1BN) Aetna-Coventry Signals Health Net, WellCare Takeovers: Real M&A

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By Tara Lachapelle and Alex Nussbaum

Aug. 21 (Bloomberg) -- With takeovers of managed care providers exceeding $14 billion in less than a year, Health Net Inc. and WellCare Health Plans Inc. are among the last remaining targets as aging baby boomers and the new health-care law boost demand.

Aetna Inc. said yesterday it will expand further into plans administering Medicare and Medicaid with a $5.6 billion purchase of Coventry Health Care Inc., the biggest takeover of a U.S. health maintenance organization since 2005, according to data compiled by Bloomberg. The announcement follows Cigna Corp.'s agreement in October to buy Healthspring Inc., and the WellPoint Inc. disclosure last month that it will acquire Amerigroup Corp.

Demand for Medicare, the U.S. health plan for the elderly and disabled, is on the rise with 8.6 million more Americans projected to enroll by 2016 as the first wave of baby boomers turns 65. At the same time, the Patient Protection and Affordable Care Act upheld by the Supreme Court in June will add more patients to Medicaid, which provides coverage for the poor.

Stifel Financial Corp. says the next takeover targets may include WellCare, both a Medicare and Medicaid insurer, or Health Net, which like Coventry offers commercial insurance in addition to the U.S. government-sponsored plans.

"You still could see more consolidation," Maria Mendelsberg, a Denver-based fund manager at Cambiar Investors LLC, which oversees $7 billion, said in a telephone interview.
"Obviously the list is getting shorter and shorter just because you've had a lot of transactions, but I think a lot of these bigger companies want to boost their Medicaid and Medicare businesses because those are the areas that are growing."

Acquiring Medicare

Cambiar's Small Cap Fund, which owns Health Net shares, has outperformed 95 percent of rival funds in the last three years.

Crystal Warwell Walker, a spokeswoman for Tampa, Florida- based WellCare, and Brad Kieffer, a spokesman for Woodland Hills, California-based Health Net, said it's the companies' policies not to comment on market speculation.

Today, shares of WellCare rose 1.6 percent to $55.47 for the second-biggest gain in the Standard & Poor's Midcap Health Care Index. Health Net fell 1.7 percent to $21.60.

Aetna, the third-biggest U.S. health plan, said yesterday that its acquisition of Bethesda, Maryland-based Coventry will add more than 5 million more customers to its existing 18 million people in medical plans. The additions include 253,000 people on Medicare health plans as of June 30, 932,000 on Medicaid, and almost 1.5 million more Medicare enrollees who get prescription drug coverage.

Aging Boomers

The government currently pays about half of the total medical bill for the U.S. through programs such as Medicare and Medicaid. Starting in 2014, the new health-care law orders states to open Medicaid to people making as much as 133 percent of the federal poverty level. The law, backed by President Barack Obama, may add as many as 17 million patients under the Medicaid program.

Medicare enrollment will rise to 57.3 million people in 2016, an increase of 8.6 million from 2011, according to the 2012 annual report from the government program's trustees. The program is experiencing an influx as the first baby boomers -- people born between 1946 and 1964 -- started turning 65 last year.

Commercial insurers such as Health Net and WellCare offer the government program through Medicare Advantage plans, covering medical costs including physician fees and hospital charges.

Targeting WellCare

"Anything with government exposure -- Medicare Advantage and Medicaid -- are viewed as more attractive growth opportunities," Robert Kang, a San Francisco-based health care analyst and fund manager at Highmark Capital Management Inc., which oversees about $17.5 billion, said in a phone interview.

"The Medicare Advantage program is a very attractive insurance product for seniors. With the aging of the population, there is a secular trend that favors that particular line of business."

WellCare may draw takeover interest after almost 60 percent of its $6.11 billion in sales last year came from offering Medicaid policies, and the rest from Medicare, in states such as New York and Florida, said Thomas Carroll, an analyst at Stifel in Baltimore. Like other Medicaid specialists, the $2.35 billion company may seek the safety of a larger owner as it faces the challenges of bringing on expensive new patients and fighting for state contracts, he said.

