	\$3,535	\$2,261	\$3,388	\$12,549	\$40,680	\$12,000
Total Hospital and Physician Costs	Appendectomy	\$2,436	\$2,700	\$2,500	\$2,700	\$2,959	\$2,634	\$11,997	\$26,373	\$10,400
	Bypass Surgery	\$14,111	\$11,916	TBD	TBD	\$15,761	\$12,868	\$56,472	\$116,798	\$22,092
	Hip Replacement	\$8,483	\$8,200	\$8,500	\$7,600	\$9,152	\$8,347	\$32,093	\$67,983	\$17,500
	Normal Delivery	\$1,957	\$2,800	\$3,400	\$1,000	\$2,555	\$1,924	\$7,473	\$12,226	\$7,259
Tests and Cultures	Pap Smear	\$27	\$14	\$26	\$16	\$20	See above	\$24	\$64	\$17
	Throat Culture	\$17	Included	\$9	Included	\$10		\$9	\$32	\$17
Drug Prices	Lipitor	\$33	\$53	\$48	\$63	\$32	\$40	\$125	\$334	No
	Nexium	\$65	\$67	\$37	\$102	\$36	\$41	\$154	\$424	Medicare Rx
	Plavix	\$85	\$77	\$85	\$77	\$58	\$59	\$133	\$540	Fees

Public Plan is main source of inefficiency in U.S. Health

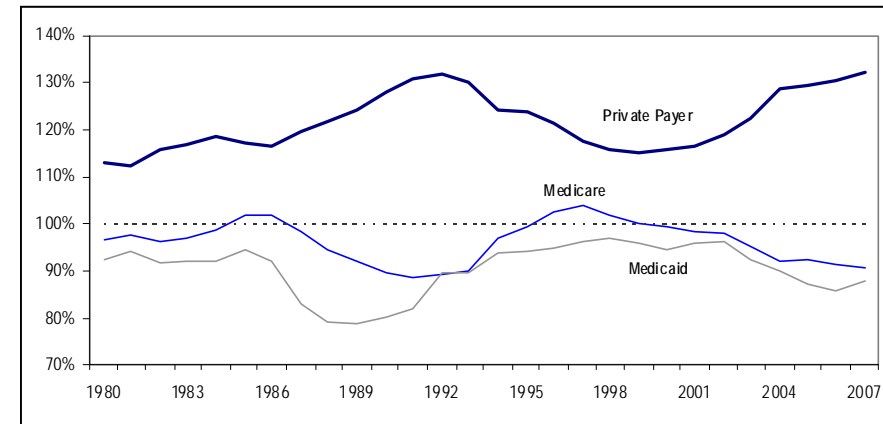
- **Medicare, the U.S. public plan, is a 40%+ customer of hospitals.** It is the only payer with enough leverage over hospitals, physicians, and other providers of healthcare to influence the supply chain, i.e., how healthcare is delivered.
- **Medicare pays fee-for-service**, and doesn't manage care or network providers, driving inefficiency in how healthcare is delivered in the U.S. As a government ward, decisions are politicized, see the "Medicare Industrial Complex."
- **Managed Care prove savings, despite low leverage**
 - Over 1,200 insurers collectively are a 30% customer of hospitals. Even the largest is generally < 10% customer.
 - MedPac showed Managed Care cut hospital costs 5%.
 - States employ Managed Care to achieve Medicaid savings
 - Reflects huge inefficiencies in the U.S. public plan
- **Monopsony of Medicare, Monopoly of Providers**
 - Insurers suffer a double whammy of the inefficiency of a supply chain driven by the fee-for-service payment system of Medicare, and the monopoly power of providers that push high price increases onto private payers to offset government price cuts.
 - When the government cuts reimbursement, hospitals raise price to private payers, shifting cost to the private sector.

Second Quarter 2010 Payor Mix Analysis versus Second Quarter 2009 (Credit Suisse Quarterly Hospital Survey, Second Quarter 2010)



Source: Credit Suisse Healthcare Facilities Analyst Ralph Giacobbe.

