The Next Phase of Price's War on the ACA? Bundles Delayed

This afternoon CMS published an Interim Final Rule in the Federal Register that further delays the effective and implementation dates of three key expansions of the bundled payments pilots: Cardiac Rehab, Acute Miocardial Infarctions & Hip and Femur Fractures from 3/21/17 (tomorrow) to 5/20/17 and from 7/1/17 to 10/1/17. CMS requests comments on a further delay to 1/1/18. The Rule talks about further changes to underlying regulation as being possible and notes that to implement the original rule for only a short time and then change it would be disruptive for those hospitals (and post-acute providers) subject to the rule for post-acute bundling.

It looks to us as if Sec'y Price, who was quite anti-bundling when in Congress, is starting to make good on his comments that further ACA changes, beyond the repeal/place bill, would be done through the regulatory process: the war on value-based payments seems to have begun. This could be negative for home health, as it delays, perhaps indefinitely, the move of hip/femur fracture patients out of SNFs and into home health - so it seems correspondingly positive for SNFs in the short term, at least in our view. Heart attack (AMI) patients and those who have had open heart procedures have been shown to benefit materially from cardiac rehab, an under-utilized service. Cardiac rehab is outpatient, as a rule, or would likely move there under the bundled payment arrangement. So a delay in the financial incentives and bundling for these conditions probably helps the Inpatient Rehab Hospitals (like HLS's) at the margin (because they do get cardiac rehab cases), but more likely means fewer patients will get it as a result of the delay. How this is good for patients/Medicare beneficiaries is hard for us to understand. We are further concerned that the potential changes to the underlying bundled payments model, alluded to in the Rule, could make this delay a more permanent one, not so good for home health, IRFs and even outpatient rehab providers' traditional Medicare business.

But the private sector moves on....UNH now spends more than $5B/yr out of $53B in total value-based arrangements annually (per UNH) on specific-condition value-based contracts, including bundles, and we expect that effective model to continue to grow. The Surgical Care Affiliates acquisition by OptumCare could accelerate UNH's move into even more value-based arrangements that lead to better outcomes at materially lower costs. One concern we have about home health is that Medicare Advantage rates for home health are materially below that of traditional Medicare - so while there may be more cases available, the margins would be under significant pressure in a privatized bundled market. As more Medicare beneficiaries move into Medicare Advantage, the impact on practice patterns, away from high cost settings to home/outpatient, likely continues to accelerate. We like UNH, and are cautious on AMED, HLS and KND as the war on the ACA continues.

Company	Symbol	Price (3/17)	Rating	PT
Amedisys, Inc.	AMED	$50.25	Neutral	$50.00
HealthSouth Corporation	HLS	$42.45	Neutral	$44.50
Kindred Healthcare, Inc.	KND	$8.25	Neutral	$8.50
UnitedHealth Group Incorporated	UNH	$169.70	Buy	$178.00

Source: Bloomberg and Mizuho Securities USA

Sheryl R. Skolnick, Ph.D.
Director of Research
+1 212 205 7853
Sheryl.Skolnick@us.mizuho-sc.com

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Price Target Calculation and Key Risks

Amedisys, Inc.

Our $50 one-year PT is based on a PEG of 1.1x on 23% projected EPS growth from ’16E to ‘17E and an 12.2x EV/EBITDA multiple on 2017E.

Risks to our target include: repeal/replacement of the ACA and bundling, execution, reimbursement, investigation (an active hospice investigation is ongoing in New England and West Virginia and AMED currently operates under a corporate integrity agreement) and legislative risk, among others.

HealthSouth Corporation

Our 12-month price target of $44.50 is 9x our 2017E EBITDA of $811mm (vs. $828mm), at the below the low end of post-acute facility trading ranges of 9-11x due to the risks around Medicare reimbursement and repeal/replacement of the ACA.

Risks to valuation include, but are not limited to, repeal/replacement of the ACA, cuts in reimbursement from private payors and the government, competition, government investigations and litigation, increasing costs (including but not limited to labor costs), increased government regulation and investigations, and potential bundling of payments.

Kindred Healthcare, Inc.

Our one-year PT of $8.50 for KND shares is based on 7.6x EV/Core EBITDAR pro forma for the SNF sale. Our EV now includes an estimate of the value of non-controlling interests to reflect significant non-KND interests in the business and also uses a revised 8x rent instead of 6x rent to value the capitalized leases. We assume $200mm in asset sale proceeds, a $30mm reduction in capex treated as an increase in cash and $40mm in cash from the termination of the dividend. We estimate a $40mm reduction in NCI as a result of the transaction. We use our estimate of Core EBITDAR for the SNF business and $45mm in cost savings beyond the facility level to calculate core EBITDAR on a pro forma basis. Given our post-acute sector concerns, we see these multiples as reasonably valuing KND, especially given risks to LTACH criteria, bundling and potentially Medicare reimbursement.

Risks to our PT and rating include but are not limited to: repeal/replace the ACA, execution risk, reimbursement risk, changes in upstream (hospital volume) and referral patterns in response to changing reimbursement methods (especially for KND's LTACHs) and incentives, changes in regulations and the potential for M&A (both as a buyer and as a target).Should KND be unable to sell the SNFs, or receive proceeds outside the guidance range of $100mm to $200mm our valuation work would likely require revisions to our PT.

UnitedHealth Group Incorporated

Price Target Methodology: Our $178 one-year PT is based on a 50/50 blend of our DCF model using a 2.5% long-term growth rate, of $178 and a target P/E of 18.5x our 2017E Adjusted EPS of $9.50. Blending the two equally yields our $178 1-year price target for UNH shares. We intend to review our PT after 1Q results are reported (scheduled for 4/18).

