



Smart Moves Begin with



# TMG Health

The **Leader** *in Business Process Outsourcing for Medicare & Medicaid Health Plans*



# Experience

**Most Experienced Business Process Outsourcing Vendor Serving Medicare Advantage and Part D plans**

**Exclusively focused on the administration of Medicare and Medicaid products since 1998**

**Medicare Product Experience** – Expertise in supporting the full range of Medicare Advantage products,( HMO, PPO, PFFS, SNP, PDP) for 2.5 million members

**CMS Compliance Focused Operations and Technology**

**Client Experience** – 42 clients serving members in all 50 states

- **Mid-size regional to Large National Plans including 14 BCBS Plans**
- **More than 100 Employer Groups Implemented. 190,000 members**



# Scope - Portfolio of Services

**Medicare Configured Managed Care Information System**

**Enrollment & Disenrollment Processing**

**Eligibility Files (System of Record)**

**CMS Eligibility Reconciliation and Maintenance**

**Premium Billing and Cash Receipts Posting**

**Claims Processing & Payment – RAPS Submission**

**Member & Provider Services and Call Center**

**Additional Services & Applications**

- Appeals & Grievance Support
- Medical Management App.
- Surveys (HRA, WAS/Pt. D COB)
- Internet Provider Portal
- Broker Commission
- Data Warehouse & Reporting



# Why Do Clients Choose TMG Health?

- **Expertise**
- **Comprehensive, Integrated and Scalable Systems**
- **Menu of Administrative Services**
- **Flexibility to Accommodate Volume and Market expansion/contraction**
- **Lower Entry Costs and Reduced Resource Involvement**
- **Mitigate the Risks**
- **Compliant Operations**



# Questions?

**Please send questions to:**

John Montague

**[jmontague@tmghealth.com](mailto:jmontague@tmghealth.com)**



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# Oppenheimer & Co. Inc. Equity Research

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**Managed Care & Other Healthcare Services**

**Carl McDonald, CFA** | 212.667.6558 | [carl.mcdonald@opco.com](mailto:carl.mcdonald@opco.com)

**James Naklicki, CFA** | 212.667.7592 | [james.naklicki@opco.com](mailto:james.naklicki@opco.com)

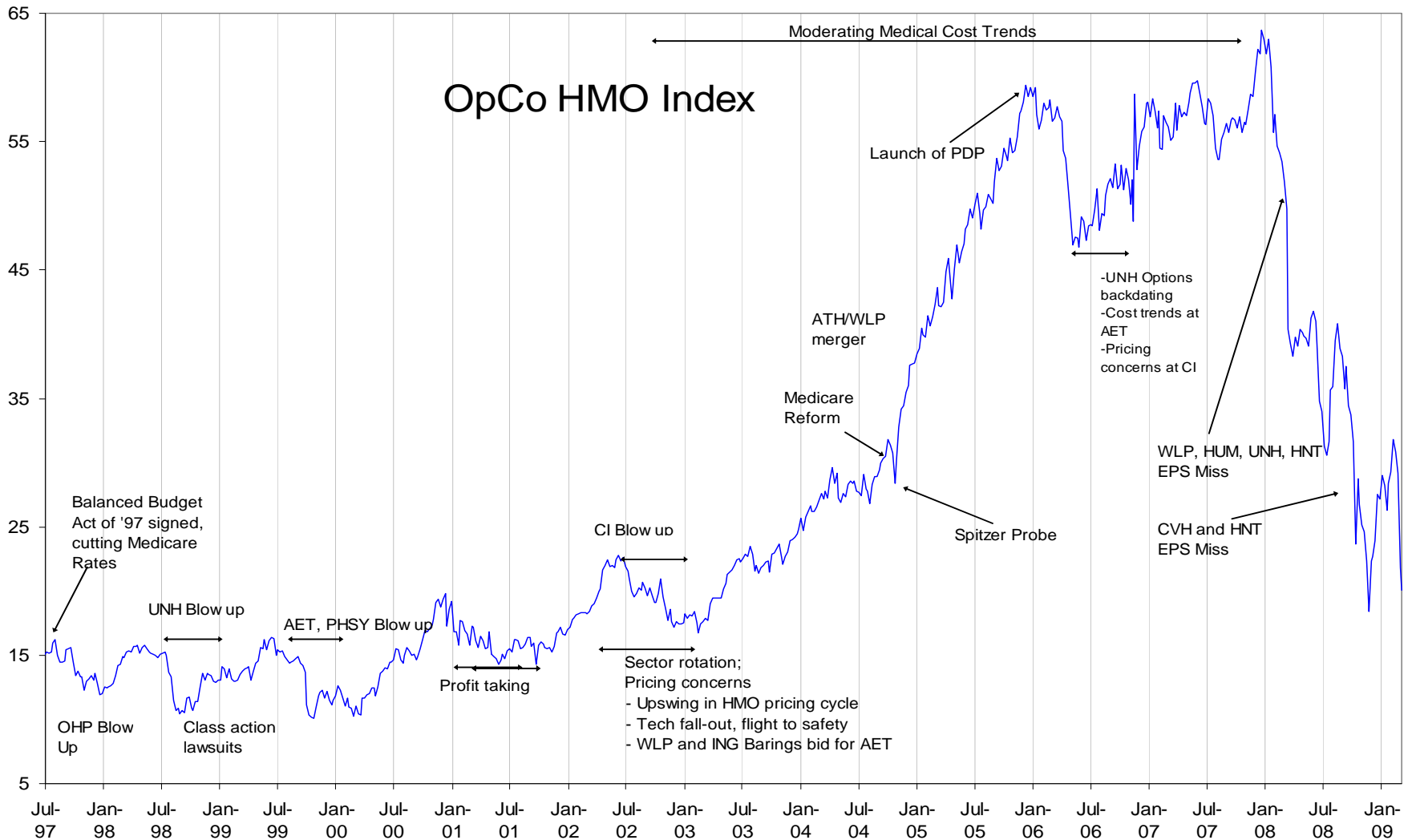
|  |        |    | Closing Price | Price Target | Price Target Multiple | Upside Downside Target | 2008 Stock Perf. | 2009 YTD Stock Perf. | Market Cap (\$ Mil) | 2008 EPS | 2009E EPS | 2010E EPS | 2008E P/E | 2009E P/E           |
|--|--------|----|---------------|--------------|-----------------------|------------------------|------------------|----------------------|---------------------|----------|-----------|-----------|-----------|---------------------|
|  | Rating |    | 4/06/09       | Target       |                       | Target                 |                  |                      |                     |          |           |           |           |                     |
| <b><u>Diversified plans</u></b>              |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| Aetna, Inc.                                  | AET    | O  | \$24.77       | \$47         | 12.1                  | 90%                    | -50%             | -13%                 | \$11,303            | \$3.93   | \$3.90    | \$4.45    | 6.3       | 6.4                 |
| CIGNA Corp                                   | CI     | O  | \$17.90       | \$38         | 9.4                   | 112%                   | -69%             | 6%                   | \$4,852             | 3.42     | 4.05      | 4.45      | 5.2       | 4.4                 |
| Coventry Health Care                         | CVH    | P  | \$13.78       | \$20         | 10.8                  | 45%                    | -75%             | -7%                  | \$2,043             | 2.69     | 1.85      | 3.00      | 5.1       | 7.4                 |
| Health Net, Inc.                             | HNT    | O  | \$15.00       | \$22         | 11.0                  | 47%                    | -77%             | 38%                  | \$1,556             | 1.85     | 2.00      | 2.20      | 8.1       | 7.5                 |
| UnitedHealth Group                           | UNH    | P  | \$21.93       | \$32         | 10.7                  | 46%                    | -53%             | -18%                 | \$26,338            | 2.95     | 3.00      | 3.30      | 7.4       | 7.3                 |
| WellPoint, Inc.                              | WLP    | O  | \$38.74       | \$61         | 10.8                  | 57%                    | -52%             | -8%                  | \$19,495            | 5.52     | 5.65      | 6.10      | 7.0       | 6.9                 |
| Average                                      |        |    |               |              | 10.8                  | 66%                    | -63%             | 0%                   |                     |          |           |           | 6.5       | 6.6                 |
| <b><u>Medicare</u></b>                       |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| HealthSpring, Inc.                           | HS     | P  | \$8.50        | \$20         | 9.5                   | 135%                   | 6%               | -57%                 | \$470               | 2.12     | 2.10      | 2.15      | 4.0       | 4.0                 |
| Humana, Inc.                                 | HUM    | O  | \$26.31       | \$73         | 12.0                  | 177%                   | -52%             | -29%                 | \$4,442             | 4.27     | 6.10      | 7.00      | 6.2       | 4.3                 |
| Triple-S                                     | GTS    | O  | \$12.64       | \$20         | 10.5                  | 58%                    | -43%             | 10%                  | \$409               | 1.82     | 1.90      | 2.00      | 6.9       | 6.6                 |
| Universal American                           | UAM    | O  | \$9.08        | \$16         | 10.7                  | 76%                    | -65%             | 3%                   | \$729               | 1.61     | 1.50      | 1.65      | 5.6       | 6.1                 |
| WellCare Health Plans                        | WCG    | O  | \$12.76       | \$23         | 10.2                  | 80%                    | -69%             | -1%                  | \$539               | 3.10     | 2.25      | 2.50      | 4.1       | 5.7                 |
| Medicare average                             |        |    |               |              | 10.6                  | 105%                   | -45%             | -15%                 |                     |          |           |           | 5.4       | 5.3                 |
| <b><u>Medicaid</u></b>                       |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| AMERIGROUP Corp                              | AGP    | O  | \$28.47       | \$33         | 12.4                  | 16%                    | -20%             | -4%                  | \$1,465             | 2.76     | 2.65      | 2.95      | 10.3      | 10.7                |
| Centene Corp                                 | CNC    | U  | \$19.23       | \$16         | 8.6                   | -17%                   | -29%             | -2%                  | \$827               | 1.99     | 1.85      | 1.95      | 9.7       | 10.4                |
| Molina Healthcare, Inc.                      | MOH    | P  | \$20.67       | \$30         | 13.1                  | 45%                    | -54%             | 17%                  | \$528               | 2.24     | 2.30      | 2.55      | 9.2       | 9.0                 |
| United American Health                       | UAHC   | NC | \$1.40        | NA           | --                    | --                     | -42%             | -3%                  | \$12                |          |           |           |           |                     |
| Medicaid average                             |        |    |               |              | 11.4                  |                        | -34%             | 4%                   |                     |          |           |           | 9.7       | 10.0 <sup>6.9</sup> |
| <b><u>Behavioral Health</u></b>              |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| Magellan Health Services                     | MGLN   | O  | \$36.74       | \$46         | 20.9                  | 25%                    | -16%             | -6%                  | \$1,360             | 2.16     | 2.20      | 2.50      | 17.0      | 16.7                |
| <b><u>Online Health Insurance Agency</u></b> |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| eHealth                                      | EHTH   | P  | \$16.57       | \$16         | 26.5                  | -3%                    | -59%             | 25%                  | \$430               | 0.55     | 0.60      | 0.70      | 30.3      | 27.4                |
| <b><u>Market Index</u></b>                   |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| S&P 500                                      | SPX    |    | 835           |              |                       |                        | -38%             | -8%                  |                     | 77.56    |           |           | 10.8      |                     |
| HMO Index                                    | HMO    |    | 941           | 1,586        |                       | 69%                    | -55%             | -2%                  |                     |          |           |           |           |                     |
| <b><u>Index Average</u></b>                  |        |    |               |              |                       |                        |                  |                      |                     |          |           |           |           |                     |
| Overall                                      |        |    |               |              | 11.4                  | 68.6%                  | -47.4%           | -4.6%                |                     |          |           |           | 6.8       | 6.9                 |