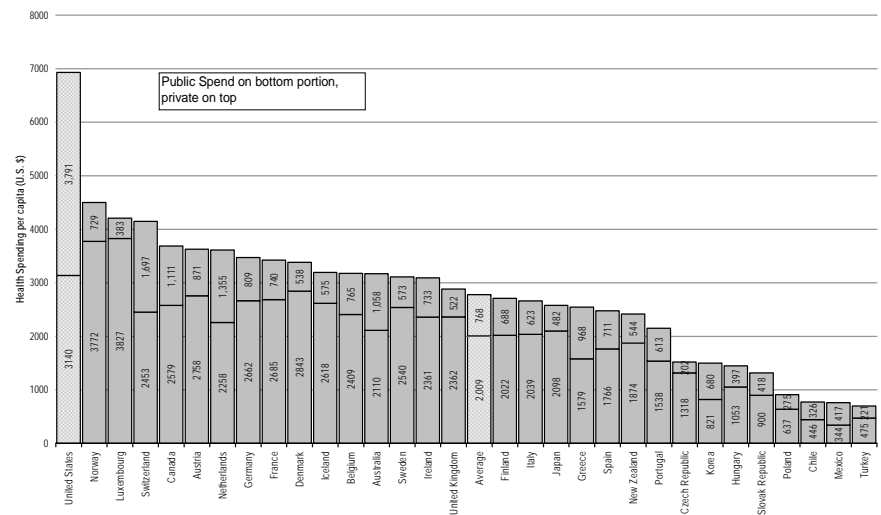
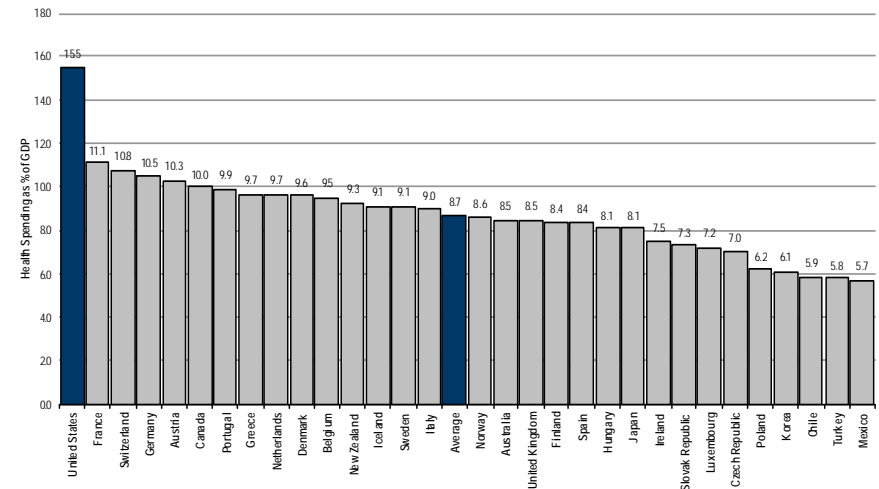
Hospital Payment-to-Cost Ratio



Source: American Hospital Association, Avalere Health, Kaiser, Credit Suisse.

U.S. Could Save \$750 billion/year with Managed Care

- The U.S. in 2010 will spend 17% of GDP or \$7,500+ per capita on healthcare, highest in the world, and 17% are uninsured.
- The second highest spenders, Switzerland and France, spend 12% of GDP and are ~100% insured.
- U.S. public plans spend the same % of GDP to cover elderly & poor as OECD average spend to cover the entire population.
 - It's clear the U.S. public plan is the problem, not the solution.
- The U.S. would save \$750 billion per year AND cover 50 million uninsured if it could tie for 2nd at 12%.
- Instead, the PPACA will make it worse, adding \$1 Trillion in U.S. health spend over 10 years to cover most uninsured.
- We believe Managed Care can achieve a tie with France.
 - Medicare and Medicaid HMOs provide better value for the money, even with low leverage over providers
 - Managed Care could achieve much greater savings if public plan lives from Medicare would migrate to Managed Care, reducing public plan leverage and increasing Managed Care leverage.
 - While investors are concerned over a public plan takeover one day, we believe it is Managed Care that will be adopted by public plans to achieve savings.



Source: OECD Health Data, Credit Suisse estimates