

Healthcare Reforms Winners and Its Impact

InfoSTEP Inc.

Introduction

The debate has been raging since President Obama inked the new law on March 23rd... is the new law good, *or bad*, for healthcare stocks, and *which* industries stand to win or lose?

So far, most pharmaceutical companies and hospitals have been deemed to be net beneficiaries, while insurers will probably be facing more liabilities despite a massive inflow of new customers. Too bad the discussion completely leaves out the only companies that are more certain to benefit from the reform overhaul.

Wondering what that group is? Here's a clue... when a legislative act is 2000 pages long, it's going to create a mountain of red tape, procedures, and paperwork for the companies subject to the bill's requirements. *Now*, somebody's *absolutely* got to help the insurance companies and healthcare providers do something they *don't* do well enough already.... which is manage the billing, collection, reimbursement, waste, and loss aspects of the new era in healthcare.

In other words, **healthcare information services companies will see more net benefit from President Obama's reform than any other healthcare industry.** Since nobody else is talking about them, we will.

First Things First

A quick run-down of the major pressures, by industry, is in order.

Insurers: More customers may mean more revenue, but not necessarily more *profit*.

When an additional 32 million paying customer are enrolled in the soon-to-be-required coverage, insurance companies will see a better top line. But, with the government dictating how, where, and whom insurance companies will cover, the allowed premiums may not be enough to cover reimbursement expenses any longer.

One stark example is Humana (NYSE:HUM), which has built a big business around its Medicare Advantage plans. With a proposed \$200 billion cut in government payments to Medicare Advantage plan providers, Humana may find itself trapped between a fiscal rock and a hard place.

Bottom line? It's all about expense management from this point forward.

Hospitals: We think Tenet Healthcare (NYSE:THC) is a prime example of the scope of relief that healthcare reform will bring to hospitals. Between the 50 or so hospitals it runs, it eats \$1 million every day due to uninsured and non-paying patients. For comparison, that's 4% of last year's revenue, and about 200% of last year's earnings. This is really huge.

That being said, though the reform will increase the number of insured Americans by about 15%, there's a good chance this last 15% of people may create proportionally more than 15% of those seeking treatment. Hospital administrative staffing levels may become inadequate by 2014, adding to hospitals' costs.

Healthcare Reforms Winners

Pharmaceuticals: More insured people means more potential customers, which bodes well for all drug companies. Plus, the new legislation didn't really do anything to foster international competition, or even push for the lowered costs offered by more generic drugs. That's good news for big Pharma companies.

On the flipside, the bill will also incur about \$80 billion in fees over the next ten years - *to be paid by drug makers* - by forcing more discounts (via Medicare D) and larger Medicaid rebates. Overall, the upside and downside nets out to a wash.

There was one group with the pharmaceutical arena that did get some *big-time* help though... biotechs that make so-called 'biologics', or cell-based therapies. Now, these companies are guaranteed 12 years of marketing exclusivity for any drugs they make.

Putting Two and Two Together

Though probably not so much with the pharmaceutical industry, the healthcare reform's requirements are apt to be a logistical nightmare for hospitals and insurance companies... a healthcare system that *already* loses about \$700 billion each year due to fraud, waste, and abuse.

How does that happen? It is because of sheer size and excessive complexity. The loopholes and potential abuse packed into a 2000 page bill will only make this number bigger.

More than that though, the new laws were specifically built to pass as much cost along to the plans and providers (i.e. shrink margins) as possible... the last thing either industry needed right now.

The solution to the problem pretty much became a *requirement*, when the reform bill became law. In order to preserve profits, these companies are going to have to bring in the professionals to make their whole operation more streamlined and less wasteful. While most of those companies are focusing on the hospital and billing side of the table, slowly but surely the push for more efficient insurance is putting some attention on the insurers themselves, and managing their risks.

At the top of the list of the healthcare IT industry's companies is Emdeon (NYSE:EM). Though known mostly as a billing and payment cycle management organization, Emdeon actually has its hand in every step of the patient-care process. Better still, the company is profitable, and is the beneficiary of a recurring revenue model. Top and bottom line growth will be primarily be fueled the acquisition of new clients.... which President Obama just made easier on Tuesday.

Mediware Information Systems (NASDAQ:MEDW) is *another* solid player in the healthcare-management-and-efficiency game. It's beat earnings estimates in its last two quarters, is profitable, and lacks any analyst coverage.... *yet*.

Quality Systems Inc. (NASDAQ:QSII) and Cerner Corp. (NASDAQ:CERN) are *also* both quality names in the healthcare IT space. Either is a little pricey by most standards, with P/E ratios approaching 40. But, the quality of earnings - *and the projected growth* - may command something of a premium.

Healthcare Reforms Winners

The bulk of the companies in the healthcare-efficiency space stand to benefit from the new law though. Indeed, *the complexity of the healthcare overhaul and the need to preserve profits almost makes the services these companies offer an outright necessity.*

Just something to think about while everyone else is talking in circles.

About InfoSTEP

Based out of Santa Clara, California, InfoSTEP is focused on providing end to end Business Intelligence solutions to its clients. The company was established in 1998 and has been working with a variety of clients including Adobe Systems, BMC, Cisco, Stanford Medical, Wells Fargo and others. InfoSTEP's Center of Excellence (COE) for BI does proactive and reactive research in several BI verticals, tools and technologies to provide best of breed frameworks and implementation methodologies to its clients. For more details about the company, please visit www.infostep.com.