EPS projections for Not Rated Stocks are First Call consensus

O = Outperformer; P = Performer; U = Underperformer; NC = Not Covered; R = Restricted

Source: Oppenheimer & Co. Inc., company reports and FactSet

# 2008 Was An Ugly Year For Managed Care Stocks...



Source: Oppenheimer & Co. Inc.

Note: The stock-price performance results presented above cannot and should not be viewed as an indicator of future results.



# It Seems Underappreciated How Much Medicare Contributed To The Downturn

**By our calculations, Medicare issues contributed about half of the earnings decline for the industry last year.**

- All Medicare premiums and benefit designs are re-set on January 1, 2009, giving plans the ability to re-price (HUM, PDP), or simply exit (WLP, PFFS), unprofitable business.
- Bids for 2009 were due to CMS in the first week of June, so plans have to fully understand Medicare issues before then.

|         | <b>Change in Guidance By Product</b> |                 |              |
|---------|--------------------------------------|-----------------|--------------|
|         | <b>Commercial</b>                    | <b>Medicare</b> | <b>Other</b> |
| CVH     | 43%                                  | 47%             | 9%           |
| HNT     | 51%                                  | 33%             | 16%          |
| HUM     | 0%                                   | 91%             | 9%           |
| UNH     | 35%                                  | 45%             | 21%          |
| WLP     | 67%                                  | 25%             | 8%           |
| Average | 39%                                  | 48%             | 13%          |
| Median  | 43%                                  | 45%             | 9%           |

## **Medicare Advantage represents less than 20% of earnings at most of the diversified managed care plans**

- A number of diversified plans, like Aetna, CIGNA, and WellPoint, still have less than 10% of earnings derived from Medicare

## **However, by our calculations, Medicare Advantage accounted for 60% of the industry's gross profit growth in 2008**

- Nearly all of United's gross profit growth has come from Medicare in recent years, and Medicare even contributed about a third of Aetna's earnings growth in 2008

## **The good news is that much of the earnings growth has come from enrollment, rather than margin expansion**

- Enrollment driven earnings are more sustainable, although much of the enrollment has come from private fee for service (PFFS) products, which are going to have a more difficult next few years relative to the Medicare HMO / PPO products.

## **Publicly traded plans are generally not in love with Medicare, but...**

- ...in an environment where commercial profitability is pressured and enrollment is down, a lot of plans don't have a lot of choice
- Commercial risk gross profits fell more than \$850 million in 2008, a drop of 4%.

# Companies do not generate a lot of earnings from Medicare Advantage...

- Medicare does not have a material impact on the earnings of most large plans, so any potential cuts would not dramatically alter the earnings trajectory of the industry.
- We estimate that Medicare Advantage profits will represent just 12% of total profits for the industry, after excluding outliers such as HealthSpring and Humana.

| <u>Company</u>                        |     | Medicare<br>Advantage<br>EBITDA | Total<br>EBITDA | % of<br>Total |
|---------------------------------------|-----|---------------------------------|-----------------|---------------|
| HealthSpring Inc                      | HS  | \$167                           | \$217           | 77.3%         |
| Humana Inc                            | HUM | \$965                           | \$1,567         | 61.6%         |
| Triple-S                              | GTS | \$32                            | \$55            | 58.6%         |
| WellCare Health Plans                 | WCG | \$85                            | \$160           | 53.2%         |
| Universal American                    | UAM | \$76                            | \$178           | 42.5%         |
| UnitedHealth Group                    | UNH | \$1,250                         | \$6,390         | 19.6%         |
| Health Net Inc                        | HNT | \$64                            | \$621           | 10.4%         |
| Aetna Inc                             | AET | \$36                            | \$744           | 4.9%          |
| WellPoint Inc                         | WLP | \$230                           | \$4,914         | 4.7%          |
| AMERIGROUP                            | AGP | \$12                            | \$272           | 4.2%          |
| CIGNA Corp                            | CI  | -\$3                            | \$1,056         | -0.2%         |
| Coventry Health Care                  | CVH | -\$27                           | \$521           | -5.2%         |
| Totals / Weighted Average             |     | \$2,888                         | \$16,694        | 17.3%         |
| Totals / Weighted Average, ex HS, HUM |     | \$1,756                         | \$14,911        | 11.8%         |

Source: Oppenheimer & Co. Inc. estimates

- Organic risk enrollment has fallen, while ASO membership is on the rise.

## Organic at-risk enrollment growth

|              | 2003           | 2004         | 2005         | 2006           | 2007         | 2008           | Total          |
|--------------|----------------|--------------|--------------|----------------|--------------|----------------|----------------|
| AET          | (838)          | 295          | 297          | (27)           | 330          | 177            | 234            |
| CI           | (691)          | (613)        | (92)         | (662)          | 73           | (146)          | (2,131)        |
| CVH          | (10)           | (27)         | (42)         | 26             | 20           | (74)           | (107)          |
| HNT          | (113)          | (212)        | (258)        | (94)           | (26)         | (201)          | (904)          |
| HUM          | 13             | (220)        | (287)        | (310)          | 54           | 136            | (612)          |
| UNH          | (70)           | (40)         | (20)         | (520)          | (490)        | (773)          | (1,913)        |
| WLP          | 101            | 281          | (157)        | (218)          | (598)        | (391)          | (982)          |
| <b>Total</b> | <b>(1,608)</b> | <b>(536)</b> | <b>(559)</b> | <b>(1,805)</b> | <b>(637)</b> | <b>(1,272)</b> | <b>(6,415)</b> |

## Organic ASO enrollment growth

|              | 2003       | 2004         | 2005         | 2006         | 2007         | 2008         | Total         |
|--------------|------------|--------------|--------------|--------------|--------------|--------------|---------------|
| AET          | (121)      | 332          | 644          | 647          | 400          | 440          | 2,342         |
| CI           | (794)      | (1,212)      | (588)        | 226          | 500          | 283          | (1,585)       |
| CVH          | 89         | 76           | 32           | 29           | 29           | (36)         | 219           |
| HNT          | 16         | (8)          | 36           | (7)          | (41)         | (24)         | (28)          |
| HUM          | 69         | 331          | 208          | 356          | 97           | 51           | 1,111         |
| UNH          | 600        | 735          | 805          | 1,040        | 285          | (50)         | 3,415         |
| WLP          | 795        | 779          | 1,183        | 511          | 992          | 783          | 5,043         |
| <b>Total</b> | <b>653</b> | <b>1,033</b> | <b>2,320</b> | <b>2,802</b> | <b>2,262</b> | <b>1,447</b> | <b>10,517</b> |

\* UNH enrollment data is prior to the 1Q08 reclassification for 2006 and 2007.

Source: Company reports and Oppenheimer analysis

# Non-Profit Blue Cross Plan Income Statement and Capital Metrics (2003-3Q08)



➤ Blue Cross underwriting margins appear to have peaked in 2004 at 4.4% before beginning a three year deterioration that finally ended this year.

➤ However, RBC levels increased for four straight years (2003-2007) as investment income has become a larger driver of earnings. 2008 ended this trend.

➤ In large part due to the high concentration of common stocks in Blue Cross investment portfolios, investment income suffered through the first three quarters of 2008, ending the streak of consecutive RBC gains.

