



Health Care Strategies

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Presentation Summary



Part I: Key Health Care Trends

Part II: Strategies for Investing in Managed Care Companies

Part III: The Pharmaceutical Landscape

Part IV: Strategies for Investing in Pharmaceuticals



Part I: Key Health Care Trends



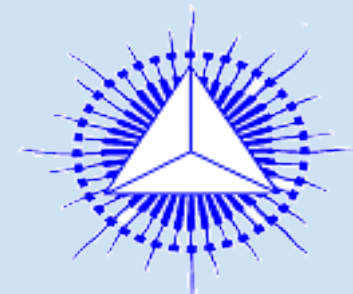
Key Health Care Trends

- Aging population drives demand for pharmaceuticals and services
- Recession impacts health insurance enrollment
- Generics impact revenue growth for pharmaceuticals
- New therapies offer upside for investors

Health Care Insurance Reform



- Health Care bill to expand access to health care through reform of health care insurance practices and expansion of Medicaid coverage
- Mandatory health insurance will drive consumers to make compromises to achieve minimum level of care
- Subsidies necessary to help ease the burden on middle class families
- Benefit to providers unclear



Health Care Reform Bills

Taking shape around Senate Finance bill:

	Senate Health Care Senator Harry Reid D	Senate Finance Sen Max Baucus, D	House Rep Nancy Pelosi D
Reform health insurance industry practices	yes	yes	yes
Expand Medicaid to 133% of poverty line	yes	yes - 2014	yes - 2013
Require employers to provide family coverage	yes	yes	yes
Employer penalty	penalty \$750 per year per worker	must refund government subsidy	penalty 8% of payroll
Employer exemption	fewer than 25 employees	fewer than 50 employees	payroll <\$250,000
Support for individuals up to 400% of poverty line	yes	yes	yes - 2013
Penalties for individuals without coverage	hardship exemption	hardship exemption 8.0% of income	non-compliance penalty 2.5% of income
Tax premiums for high cost health care insurance	no	yes insurance co tax 40% of premiums	yes
State run health insurance exchanges	yes	yes	yes
Government option	yes	no	yes
Empower CMS	Cuts on Medicare and Medicaid	Cuts on Medicare and Medicaid	CMS to negotiate with providers
Timing of floor vote	none	October	November
Projected cost	\$615 billion	\$900 billion	\$1.5 trillion

Medicaid is THE Growth Market



- US total Medicaid spending \$320 billion FY 2007
up 19% from FY 2006
source: StateHealthFacts.org, funded by Kaiser Family Foundation
- CMS forecasts US Medicaid spending \$339 billion FY 2008
up 7% from FY 2007
source: CMS Medicaid report 10/17/2008

Medicaid Spending by Segment



	Enrollment % of total	Spending % of total
children	50 %	19%
adults	25 %	12%
elderly	10 %	24%
disabled	15 %	41%
unknown	0%	4%
	<u>100%</u>	<u>100%</u>

- Most current Medicaid adult spending allocated to pregnant women
- No current Medicaid coverage for single adults

Medicaid Expansion By Income



- Proposal to expand adult Medicaid eligibles to 133% of federal poverty guidelines
- Provides for a family of 4 earning annual income of \$29,327 or single adult earning \$14,400

2009 Poverty Guidelines (48 contiguous states)

Persons in family	Poverty guideline
1	\$10,830
2	14,570
3	18,310
4	22,050
5	25,790
6	29,530
7	33,270
8	37,010

For families with more than 8 persons,
add \$3,740 for each additional person.

Medicaid Adult Spending to Grow



- % of total US household incomes under \$22,500 26%
 - add % of total US household incomes \$22,500-\$29,999 9%
- source: US Census Bureau*
- proposed expansion of adult portion of Medicaid 35%

Note: total % increment to be higher due to first time coverage of single adults

Total Projected cost:

\$15-\$20 billion

Reasons to Expect Success



- Medicaid currently covers children of low income parents to be extended Medicaid coverage
- Medicaid almost entirely served by existing managed care contracts
- Medicaid coverage accepted by almost all providers
- Rapid transition to lower uninsured population by 11 million



