

This article has been excerpted from a letter by MOI Global instructor Stephen Dodson, portfolio manager at Bretton Fund, based in San Francisco.

Stephen is a featured instructor at Best Ideas 2021.

UnitedHealth is the behemoth of the American healthcare system, generating \$240 billion in revenue from services that touch more than one in three Americans. Readers who follow American politics may be aware that healthcare payment is handled differently in the US than in other developed countries, and a brief overview is useful to understanding UnitedHealth's role.

Contrary to popular assumptions, developed countries have widely varying healthcare systems, even within Europe. The UK has a single, public provider; Canada and Taiwan have a single payer but private providers; Germany and the Netherlands have private insurance; France and Australia have blended systems of basic single payer and broad supplemental insurance. The US has elements of each of these systems: a single provider (Veterans Administration), a single payer (Medicare), private insurance, and blended gap coverage.

What distinguishes the US from other systems is that doctors and hospitals are free to set prices as they wish. Providers (e.g., doctors, hospitals) typically earn about 50% more in the US than in other countries. The counterbalance to this situation is that American healthcare features the concept of "networks." A payer (e.g., an insurance company, Medicare) contracts with doctors to accept a specified rate, and either will not pay at all for services rendered outside this network or will only pay its own contracted rate, leaving the patient exposed to the difference. Note that these are intimately linked: a system of unlimited pricing authority can only survive if the payer can reject payment.

Providers have a perishable resource—their time—and like other vendors of perishable resources, such as airlines and hotels, they often sell the same product at different prices to different people. Many doctors will see Medicaid patients at a very low Medicaid rate, Medicare patients at the modest Medicare rate, and commercially insured patients at a high rate. Patients with commercial insurance will be offered more attractive appointment times; Medicaid patients will find only the slots the doctor would not otherwise be able to fill.

UnitedHealth uses its role as the broadest, highest quality network to have a leadership position providing "administrative services only" services to large, self-insured customers. These large industrial concerns do not need someone else to bear the financial risk of health insurance, but they do need someone to manage a network and process claims. Over 19 million Americans get their health coverage through UnitedHealth in this fashion. Another 8.5 million receive coverage through small- to medium-sized business insurance where UnitedHealth bears the financial risk of claims.

Beyond these customers, about 15.5 million Americans who are enrolled in government health plans actually work with UnitedHealth, split relatively evenly between Medicare Advantage (where the government pays UnitedHealth and UnitedHealth pays members'

expenses), Medicaid (similar concept, except the federal government pays the states and the states pay the carriers), and Medicare supplemental insurance, where someone has traditional fee-for-service Medicare and then uses UnitedHealth (co-branded with AARP) to address uncovered expenses.

UnitedHealthcare also operates two non-insurance businesses under the “Optum” umbrella: , a pharmacy benefits manager, and OptumHealth/OptumInsight, which provide health analytics. The pharmacy benefits business may be the most Byzantine niche of the healthcare system, and it thrives on the high rebates paid by drug manufacturers that want high list prices for their drugs. Regulation will eventually dig into this profit pool. OptumHealth and OptumInsight are fantastically profitable, growing vendors of health information and analytics.

Investing in a health insurance business during the largest pandemic in a century may seem odd, but we think the impacts will be transitory. On one hand, health insurers benefit from the direct impact of the coronavirus: expensive elective procedures have been canceled as medical system capacity is repurposed to care for the virus. On the other hand, the negative impact to UnitedHealth is the significant job loss created by the ensuing recession. We expect large corporate employment to hold up better than small business, and Medicare and Medicaid will add subscribers.

The content of this website is not an offer to sell or the solicitation of an offer to buy any security. The content is distributed for informational purposes only and should not be construed as investment advice or a recommendation to sell or buy any security or other investment, or undertake any investment strategy. There are no warranties, expressed or implied, as to the accuracy, completeness, or results obtained from any information set forth on this website. BeyondProxy's officers, directors, employees, and/or contributing authors may have positions in and may, from time to time, make purchases or sales of the securities or other investments discussed or evaluated herein.