## Blue Cross Income Statement and Capital

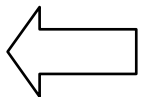
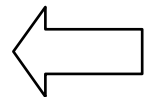
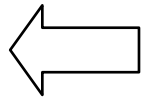
|                             | 2003             | 2004             | 2005              |
|-----------------------------|------------------|------------------|-------------------|
| Revenue                     | \$88,760,595,927 | \$98,239,044,967 | \$106,687,419,634 |
| Medical expense             | \$74,531,811,480 | \$82,567,337,197 | \$89,697,538,908  |
| MLR                         | 84.0%            | 84.0%            | 84.1%             |
| Claims adjustment expense   | \$3,419,755,427  | \$3,580,053,337  | \$4,046,100,599   |
| Administrative expense      | \$6,994,892,510  | \$7,335,019,608  | \$8,133,653,579   |
| Total SG&A                  | \$10,414,647,937 | \$10,915,072,945 | \$12,179,754,178  |
| SG&A ratio                  | 11.7%            | 11.1%            | 11.4%             |
| Net underwriting gain       | \$3,665,276,496  | \$4,314,945,510  | \$4,456,939,630   |
| Underwriting margin         | 4.1%             | 4.4%             | 4.2%              |
| Investment income           | \$1,220,653,539  | \$1,793,537,470  | \$2,206,601,325   |
| Net income                  | \$3,844,429,436  | \$4,658,275,105  | \$5,153,677,924   |
| Total members               | 39,481,014       | 41,725,642       | 41,222,778        |
| Total member months         | 478,132,668      | 500,959,102      | 489,992,076       |
| Total adjusted capital      | \$24,068,825,314 | \$30,662,914,774 | \$35,848,967,970  |
| Authorized control level    | \$3,759,187,275  | \$4,293,149,996  | \$4,681,064,668   |
| RBC ratio                   | 640%             | 714%             | 766%              |
| ACL as % of revenue         | 4.2%             | 4.4%             | 4.4%              |
| Total cash and investments  | \$34,129,788,966 | \$38,177,332,978 | \$51,441,151,359  |
| Common stock                | \$9,658,458,899  | \$11,965,645,526 | \$15,590,555,563  |
| Common stock, as % of total | 28.3%            | 31.3%            | 30.3%             |

Source: Company notes, SNL, and Oppenheimer & Co. analysis.

# Non-Profit Blue Cross Plan Income Statement and Capital Metrics (2003-3Q08)



|                             | 2005              | 2006              | 2007              | 3Q08              |
|-----------------------------|-------------------|-------------------|-------------------|-------------------|
| Revenue                     | \$106,687,419,634 | \$117,822,006,611 | \$127,200,812,184 | \$100,754,446,964 |
| Medical expense             | \$89,697,538,908  | \$100,170,517,903 | \$109,915,423,725 | \$87,162,580,520  |
| MLR                         | 84.1%             | 85.0%             | 86.4%             | 86.5%             |
| Claims adjustment expense   | \$4,046,100,599   | \$4,889,413,327   | \$5,442,510,446   | \$4,195,822,605   |
| Administrative expense      | \$8,133,653,579   | \$9,163,553,420   | \$10,018,269,228  | \$7,674,392,569   |
| Total SG&A                  | \$12,179,754,178  | \$14,052,966,747  | \$15,460,779,674  | \$11,870,215,174  |
| SG&A ratio                  | 11.4%             | 11.9%             | 12.2%             | 11.8%             |
| Net underwriting gain       | \$4,456,939,630   | \$3,469,624,962   | \$1,618,830,179   | \$1,710,664,341   |
| Underwriting margin         | 4.2%              | 2.9%              | 1.3%              | 1.7%              |
| Investment income           | \$2,206,601,325   | \$2,792,739,419   | \$3,631,553,454   | \$1,515,288,747   |
| Net income                  | \$5,153,677,924   | \$4,933,237,679   | \$4,696,133,133   | \$2,378,355,376   |
| Total members               | 41,222,778        | 43,531,056        | 43,715,000        | 42,176,916        |
| Total member months         | 489,992,076       | 512,484,949       | 520,409,841       | 379,807,216       |
| Total adjusted capital      | \$35,848,967,970  | \$41,483,263,362  | \$45,066,517,786  | \$43,941,336,575  |
| Authorized control level    | \$4,681,064,668   | \$5,298,731,186   | \$5,746,523,982   | \$6,023,037,574   |
| RBC ratio                   | 766%              | 783%              | 784%              | 730%              |
| ACL as % of revenue         | 4.4%              | 4.5%              | 4.5%              |                   |
| Total cash and investments  | \$51,441,151,359  | \$58,049,052,472  | \$61,720,733,806  | \$61,321,189,264  |
| Common stock                | \$15,590,555,563  | \$19,271,241,656  | \$19,939,969,698  | \$17,797,348,005  |
| Common stock, as % of total | 30.3%             | 33.2%             | 32.3%             | 29.0%             |



# The Pension Plans Of The Blues Will Put Further Pressure on Capital



## Pension & Post Retirement Obligations Of Six Non-Profit Blues, 2007

|                                     | <b>BCBS<br/>MA</b> | <b>BCBS<br/>MI</b> | <b>CareFirst<br/>BCBS</b> | <b>HCSC</b>      | <b>Highmark</b>  | <b>Horizon<br/>BCBS</b> | <b>Total</b>     |
|-------------------------------------|--------------------|--------------------|---------------------------|------------------|------------------|-------------------------|------------------|
| Pension obligations                 | \$423.3            | \$1,024.0          | \$465.2                   | \$982.0          | \$1,244.9        | \$276.0                 | \$4,415          |
| Post retirement obligations         | \$93.5             | \$574.7            | \$74.1                    | \$278.9          | \$231.9          | \$133.7                 | \$1,387          |
| <b>Total obligations</b>            | <b>\$516.9</b>     | <b>\$1,598.7</b>   | <b>\$539.2</b>            | <b>\$1,260.9</b> | <b>\$1,476.9</b> | <b>\$409.7</b>          | <b>\$5,802</b>   |
| Fair value pension assets           | \$495.8            | \$1,037.4          | \$480.0                   | \$850.8          | \$999.6          | \$309.6                 | \$4,173          |
| Fair value post retirement assets   | \$28.4             | \$0.0              | \$2.9                     | \$62.0           | \$169.4          | \$0.0                   | \$263            |
| <b>Total assets</b>                 | <b>\$524.2</b>     | <b>\$1,037.4</b>   | <b>\$482.8</b>            | <b>\$912.8</b>   | <b>\$1,169.0</b> | <b>\$309.6</b>          | <b>\$4,436</b>   |
| Pension over (under) funded         | \$72.5             | \$13.4             | \$14.8                    | (\$131.2)        | (\$245.4)        | \$33.7                  | (\$242)          |
| Post retirement over (under) funded | (\$65.1)           | (\$574.7)          | (\$71.2)                  | (\$216.9)        | (\$62.5)         | (\$133.7)               | (\$1,124)        |
| <b>Over (under) funded status</b>   | <b>\$7.3</b>       | <b>(\$561.3)</b>   | <b>(\$56.4)</b>           | <b>(\$348.1)</b> | <b>(\$307.9)</b> | <b>(\$100.1)</b>        | <b>(\$1,366)</b> |
| Equity assets                       | 55%                | 72%                | 35%                       | 67%              | 56%              | 56%                     | 57%              |
| Expected return                     | 8.0%               | 9.0%               | 8.5%                      | 8.0%             | 8.0%             | 7.5%                    | 8.2%             |

## **Enrollment should rise by more than 1 million lives in 2009**

- That's down from growth of 1.4 million lives in 2008, and 1.3 million lives in 2007

## **Group employer PFFS enrollment will slow**

- Employers will be even more hesitant to switch given the pending changes to the PFFS program, and the newness of group PPO products

## **Rate cuts in 2010 and the specter of Medicare Advantage competitive bidding in 2012 will be overhangs for the group this year**

- On Monday, April 6, CMS released final 2010 MA rates that were 3-4% lower than 2009 rates. However, if a doc fix is passed by Congress later in the year, a clause in the announcement permits CMS to work with Congress to adjust plan reimbursement next year. That said, CMS was pretty clear that logistically, the doc fix would have to occur by June, and it seems unlikely to us that Congress will move that fast.
- President Obama released his 2010 budget on February 25, calling for savings of \$177 billion from the MA program over 10 years through the introduction of competitive bidding in 2012

## **Broker commissions are down materially in 2009**

- Brokers have a lot less incentive to push Medicare this year
- Will help plans with an internal salesforce, like Humana and Universal American, since many of the changes don't apply

## **There are some positive offsets: the economy, and the aging process**

- The downturn in the economy couldn't have come at a better time
- More seniors will age into Medicare in 2009 than either of the prior two years



**PFFS plans will continue to be a focus for a number of plans, but many in the industry are already shifting to the future**

- Humana can offer a network product to 80% of its current PFFS membership, and the PPO network is roughly 75% as big as the PFFS provider network
- Humana is very clearly favoring the PPO product over PFFS through benefit design

**Profit shortfalls were often concentrated in new PFFS plans, so some companies are not marketing as aggressively in 2009**

- Coventry and WellPoint are two good examples

**Membership growth in 2009 has been more heavily weighted to network products**

- PFFS enrollment is up about 80,000 lives this year, compared with about additions of about 500,000 lives in the HMO/PPO product

**2009 will be the year of the local PPO**

- Membership in the local PPO currently totals about 880,000 lives, compared with 700,000 lives at the end of 2008, and 440,000 at the end of 2007

