SmartMoney

Screens by Jack Hough Published December 22, 2009

3 Stocks Soaring on Health-Care Bill

America is getting augmented health care for Christmas, it seems. But of course, whether the changes count as reform is a matter of opinion.

Before dawn Monday, all 58 Senate Democrats and both Independents banded together in a procedural vote that suggested a health-care bill will pass the Senate as soon as Tuesday. If it can be reconciled with a House version, the measure might be made law soon after.

All 40 Senate Republicans opposed the bill.

Who will benefit from the proposed changes? Fittingly for such a party-lines bill, commentators show bitter disagreement. Henry Aaron, a senior fellow with the Brookings Institute, a think tank that identifies itself as independent, wrote last week that the measure will simplify health care administration, support treatment studies, fund preventative care and promote team-oriented care to reduce costs and improve quality. Meanwhile, Michael Cannon, director of health policy studies for the Cato Institute, a think tank that calls itself libertarian, wrote that the bill is something else altogether: “a massive $450 billion bailout for private insurance companies that will drive health insurance premiums and taxes higher while reducing quality, all for the benefit of a small cadre of Democrats with a preternatural need to control other people’s health care.”

The stock market’s collective view seems to be that health-care providers will indeed profit, or at least, that they will suffer less than originally believed. Since the end of October, the broad U.S. stock market has gained 8%, judging by the S&P 500 index. Exchange-traded funds that track segments of the health-care sector have done better. The **iShares Dow Jones U.S. Medical Devices Index Fund** (*IHI* [1]) is up 10%. Sibling funds that track **drug makers** (*IHE* [2]) and health-care **insurers and providers** (*IHF* [3]) are up 13% and 18%.

Insurer shares, in particular, are zooming. There are three reasons. First, stripped from the Senate bill is the so-called public option — a government health plan that threatened to undersell private insurers. Second, a proposed $6.7 billion industry tax is now likely to be phased in only gradually beginning in 2011, which should give health plans enough time to raise prices accordingly. Third, individuals will be required to purchase insurance — a fine deal for insurance sellers — although critics say the penalties for noncompliance are weak, suggesting many individuals will prefer to remain uninsured.

It’s not all good news for insurers. The Senate bill would impose a “medical loss ratio” of 80% to 85%, depending on the market segment, meaning insurers would have to spend 80 to 85 cents of each dollar they collect from plan members to provide health care. Carl McDonald, a health care analyst with Oppenheimer & Co., an investment bank, wrote in a note to clients Monday that the number was “workable” for insurers, especially if they can label certain items that count as corporate expenses for accounting purposes as health care for purposes of meeting the spending minimum.

Below are three health-care companies whose shares are soaring and still seem cheap, assuming that something resembling the Senate bill becomes law.

Aetna

Stock gain since end of october: 31%

Hartford, Conn.-based **Aetna** (*AET* [4]) provides mostly workplace health plans, and so has lost customers to unemployment this year. Its shares are down sharply over the past two years. Earlier this month this column *pointed out* [5] that the stock looked cheap and that company insiders were buying shares. Even after a 5% jump Monday, the stock trades at just 12 times earnings, a discount of around 40% to the broad stock market.

Cigna

Stock gain since end of october: 29%

Based in Philadelphia, **Cigna** (*CI* [6]) had less to lose than other insurers from the health-care reform process, because it has little exposure to parts of the business targeted for big cuts, like Medicare Advantage and small group plans. It stands to reason, then, that shares of Cigna should have shrugged off Monday’s news from the Senate. Instead they jumped 4% -- a sign that investors view the bill as adding new profits. Shares of Cigna are just nine times earnings.

WellPoint

Stock gain since end of october: 28%

Indianapolis-based **WellPoint** (*WLP*[7]) recently sold its prescription benefits management business to **Express Scripts** (*ESRX*[8]). With that transaction and the company's routine cash generation, Oppenheimer's McDonald reckons WellPoint might amass $6.6 billion in cash by the end of 2011, an amount equal to about one-quarter of its stock market value. He recommends management continue to aggressively repurchase shares with the funds. In a Nov. 20 research note, McDonald wrote that Congress's health-care changes would have to prove "catastrophic" for the stock not to be a good deal at its price of $52 and change at the time. Indeed, pending changes seem anything but catastrophic for insurers, and while WellPoint now fetches $60 a share, that's still just 10 times earnings.

1 http://www.smartmoney.com/quote/IHI/
2 http://www.smartmoney.com/quote/IHE/
3 http://www.smartmoney.com/quote/IHF/
4 http://www.smartmoney.com/quote/AET/
5 http://www.smartmoney.com/Investing/Stocks/3-Companies-Still-Buying-Their-Own-Shares/
6 http://www.smartmoney.com/quote/CI/
7 http://www.smartmoney.com/quote/WLP/
8 http://www.smartmoney.com/quote/ESRX/

URL for this article:
http://www.smartmoney.com/Investing/Stocks/3-Stocks-Soaring-on-Healthcare-Bill/