Lehmann's Corner

Roulston Research hosted a healthcare forum in Boston on July 21, 2010 with industry experts Mark Lindsay, Director, The Livingston Group, Health Care & Pharmaceuticals Practice, and Ronald Hollander, Principal, Reform Exchange. The audience's main concerns were:

1. Will the healthcare bill be repealed and if so what is "plan B" (alternative plan)?
2. Who are the likely beneficiaries or losers?
3. What will happen to costs, especially in light of the Massachusetts healthcare plan?

A summary of the panel's responses are as follows:

1. The bill will not be repealed.
2. The bill contains over 800 issues that need clarification, which could take many months or even years.
3. Industry lobbyists will attempt to "educate" the legislatures in order to make the bill understandable and pragmatic so that businesses can adjust their policies to the final bill.
4. The panelists feel that companies such as Aetna, HCA, United Healthcare, Kaiser Permanente, and WellPoint are big enough and have the depth to alter their strategies to conform to the new policies.
5. There will be fewer hospitals, as they expect significant industry consolidation since smaller hospitals and private practices will not have the resources to remain independent.
6. Converting handwritten medical records to electronic data bases. (The present legacy data must be digitized)

7. PPO's, HMO's, etc. will need to address their cost issues. Current programs are still too expensive but the industry must await the new rules before implementing their measures to deal with the new realities.
8. Medicare and Medicaid costs and pricing will have to undergo changes in order for the system to remain viable.
9. End of life costs will have to be seriously addressed since a significant part of patient care expenses are associated with this period.

10. Insurers must get more data from the rulemaking before they can make changes to their policies and the pricing in order to generate satisfactory profits.
11. Supposedly, according to Mr. Hollander the Massachusetts healthcare bill only increased the state's budget by 1%. (The audience found this hard to believe and this is difficult to not view as an issue of semantics).
12. Employers will have to scrutinize their healthcare costs and realign their efforts to preventive care and perhaps more self insurance.
13. Establishing more cost effective medical screening to reduce absenteeism and changing the attitudes of workers to help themselves.
14. Establishing different type of community health services along the line of urgent care centers.
15. Medical staffing may become more of an issue because of uneven hospital bed occupancy.
16. Although record keeping changes may occur rapidly, observers would like to see what cost benefits will ensue.

Investment Implications

Investors are urged to look "outside the box," beyond the current industry leaders, to those businesses that could benefit from some of the likely changes. In addition to the traditional companies mentioned by the panelists (see point 4), one should consider CR Bard, Abbott Labs, Baxter Labs, and other big pharmaceutical and biotech companies that have a good pipeline, and large insurance companies that can come up with new policies to address the changes.

Some points to consider before being able to invest prudently are:

1. Key issues not addressed in the original bill need to be clarified to allow corporate planners and individuals to formulate strategies that will make the bill a document that solves the healthcare issues, which the original bill has failed to do, i.e., wider coverage at affordable rates, tort reform, streamlining data input/and not increasing the currently enormous debt.
2. One should look at the history of two highly successful Federal Government projects -the atomic bomb program initiated under President Roosevelt and the space program begun under President Kennedy, as models since these programs were true "game changers", because they had specific missions and were well thought out. These bills created whole new businesses and sub-industries. A properly structured healthcare bill is likely to lead to similar industry changes.
3. It is highly likely that over the next 10-20 years the healthcare bill will spawn whole new cottage businesses that will service the current participants. The need to computerize legacy data and manage billing systems and hospital procedures will create significant opportunities for the existing vendors in that space along with entrepreneurs that will launch ancillary services. Outsourcing of physicians, nurses and other specialized skills will create vast opportunities. If companies will really opt for having healthier employees to reduce absenteeism and reduce insurance costs, that would necessitate more in-house nurse practitioners,

educational training in exercising and nutrition. Perhaps, we as a population will have to take greater responsibility for our care and watch our diets thereby forcing the food industry to offer more healthful products. Restaurants and fast food changes may have to not only alter what they serve but have better portion control. Insurance companies must improve the feedback from its insured patients and price their products accordingly.

4. Many high quality technology companies could benefit from the greater need of storing information, transferring and processing of the data. Select medical instrumentation companies could benefit from more screening tests. Home healthcare and hospices, more user friendly packaging and dispensing of drugs could be major beneficiaries as they realign their businesses. Insurance companies will have to create new products to address the new environment, which ultimately should generate higher profits. The legal and accounting profession will benefit from interpreting the new regulations and defending the violators.

5. Examples of companies that could benefit are:

    - Arcadia Resources (KAD)* – A $100 million sales company, that provides home care, medical staffing, and pharmacy services and has 70 facilities in 18 states. Perhaps, the most interesting aspect of this $92 million capitalization stock is its Daily Med pharmacy division. This entity distributes medications to patients that take multiple drugs on a daily basis in a user friendly pack that enables the patient to get the proper dosage at the right time. Daily Med has a very strong relationship with WellPoint that has excellent long-term potential. They are currently servicing WellPoint insured patients in California and Virginia, and South Carolina and will soon be in New York, and Kansas. The initial feedback from its current patients has been favorable. WellPoint is better able to track its patients and thereby help control costs and pricing of their policies. A key point in the current healthcare bill is Medical Therapy Management (MTM), which is exactly the area that Daily Med is in and may be the only independent company in this area. Arcadia Resources is in the "sweet spot," driving down total cost by improving patient compliance of drug therapy. They just had their contract with WellPoint extended for three more years.
    - PRGX Global Inc. (PRGX)* – With estimated sales of $180 million in 2010, and a market capitalization of about $120 million, PRGX provides audit recovery services, principally to business and government agencies having numerous payment transactions and complex purchasing environments. They serve many different types of customers that include pharmaceutical firms, healthcare payers, both private sector and health insurance companies along with State and Federal government agencies such as the Center for Medical Services (CMS). The U.S. Government recently decided to audit Medicare payments and asked PRGX Global to run a demonstration model on $89 billion of Medicare payments (A&B) to

determine what overpayments may have been made. PRGX indicated that $330 million could have been saved. The U.S. Government has officially hired PRGX to analyze $30 billion of Medicare payments. Assuming similar type results in the previous analysis at PRGX's 9% fee of the savings would generate about $10 million to the company at high margins. This contract is scheduled to start in the Q3 of 2010. A substantial part of the costs were absorbed in the earlier demonstration project. It is easy to see how PRGX could benefit from the healthcare bill. This combined with its existing business augurs well for the future.

- Cerner Corporation (CERN) is a supplier of healthcare information technology solutions, healthcare devices and related services and is instrumental in transforming IT functions for its enormous customer base of 3,400 physician practices that covers 30,000, 2,300 hospitals, 1,500 retail pharmacies, 600 ambulatory facilities, and 700 home care facilities. Cerner's strong position could receive a significant boost of the healthcare bill. Cerner with a $6.3 billion market capitalization is selling at 26.6 times management's $2.85 per share projected for 2010, a debt/equity of 0.07, and a $3.6 billion backlog, the stock may be attractive, particularly on pullbacks to the $70 level.