U.S. Managed Care Industry

“No Lost Decade for Managed Care”

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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

S&P 500 Healthcare Weighting

June 30, 2010

Source: FactSet
Health Spending Growth is Robust

The U.S. currently spends 17% of GDP on healthcare

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)

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

Drugs: $235bn
- Oral - $165bn
- Injectable/Biotech - $70bn

Source: CMS, CS ests
Middle Men May Gain Share: Penetration just 40%

$1.6 trillion in US Healthcare spending addressable by private managed care organizations. Of that, only 40% is penetrated by managed care.
## PPACA “Reform” Timeline: Margins Regulated 2011+

<table>
<thead>
<tr>
<th>Year</th>
<th>Commercial</th>
<th>Medicaid</th>
<th>Medicare Advantage</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>■ COBRA subsidy</td>
<td>■ CHIP (Children's Health Insurance Program) extension and expansion</td>
<td>■ Creates the Co-Op program to establish non-profits to offer health benefit plans in 50 states</td>
<td>■ 2.9% med device tax begins</td>
</tr>
<tr>
<td>2010</td>
<td>■ Creates the Co-Op program to establish non-profits to offer health benefit plans in 50 states</td>
<td>■ Temporary FMAP (Federal matching $ for States) assistance</td>
<td>■ States must demonstrate efforts to begin exchange set-up by 1/1/13</td>
<td>■ Special Needs Plans (SNPs) no longer offered after 12/31/13, but we expect SNPs for duals to be extended</td>
</tr>
<tr>
<td>2011</td>
<td>■ Minimum MLRs (80% individual &amp; small group, 85% large group, no Medicaid); if lower consumer receive &quot;rebate&quot;</td>
<td>■ National high-risk pools created (no impact to MCOs)</td>
<td>■ Medicare Advantage benchmarks to modified fee-for-service (FFS) (2012+)</td>
<td>■ 2010 mid-term elections</td>
</tr>
<tr>
<td>2012</td>
<td>■ Expect medical loss ratio (MLR) definition mid to late August, possibly Sept. HHS to finalize after</td>
<td>■ Plan design changes: ban on lifetime caps, restrictions on annual limits, restrictions on rescission, ban on pre-existing exclusions for children, requirement to provide coverage for children up to age 26, and free preventative services (applies to MA too, but most plans already provide this service)</td>
<td>■ Quality bonuses begin</td>
<td>■ Deficit Commission reports to POTUS on deficit</td>
</tr>
<tr>
<td>2013</td>
<td>■ Opens enrollment now 11/15-12/31</td>
<td>■ Patients in all health plans can contest claim denials</td>
<td>■ Medicare Advantage: freezes reimbursement rates</td>
<td>■ Pharma tax begins ($2.5bn in ’11)</td>
</tr>
</tbody>
</table>

- Commercial:  
  - COBRA subsidy  
  - CHIP (Children's Health Insurance Program) extension and expansion

- Medicaid:  
  - Temporary FMAP (Federal matching $ for States) assistance

- Medicare Advantage:  
  - Medicare Advantage benchmarks to modified fee-for-service (FFS) (2012+)

- Other:  
  - 2.9% med device tax begins

Source: Government data, Credit Suisse estimates
Timeline 2014+ coverage expansion, guaranteed issue

- **2014**: Managed Care industry tax begins: $8bn in '14, which we estimate adds 115bps to industry premiums
- **2015**: Exchanges open to small groups w/ up to 100 full time employees
- **2016**: Subsidies available to those w/ incomes btwn 133%-400% of FPL; minimum benefit designs mandated in exchange
- **2017**: Individual mandate
- **2018**: Employer play or pay (w/ 50+ FTEs)
- **2019**: Bans exclusions for pre-existing conditions, guaranteed issue, premium rating bands

**All Risk Products**: MCO tax: $11.3 in ’15 and ’16

**Commercial**: Exchanges open to large groups

**Uninsured reduced by est 32mn (CBO)**

**Risk Products**: MCO tax: $13.9bn

**Commercial**: "Cadillac Tax" (excise tax on plans costing more than $27.5k/$10.2k fam/ind) begins (40%)

**All Risk Products (Commercial Risk, Individual, Small Group, Medicaid, MA)**: Managed Care industry tax begins: $8bn in ’14, which we estimate adds 115bps to industry premiums

**Commercial**: State based exchanges; subsidies available to those w/ incomes btwn 133%-400% of FPL; minimum benefit designs mandated in exchange

**Individual mandate**

**Employer play or pay (w/ 50+ FTEs)**

**Bans exclusions for pre-existing conditions, guaranteed issue, premium rating bands**

**Extends the prohibition on excessive waiting periods to existing health plans.**

**Medicaid**: Expansion to 133% of FPL w/ 100% federal funding on new enrollees

**Medicaid MLRs could be better in ’14 due to healthier population entering market**

**Medicare Advantage**: Reduces MA benchmarks to modified FFS

**Minimum MLRs (85%)**

Source: Government data, Credit Suisse estimates
Our 10 Year Model

Revenue Growth \times \text{Margin Contraction} = \text{Flat Profits; But Survivors Will Gain Share}

Source: Company data, Credit Suisse estimates
Winners will have Medicare and Medicaid Experience

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

Stripped bars = '11 & '14 (Reform)
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