Affordability Issues

Impact of cost of purchasing individual health care insurance

	Monthly Cost of Coverage				Family Premium Coverage Percentage of Annual Income		
	Individual basic	Individual premium	Family basic	Family premium	\$35,000	\$60,000	\$90,000
Age 25	\$180	\$250	\$931	\$1,294	44%	26%	17%
Age 40	\$249	\$346	\$965	\$1,341	46%	27%	18%
Age 50	\$407	\$566	\$1,188	\$1,650	57%	33%	22%
Age 55	\$564	\$781	\$1,461	\$2,031	70%	41%	27%

source: AmeriHealth, offering BC/BS individual healthplan in NJ, DE, PA

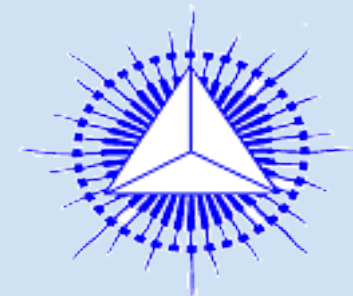
Note 2007 median US household annual income \$50,233

source: US Census Bureau



Support for Individual Coverage

- Proposal to extend tax credit up to 400% of federal poverty level
- Includes family of 4 with annual income up to \$88,000
- Employers not offering family coverage must refund federal cost of tax credit provided to individuals
- Amount of tax credits yet to be determined



Consumer Control of Health Decisions

- Expect more consumers to opt for basic plans
- Expect more use of emergency services and less use of primary care
- Rx decisions to prioritize OTC and generic options
- Delayed treatments will mean higher utilization for both employer funded and Medicare plans
- Heaviest burden falls on over 50 population



Health Sectors Gain

- Fewer uninsured means lower bad debt for providers
- Delayed procedures to impact Medicare spending
- Higher Medicaid enrollment provides opportunity for Medicaid managed care providers
- Generic drugs to gain share of total drug spending
- More spending at retail drug chains

Probable Economic Outcomes



- Pressure on consumer disposable income drives health care spending decisions
- Small businesses to limit employment
- More unemployment, more self-employment
- More credit issues for consumers
- Compliance likely to be long delayed



Enduring Themes

- Health care insurance regulation to drive more consumer choice
- Economy more important than regulation to growth and profits of health care companies
- Cost pressures always get worse
- New therapies drive investment



Part II:

Strategies for Investing in Managed Care Companies



Managed Care Issues

- Impact of recession on enrollment the key issue for 2009
- Future growth of individual plans unlikely to offset lower small business employment during 2010 and beyond
- Potential for Medicaid expansion may drive acquisitions
- Higher utilization drives unexpected medical losses

RECOMMENDATION - underweight to 0.5%
(half of S&P 500 Index weighting)

PBMs - Growth from Generics



- Medco Health Solutions MHS
growth rate 18%-20%
generics dramatically add to profitability
- Express Scripts ESRX
to add 50% to revenues on merger with NextRx
- CVS Caremark
PBM market share loss to Medco
offset by growth of CVS retail operations
NOT included in health care sector of S&P 500 Index

RECOMMENDATION overweight PBMs to 1.5%-2.0%

Managed Care Stocks



- BUY WellPoint WLP for Blue Cross individual plans
- BUY Humana HUM for Medicare Advantage growth
- BUY Coventry CVH for takeover potential

- BUY Health Net HNT for Medicaid exposure in CA
(Health Net NOT INCLUDED in S&P 500 Index)

- SELL Aetna AET on medical cost and margin issues
- SELL UnitedHealth Group UNH on internal issues



Part III: The Landscape for Pharmaceuticals

Mature Industry



Consolidation in the face of increasing competition

- **Merck announces acquisition of Schering Plough**
 - March 9, 2009 \$41 billion
 - Provides Merck with access to brand-name products with long patent lives
- **Pfizer announces acquisition of Wyeth**
 - January 26, 2009 \$68 billion
 - Offset loss of key blockbuster drug Lipitor to generic competition in 2011
- **Novartis announces acquisition of 25% stake in Alcon**
 - April 7, 2008 \$11 billion
 - Strategic fit with existing contact lens and ophthalmological drugs business
- **AstraZeneca announces acquisition of MedImmune**
 - April 23, 2007 \$15 billion
 - Provides AstraZeneca with access to MedImmune's vaccine platform

Challenges vs. Opportunities



Patent Expirations and
Generic Substitution

Weak Pipelines

Regulatory Pressure

Pricing Pressures

Revenue Impact of Foreign
Currency Translation

Brisk Scientific Progress

Profitable Specialty Products

Emerging Markets

Aging Population

Globalization



Drivers of Change

- R&D Productivity
- New Technologies
- Health Care Cost Containment
- Globalization
- Pressures for Biological Generics