**2009 will also be a year of major PPO network development ahead of the 2010 selling season**

# Humana's Benefit Design Heavily Favors The PPO in 2009



## Humana's Medicare Benefit Design In Lancaster County, PA: 2008 Versus 2009

|                        | Gold Choice-PFFS<br>H1804-091 |           | Gold Choice-PFFS<br>H1804-223 |           | Humana Choice-PPO<br>R5826-002 |           | Humana Choice-PPO<br>R5826-062 |           |
|------------------------|-------------------------------|-----------|-------------------------------|-----------|--------------------------------|-----------|--------------------------------|-----------|
|                        | 2008                          | 2009      | 2008                          | 2009      | 2008                           | 2009      | 2008                           | 2009      |
| Premium                | \$0                           | \$18      | \$23                          | \$38      | \$69                           | \$38      |                                | \$0       |
| Deductible             | \$0                           | \$0       | \$0                           | \$0       | \$0                            | \$0       |                                | \$0       |
| Drug coverage          | Yes                           | Yes       | Yes                           | Yes       | Yes                            | Yes       |                                | No        |
| Part D deductible      | \$0                           | \$0       | \$0                           | \$0       | \$0                            | \$0       |                                | NA        |
| Out of pocket max      | \$5,000                       | \$6,000   | \$4,000                       | \$6,000   | \$3,000                        | \$5,000   |                                | \$3,000   |
| <b>Drug copays</b>     |                               |           |                               |           |                                |           |                                |           |
| Generic                | \$4                           | \$7       | \$4                           | \$7       | \$5                            | \$7       |                                |           |
| Preferred Brand        | \$30                          | \$40      | \$30                          | \$40      | \$35                           | \$40      |                                |           |
| Non-preferred brand    | \$60                          | \$65      | \$60                          | \$65      | \$65                           | \$65      |                                |           |
| Specialty              | 25%                           | 33%       | 25%                           | 33%       | 25%                            | 33%       |                                |           |
| <b>Doctor copays</b>   |                               |           |                               |           |                                |           |                                |           |
| PCP                    | \$15                          | \$15      | \$15                          | \$15      | \$10                           | \$15      |                                | \$10      |
| Specialist             | \$30                          | \$30      | \$30                          | \$30      | \$30                           | \$30      |                                | \$30      |
| <b>Hospitalization</b> |                               |           |                               |           |                                |           |                                |           |
| Per admit              | \$625                         | \$950     |                               |           | \$550                          | \$800     |                                | \$550     |
| Per day                |                               |           | \$200                         | \$225     |                                |           |                                |           |
| Days specified         |                               |           | 1 - 5                         | 1 - 5     |                                |           |                                |           |
| Per day                |                               |           | \$0                           | \$0       |                                |           |                                |           |
| Days specified         |                               |           | 6 - 90                        | 6 - 90    |                                |           |                                |           |
| Annual # of days       | Unlimited                     | Unlimited | Unlimited                     | Unlimited | Unlimited                      | Unlimited |                                | Unlimited |

Source: Medicare.Gov; Company reports and Oppenheimer & Co analysis.

## **Medicare rates will be reduced as part of the plan**

- The subsidy to private plans will be reduced or eliminated through the introduction of competitive bidding in 2012
- As far as we can tell from the initial view that the administration has provided, the savings from competitive bidding will be phased in over a period of about 5 years, giving plans ample time to adjust benefits to preserve margins

## **Obama's Healthcare Reform plan would cover a lot more people, but funding will be an issue**

- An SCHIP expansion was passed early in 2009 with funding coming from an increase to the cigarette tax
- We think Obama's broader plan for the uninsured will be too expensive

## **Medicare reimbursement will be cut in 2010 to offset the change in Medicare physician reimbursement and again in 2012 with the advent of competitive bidding**

- The worst case for 2010: probably a 3-4% cut in rates
- Competitive bidding is expected to trim MA payments by \$177 billion over 10 years.
- More important than the magnitude of the cut, however, will be the phase in period, and it looks as though the phase-in will be 5 years, which is a lot better than 3 years.
- Over time, plan reimbursement will gravitate toward the vicinity of 100% of government cost

## **Congress still has some difficult issues to work out that haven't gotten a lot of attention**

- The urban / rural divide – take reimbursement to 100%, and it becomes a lot more difficult to offer plans in more rural areas
- The low income / minority impact – will reductions to Medicare Advantage payments disproportionately impact these demographic groups?

## **Plans will wear out the halls of Congress trying to show better quality and utilization metrics, but it will be too little, too late**

- Plans are just starting to present data showing improvements over the government Medicare program. Would have been useful and helpful a couple years ago.

**A common misperception: BBA-97 was a successful attempt by Congress to eliminate private plans from Medicare**

- Congress actually had the noble intention of trying to bring private plans (and more choices) to seniors in rural areas. A whole series of unintended consequences led to the near destruction of the program

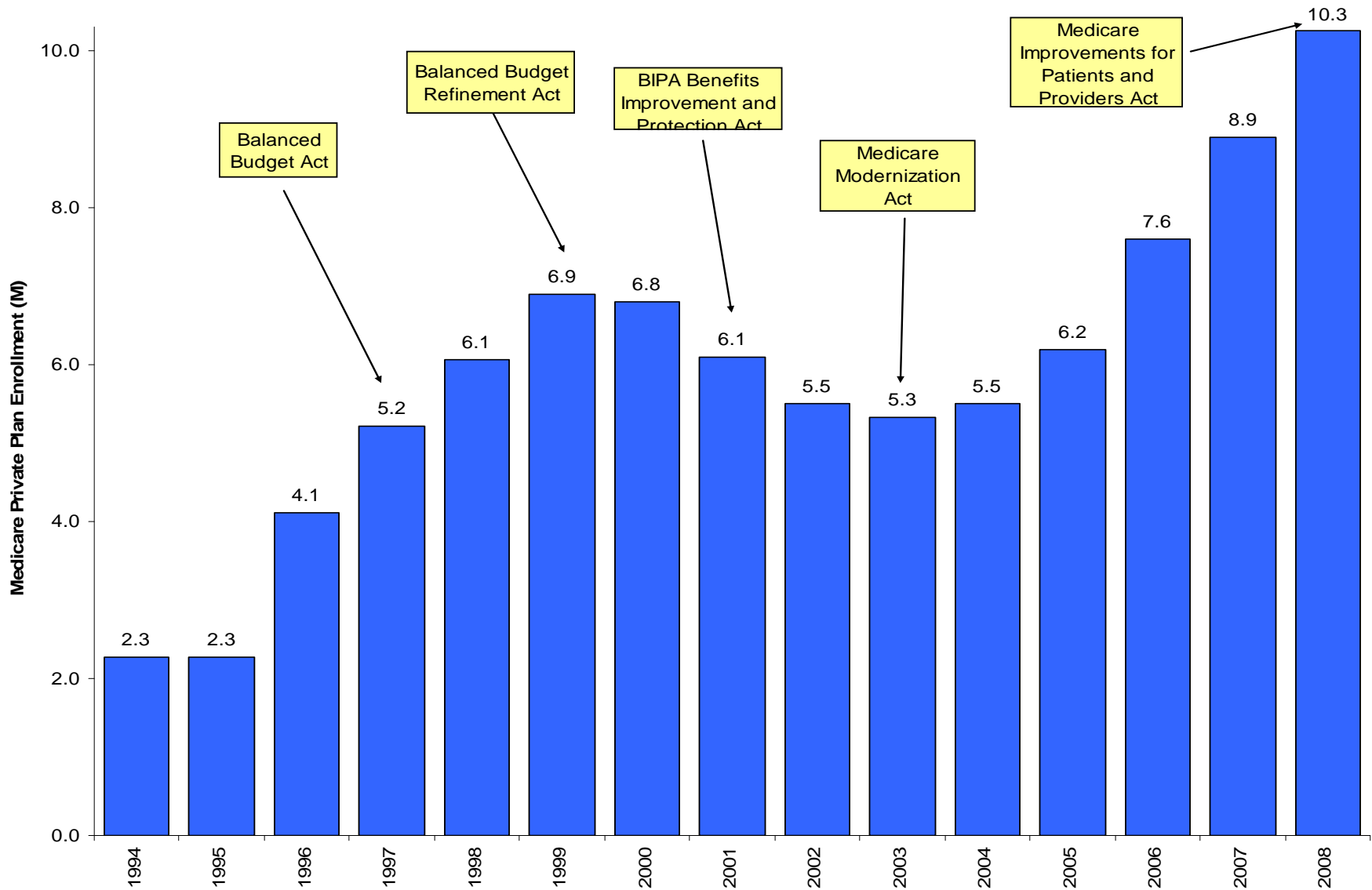
**Even with catastrophic rate cuts, it took 3 years for membership to fall**

- The BBA was passed in 1997, and membership actually grew nicely in 1998 and 1999, before reaching a plateau in 2000, and then membership dropped precipitously until the program was rescued by the Medicare Modernization Act in 2003
- The implication is that plans can adjust benefits in order to maintain margins, and a rate cut in 2011 will not result in a huge drop in membership, at least initially

**Most of the enrollment declines occurred when plans exited markets, rather than because seniors decided to return to the government Medicare program en masse**

- Seniors won't move unless they have to, particularly if what they receive is still better than what the government offers, even if benefit packages have been reduced

# It Took A Long Time For Enrollment To Fall After The BBA-97



Source: CMS data and Oppenheimer & Co analysis.

## **There are a lot more seniors enrolled in Medicare Advantage today, and membership is much more dispersed**

- In 1997, there were 5.2 million seniors in the Medicare program, and the top 5 states accounted for 57% of this membership. Today, there are 10.8 million seniors in the program, and the top 5 states represent 45% of membership.
- There are about 80 Senators with a vested interest in the program, as 39 states have Medicare Advantage populations of more than 50,000 lives, and 25 states have Medicare Advantage enrollment above 100,000 lives.
- In Iowa, in 1997, there were 17,000 Medicare Advantage members, versus 58,000 today, while in Montana, there were just 1,300 Medicare members a decade ago, versus 23,000 today.

