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M&A: SHAPING THE FUTURE

Health insurers

Balanced market has twists and turns, nonetheless

by Charles Carroll

Most experts in insurance mergers and acquisitions (M&A) would characterize the recent market as one where an oversupply of buyers has led to extraordinarily high prices for target companies relative to intrinsic value. But a fairly active segment within the broader market exhibits totally different dynamics. This segment is characterized by primarily strategically driven (as opposed to financially driven) transactions, rational pricing, and a relatively balanced supply of buyers and sellers. Deal flow may not be as extensive as in other segments, but a steady stream of transactions occurs.

This segment is the group health / managed care business. While it is difficult to accurately track the activity in this M&A sector, a partial list of well-known deals of recent years shows a high level of activity (see chart below). The chart does not even include the significant number of Blue Cross Blue Shield mergers.

What is driving activity in this sector? Probably the easiest thing to understand is why companies want to sell and get out of the business — particularly traditional insurers, such as MassMutual and John Hancock. For most of these sellers, the motivations are obvious. They are concluding that managed care or the group health business is not a good place to deploy their capital. For many of these companies, this business has been characterized by a pronounced cyclical pattern in which substantial losses are followed by periods of respectable, but unimpressive, gains. This pattern was temporarily broken in the early '90s, when there was a decided slowing of medical care inflation, attributed by some to the dynamics of the national debate surrounding the health care proposals by U.S. President Bill Clinton's administration. The result was a more extended period of positive underwriting results than was typical of the normal cycle.

That era has come to an abrupt halt as medical inflation has accelerated and competition has run rampant. The introduction of risk-based capital and the rating agencies' generally negative attitudes toward the health insurance business have undoubtedly contributed to the move to divest. Companies in which group health or managed care is not the predominant business are rapidly concluding that it simply does not make economic sense to continue operating in this rapidly changing and dynamic market. (Correspondingly, companies such as Aetna and CIGNA, for whom managed care is the dominant business, are shedding their individual life and annuity businesses. So much for synergy.) Although many of these deals are quite fully priced, achieving maximum value in dollar terms is not the primary objective for most sellers. Instead, the seller is seeking a graceful exit from the business — that is, the company's reputation is protected, clients are not disadvantaged, and employee disruption is minimized.

Another critical element in the decision-making process for many sellers is a realistic assessment of their chances for success. Ten years ago, many analysts predicted that size would be a critical factor for health insurers' success; only a handful of giants would survive, possibly including CIGNA, Aetna, Prudential, and Metropolitan. However, the last 10 years have shown that geographic concentration is a much more significant determinant of success than pure size. In a managed care setting, controlling costs by effectively negotiating with providers and managing the behavior of covered individuals through incentives became the

Recent Health Industry Mergers

Target	Acquirer
Provident Life & Accident's group health business	HealthSource
Metra / Health	United Healthcare
MassMutual's group health business	Wellpoint
John Hancock's group health business	Wellpoint
Emphasys	Humana
BCBS of Georgia	Wellpoint
NYLCare Health Plans, Inc.	Aetna
Anthem Health and Life Ins. Co.	Great West Life
Prudential's group health business	Aetna
Anthem Health and Life Ins. Co.	Great West Life