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BJORKLUND FUND

March 14, 2018

Company Name: Magellan Health (MGLN)

Theo Wind

Sector: Healthcare
Industry: Healthcare Provider
Current Price: $107.95
Target Price: $130.61

Magellan Health is one of the largest managed behavioral health care companies in the United States. They operate in two segments: Healthcare and Pharmacy Benefit Management. Magellan serves about 68 million members through contracts federal and local government agencies, insurance companies, and employers.

BUY

Current Price:	$107.95
Target Price:	$130.61
Return:	26.19%
Market Cap:	$2.6B
Beta:	1.0
ROIC:	6.56%
WACC:	10.1%
D/E:	11.31%
Credit Rating:	BB

Catalysts:

- Short Term (within the year): States realizing the importance of recognizing and treating serious mental illness in their populations. As well as recent government policies.
- Mid Term(1-2 years): Growth opportunities to manage populations in more states
- Long Term(3+): Projected Medicare enrollment is predicted to grow significantly over the next decade

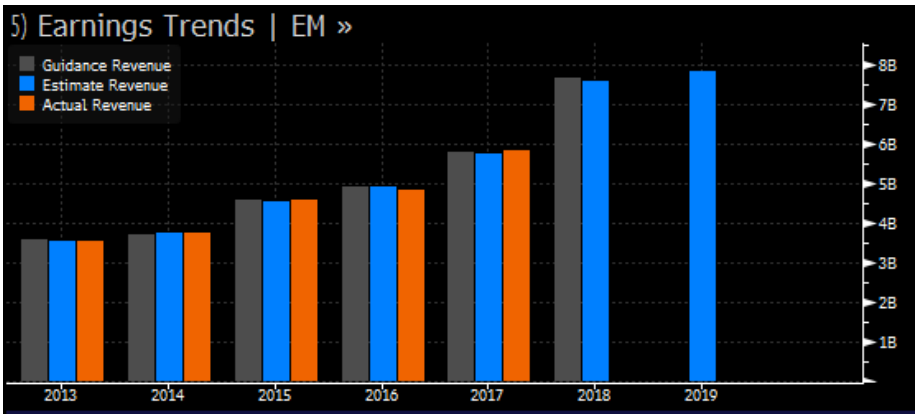
Thesis:

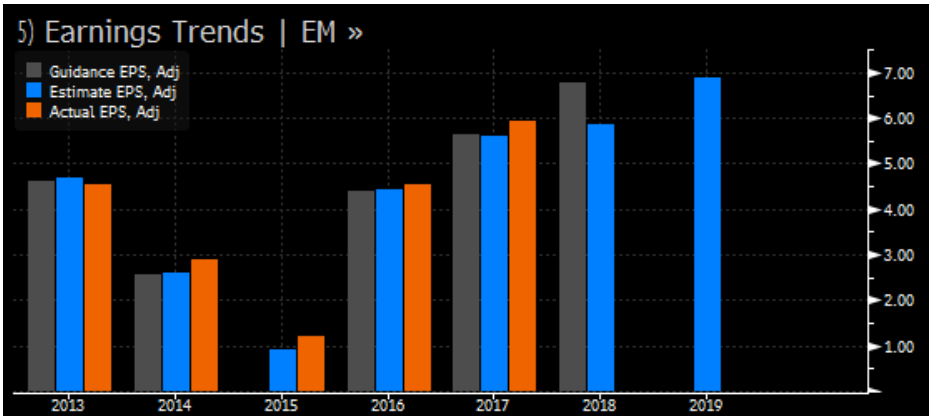
Magellan Health is a buy because of their continued focus on the pharmacy benefit management (PBM) sector as well as the growth opportunities in their behavioral healthcare management sector. They are going to outperform other healthcare companies because their approach is very personalized to each client. They are able to integrate their services to manage these complex populations and offer highly personalized solutions to each client's unique needs providing better patient outcomes. Their success in this high-risk population has drawn the attention of other states that our interested in their services. Magellan is able to better control costs in the very costly area of behavioral health because of their commitment to their PBM sector.