## **Loss ratios and margins deteriorated almost immediately after cuts were implemented**

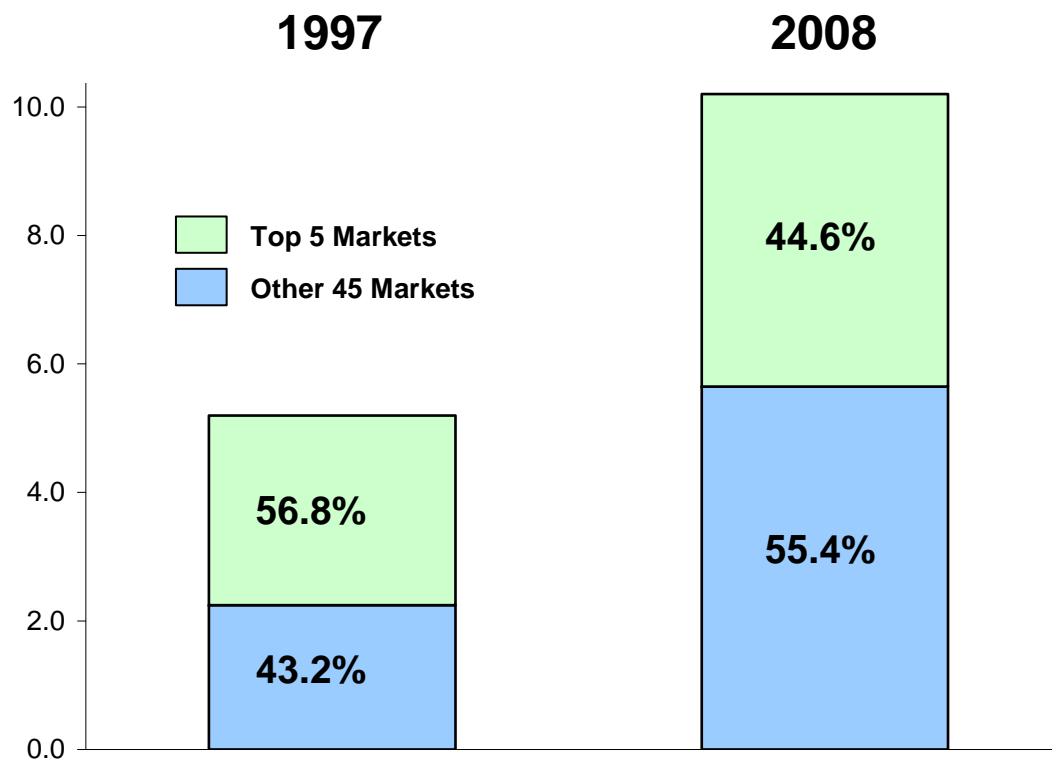
- It's unclear how much of this was driven by lower reimbursement, and how much related to the timing of bid submissions, which was pushed up as part of the legislation, giving plans much less visibility into profitability before the bid for the following year was due.

## **Geography and business model were a couple critical factors**

- Some plans did just fine, including those in high cost areas with high reimbursement, and those with a greater ability to control cost.

# Medicare Membership Is A Lot More Geographically Diversified Today

## Medicare Health Plan Enrollment Concentration, 1997 Versus 2008



Source: CMS data and Oppenheimer & Co analysis.



- **The structure of Medicare pricing means that swings in profitability can be elongated over a multi-year period.** Bids are due to CMS in June, which means that many plans are pricing next year's product with very little understanding of how profitable the product was this year, particularly in products with long claims lag, like PFFS.
- **This feature will likely result in wider profit margin swings, both to the upside and downside.** Coventry, for example, disclosed \$50 million in unfavorable development related to its PFFS plan, and it will not be able to fully make up these unexpected costs until 2010, which will be tough given CMS' initial view of 2-4% MA rate cuts for 2010.
- **This factor has been a generally positive thing for plans lately, as loss ratios have generally been more favorable than expected.**

- **Strategic value – market concentration, more exposure to a new population / geography, proven medical management techniques**
- **Earnings accretive, or at least not dilutive**
- **A strong, double-digit return in the first year**
- **The willingness of existing management to stick around is often not an important consideration, at least for the long-term.**
- **For plans without a major Medicare business, management is a much more important consideration, as is a model that can easily be duplicated in other markets.**

# Recent Medicare Transactions

The price a plan is willing to pay is highly dependent on profit margins.

Health plans will also pay a premium for plans in attractive geographies, such as Florida.

| Medicare                       |                                   |            |                      |                     |                           |                      |  |
|--------------------------------|-----------------------------------|------------|----------------------|---------------------|---------------------------|----------------------|--|
| Acquiror                       | Target                            | Date       | Enrollment           | Price (in millions) | Membership (in thousands) | Valuation Per Member |  |
| Humana                         | Metcare Health Plans              | 6/30/2008  | Medicare             | \$14                | 7.2                       | \$1,950              |  |
| Humana                         | United (Las Vegas)                | 2/26/2008  | Medicare             | \$185               | 25.0                      | \$7,400              |  |
| Munich Re                      | Sterling                          | 12/17/2007 | Medicare             | \$352               |                           |                      |  |
| HealthSpring                   | Leon Medical Centers Health Plan  | 8/9/2007   | Medicare             | \$355               | 26.7                      | \$13,296             |  |
| Bravo Health                   | Senior Partners                   | 8/1/2007   | Medicare             |                     | 22.8                      |                      |  |
| HealthSpring                   | America's Health Choice Med.Plans | 5/30/2006  | Medicare             | \$50                | 13.0                      | \$3,846              |  |
| Aveta                          | PMC Medicare Choice               | 5/12/2006  | Medicare             | \$250               | 55.0                      | \$4,545              |  |
| United                         | PacifiCare                        | 7/6/2005   | Medicare, Commercial | \$8,100             |                           |                      |  |
| Preferred Care Partners        | Neighborhood Health Partnership   | 4/27/2005  | Medicare             |                     | 38.0                      |                      |  |
| Humana                         | CarePlus                          | 12/14/2004 | Medicare             | \$408               | 50.4                      | \$8,095              |  |
| Universal American             | Heritage Health Systems           | 5/28/2004  | Medicare             | \$98                | 15.7                      | \$6,242              |  |
| Average                        |                                   |            |                      |                     |                           | \$6,482              |  |
| Average (ex. Leon and Metcare) |                                   |            |                      |                     |                           | \$6,026              |  |

\*PMC assumes earnout of \$68 million over the following 18 months

| Medicare PDP       |               |          |            |                     |                           |                      |  |
|--------------------|---------------|----------|------------|---------------------|---------------------------|----------------------|--|
| Acquiror           | Target        | Date     | Enrollment | Price (in millions) | Membership (in thousands) | Valuation Per Member |  |
| Universal American | Member Health | 5/8/2007 | PDP        | \$529               | 1,100.0                   | \$481                |  |
| Average            |               |          |            |                     |                           | \$481                |  |

Source: Oppenheimer & Co analysis.

# What Will Plans Pay?

Price per member is a terrible metric, but it's often all we have to go on.

|                  | <u>Metcare</u> | <u>United<br/>(Las Vegas)</u> | <u>Leon Medical<br/>Centers</u> | <u>Senior<br/>Partners</u> | <u>America's<br/>Health Choice</u> | <u>PMC</u> | <u>Careplus</u> | <u>Heritage</u> |
|------------------|----------------|-------------------------------|---------------------------------|----------------------------|------------------------------------|------------|-----------------|-----------------|
| Enrollment       | 7.2            | 25.0                          | 25.9                            | 22.8                       | 13.0                               | 55.0       | 50.4            | 16.1            |
| Member Months    | 86.1           | 300.0                         | 304.7                           | 273.6                      | 156.0                              | 660.0      | 604.8           | 193.2           |
| PMPM             | \$870.31       | \$843.00                      | \$1,101.96                      | \$1,115.00                 | \$1,103.08                         | \$600.00   | \$880.00        | \$693.46        |
| Premiums         | \$75.0         | \$252.9                       | \$335.7                         | \$305.1                    | \$172.1                            | \$396.0    | \$532.2         | \$134.0         |
| Medical expenses | \$63.5         | \$203.1                       | \$262.6                         | \$250.5                    | \$147.1                            | \$336.6    | \$425.8         | \$111.6         |
| MLR              | 84.7%          | 80.3%                         | 78.2%                           | 82.1%                      | 85.5%                              | 85.0%      | 80.0%           | 83.3%           |
| SG&A expenses    | \$8.2          | \$27.8                        | \$32.7                          | \$45.8                     | \$23.0                             | \$39.6     | \$63.9          | \$16.9          |
| SG&A ratio       | 11.0%          | 11.0%                         | 9.7%                            | 15.0%                      | 13.4%                              | 10.0%      | 12.0%           | 12.6%           |
| Estimated EBITDA | \$3.2          | \$22.0                        | \$40.4                          | \$8.8                      | \$1.9                              | \$19.8     | \$42.6          | \$5.5           |
| EBITDA margin    | 4.3%           | 8.7%                          | 12.0%                           | 2.9%                       | 1.1%                               | 5.0%       | 8.0%            | 4.1%            |
| Acquirer         | Humana         | Humana                        | HealthSpring                    | Bravo Health               | HealthSpring                       | Aveta      | Humana          | UAM             |
| Acquisition Date | 6/30/2008      | 2/26/2008                     | 8/9/2007                        | 8/1/2007                   | 5/30/2006                          | 5/12/2006  | 12/14/2004      | 5/28/2004       |
| Purchase Price   | \$14           | \$185                         | \$355                           | NA                         | \$50                               | \$250      | 408.0           | \$98            |
| Price/EBITDA     | 4.3            | 8.4                           | 8.8                             | NA                         | 25.8                               | 12.6       | 9.6             | 17.8            |

Source: Oppenheimer & Co analysis.

