Investment Philosophies
New York University
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Sell Side Equity Research

◆ What it takes to be a Sell-Side analyst

◆ How my role as a sell-side analyst has changed over time

◆ My outlook for the future
  • Great time to enter business
  • High turnover presents opportunity
It takes Both Sides of Brain

- Passion for Investing
- Resourceful & Efficient
- Analytical
- Effective Communicator
Passion for Investing

◆ Career Advice: Follow your Passion

◆ Also a Passion for Industry Following
  – Healthcare 15% of GDP, Changing, Important
  – Health Benefit Providers at Vortex & Agents of Change

◆ Fundamental Discipline
  – Value of Firm = Discounted Free Cash Flow

◆ Be Aware of other Investing Styles, Time Horizons & Imbalances
  – Near-term Supply & Demand for Shares of Stock
  – Trader vs. Investor
US Healthcare 15% of GDP & Growing

Source: Health Care Financing Administration and Bureau & Citigroup Investment Research.
Intermediaries in $2 Trillion Industry

Buyers of Health Benefits

Employers: “Hello HSA, Goodbye HMO”
150 million persons covered $600 billion/yr
=$380bn Managed Care + $220bn self-insured

Medicare: Expanding, Privatizing
44 mn Age 65+ & disabled
$400 bn ‘06Federal +$100 bn individual

Medicaid, SCHIP: Expanded, Privatizing
50 mn indigent, children of which
6.5 mn dually eligible for Medicare
$325 billion Federal + State

Individuals
18 mn; $45 billion

Uninsured – HSA, & Tax Breaks
50 mn; $100 billion potential

TRICARE, VA
8+ mn Military, $6+ billion
4 mn Veterans

Suppliers

Health Products & Service Cos.

Physicians

Hospitals

Pharmacies

Diagnostics, Lab, other

Managed Care

Health Benefit Provider
- Insurance
- Administration
- Care Coordination
- Savings Accounts
- Informatics, etc.

Source: Citigroup Investment Research estimates.
Resourceful & Efficient

◆ Start with "Weak" form of Efficient Market Hypothesis
  – All past data fully reflected in securities prices

◆ What is New or Different This Time?

◆ Find New Information &/or Form New Mosaic
  – Before Somebody Else Does & Market Discounts

◆ Know your Business Cycle
  – Look at Appropriate Time Horizon
  – Often It Exceeds Many Investment Horizons
Example: 6-Year Cycles 1965 - 1993

Source: BCBS Association & Citigroup Investment Research
2000: Forward P/E 60% Discount vs. S&P
Market Expects History to Repeat for Managed Care & Sees “New Economy”

Source: FactSet, Citigroup Investment Research.
6 Yrs of Sideways, Record Market

(a) Managed Care Companies: AET, CI, CVH, HNT, HNT, PHS, SIE, UNH, WC, and WLP, including predecessors CBZ, MME, TGH, FHCC and WLP (pre-ATH).

Source: FactSet, Citigroup Investment Research.
What Industry Insiders Saw

- Why the Cycle Existed?
  - Non-profit and Mutually-owned Dominated
  - Excess Capital Given Back in form of Premium Cuts

- What Changed?
  - Non-profit and Mutually-owned Health Insurers Converting

- Upshot
  - Business Cycle Elongated, Soft Landing
Elongated Cycle, Expect Soft Landing

Source: BCBS Association & Citigroup Investment Research

We expect BCBS margins to decline in 2004-05
2005: P/E Closer to Market Multiple

![Graph showing Industry Managed Care Forward P/E's (Mkt Cap. Weighted) Relative to S&P 500 Forward P/E GAAP.]

Source: Smith Barney & FactSet

(a) Managed Care Companies: AET, CI, CVH, HNT, HUM, PHS, SIE, UNH, WC, and WLP, including predecessors CBZ, FHCC, MME, OHP, TGH, and WLP (pre-ATH).