Earnings Performance:

Magellan since 2013 has been able to consistently outperform both the analyst estimates as well as the guidance set for the company, as shown in the graph below. According to their CFO, they reported revenue of $5.8 billion which is an increase of 20% versus 2016. Looking forward to their 2018 guidance they are expecting another significant increase in revenue to about $7.8 billion. This shows that the company believes that they are still growing and generating new revenue from new populations. They are also estimating an increase in their revenue 2019. As far as segment revenue, they generated about $3.5 billion from their managed care segment and a little over $2.3 billion from their PBM segment. Both segments have grown since 2015, however their PBM segment has growth the most, about 20% from 2016, and is now responsible for approximately 40% of their total revenue.

Magellan's EPS for 2017 beat analyst estimates four out of the last five years. In 2017, they were able return an adjusted earnings per share of $5.92. This is a year over year growth in EPS of 31%. Based on their 2018 guidance they expect a significantly higher EPS then analysts expect. I believe this is because they expect their PBM to generate more cost savings as well as their growth form recent acquisitions. Generating cost savings is important for Magellan because mental health conditions are extremely expensive to both diagnose and treat. Magellan generating an increase of 31% in EPS year over year should signal to investors that they are both generating more revenue while simultaneously cutting costs. Their EPS should increase again in 2018 because of the new tax law that is now 21%, and their as their PBM segment continues to grow





Business/Operations:

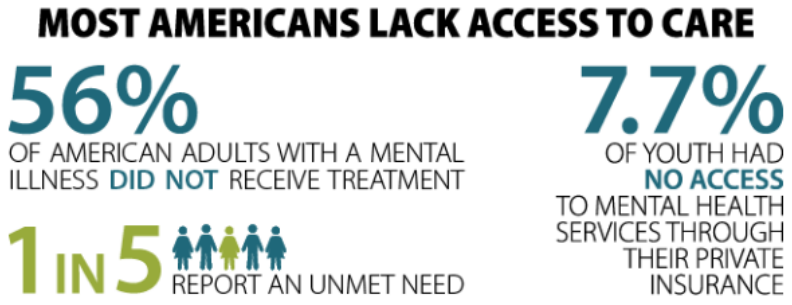
As mentioned Magellan operates two distinct segments however they are highly dependent on each other to drive the success of the company. The first segment is their managed care behavioral health segment. This segment is where the majority (55%) of their revenues come from; however, the dependence on this segment has declined over the past 3 years as they have focused on growing their PBM segment. The healthcare segment uses a network a of medical and behavioral heath professionals, clinics, hospitals, skilled nursing facilities, home care agencies, and ancillary service providers to provide care to customers. Magellan provides services to health plans, insurance companies, employers, labor unions, and states and the federal government States have been contracting Magellan to provide behavior health services to their Medicare and Medicaid population. The management of the total medical costs and long-term support services is delivered through Magellan Complete Care. This program has been designed specifically for special needs and high-risk populations. These populations include individuals with serious mental illness, dual eligibles for both Medicare and Medicaid, aged, blind, and disabled. These populations often generate the most cost because of their unique and complex healthcare needs. Magellan is paid by on a per member per month basis, so it is in Magellan's best interest to improve the health outcomes of the individuals to generate cost savings.

Magellan's pharmacy management segment operates as a PBM for their managed care segment. A PBM is a third party between the drug manufacturers and pharmacies. They are able to negotiate discounts and rebates to generate cost savings. The goal is to generate cost savings while still improving the health outcomes of the individuals. Magellan's PBM is extremely important part of their business because of the cost savings it can generate for the extremely costly behavioral health business. This is precisely why Magellan has put so much effort into growing this part of the business, which includes two acquisitions since 2015. Magellan has reported that their PBM has been able to generate cost savings to customers of between 12% and 20% with their medical pharmacy expenditures and improved health outcomes.

