A Bundle of Change: The Next Great Health Care Investing Opportunity

By Keith Speights - April 20, 2012

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A change is coming soon that will radically alter the health care landscape in a major way – and provide yet another health care investing opportunity after the Meaningful Use bonanza. What is this big change? It's called payment bundling.

Payment bundling is at the heart of the Centers for Medicare and Medicaid Services (CMS) strategy to "bend the cost curve" downward for health care expenses. The cost curve is bending in a major upward direction now and will continue to do so in the future without major changes. Payment bundling appears very likely to be implemented regardless of which political party is in power after the 2012 elections.

Follow The Money

The Congressional Budget Office (CBO) recently reported that nine of ten federally-funded projects that attempted to control Medicare costs resulted in either little or no savings. Some even resulted in increased costs. The only project to successfully reduce costs used payment bundling. This project produced savings of nearly 10% with no apparent adverse impact on patient outcomes. There is little wonder that federal and state governments as well as health insurance companies are very interested in payment bundling.

How does payment bundling cut health care costs? There is no magic involved, just the old-fashioned law of supply and demand. The payer (Medicare, Medicaid, or insurance company) negotiates a bundled payment rate with a health care consortium including hospitals and physicians that are lower than the separate payments the providers would have received otherwise. The providers accept these lower rates in anticipation that their volumes will increase.

Payment bundling sounds straightforward, but it is actually quite complex. The mechanics of payment bundling could cause nightmares for payers and providers - setting the rates, tracking actual costs for the payment bundle conditions, and distributing the payments received to the different health care providers. But the payoff for payers and providers (at least for the ones that win the contracts) could be huge.

Opportunities for Investors

Investors should focus on three primary areas to benefit from the payment bundling boom:

1. Vendors providing technology to enable payment bundling for payers
2. Vendors providing technology to manage payment bundling for health care providers
3. Health care providers positioned to succeed with payment bundling

We will only focus on the first area in this article. There are three vendors at the forefront of providing payment bundling technology to payers:

- **Trizetto Group**
- **MedAssets** (NASDAQ: MDAS)
- **McKesson** (NYSE: MCK)

Trizetto went private in 2008 after trading on NASDAQ for a decade, so it isn't an alternative for investors. That's too bad, because Trizetto is perhaps the strongest of the three in payment bundling technology. Both MedAssets and McKesson are publicly traded, though, and warrant a look by investors.

MedAssets markets a web-based product that scoops in fee-for-service claims and groups the claims into bundles associated with industry-standard benchmarks. The payer then pays providers a set amount for the bundle of claims. MedAssets had revenue of $578 million over the past twelve months with year-on-year revenue growth in its most recent quarter of 46.60%. However, the company is not currently profitable. MedAssets' current ratio of 0.63 is worrisome also.

The better pick for investors is McKesson. Their product bundles claims in real-time within the payer's current claims workflow. McKesson is a health care juggernaut with annual revenue of nearly $120 billion. Revenue growth is solid. Return on equity is a respectable 17.94%. The stock is up over 15% in 2012 so far but is still attractively priced with a forward P/E of 12.58 and a PEG ratio of 0.96.

Investors who want to take advantage of the payment bundling momentum have the opportunity to pay a fair price for McKesson now and potentially make a bundle in the not-too-distant future.