Source: FactSet, Citigroup Investment Research.
Index up 5x From Trough

(a) Managed Care Companies: AET, CI, CVH, HNT, PHS, SIE, UNH, WC, and WLP, including predecessors CBZ, MME, OHP, TGH, FHCC and WLP (pre-ATH)

Source: FactSet, Citigroup Investment Research.
Resourceful

- Street was Focused on Technology

- Ground Swell of Conversions & Demutualization
  - Helps to be expert at industry
  - Helps to have industry contacts
Analytical

- Basic Problem Solving In Dynamic Environment
  - Gather Facts Resourcefully & Efficiently
  - Analyze Facts to Form Conclusion or “Mosaic”
  - Repeat

- Use History as a Lesson  NOT  as a Guide

- Common Pitfalls
  - Assuming Street is Correct on Valuation
    • Don’t lose Discipline Just Because Street Does (dot com)
  - Copying “homework”, be Original & Creative
    • It is by definition too late if you use ideas of others
  - Always taking Contrarian's Stance
    • Sometimes Consensus is Right!
Analytical: Medicare Privatization

- Possibly the Largest privatization of our time
  - $400-$500 Billion New Revenue Opportunity
  - 10x Revenue of Largest company in Industry

- Clearly Can’t use History as Guide for Future Valuation
  - Brand new market opportunity
  - Rely on ability to forecast new growth & profitability

- 2005: 3 Lowest Ranked Stocks in group were 3 Best Performing

- Opportunity for Primary Research
  - Helps to be Industry Expert with sources in D.C.
Analytical: Hello H.S.A.

- Health Savings Account
  - Signed into law end of 2003
  - To Healthcare what 401(k) was to retirement

- Will Create Winners and Losers

- Again, Can’t Use History as Guide
  - Understanding of industry to predict winners & losers
  - Understanding of History as Lesson
    - 20 yrs for HMOs & 401(k) to reach 80% Penetration
  - But History Not a Guide
    - 70% of Employers somewhat or very likely by 2006
Effective Communicator

◆ An Idea is Good If Investors Act on it

◆ Investors are Inundated with Information
  – But Never Have Enough Good Investing Ideas

◆ Written, Oral, Telephonic
  • Start with Conclusion – Opposite of How Problems are Solved

• Titles & Phrases That Concisely Tell The Story
  – “Elongated Cycle, Soft Landing”
  – “Hello H.S.A., Goodbye H.M.O.”
  – “Medicare Handoff Elongates Cycle”
Effective Communicator

◆ Communication Should Be Two Ways
  • Only way to know what is Discounted By Street

◆ Sometimes Ideas Don’t Work
  – Ideas that Work are of course Ideal

  – Ideas that Doesn’t Work Aren’t Necessarily Bad
    – If 80% Chance Something Works, Don’t Let 20% Hold you Back – But Be Clear on Risks
    – Be Right > Half The Time

  – Communicate Failures Well
    – Understand What Went Wrong
How My Role has Changed

◆ Less Time on Capital Formation

◆ Greater Demand from Trading-Oriented Clients
  • Many New Clients, Increased Demand for My Time
  • Focus on Near-term vs. Long-term Performance
  • Client Turnover, High Hedge Fund Failure Rate

◆ Reg FD
  • Less Information Flow from Companies
    – Less Leverage over Relationships with Managements
  • Opportunity to Leverage Long-time Industry Sources
    – Net Positive for Good Analysts
My Outlook for the Future

- Great time to Enter the Business & Get Established
  - Challenging Post-Bubble Market
  - Position Well for Next Cycle Turn

- Treat Career Like Investment: Avoid Following the Herd

- Great Jumping Off Point
  - To Industry
  - To Buy-Side Mutual, Hedge, Private Equity, VC, etc.
  - To Investment Banking
  - To Retirement!
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<th>Sell</th>
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<td>42%</td>
<td>18%</td>
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