Growth:

Magellan recently acquired Senior Whole Health in October 2017 for $400M in cash. Senior Whole Health was a privately held healthcare company focused on serving complex and high-risk populations. They provided both Medicare and Medicaid dual-eligible benefits to about 22,000 members in New York and Massachusetts. This merger was especially important because it allows Magellan to gain more presence in the MLTC segment in New York, as well as break into Massachusetts, a state that they had not previously conducted business. Magellan has grown their PBM business over the last two years with the acquisitions of Veridicus Holdings in 2016 and 4D Pharmacy Management Systems in 2015. These acquisitions have helped Magellan grow its PBM footprint which allows them to negotiate better cost savings for the expensive and specialty drugs that their populations need.

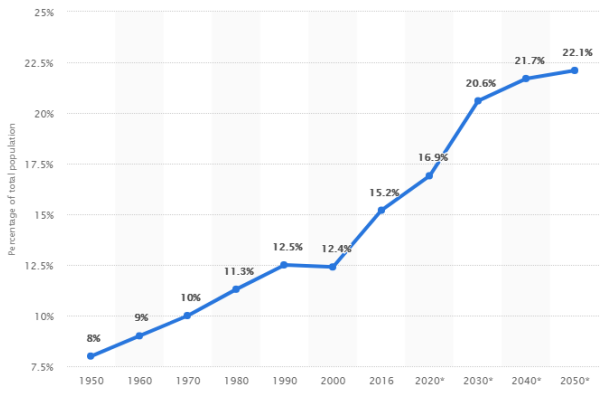
Another big deal for Magellan is the deal they struck with the state of Virginia. Magellan was one of six plans selected to participate in the Medallion 4.0 program. The Medallion program serves about 740,000 Medicaid enrollees. This contract allows Magellan to expand their presence in Virginia where they currently serve with the MLTC population, which will allow them to continue with existing staff and capabilities. The Medallion 4.0 program will phase in membership August- December 2018. This partnership has work so well that Virginia has asked Magellan to help manage their TANF population, an area where they do not usually get involved; however, they saw it as a great opportunity to expand and prove their business model of personalized care. Magellan is currently only in 30 states and the District of Columbia with bids out to other states that they would not specify in their conference calls. The graphic below shows how much of a short fall there is for treatment of mental health disorders. This proves the potiental untapped customers in the United States right now. As states improve their availablilty of care they will need managed care companies like Magellan to cover the populations.

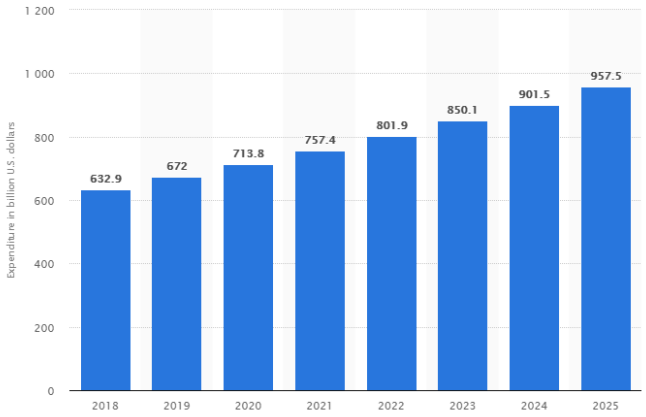


Magellan plans to grow their pharmacy business by reducing administrative costs by improving their systems and operational processes to increase service levels. They plan to do this by creating and leveraging more digital tools to enhance member engagement and developing advanced analytics to strengthen their clinical management capabilities. They have had an increase of PPM membership to about 2 million lives which is a 14% increase from 2016.