## **With commercial enrollment still falling, plans need some source of organic growth**

- The SCHIP expansion could add 4 million new insured lives
- Medicaid growth will come from new areas, like aged, blind, and disabled (ABD) population
- Fewer major RFPs on the horizon

## **It has been difficult for plans to get into the business without acquisitions**

- Aetna and Coventry have wanted a larger Medicaid presence for years
- WellPoint has really struggled in the business, despite its better commercial unit costs
- The quarterly volatility of the Medicaid business is a concern, and the fear of state budget cuts remains high

**The Medicaid stocks outperformed the HMO Index by 2,100 basis points in 2008, although the Medicaid stocks still fell about 35% last year.**

- Better financial performance than the diversified plans
- The one health insurance sub-sector with a clear benefit from the new Administration in DC
- Continued organic enrollment growth
- Greater interest in Medicaid from the non-traditional, larger diversified managed care plans

# Medicaid Is Still Not A Very Large Contributor To Earnings At The Big Plans

➤ On average, Medicaid will generate about 5% of earnings in 2009 across the managed care industry

## Medicare Advantage EBITDA by Plan 2009E (in millions)

| <u>Company</u>                   |     | Medicaid<br>EBITDA | Total<br>EBITDA | % of<br>Total |
|----------------------------------|-----|--------------------|-----------------|---------------|
| AMERIGROUP                       | AGP | \$257              | \$273           | 94.2%         |
| Molina                           | MOH | \$129              | \$145           | 89.0%         |
| Centene                          | CNC | \$142              | \$168           | 84.9%         |
| WellCare Health Plans            | WCG | \$50               | \$159           | 31.6%         |
| Health Net Inc                   | HNT | \$61               | \$366           | 16.6%         |
| Coventry Health Care             | CVH | \$53               | \$521           | 10.2%         |
| Triple-S                         | GTS | \$4                | \$55            | 8.2%          |
| UnitedHealth Group               | UNH | \$175              | \$6,390         | 2.7%          |
| WellPoint Inc                    | WLP | \$19               | \$5,025         | 0.4%          |
| Aetna Inc                        | AET | \$1                | \$695           | 0.1%          |
| Humana Inc                       | HUM | -\$32              | \$1,567         | -2.0%         |
| <b>Totals / Weighted Average</b> |     | <b>\$859</b>       | <b>\$15,363</b> | <b>5.6%</b>   |

# RFPs Have Been A Great Source Of Growth, Particularly For The Largest Plans



- Larger, more commercially oriented plans have outperformed the pure-play Medicaid plans in the past twelve RFP contests.
- In the last 12 RFPs, United and WellPoint have been the most successful bidders, winning 16% and 10%, respectively, of the available lives.

|                             | Indiana        | Kansas         | Nevada         | Ohio             | Ohio ABD       | TennCare Middle | Indiana ABD    | Hawaii ABD    | District Columbia | TennCare East/West | Arizona        | Florida Healthy Kids | Past 12 RFP's    | Penetration Rate |
|-----------------------------|----------------|----------------|----------------|------------------|----------------|-----------------|----------------|---------------|-------------------|--------------------|----------------|----------------------|------------------|------------------|
| Private plans               | 171,000        | 74,000         | -              | 599,500          | 39,110         | -               | 200,000        |               | 98,620            | 387,642            | 721,330        | 5,826                | 2,297,028        | 49.6%            |
| United                      |                |                |                |                  |                | 170,000         |                | 20,500        |                   | 387,642            | 147,747        | 30,099               | 755,988          | 16.3%            |
| WellPoint                   | 171,000        | 84,500         | 52,500         | 144,000          | 29,203         |                 |                |               |                   |                    |                |                      | 481,203          | 10.4%            |
| AMERIGROUP                  |                |                |                | 63,500           | 5,221          | 170,000         |                |               | 39,889            |                    |                | 79,411               | 358,021          | 7.7%             |
| Centene                     | 193,000        |                |                | 110,000          | 18,000         |                 |                |               |                   |                    | 14,040         |                      | 335,040          | 7.2%             |
| Molina                      | -              |                |                | 141,000          | 21,621         |                 |                |               |                   |                    |                |                      | 162,621          | 3.5%             |
| WellCare                    | -              |                |                | 65,000           | 4,500          |                 |                | 20,500        |                   |                    |                | 72,099               | 162,099          | 3.5%             |
| United (formerly Sierra)    |                |                | 52,500         |                  |                |                 |                |               |                   |                    |                |                      | 52,500           | 1.1%             |
| Coventry                    |                |                |                |                  |                |                 |                |               |                   |                    |                | 24,508               | 24,508           | 0.5%             |
| <b>Total Eligibles</b>      | <b>535,000</b> | <b>158,500</b> | <b>105,000</b> | <b>1,123,000</b> | <b>124,115</b> | <b>340,000</b>  | <b>200,000</b> | <b>41,000</b> | <b>138,509</b>    | <b>775,284</b>     | <b>883,117</b> | <b>211,943</b>       | <b>4,635,468</b> |                  |
| Publicly traded plans       | 364,000        | 84,500         | 105,000        | 523,500          | 78,545         | 340,000         | -              | 41,000        | -                 | 387,642            | 161,787        | 206,117              | 2,292,091        |                  |
| Pure play Medicaid          | 193,000        | -              | -              | 316,000          | 49,342         | 170,000         | -              | 20,500        | -                 | -                  | 14,040         | 151,510              | 914,392          |                  |
| Publicly traded penetration | 68.0%          | 53.3%          | 100.0%         | 46.6%            | 63.3%          | 100.0%          |                | 100.0%        | 0.0%              | 50.0%              | 18.3%          | 97.3%                | 49.4%            |                  |
| Pure play penetration       | 36.1%          | 0.0%           | 0.0%           | 33.8%            | 39.8%          | 50.0%           |                | 50.0%         | 0.0%              | 0.0%               | 1.6%           | 71.5%                | 19.7%            |                  |

Source: Oppenheimer & Co. Inc.



## **Many plans would like to have a larger Medicaid presence, but RFP success has been few & far between**

- Without a big Medicaid population already, it's been hard for Coventry and Aetna to expand their market share.
- We may see more interest from Blue Cross plans, like Health Care Service Corp. (HCSC), in the Medicaid market.
- Medicaid acquisitions have been one avenue for growth.
- Probably not a lot of deals happening these days, because of the drop in public market valuations, and the large disparity between current valuation multiples and seller expectations.

## There has been a steady flow of Medicaid M&A in recent years

| Acquiror                       | Target                              | Date       | Price (in millions) | Medical Membership | Price / Medical Membership |
|--------------------------------|-------------------------------------|------------|---------------------|--------------------|----------------------------|
| AMERIGROUP                     | Centene University HP of New Jersey | 11/20/2008 |                     | 9                  |                            |
| Centene                        | AMERIGROUP Community Care of S.C.   | 11/20/2008 |                     | 53                 |                            |
| UnitedHealth Group             | Unison                              | 1/8/2008   | \$930               | 320                | \$2,906                    |
| CareSource                     | Community Choice Michigan           | 10/1/2007  |                     |                    |                            |
| Molina                         | Mercy CarePlus                      | 9/6/2007   | \$74                | 68                 | \$1,093                    |
| Centene                        | Access Health Solutions             | 7/20/2007  |                     | 90                 |                            |
| Aetna                          | Schaller Anderson                   | 5/24/2007  | \$535               | 1,300              | \$412                      |
| Centene                        | PhyTrust of South Carolina          | 4/16/2007  |                     | 30                 |                            |
| WellPoint                      | QualChoice Select                   | 4/26/2006  | \$42                | 68                 | \$618                      |
| Centene                        | OptiCare Health Systems             | 4/25/2006  | \$8                 |                    |                            |
| Centene                        | MediPlan                            | 1/31/2006  | \$9                 | 13                 | \$654                      |
| Molina                         | CAPE Health Plan                    | 1/30/2006  | \$44                | 87                 | \$506                      |
| Centene                        | AirLogix                            | 7/21/2005  | \$35                |                    |                            |
| Centene                        | SummaCare                           | 1/10/2005  | \$31                | 39                 | \$795                      |
| Molina                         | Universal Care                      | 12/16/2004 | \$6                 | 17                 | \$353                      |
| Molina                         | Sharp Health Plan                   | 11/22/2004 | \$25                | 70                 | \$357                      |
| AMERIGROUP                     | CarePlus                            | 10/26/2004 | \$125               | 114                | \$1,096                    |
| Molina                         | The Wellness Plan                   | 6/21/2004  | \$19                | 87                 | \$218                      |
| Coventry                       | OmniCare Health Plan                | 4/15/2004  | \$13                | 63                 | \$200                      |
| AMERIGROUP                     | The Wellness Plan                   | 4/15/2004  | \$38                | 103                | \$369                      |
| UnitedHealth Group             | Great Lakes                         | 3/10/2004  | \$27                | 96                 | \$281                      |
| WellCare                       | Harmony                             | 3/8/2004   | \$50                | 85                 | \$588                      |
| Molina                         | Premera (Medicaid)                  | 3/1/2004   |                     | 66                 |                            |
| Molina                         | Cimarron (NM)                       | 2/23/2004  | \$74                | 108                | \$685                      |
| <b>Average</b>                 |                                     |            |                     |                    | <b>\$585</b>               |
| <b>Average, ex-AmeriChoice</b> |                                     |            |                     |                    | <b>\$547</b>               |

Source: Company notes and Oppenheimer & Co. analysis.

