COLORADO CENTER on LAW & POLICY
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Forging Pathways from Poverty

October 26, 2016

Statement from Elisabeth Arenales, Director of the Colorado Center on Law and Policy's Health Program

Good evening. These comments are submitted by the Colorado Center on Law and Policy. CCLP is a non-partisan non-profit, advocacy organization. Our mission is to ensure that every Coloradan has the tools and supports they need in order to achieve and maintain economic security.

CCLP has a long-standing history of participation on behalf of the public interest in Colorado healthcare conversions. Our interest in this transaction is focused on ensuring that the converting company, Rocky Mountain HMO, is fairly valued and that the foundation receiving the proceeds of the conversion receives the full value of the converting nonprofit.

We appreciate the opportunity to provide testimony at this public hearing and intend to submit more extensive written comments and an expert report on valuation by the close of the public comment period, next week.

Our principle concern with the proposed Plan of Conversion is that the current proposed valuation will result in United's acquiring Rocky at a substantial discount. Because Rocky assets are community assets, realized as a result of the operation of a non-profit, they belong to the community and it is in Colorado's interest to value them fairly.

As I begin, we want to acknowledge the significant contribution Rocky Mountain HMO has made to the State of Colorado. Over its more than forty years in business, Rocky has earned a well-deserved local, statewide and national reputation for good value, high quality service and community engagement. Rocky Mountain HMO is a very desirable addition to United Healthcare Services for precisely this reason; because it is a well-regarded local insurer with a national reputation and a long history in its core market; because it is a business with a major presence on the Western Slope and because it is a highly regarded, highly rated long-standing participant in the Colorado Medicaid and Medicare markets.

While we will go into detail in our written filing, we want to flag our most significant concerns with the proposed valuation here:

In brief: With respect to fair market value, (or net consideration), it is our opinion that the PYA valuation over-weights Rocky's recent financial challenges, while failing to reflect fully its long standing connection to the community, reputation for service and strong role and growth potential in the Colorado Medicaid market. Rocky is not a troubled company, rather, it is a company that needs a cash infusion. Once it gets that infusion, the company is well positioned to continue to do well and the valuation should recognize this fact.

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First, with respect to the valuation:

PYA relied on three methods: (1) Income Approach – Discounted Cash Flow Method, (2) Market Approach – Merger & Acquisition Transaction Data Method, and (3) Market Approach – Guideline Public Company Method. These methods were weighted 70%, 20%, and 10%, respectively, in the final report.

The PYA valuation is weighted disproportionately -70%- to the Income Approach, and Rocky Mountain HMO has redacted the assumptions underlying their discounted cash flow projection. This makes it impossible to evaluate their underlying product level membership and premium growth projections, product-level medical expense assumptions, and non-medical expense assumptions. We assume the expert review of valuation methodology conducted by the Attorney General will evaluate these assumptions.

However, even without the underlying information, it seems that a "market approach", or market multiple, methodology to valuation is most valid in this case. The purchaser, United Healthcare, is a major for-profit managed care firm – trading its shares on the public equity markets and its value is determined by the market.

On a comparable basis, Rocky would be valued at closer to $100 million because United shares are trading at approximately 15.5 times estimated 2017 net income. In contrast, the PYA valuation estimates Rocky Mountain's valuation at 11.6 times the PYA valuation of estimated 2017 net income. At 11.6 times estimated earnings for Rocky compared to 15.5 times estimated earnings for United, the proposed transaction values Rocky at a substantial discount.

Since the addition of Rocky will add incrementally to United's value, the valuation of Rocky Mountain HMO can justifiably be considered in the context of the value it will add to this publicly traded entity. Moreover, using the data and calculations that PYA included in Exhibits E-1 and F-1, it is our opinion that that using the median or mean values for these market approaches is a more valid approach and arrives at a significantly higher valuation for Rocky Mountain, more in line with the market valuation of United.

In contrast, PYA consistently used the first (or lowest) quartile values for components of its valuation and then provided a discount on top of that. And by using the lowest value each time there was a choice of which quartile to use, PYA compounded the discount of Rocky's price. While making an adjustment to value which accounts for Rocky's financial position may be fair, doing so over and over again reduces the fairness of the overall assessment of market value.

Finally, the projected $21.4 million adjustment for the RBC deficit –to 300% RBC – puts Rocky Mountain on firm financial footing and meets the DOI requirements. And, since it is an adjustment to the net consideration, the adjustment for RBC can be seen as largely adjusting the valuation for Rocky Mountain's current challenges. Once that adjustment is made, it is redundant to continue to make downward adjustments for value.

Second, with respect to long-term debt obligations:

The valuation subtracts long term debt obligations in the total amount of $17.8 million from total value. However, Rocky apparently has no interest bearing debt. Therefore, this adjustment seems unnecessary, and reduces the consideration paid to the Foundation by nearly $18 million.

Third: Rocky stands to realize all or some portion of a $40 million risk corridor payment owed the company by the federal government. CCLP acknowledges that the risk corridor payment is speculative and therefore cannot be counted as an asset for purposes of the transaction, however it should not be treated as a windfall to United to dispose of in its sole and absolute discretion as is contemplated in the Plan of Conversion. The $40 million should instead, be treated the same way the Plan of Conversion treats Medicare audit receivables which will be assigned by Rocky to the Foundation immediately after the closing date.

Finally, and significantly, the valuation does not appear to account for Rocky Mountain HMO's exceptionally strong position in the Colorado Medicaid market. Colorado's Medicaid program has been moving towards payment and delivery system reform since 2011. The state is currently divided into seven Regional Accountable Care Collaborative Regions or RCCOs. Each region is assigned to an entity which is paid on a per member per month basis to manage (but not pay for) physical care for Medicaid enrollees. Rocky was awarded the contract to manage RCCO Region 1, which extends up and down the Western Slope and all the way to Summit, La Plata and Larimer Counties. These RCCO contracts will be rebid in 2017, and the new entities will be responsible not only for managing physical healthcare but for paying, on a capitated basis, for behavioral healthcare.

In addition, Rocky was awarded the first payment reform pilot program contract under HB12-1281, which authorized the Colorado Department of Health Care Policy and Financing to try new approaches to Medicaid payment methodologies with a view towards moving away from Fee for Service payment. Rocky's performance in the first two years of this fully capitated payment reform pilot program has been very promising which puts Rocky in a strong position as HCPF moves forward with more risk bearing payment methods in the Medicaid program.

National managed care organizations have long been interested in the Colorado Medicaid program and United has been moving into the Medicaid market nationwide, currently just behind Anthem/Wellpoint with 10% market share. As United said in its 2011 Annual report, " The Medicaid market is expected to grow more than 28% by 2020" and "we are well-positioned to increase our penetration in some existing markets and expand thoughtfully into new geographies and product offerings where managed care needs are great and penetration is low."

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With the purchase of Rocky Mountain HMO, United will be very well positioned to take advantage of Colorado's changing Medicaid market and that should be accounted for in the valuation.

Thank you for your attention.