Congress has also helped the growth of Magellan by negotiating two short-term spending agreements. Congress reauthorized the children's health insurance program as well as authorizing the Medicare Advantage Special Needs Plans. The Medicare advantage special needs plans provide care to the Medicare population with significant healthcare needs which is the area where Magellan specializes.

Another growth opportunity that is more macro is the expected increase in Medicare members over the next decade. As you can see in the graph below on the left, the percentage of the population expected to be on Medicare is expected to grow significantly, as well as the projected spend on Medicaid. This is extremely important to the growth of Magellan. The aging population is going to need more medical care and long-term care especially. Magellan specializes in long-term care and recently expanded their presence in the MLTC population in New York. States are also increasing their awareness of mental illness and investing in the diagnosis and treatment of these individuals. They plan to market themselves to states that need guidance in managing the public mental health system like they have in Virginia. Mental health has been especially prevalent in the news lately, especially when there is a public event like a school shooting or mass murder. The public is crying for help with the mentally ill population and want there to be better systems in place to help get these individuals treatment.





Competitor Analysis:

In Magellan's most recent conference call with investors, there were questions about the pending CVS-Atena merger as well as questions about the Express Scripts and eviCore merger. Their response to the mergers were that it validates the integration of care that Magellan has been undertaking. They believe that this kind of integration is the only way to effectively deal with the complex and expensive populations. However, Magellan believes they are better suited because they believe in personalizing care to the individual and they believe they can do this better than their competitors and this will result in better healthcare outcomes for their customers and in turn lower costs.

Below are Magellan's competitors on the Healthcare side. As you can see their year over year revenue growth outperforms the median. Magellan is very focused on growth as can be seen by their recent mergers and acquisitions. They believe the revenue will continue to grow next year to about $7.8 billion, which is another large growth of over 20%. Another positive sign for Magellan is the fact that their EBITDA margin is the highest out of their three competitors. This shows that Magellan is able to control costs. This is especially important because Magellan deals with high risk populations who need very expensive care. This further proves Magellan's strategy to integrate care with their PBM business. The third metric is the medical care ratio also known as the medical loss ratio. For the two competitors the median was about 89%, but Bloomberg did not report Magellan's numbers. However, by digging through their 10K I was able to calculate the medical care ratio of Magellan by dividing revenue by the cost of care. When I calculated this ratio, I came up with 94%. This number seems high, but I believe it is higher than the others are because Magellan specializes in behavioral health, which is an inherently costly sector. I believe they are trying to make up for this higher MLR ratio by growing the PBM sector, which has a cost to revenue ratio of 84%. This is a good sign that this segment is growing the fastest as it has better margins than their healthcare segment. The integration of their PBM sector and healthcare sector is essential for the success of the business to increase their margins.

	Name	Ticker	Mkt Cap	Rev - 1 Yr Gr:Y	EBITDA to Net Sales:Y	Med Care Ratio
	Median		4.73B	19.46%	3.87%	89.10
100)	MAGELLAN HEALTH INC	MGLN US	2.62B	20.71%	4.64%	--
101)	MOLINA HEALTHCARE INC	MOH US	4.73B	11.82%	-1.90%	90.60
102)	WELLCARE HEALTH PLAN...	WCG US	8.85B	19.46%	3.87%	87.60

Short Interest/Ownership:

To the right is the ownership summary type over the last year. The important thing to look at here is the hedge fund manager section. They have deceased their ownership percentage by one percent; however, they still own 9.5% of the total shares outstanding. I believe this is due to the uncertainty in Washington over what was going to happen with healthcare. However, as I mentioned earlier Washington has recently taken steps that are positive for Magellan. They have reaffirmed the children's health insurance program as well as the Medicare Advantage Special Needs Plans, which Magellan will benefit from in the short term.