# Medicaid Focused For-Profit Plans Have Generated The Highest Margins

**In 2006, the average pre-tax Medicaid margin was 2%.**

- The loss ratio of publicly traded Medicaid plans was 300 bp better in 2006, at 85%, than private plans.
- Within the publicly traded Medicaid plans, pure play companies reported MLRs that were 300 bp better, at 84%.

|                            | <b>Private Plans</b> | <b>Publicly Traded</b> | <b>Overall Industry Average</b> | <b>Publicly Traded Pure Play Medicaid</b> | <b>Publicly Traded Diversified Medicaid</b> |
|----------------------------|----------------------|------------------------|---------------------------------|---|---|
| Premiums, PMPM             | \$222.15             | \$184.85               | \$203.44                        | \$184.62                                  | \$185.18                                    |
| Medical expenses, PMPM     | \$196.33             | \$157.27               | \$176.76                        | \$154.73                                  | \$160.84                                    |
| MLR                        | 88.4%                | 85.1%                  | 86.9%                           | 83.8%                                     | 86.9%                                       |
| Gross profit, PMPM         | \$25.82              | \$27.58                | \$26.69                         | \$29.89                                   | \$24.34                                     |
| Bed days per 1,000         | 467                  | 355                    | 404                             | 354                                       | 358   |
| Days per admission         | 3.9                  | 4.1                    | 4.0                             | 4.1                                       | 4.1   |
| Physician visits per 1,000 | 5,774                | 4,389                  | 5,096                           | 3,986                                     | 5,027                                       |

## A lot of big Medicaid RFP wins, followed by big financial losses, and subsequent market exits

- WellPoint won 4 major RFPs, and we estimate the company lost a combined \$110 million in these markets in 2007 & 2008.
- Connecticut, another large market, lost over \$40 million.
- The inability to gain competitive hospital contracts appears to be WellPoint's biggest problem.

|                           | <b>Estimated<br/>2007<br/>EBITDA</b> | <b>Estimated<br/>2008<br/>EBITDA</b> |
|---------------------------|--------------------------------------|--------------------------------------|
| <b>New markets</b>        |                                      |                                      |
| Indiana                   | (\$7.2)                              | (\$12.8)                             |
| Kansas                    | \$7.8                                | (\$3.7)                              |
| Nevada                    | (\$15.4)                             | (\$28.1)                             |
| Ohio                      | (\$43.1)                             | (\$7.3)                              |
| <b>Total, new markets</b> | <b>(\$58.0)</b>                      | <b>(\$51.8)</b>                      |
| Connecticut               | (\$30.7)                             | (\$10.5)                             |
| <b>Total</b>              | <b>(\$88.7)</b>                      | <b>(\$62.3)</b>                      |
| EPS impact                | (\$0.09)                             | (\$0.08)                             |
| Market cap impact         | <b>(\$564)</b>                       | <b>(\$466)</b>                       |

## **The increased funding from the government is a good thing, but it will take time to materialize**

- SCHIP – eligible members won't just suddenly appear, and states have to come up with new funding to receive the federal match
- FMAP – will really plug existing budget gaps rather than add new revenue
- Increased unemployment – will increase the Medicaid pool, but we doubt Medicaid growth will be linear to increasing unemployment. Also, will this be healthy membership?

## In a best case scenario, SCHIP could add more than \$0.10 in earnings on an annual basis for both AMERIGROUP & Centene

- Some of Molina's bigger states do not have a separate SCHIP program, so the funds will be commingled, and the SCHIP impact not as direct.

| Company      | Current SCHIP Enrollment | Market Share  | Expected Additional SCHIP lives | Assumed PMPM | Revenue (in million) | Assumed Margin | EBITDA       | EPS Impact |
|--------------|--------------------------|---------------|---------------------------------|--------------|----------------------|----------------|--------------|------------|
| AMERIGROUP   | 291                      | 6.2%          | 248                             | \$100        | \$297                | 3%             | \$8.9        | \$0.10     |
| Centene      | 223                      | 4.7%          | 190                             | \$100        | \$228                | 3%             | \$6.8        | \$0.09     |
| Molina       | 60                       | 1.3%          | 51                              | \$100        | \$61                 | 3%             | \$1.8        | \$0.04     |
| All Other    | 4,126                    | 87.8%         | 3,511                           | \$100        | \$4,214              | 3%             | \$126.4      |            |
| <b>Total</b> | <b>4,700</b>             | <b>100.0%</b> | <b>4,000</b>                    |              | <b>\$4,800</b>       |                | <b>\$144</b> |            |

Source: Company notes and Oppenheimer & Co. analysis.

## **This is a major structural risk for the group, because a future RFP in a key market would create a major overhang**

- In 2008, 36% of Molina's gross profit came from Washington, while Michigan accounted for 28% of gross profits.
- Centene's gross profit is largely driven by Texas (27%) and Georgia (25%).
- AMERIGROUP is highly leveraged to the state of Texas (31% of gross profit) and Maryland (21% of gross profit).

## Industry Analyses

*1st Rule Of Acting: Whatever Happens, Look As If It Were Intended-Obama Budget Like Falling off a Tall Building & After 50 Floors Saying So Far So Good-Initial 2010 MA Rates Never Face Facts, Or You Won't Get Up In The Morning-2009 Outlook & 4Q Preview Show Me A Hero & I'll Write You A Tragedy - Blue Cross Capital Analysis Faith Is Believing What You Know Ain't So - Medicare Impact Of The BBA-97 A Light at the End of the Tunnel. Just Hope It's Not a Train: 3Q08 Preview Don't Think There Are No Crocodiles Because the Water Is Calm - October Medicare You Can't Disprove Something That Doesn't Exist - More Balance Sheet Analysis Chaos, Panic, & Pandemonium - HMOs Well Capitalized To Absorb Writedowns It's The Economy, Stupid - Health Care Reform In 2009 In War, Truth Is The First Casualty - HMO Exposure To Problem Financials Limited Dissecting Humor & Frogs Tends To Leave Both Subjects Dead - 2009 PDP Rates Living A Charmed Life--2009 Medicare Rates Announced Cui Bono? Why WLP's Medical Costs Are Company Specific & Not An Industry Issue All the Armies In the World Can't Stop an Idea Whose Time Has Come-TRICARE RFP Offense Wins Games, But Defense Wins Championships--HMOs & Recessions Underwrite This! Why The Underwriting Cycle Is Dead*

## Company reports

*WCG: The Measure Of A Man Is How He Holds Up Under Misfortune--Delayed Filings WLP: The Best Defense Against Logic Is Ignorance —2009 Investor Day Analysis CVH: Meet The New Boss, Same As The Old Boss—4Q08 EPS HUM: The Best Way To Keep One's Word Is Not To Give It—Management Meeting AGP: Some Things Have To Be Believed To Be Seen: Highlights From Management Meetings CI: When Ideas Fail, Words Come In Very Handy - Investor Day Review HNT: A Military Coup - Highlights From Investor Day WCG: Only The Mediocre Are Always At Their Best - 3Q08 Statutory Filing Review HUM: If Con Is The Opposite of Pro, What's The Opposite Of Progress? Mcare Design UAM: The Dichotomy of Perception and Reality - Thoughts on Medicare Rate Cuts HNT: Thinking Outside The Box - Why Blue Shield Could Buy Health Net HUM: Money Isn't Everything, But It Sure Keeps You In Touch With Your Kids - Sub Cash AET: It's Like Being Happy at a Funeral - Highlights From Management Meeting WCG: Saints Have A Past, But Sinners Have A Future - Medicare Growth Analysis HUM: PDP Issues Are Company Specific And Won't Affect 2009 EPS*

## Medicaid Updates

*The Early Bird Gets The Worm, But The Second Worm Gets To Live: New Mexico RFP The Red Sox Aren't The Only Thing To Watch This Fall-Mass. Medicaid RFP Review An Old Broom Knows The Dirty Corners Best - Florida Healthy Kids RFP Award We Learn From History That Man Never Learns Anything From History - CT RFP Employee of the Month Is Another Example of Being Both A Winner & A Loser-TN RFP If You're Already There, Then There's No Where To Go--Florida Healthy Kids RFP Working Like They Don't Need The Money - Digging Into The Arizona Medicaid RFP Pay Attention When An Old Dog Is Barking - Digging into the TN Medicaid RFPs If You Can't Say Something Nice, Come Sit Next To Me: The SC Medicaid Expansion Come One, Come All - Digging Into The DC Medicaid RFP One More Trip To The Well - Ohio Awards Medicaid ABD Contracts We've Seen This Movie Before, And It Seems To End OK: Ohio ABD Opportunity Never Wrestle With A Pig, Since You'll Both Get Dirty, But The Pig Will Like It - TN RFP*

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➤ [carl.mcdonald@opco.com](mailto:carl.mcdonald@opco.com)

AET: Our 12-month price target is \$47.  
AGP: Our 12-month price target is \$33.  
CI: Our 12-month price target is \$38.  
CNC: Our 12-month price target is \$16.  
CVH: Our 12-month price target is \$20.  
EHTH: Our 12-18 month price target is \$16.  
GTS: Our 12 month price target is \$20.  
HNT: Our 12-month price target is \$22.  
HS: Our 12-month price target is \$20.  
HUM: Our 12-month price target is \$73.  
MGLN: Our 12-month price target is \$46.  
MOH: Our 12-month price target is \$30.  
UAM: Our 12-month price target is \$16.  
UNH: Our 12-month price target is \$32.  
WCG: Our 12-month price target is \$23.  
WLP: Our 12-month price target is \$61.

## Valuation

AET: Our price target of \$47 represents a target multiple of 12.1x our 2009 EPS projection. Our target multiple is a 4% premium to the group, reflecting the \$0.40 per share in non-cash pension charges in our EPS projections.

AGP: Our price target of \$33 represents a target multiple of 12.5x our 2009 EPS projection of \$2.65. Our target multiple for AMERIGROUP is roughly in line with the multiples applied to other Medicaid plans in the industry.

CI: Our price target of \$38 represents a target multiple of 9.4x our 2009 EPS projection. Our target multiple for CIGNA is a slight discount to the target multiples we have assumed for other companies in the group, which are based on the group's historical relationship to the market.

CNC: Our price target of \$16 reflects a target multiple of 8.6x our 2009 earnings projection of \$1.85. This is a discount to the price target multiples we have applied to the other Medicaid managed care plans in the group, mainly because of Centene's historical inability to deliver consistent results for more than a quarter or two, and the risk associated with the company's Texas Rural CHIP contract, which is currently out to bid.

CVH: Our \$20 price target implies a target multiple of 10.8x our 2009E EPS. This is in line with the target multiples we have assumed for other companies in the group. Coventry is experiencing cost trend issues in a number of its businesses, and we don't expect the situation to improve dramatically in 2009. We think there are other stocks in the group with more upside potential, since Coventry's industry-leading margins make it harder for the company to match the industry's average earnings growth rate.

EHTH: Our price target of \$16 per share represents a target P/E multiple of 26.5x our 2009 EPS projection of \$0.60. Our target multiple is a discount to the multiple at which a comparable group of Internet companies trade, adjusted for the fact that eHealth pays no cash taxes. Our price target represents a 9% discount to the Internet group average on an EV/EBITDA basis, based on our 2009 EBITDA estimate of \$28 million (excluding stock compensation expense). We think this modest discount is warranted given the company's lack of a truly recurring revenue stream.