Drug Discovery and Diagnostics



- Changing methodologies in drug discovery promise faster biological breakthroughs
- Advancements in the field of genomics
- New methodologies involve integration of multi-disciplinary approaches for targeting new therapies to address causes of disease
- Industry transition comes at the cost of escalating R&D expenses
- Drug discovery is accelerated through enhanced IT and productivity tools



Drug Development Challenges

- Longer development times:

Preclinical development span: 5 years

Clinical development span: 10 years

- High failure rate:

Attrition rate Phase 2 clinical trial: 65%

Attrition rate Phase 3 clinical trial: 50%

Average cost per NME approved by the FDA: \$1.2 billion



Addressing Clinical Failure

- Reasons for failure of drug candidates in clinical trials:
 - Pharmacokinetics (39%)
 - Lack of efficacy (30%)
 - Toxicity (11%)
- Increased response rates may be achieved by use of biomarkers for identification, validation of drug targets, and patient stratification
- Cost containment may be achieved by strategic sourcing in low cost locations



Pharmaceutical Market Outlook

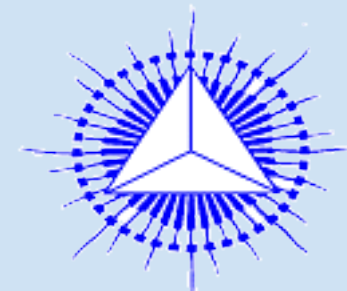
- Annual pharmaceutical sales growth to 2012: 3%-6%
(Source: IMS Health)
- Annual sales growth for global generics: 5%-7%
(Source: IMS Health)
- Key market dynamics:
 - Loss of exclusivity by patent expiration
 - New specialty-driven products
 - Greater levels of generic substitution
 - Greater focus on safety



Part IV:

Strategies for Investing in Pharmaceutical Companies

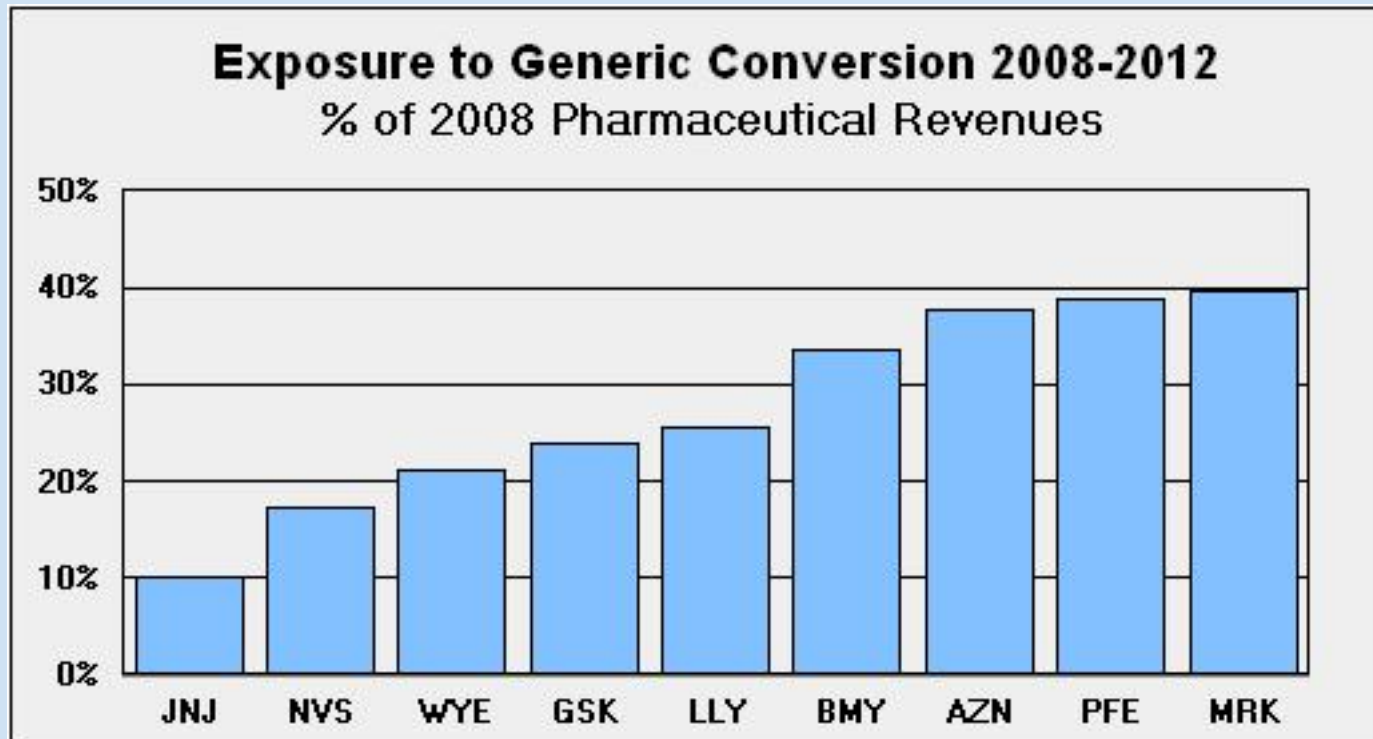
S&P 500 Health Care Sectors



Sector:	Market Cap	% of total	S&P 500 weighting
Pharmaceuticals and Biotech	\$792,518	63.9%	8.4%
Medical Devices	\$141,120	11.4%	1.5%
Managed Care	\$82,088	6.6%	0.9%
Medical Supplies	\$67,742	5.5%	0.7%
PBMs	\$47,069	3.8%	0.5%
Biotech and Lab Equipment	\$38,370	3.1%	0.4%
Drug Wholesalers	\$29,292	2.4%	0.3%
Medical Services and Diagnostics	\$16,954	1.4%	0.2%
Generic Pharmaceuticals	\$14,365	1.2%	0.2%
Hospitals, Clinics and Providers	\$8,756	0.7%	0.1%
Information Services	\$2,800	0.2%	0.0%
	<u>\$1,241,073</u>	<u>100.0%</u>	<u>13.1%</u>



Pharmaceutical Generic Exposure



Note: JNJ shown as % of total revenues, others as % of pharmaceutical revenues

Pharmaceutical OTC Potential



Consumer / OTC Revenue Contribution:

1) Johnson & Johnson	JNJ	25%
2) Merck	MRK	11%
<i>pending merger with Schering Plough</i>		
3) Pfizer	PFE	9%
<i>pending merger with Wyeth</i>		

Johnson & Johnson JNJ



- Least exposure to generics
- Highest potential from OTC sales
- Weighting should be higher than any other Health Care stock
- JNJ 21% of total pharma weighting, equal weighting at 1.7%

RECOMMENDATION: overweight Johnson & Johnson at 3.0%

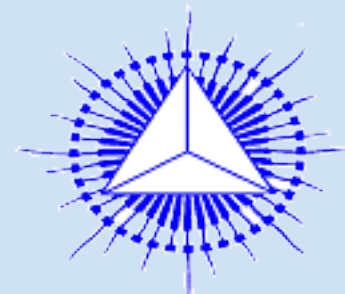
Novartis NVS



- Second lowest generic exposure after JNJ
- Direct participation in generics through Sandoz
- ADRs trade in volume on NYSE
- NOT INCLUDED in S&P 500 Index

RECOMMENDATION: include Novartis at 1.0% weighting

Public Health Issues - Vaccines



Public Health Issues Drive Interest in Vaccines

Company	Ticker	Development Phase	Notes
Gilead/Roche	GILD	Market	Tamiflu
Solvay	SVVSY	Market	Influvac, Invivac
Crucell	CRXL	Market	Inflexal
Baxter	BAX	EMA positive opinion	CELVAPAN
Vical	VICL	Phase 1	Navy sponsored trials under CRADA
Novavax	NVAX	Phase 2	VLP
Biocryst	BCRX	Phase 3	Peramivir
Generex Biotechnology Corp.	GNBT	Phase 1	AE-AI using RAPIDMIST spray
Avir Green Hills	private, Austria	Phase 1	deltaFLU
BioDerm	ASX - BDM	Phase 2	LAIV technology, license to SGP
Nobilon	Owned by SGP	Phase 2	LAIV technology, collaboration with BioDerm



Conclusions

- Pharmaceuticals, Biotech, and Medical Device companies account for 75% of the S&P 500 Health Care subsector
- Pharmaceutical stocks have failed to live up to their reputation as defensive investments, underperforming their S&P 500 Index benchmark
- Investors should overweight pharmaceutical companies with large consumer franchises and low generic exposure or direct participation in generics market
- Weak pipelines will continue to drive acquisitions of biotechnology and specialty pharmaceutical companies identified by larger players as a strategic fit



Questions and Discussion

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