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

U.S. Rank of Selected Countries

<table>
<thead>
<tr>
<th>USA Rank</th>
<th>3rd</th>
<th>2nd</th>
<th>2nd</th>
<th>6th</th>
<th>3rd</th>
<th>1st</th>
<th>1st</th>
</tr>
</thead>
</table>

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

<table>
<thead>
<tr>
<th>Fee Type</th>
<th>Procedure</th>
<th>Canada</th>
<th>France</th>
<th>Germany</th>
<th>Netherlands</th>
<th>Spain</th>
<th>UK</th>
<th>USA Average</th>
<th>USA Medicare</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Low-end</td>
<td>High-end</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Scans and Imaging</td>
<td>CT Scan Abdomen</td>
<td>$834</td>
<td>$530</td>
<td>$248</td>
<td>$258</td>
<td>$161</td>
<td>$179</td>
<td>$1,500</td>
<td>$600</td>
</tr>
<tr>
<td></td>
<td>CT Scan Head</td>
<td>$414</td>
<td>$530</td>
<td>$212</td>
<td>$258</td>
<td>$161</td>
<td>$179</td>
<td>$1,800</td>
<td>$300</td>
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<tr>
<td></td>
<td>CT Scan Pelvis</td>
<td>$83</td>
<td>$530</td>
<td>$248</td>
<td>$258</td>
<td>$161</td>
<td>$179</td>
<td>$1,800</td>
<td>$300</td>
</tr>
<tr>
<td></td>
<td>MRI Scan</td>
<td>$362</td>
<td>$530</td>
<td>$436</td>
<td>$258</td>
<td>$161</td>
<td>$179</td>
<td>$1,800</td>
<td>$300</td>
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<tr>
<td>Physician Fees</td>
<td>Well-Baby Office Visit</td>
<td>$50</td>
<td>$38</td>
<td>$15</td>
<td>TBD</td>
<td>$22</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Routine Office Visit</td>
<td>$30</td>
<td>$31</td>
<td>$22</td>
<td>TBD</td>
<td>$15</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
</tr>
<tr>
<td></td>
<td>Normal Delivery</td>
<td>$404</td>
<td>$1,023</td>
<td>TBD</td>
<td>$622</td>
<td>$1,041</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>C-Section</td>
<td>$915</td>
<td>$1,478</td>
<td>TBD</td>
<td>$1,051</td>
<td>$1,139</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Appendectomy</td>
<td>$31</td>
<td>$114</td>
<td>$376</td>
<td>$494</td>
<td>$285</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Cataract Surgery</td>
<td>$302</td>
<td>$573</td>
<td>$302</td>
<td>$496</td>
<td>$633</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Hip Replacement</td>
<td>$727</td>
<td>$126</td>
<td>$587</td>
<td>TBD</td>
<td>$1,554</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td>Hospital Charge</td>
<td>Avg. Cost/Hospital Day</td>
<td>$833</td>
<td>$1,050</td>
<td>$550</td>
<td>$502</td>
<td>$579</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Avg. Cost/Hospital Stay</td>
<td>$9,043</td>
<td>$9,840</td>
<td>TBD</td>
<td>$3,535</td>
<td>$2,261</td>
<td>$3,388</td>
<td>$3,181</td>
<td>$12,708</td>
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<tr>
<td>Total Hospital and</td>
<td>Appradectomy</td>
<td>$2,436</td>
<td>$3,000</td>
<td>TBD</td>
<td>$6,850</td>
<td>$7,600</td>
<td>$9,152</td>
<td>$6,347</td>
<td>$2,800</td>
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<tr>
<td>Physician Costs</td>
<td>Bypass Surgery</td>
<td>$14,111</td>
<td>$3,500</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Hip Replacement</td>
<td>$6,483</td>
<td>$8,200</td>
<td>$3,400</td>
<td>$7,600</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Normal Delivery</td>
<td>$1,957</td>
<td>$2,800</td>
<td>$3,400</td>
<td>$1,000</td>
<td>$2,556</td>
<td>$1,924</td>
<td>$7,473</td>
<td>$12,226</td>
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<td>Tests and Cultures</td>
<td>Pap Smear</td>
<td>$27</td>
<td>$14</td>
<td>$26</td>
<td>$16</td>
<td>$20</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td></td>
<td>Throat Culture</td>
<td>$51</td>
<td>$49</td>
<td>$15</td>
<td>$10</td>
<td>$20</td>
<td>TBD</td>
<td>TBD</td>
<td>TBD</td>
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<tr>
<td>Drug Prices</td>
<td>Lipitor</td>
<td>$33</td>
<td>$53</td>
<td>$48</td>
<td>$63</td>
<td>$32</td>
<td>$40</td>
<td>$125</td>
<td>$334</td>
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<tr>
<td></td>
<td>Naxxim</td>
<td>$65</td>
<td>$67</td>
<td>$37</td>
<td>$102</td>
<td>$36</td>
<td>$41</td>
<td>$154</td>
<td>$424</td>
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<tr>
<td></td>
<td>Plavix</td>
<td>$85</td>
<td>$77</td>
<td>$65</td>
<td>$77</td>
<td>$58</td>
<td>$59</td>
<td>$133</td>
<td>$540</td>
</tr>
</tbody>
</table>

Source: OECD Health Data, International Federation of Health Plans
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.
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.