If a buyer "wants to really strengthen its Medicaid and Medicare footprints, they could do it in one fell swoop with WellCare," he said. "It seems to me like a very well-packaged asset that would fit nicely in a big company."

Low Valuation

WellCare had 1.5 million Medicaid members and 1.04 million in Medicare as of June 30, according to its quarterly earnings statement.

Susquehanna International Group LLP also said in an interview last month that WellCare is an attractive target because of its valuation. The company's price-earnings ratio fell to a more than three-year low in June. At almost 8 times profit as of yesterday, it was trading at about a 37 percent discount to the median ratio among U.S. managed-care providers, data compiled by Bloomberg show.

Health Net may also lure buyers because it primarily focused on Medicare and Medicaid in California and it secured a $16.7 billion Pentagon contract in 2010 to provide benefits to military members and their families in the northeast U.S., Stifel's Carroll said. It had 1.06 million Medicaid customers in California and 228,000 Medicare Advantage members across three states as of June 30, according to a regulatory filing.

"All that together, to me, is a fairly attractive regional package that a larger company could do a lot with," he said.

'Very Cheap'

The stock has declined 28 percent this year, reducing its market value to $1.79 billion yesterday, as the company lowered its earnings forecast in each of the last two quarters because of problems with medical costs and claims processing. The stock drop compares with a 21 percent gain in the S&P Midcap Health Care Index.

With an enterprise value yesterday that was 0.46 times its earnings before interest, taxes, depreciation and amortization, Health Net is the cheapest U.S. managed-care company for which Ebitda multiples are available, data compiled by Bloomberg show.

Health Net "has been talked about within the marketplace as a target," said Highmark's Kang. The stock has traded "at a very, very cheap valuation, making it -- by virtue of that alone -- quite attractive for a company that was looking to add membership."

'Less Compelling'

While WellCare is attractive for its fast-growing enrollment and a stock that's cheap relative to peers, Health Net may give buyers more pause, said Michael Meyers, chief executive officer at Arcoda Capital Management LP, a New York- based hedge fund with about $100 million invested across the health-care industry.

Health Net has a history of missing earnings estimates and underestimating medical costs that may make it "a less compelling opportunity," Meyers said. "The flip side of that is that a disciplined insurer-underwriter" can find a way to boost profits, he said.

WellPoint, the second-largest U.S. health plan by enrollment, said last month it would buy Medicaid insurer Amerigroup for about $4.9 billion. Cigna, the fifth-biggest, bought Medicare specialist Healthspring for $3.8 billion in January after announcing the deal in October.

That brings the total for takeovers of U.S. providers of health-care benefits to $14.3 billion in the last 10 months. Had the deals been announced in the same calendar year, the total volume would be the highest on an annual basis for the industry since 2003, data compiled by Bloomberg show.

Window 'Closing'

Now that Aetna, WellPoint and Cigna have purchased three of the large Medicaid and Medicare providers, the number of remaining suitors is dwindling, according to David Windley, a Nashville, Tennessee-based analyst for Jefferies Group Inc. The three acquirers are the biggest managed-care providers in the S&P 500 by market value after UnitedHealth Group Inc.

WellCare shares dropped 3.3 percent yesterday, and Health Net's stock slipped 0.1 percent. The S&P Midcap Health Care Index declined 0.2 percent.

"There are still potential sellers," Windley said in a phone interview. But "the list of targets is longer than the list of buyers."

While there may be fewer big managed care deals now, Health Net and WellCare are still "the most logical targets over the next 12 months," Carl McDonald, an analyst with Citigroup Inc., wrote in a note to clients yesterday.

Smaller companies may need to find a home soon, Aetna CEO Mark Bertolini said in a phone interview yesterday, after the Coventry acquisition was announced. Buyers will want to have a clear view of a targets' costs and profitability heading into 2014, when major health-law provisions kick in, he said. That means getting a deal done by mid-2013, when health plans typically set their prices for the next year.

"The window may be closing," Bertolini said. "If you don't have control of the business you're buying, you are taking a big risk."

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