Top Ownership Type (%)

54) Ownership Type	03/12/17	Curr	Change
41) Investment Advisor	78.41	80.23	+1.82
42) Hedge Fund Manager	10.74	9.48	-1.26
43) Private Equity	3.30	2.94	-0.36
44) Pension Fund	3.09	2.33	-0.76
45) Sovereign Wealth Fund	0.94	1.82	+0.88
46) Insurance Company	0.70	1.15	+0.45
47) Individual	0.98	0.86	-0.12
48) Bank	1.05	0.76	-0.29
49) Government	0.25	0.21	-0.04

Short interest for Magellan has decreased significantly since December to about 1.49. This has coincided with an increase in stock price. This signals to me that investors still believe the price of Magellan's stock will increase because the short interest is low while the stock price keeps climbing. It also shows that investors in the company are not betting against Magellan by shorting it. I believe this relationship between short interest and price is a strong buy signal for Magellan's stock

Conclusion:

Magellan Health is an industry leading behavioral health managed care company. This can be seen by their recent success achieving a bid in Virginia to manage their behavioral health populations. Mental health is currently a very hot topic for states as many are realizing the significance of treating this population as it is currently underserved in the United States. Magellan has been able to successfully integrate their care with their PBM business to generate important cost savings. They have been able to generate savings of 12-20% to the customer, which will allow them to have make captivating bids to companies and states looking for help with their behavioral health population. I believe they will continue to target companies for acquisitions in order to grow both sides of the business. They have been able to achieve revenue growth of 20% year over year from 2016-2017, and are projected to have the same growth in 2018. I believe that now is the time to invest in Magellan as they continue to grow throughout the US, as they are currently only present in 30 states and the District of Columbia. They compare favorably with their competitors in both revenue growth and EBITDA margin. Healthcare spending in the United States is going to increase significantly because of the increasing cost of care and prescription drugs as well as the aging population. Magellan is a buy because they are growing their PBM to control costs on the managed care side and they are able to offer customers personalized treatment generating better health outcomes and therefore more profits to shareholders.

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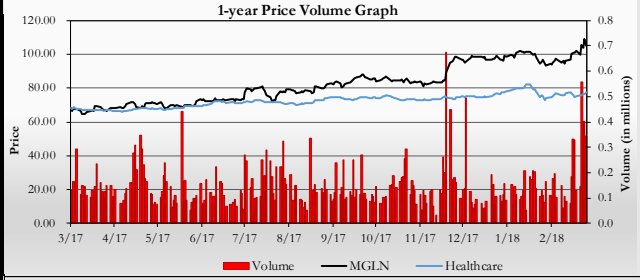
Magellan Health, Inc. (MGLN)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Al Capone	Current Price:	$103.50	Intrinsic Value	$120.59
3/16/2018	Divident Yield:	0.0%	Target Price	$130.61

Target 1 year Return: 26.19%
Probability of Price Increase: 100%



Description

Magellan Health, Inc. provides healthcare management services in the United States.

General Information

Sector	Healthcare
Industry	Healthcare Providers and Services
Last Guidance	February 12, 2018
Next earnings date	April 30, 2018

Market Assumptions

Estimated Equity Risk Premium	5.00%
Effective Tax rate	21%

Market Data

Market Capitalization	$2,517.55
Daily volume (mil)	0.13
Shares outstanding (mil)	24.32
Diluted shares outstanding (mil)	24.44
% shares held by institutions	109%
% shares held by investments Managers	81%
% shares held by hedge funds	11%
% shares held by insiders	1.03%
Short interest	0.85%
Days to cover short interest	1.33
52 week high	$109.80
52-week low	$64.05
Volatility	28.05%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2016	-4.96%	-16.83%
3/31/2017	-2.07%	-9.28%
6/30/2017	1.18%	-39.14%
9/30/2017	-4.80%	-2.48%
12/31/2017	4.91%	N/A
Mean	**-1.15%**	**-16.93%**
Standard error	0.8%	#VALUE!