Key Risks: Among the key risks to our rating and price target are repeal/replace the ACA, execution risk; reimbursement and regulatory risks; competitive risks and market risk. Further, UNH is modestly exposed to exchange rate risk, with less than 5% of its revenue derived from its global businesses, principally in Brazil. Execution risk includes, but is not limited to, risks in both the benefits and services businesses. In

the benefits business, estimation of cost trends and other actuarial calculations are critical activities as they influence pricing and reserves for the Company's insurance products. Any misstep there could result in a material and negative effect on the stock price. In addition, the Optum services business is highly innovative and technology driven. Missteps there could lead to the potential for material disappointments in results and multiple compression. Reimbursement and regulatory risk could not only affect pricing, but also members served. The timing and extent of such changes are usually out of the Company's control and therefore could represent exogenous events with negative earnings and stock price implications. Political/health policy risks could be significant and future national health policy remains highly uncertain.

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Investment Risks and Valuation Methods can be located in the following section of this research report - Price Target Calculation and Key Risks.

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Neutral: Stocks for which the anticipated share price appreciation is within 10% of the share price.
Underperform: Stocks for which the anticipated share price falls by 10% or more.
RS: Rating Suspended - rating and price objective temporarily suspended.
NR: No Rating - not covered, and therefore not assigned a rating.

Rating Distribution

(As of 3/17)	% of coverage	IB service past 12 mo
Buy (Buy)	41.97%	42.97%
Hold (Neutral)	54.43%	37.35%
Sell (Underperform)	3.61%	45.45%

For disclosure purposes only (NYSE and FINRA ratings distribution requirements), our Buy, Neutral and Underperform ratings are displayed as Buy, Hold and Sell, respectively.

Rating and Price Target History for: Amedisys, Inc. (AMED) as of 03-17-2017
06/30/15 I:B:$45
11/11/15 N:$45
01/18/16 B:$49
04/11/16 B:$57
08/03/16 N:$55
10/07/16 N:UR
11/03/16 N:$47
11/07/16 B:$47
11/09/16 N:$33
02/28/17 N:$50
60
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30
15
0
Q1
Q2
Q3
2015
Q1
Q2
Q3
2016
Q1
Q2
Q3
2017
Created by BlueMatrix

Rating and Price Target History for: HealthSouth Corporation (HLS) as of 03-17-2017
07/28/14 B:$45
01/20/15 B:$47
02/24/15 B:$50
10/29/15 B:$40
04/28/16 B:$47
11/09/16 N:$38
02/22/17 N:$44.5
50
45
40
35
30
25
Q1
Q2
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2015
Q1
Q2
Q3
2016
Q1
Q2
Q3
2017
Created by BlueMatrix

Rating and Price Target History for: Kindred Healthcare, Inc. (KND) as of 03-17-2017
09/30/15 I:N:$16.75
11/11/15 N:$12.75
01/13/16 N:$9
05/05/16 N:$13.5
07/05/16 N:$11
11/07/16 N:$7
11/09/16 N:$5
02/28/17 N:$8.5
32
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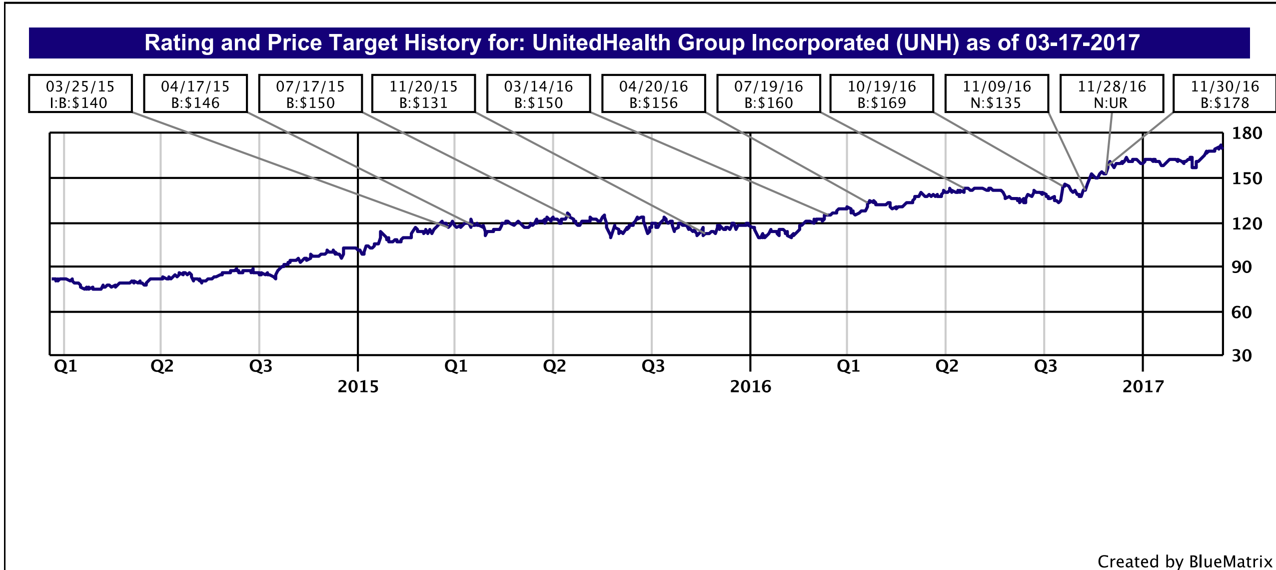
Created by BlueMatrix



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