

# Analysis of humana inc.



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Humana Inc. was faced with a decision that its hospitals were not showing as much growth or profit, as its insurance health plan. The added value to separating the two segments and spinning them off would be substantial to one; though, possibly detrimental to the other. " Instead of shedding properties that are under-performing or are incompatible with core businesses, companies are now freeing the divisions that offer the greatest potential for growth and, oftentimes, are essential components of their businesses."

(Taptich, 1999) Because maximizing shareholder value is the mantra that is supposed to guide every decision made by the CEOs of publicly traded companies, there is a great deal of pressure to realize every last ounce of growth potential.) The CEO David Jones realized the Health Plan had potential for growth and innovativeness; however, in its current structure it would be buried under the existing organization.

Analysis: In reviewing the case, I could not figure out if spinning off of Humana Inc was the appropriate solution to the problem. As illustrated in the case, Kaiser Permanente has stood as a leader in the both Health, plans and Hospitals for year doing the business in integrated manner. This led me to analyze of some other possible reason for the problem. But as I see from the case, " 60% of all U. S hospitals operated at a loss on their Medicare patients, meanwhile the aging population meant that Medicare patient-days had come to represent an increasing share of hospitals' total patient days.

To make a profit, hospital had to charge higher rates on their insured patients in order to recoup losses on their uninsured and Medicare/Medicaid

patients"(Stuart, P. g. 5). Further, there was some bad media coverage on Humana Hospital over charging its patients and Humana's disputes with doctors. HMO plans were rapidly growing industry and the management decision to spin off Humana Inc, as the company was not receiving appropriate market share price on its share. Spinning off the Health Plan business unit is a way to set free the management team of the new entity while enabling it to help itself to the assets and skills the parent company can support it with. It is also a way to maximize the value of the new entity, as outside analysts and investors can more easily access its stand-alone value.

From my calculation, Humana Inc would create an additional stock value of \$ 3188 million. Beside its increased stock value, it would make its two-business operation independent. This means both the entities will have opportunity to explore new market segments, which were earlier restricted to them because of the integrated operation mode. This additional value for Humana's was created because of the financial leverage that it gained from the spin off. Further more, the additional value to stockholders was created as the spinning off of Humana separated its performance in two separate operations. This lead to real valuation of each business segments of Humana in comparison to their respective industrial segment.

With regard to structuring the Spin off of Humana, I would suggest that its corporate portion of Debt and the corporate portion of Net interest expenses be totally allocated to the Hospitals. The asset valuation of Hospitals and the cash flow generation from hospital as on the year 1991 is much higher than the asset value and the cash flow generation from the health plan.

Therefore, allocating the corporate portion of debt and interest expenses to hospital would help Humana to maintain the same credit rating for Hospitals as well as Health plans as it was before the Spin off.

Other corporate overheads of Humana Inc. can be allocated [HES1]at equally on both entities. My other recommendation of structuring of the spin off is that the two companies should not contain the same Board members. The reasons may seem to be obvious, the biggest one conflict of interest. In these times of Enron, the SEC is now changing the accounting, business structure through new rules and regulations.

The tax problem Humana was the anticipated one. But as per the IRS ruling, if [HES2]80% of the spun off company's stock were issued to the stock holder of its earlier company there would be no tax deductions. This means Humana's strategy of Spin off would not be taxed. Note: There are some other techniques by which we can calculate the extra value that might be created by this spin off like the liquidation method, or the unit value creation technique.