Market and Credit Scores

Recommendation (STARS) Value--0
Recommendation (STARS) Description--0
Quality Ranking Value--B
Quality Ranking Description--Below Average
Short Score--0
Market Signal Probability of Default % (Non-Ratings)--0.15%
CreditModel Score (Non-Ratings)--bb

Industry and Segment Information

LTN Revenues by Geographic Segments	LTM Revenues by Business Segments
United States--100%	Healthcare--55%
--	Pharmacy Management--47%
--	Corporate and Elimination---2%
--	--
--	--

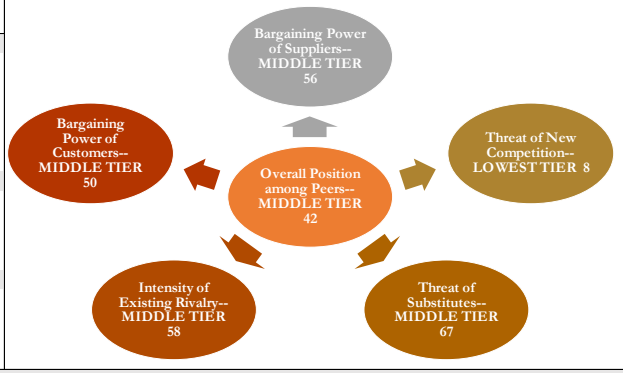
Peers

Molina Healthcare, Inc.	MEDNAX, Inc.
Diplomat Pharmacy, Inc.	Universal Health Services, Inc.
WellCare Health Plans, Inc.	Community Health Systems, Inc.
Brookdale Senior Living Inc.	Tenet Healthcare Corporation
Triple-S Management Corporation	Premier, Inc.

Management	Position	Total Compensations Growth	Stock Price Growth During Tenure
Smith, Barry	Chairman & CEO	109.29% per annum over 5y	1.01% per annum over 5y
Rubin, Jonathan	Chief Financial Officer	6.19% per annum over 5y	1.01% per annum over 5y
Gregoire, Daniel	General Counsel & Secretary	2.42% per annum over 5y	1.01% per annum over 5y
Srivastava, Sanjeev	Chief Executive Officer of Magellan Healthcare	22.55% per annum over 2y	11.96% per annum over 2y
Kamal, Mostafa	Chief Executive Officer of Magellan Rx Manageme	12.65% per annum over 1y	22.04% per annum over 1y
West, Jeffrey	Principal Accounting Officer, Senior VP & Contr		

Profitability	MGLN (LTM)	MGLN Historical	Peers' Median (LTM)
Return on Capital (GAAP)	11.5%	18.43%	-4.26%
Operating Margin	4%	5.48%	8.86%
Revenue/Capital (GAAP)	3.08	3.37	-0.48
ROE (GAAP)	12.2%	11.5%	9.8%
Net margin	2.3%	3.2%	4.1%
Revenue/Book Value (GAAP)	5.31	3.59	2.40
Invested Funds	**MGLN (LTM)**	**MGLN Historical**	**Peers' Median (LTM)**
Cash/Capital	17.5%	28.0%	27.6%
NWC/Capital	18.9%	10.8%	-20.3%
Operating Assets/Capital	18.1%	21.0%	69.7%
Goodwill/Capital	45.5%	40.3%	22.9%
Capital Structure	**MGLN (LTM)**	**MGLN Historical**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.42	0.18	0.49
Cost of Debt	3.5%	3.4%	6.6%
CGFS Rating (F-score, Z-score, and default Probability)	B		
WACC	7.8%	7.9%	9.0%

Porter's 5 forces (Scores are percentiles)



Valuation

Forecast Assumptions	Explicit Period (6 years)	Continuing Period
Revenue Growth CAGR	6%	2%
Average Operating Margin	4%	4%
Average Net Margin	2%	2%
Growth in Capital CAGR	7%	2%
Growth in Claims CAGR	2%	2%
Average Return on Capital	7%	6%
Average Return on Equity	9%	6%
Average Cost of Capital	8%	9%
Average Cost of EquityKe	10%	10%