GTS: Our price target of \$20 represents a target multiple of 10.5x our 2009 EPS projection, in line with the Medicare group. Our target multiple factors in our belief in the likelihood that Triple-S is ultimately acquired, offset by the risk associated by operating virtually all of the business in one market, Puerto Rico.

HS: Our price target of \$20 represents a target multiple of 9.5x our 2009 EPS. We think HealthSpring's stock is undervalued, but there are other Medicare names with greater upside relative to our price targets over the next 12 months. Our target multiple for HealthSpring is slightly below the 10.6x target multiple we've assumed for other companies in the Medicare group.

HNT: Our \$22 price target represents a target multiple of 11.0x our 2009 EPS projection of \$2.00. This is a higher multiple than we've assigned to other plans in the group, reflecting our belief that Health Net will realize cash proceeds of at least \$500 million through the divestiture of its Northeast and Arizona operations. Adjusting for this significant cash balance, along with the \$150 million in cash Health Net held at the parent company at the end of 2008, our price target multiple relative to the company's continuing business is at a meaningful discount to the peer group. Health Net has struggled to meet expectations recently, and our 2009 EPS projection of \$2.00 is well below the company's guidance range of \$2.25-2.40 per share.

HUM: Our price target of \$73 represents a target multiple of 12.0x. Our target multiple for HUM is a 10% premium to the Medicare average, reflecting our view that the company can grow earnings significantly faster than the industry over the next 3 years.

MGLN: Our price target of \$46 per share represents an EV/EBITDA multiple of 6.5x our 2009 EBITDA projection, which is roughly in line with the managed care average, assuming cash grows to about \$650 million by the end of next year.

MOH: Our price target of \$30 represents a target multiple of 13x our 2009 EPS projection. This is a significant premium relative to the P/E target multiples of other Medicaid plans, as Molina tends to incur much higher D&A-related expenses, given its more conservative accounting on acquisitions. On an EV/EBITDA basis, our price target multiple is much more in line with the other Medicaid plans.

UAM: Our price target of \$16 represents a target multiple of 10.7x our 2009 EPS projection. Our target multiple for Universal American is in line with the multiples we have assumed for other companies in the group.

UNH: Our target price of \$32 represents a 10.7x multiple. This is approximately 3% higher than the target multiples we have assumed for other companies in the group.

WCG: Our price target of \$23 is derived from a P/E multiple valuation methodology. WCG is currently trading at 5.2x our 2009 EPS projection of \$2.25, reflecting the uncertainty of the company's legal overhang after an FBI raid in October 2007. Our price target represents a multiple of 10.2x our 2009 EPS projection. Our target multiple for WCG: WellCare is a modest discount to the target multiples we have assumed for other companies in the group, given the uncertain news flow that will impact the company's share price as the investigation progresses.

WLP: Our price target of \$61 represents a target multiple of 10.8x our 2009 EPS estimate, in line with the target multiples for other companies in the group.

## Risk Factors

**AET:** Aetna could announce a significant acquisition, or close on a merger and then experience integration difficulties; it could price more aggressively in an effort to grow fully insured medical enrollment; money flows out of the managed care sector; an unexpected increase in utilization that leads to higher medical cost trends; budget deficit issue that result in Medicare funding cuts; Medicare growth assumptions that are too aggressive; the uncertain impact of potential association health plan legislation; seasonal trading patterns in managed care; and an uncertain Medicare reimbursement outlook.

**AGP:** Risks to our price target include the pending litigation in Illinois; AMERIGROUP's dependence on the Medicaid market; budget deficits at the state level that may result in cuts to the Medicaid program; an unexpected increase in medical cost trends; an uptick in utilization; the uncertain impact of federal Medicaid reform; money flows out of the managed care sector remain a concern; continued unfavorable prior-period development; the potential loss of the company's SCHIP contract in D.C.; increasing interest in the Medicaid business from the larger plans in the industry; and seasonal trading patterns in the managed care industry.

**CI:** Risks to our price target include an inability to accurately predict medical cost trends and price its products appropriately; unfavorable prior-period development; an industry-wide increase in utilization; money flows out of the managed care sector; budget deficit issues that lead to lower Medicare funding; rising Medicare cost projections; slower than expected uptake of new Medicare programs by beneficiaries; the potential impact of association health plan legislation; and seasonal trading patterns in the managed care industry.

**CNC:** The biggest risk factor in Centene's stock is the volatility of the company's quarterly results, as it has been unable to consistently meet earnings projections. We are specifically concerned with Centene's ability to show improvement in its Ohio Medicaid MLR, while the new Texas Foster Care contract is a risk. We are also monitoring Centene's ongoing system upgrade.

**CVH:** Risks to our price target include an unexpected increase in medical costs; merger integration risks; loss of business in First Health's corporate and FEHBP business; the expiration of favorable hospital contracts reached during the acquisition of a provider-sponsored HMO; underpricing by not-for-profit Blue Cross competitors; budget deficit issues and the impact on long-term Medicare funding; the potential for underpricing in the private fee-for-service book; and the impact of potential federal Medicaid reform.

**EHTH:** The online health insurance distribution system has been growing rapidly, and eHealth could benefit more significantly from this new model than our current expectations anticipate. It's also possible that the company might be acquired by another Internet-focused company seeking to leverage eHealth's expansion into the health insurance industry. We may be too valuation sensitive on the name, since Internet-focused companies have traditionally traded at a significant premium to more mature industries, like health insurance.

**GTS:** Risks to our price target includes the significant amount of earnings generated from the company's Medicare Advantage business, and the execution risk associated with the company's efforts to improve its largely unprofitable commercial business.

**HNT:** Risks to our price target include an inability to accurately predict medical cost trends and price its products appropriately; the inherent risks of a managed care turnaround, including a continued increase in cost trends; higher than expected provider settlements; a substantial percentage of Health Net's revenue and earnings are dependent on government payers, and change in legislation could negatively impact earnings; an industrywide increase in utilization; money flows out of the managed care sector; the potential impact of association health plan legislation; and seasonal trading patterns in the managed care industry.

**HS:** Risks to our price target include lower than expected Medicare enrollment, the weak performance of HealthSpring's commercial business; increased competition in Tennessee, the company's largest market; increased utilization that leads to higher than expected cost trends; money flows remain a concern; the managed care industry's heavy reliance on government funding; revisions to the cost of Medicare reform; slower than expected participation in new Medicare programs; the uncertain impact of proposed federal Medicaid legislation; the potential impact of association health plans; seasonal trading patterns in the managed care industry; and uncertainty over the long-term Medicare reimbursement outlook.

**HUM:** Risks to our price target include the potential for cuts to Medicare reimbursement rates; the poor past performance of Humana's commercial business; the uncertain profitability of the Medicare PPO opportunity; increased utilization that leads to higher than expected cost trends; money flows remain a concern; the managed care industry's heavy reliance on government funding; revisions to the cost of Medicare reform; the uncertain impact of proposed federal Medicaid legislation; the potential impact of association health plans; seasonal trading patterns in the managed care industry; the impact of stock options expensing on valuation; and uncertainty over the long-term Medicare reimbursement outlook.

**MGLN:** There are two key risks to Magellan's price target, in our view. The first is losses of large contracts in the company's core behavioral health business. Magellan has lost a number of contracts recently, as health plans take a more integrated approach to the entire spectrum of health benefits, while acquisitions have also hurt, since larger plans with in-house behavioral plans have been acquiring Magellan customers. Neither of these trends will abate over the next year, but we do expect potential contract losses to be smaller than what Magellan has recently experienced. The second key risk to the price target would be if managed care companies began bringing radiology management contracts in-house.

**MOH:** Risks to our price target include Molina's dependence on the Medicaid market and government payors; potential Medicaid reimbursement cuts in key markets; expansion into new markets; new product offerings that may increase earnings volatility; budget deficits at the state level that may result in cuts to the Medicaid program; an unexpected increase in medical cost trends; an uptick in utilization; the impact of federal Medicaid reform is uncertain; money flows out of the managed care sector remain a concern; and seasonal trading patterns in the managed care industry.

**UAM:** Risks to our price target include the effect of a slower long-term earnings growth rate, money flows out of the managed care sector, an unanticipated increase in medical costs, budget deficit issues that result in Medicare funding cuts, the impact of proposed federal Medicaid reform, the potential for legislation enabling association health plans, seasonal trading patterns of the managed care stocks, and the long-term Medicare reimbursement outlook.

**UNH:** Risks to our price target include the effect of a slower long-term earnings growth rate; money flows out of the managed care sector; an unanticipated increase in medical costs; budget deficit issues that result in Medicare funding cuts; the impact of proposed federal Medicaid reform; the potential for legislation enabling association health plans; seasonal trading patterns of the managed care stocks; and the long-term Medicare reimbursement outlook.

**WCG:** The major risk to our price target is the emergence of documents or evidence that WellCare engaged in systematic, widespread fraud in its business. If this occurs, it increases the likelihood that WellCare is stripped of one or more of its government contracts, and raises the possibility that the company will be put out of business. Other risks to our price target include WellCare's relatively high level of profitability in the Florida Medicaid business, high concentration of membership in Florida; an unexpected increase in medical cost trends; budget deficit issues that result in Medicaid funding cuts; actions by Congress to reduce Medicare reimbursement, particularly in the Medicare private fee for service program. We expect WellCare to lose Medicare membership next year, but the legal situation could make our forecast aggressive. Money flows out of the managed care sector remain a concern, particularly in an election year.

**WLP:** Risks to our price target include systems integration and other merger-related integration difficulties; money flows out of the managed care sector; an unanticipated increase in medical costs; budget deficit issues that result in Medicare funding cuts; the impact of national and state Medicaid reform on WellPoint's Medicaid business.

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