

Americas: Managed Care

A tougher road ahead for Medicare Advantage

News

On Friday February 20 (after market close), the federal Centers for Medicare and Medicaid Services (CMS) released its 45-day notice of the estimated 2010 Medicare Advantage (MA) growth percentage of 0.5%. The final 2010 rate is subject to further calibration and will be announced April 6, 2009.

Analysis

Driven by technical factors, the preliminary 2010 increase of 0.5% is below the 3%-5% range we expected and compares to 4.8% a year-ago (for 2009) and 4.1% two years ago (for 2008). CMS also announced a downward adjustment of 3.74% to compensate for inflation of MA plan risk scores relative to traditional Medicare over the years from 2004-2007, subject to potential refinement as CMS receives comments from stakeholders (the adjustment may ultimately be more severe if catch-up for 2008 is included as well). Note that the final 2010 rate will also be downwardly affected by the continuing phase-out of budget neutrality, FFS normalization, and the phase-out of Indirect Medical Education (IME) payments to MA plans.

Implications

All in all, we expect MA rates may be down about 5% next year, although a quick repeal of the scheduled 20% physician fee cut might factor into the rate setting process as a positive offset' however, the bottom line is that MA plans will need to cut benefits to maintain profit margins, which could be tricky with many more plans competing for MA lives relative to prior years. At most, however, this represents an acceleration of the timeframe given proposals already on the table to cut back MA funding (in fact, the Obama Administration is reportedly set to unveil broader MA funding cutbacks as soon as this week). The broader funding cuts are expected to be phased in starting in 2011, coincident with the termination of the MA private fee-for-service product (MA-PFFS) for most geographies.

We believe our EPS estimates already incorporate the tougher road ahead for MA (e.g., for Humana, we forecast 0% EPS growth next year and an 8% decline in 2011). Most exposed in our view is Universal American (UAM, CL-Sell) with over 75% of its MA enrollment in MA-PFFS and the daunting task of *de novo* provider network development as part of a product transition strategy (unlike our other covered names, UAM does not have commercial or public sector provider networks in most of its MA markets).

MEDICARE ADVANTAGE AS PERCENT OF COMPANY REVENUE (2009E)

Company	Ticker	Rating	MA % of revenue	
			All products	MA-PFFS
Aetna (a)	AET	CL-Sell	18%	10%
CIGNA (a)	CI	CL-Buy	3%	1%
Coventry	CVH	Neutral	31%	20%
Health Net	HNT	Neutral	21%	1%
HealthSpring	HS	Buy	85%	0%
Humana	HUM	Neutral	51%	25%
UnitedHealth	UNH	Buy	23%	3%
WellPoint	WLP	Neutral	6%	2%
AmeriGroup	AGP	Neutral	2%	0%
Centene	CNC	Buy	0%	0%
Molina	MOH	Neutral	3%	0%
Universal Am.	UAM	CL-Sell	51%	34%
WellCare	WCG	Not Rated	38%	16%

(a) As percent of healthcare revenue - CIGNA includes Medicaid

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Source: Company data, Goldman Sachs Research estimates.

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Goldman Sachs Investment Research global coverage universe

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