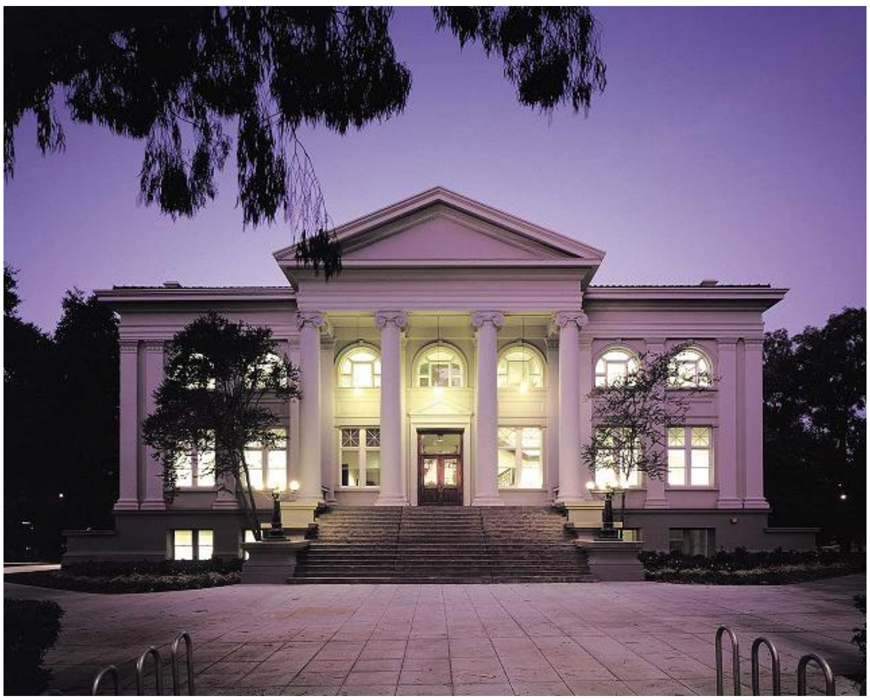
# Anthem Blue Cross

## CLIENT REPORT

# SONTAG SOLUTIONS



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# Executive Summary

With the introduction of the Affordable Care Act, insurance companies have to abide by medical loss ratios set by the government, which essentially limit profitability levels per insurance customer. Because Anthem is already at the target profitability levels, in order to improve overall profits, Anthem should do three things. Anthem should expand its national presence by acquiring smaller insurance companies in states in which Anthem does not yet operate (New Jersey is a prime target). Anthem should also push to cross-sell its insurance products. Lastly, Anthem should explore investment opportunities in health care products. In particular, Anthem should consider investing in the wearable technology market, which is currently a \$14 Billion market and is expected to be \$70 Billion in 2024. By partnering with a wearable technology firm, Anthem can combine the firm's technological savvy with Anthem's brand name and extensive health care networks to advertise and distribute a wearable technology product designed to keep track of the customer's health and general lifestyle. With this product and unique distribution setup, Anthem could capture a portion of the \$70 Billion market and increase their profits in a way that is not regulated by the Affordable Care Act.

# Company Background

Anthem Blue Cross is one of the leading health benefits companies in the United States, serving one in nine Americans. The company, while under a different name, started in 1944 and has gone through a series of mergers and acquisitions to become Anthem Blue Cross.  They offer a wide range of insurance coverage options, including health, life, dental, vision, and disability insurance for their customers.

Anthem has many different insurance options to meet the needs of its varied customers. Anthem has group plans for employers of small and large firms, offers insurance for individuals and families, and works with government agencies to help provide insurance to members with Medicaid and Medicare. Due to the variety of customers Anthem Blue Cross serves, there are many different price points and health coverage levels available to Anthem customers. These options include the traditional health insurance options of choosing between Preferred Provider Organizations (PPO) or Health Maintenance Organizations (HMO), but also include “hybrid” and “specialty products” to meet the wide variety of needs of Anthem’s insurance customers. Having these options allows customers to choose how much they value the cost of their healthcare versus the freedom they have in choosing their healthcare providers.

## Financial Analysis

Anthem Blue Cross is a large company, with a market capitalization of $42 billion. When reviewing Anthem's financials, the metrics are about on par with the rest of the companies in the health insurance industry. Anthem has a PE ratio of 17, which is close to the industry average of 18, and its operating margin is 5.91%, which is slightly above the industry average of 5.7%. One particular metric that is not on par with the industry is Anthem's revenue growth rate of 6.8%, which is far less than the industry average of 14.4%, though Anthem's expected revenue growth for 2015 is much closer to that number at an estimated 11.17%.

From an investor standpoint, Anthem's dividend growth is appealing. In the last three years, the dividend has grown over 100%. Additionally, Anthem has repurchased 30.4 million shares during the last year, amounting to about 10.4% of the total shares outstanding, suggesting to investors that Anthem is confident in its ability to profit moving forward, and in the stock market, confidence is often key.

**Stock Comparables**

| | | | Valuation | | | Financial ratios | Operating metrics | | | Stock metrics | Margins | | | Income statement |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Company name | d \| m \| y | Earnings per share | P/E ratio | Mkt Cap | Total debt to equity | Return on avg assets | Return on avg equity | Return on investment | Beta | Net profit margin | EBITD margin | Operating margin | Revenue |
| **ANTM** | **Anthem Inc** | | 8.94 | 17.27 | 42.05B | 62.48 | 4.21 | 10.45 | | 0.62 | 3.46 | 8.05 | 6.72 | 73,923.10 |
| UNH | UnitedHealth Grou... | | 5.66 | 20.59 | 112.65B | 53.63 | 6.68 | 17.40 | 10.48 | 0.62 | 4.31 | 8.68 | 7.87 | 130,474.00 |
| AET | Aetna Inc | | 5.67 | 18.92 | 37.92B | 59.25 | 3.96 | 14.32 | | 0.89 | 3.53 | 8.00 | 6.60 | 58,003.20 |
| HNT | Health Net, Inc. | | 1.79 | 33.43 | 4.68B | 29.22 | 3.12 | 8.73 | 6.06 | 0.87 | 1.04 | 2.50 | 1.65 | 14,008.59 |
| UAM | Universal America... | | -0.35 | | 883.37M | | | | | 1.33 | -1.45 | 0.05 | -0.79 | 2,039.80 |
| HUM | Humana Inc | | 7.34 | 24.16 | 26.99B | 43.12 | 5.19 | 12.10 | | 0.78 | 2.36 | 5.80 | 4.87 | 48,500.00 |
| MGLN | Magellan Health Inc | | 2.91 | 23.53 | 1.86B | 23.95 | 3.85 | 6.93 | 5.35 | 0.64 | 1.97 | 5.71 | 3.30 | 3,760.12 |
| CI | CIGNA Corporation | | 7.71 | 16.46 | 33.50B | 47.82 | 3.80 | 19.70 | | 0.58 | 5.99 | 12.07 | 9.45 | 34,950.00 |
| CNC | Centene Corp | | 2.22 | 31.04 | 8.33B | 51.20 | 5.57 | 18.00 | | 0.95 | 1.58 | 3.34 | 2.80 | 16,560.00 |
| CVH | Coventry Health C... | | 3.29 | 0.00 | | 33.56 | 5.55 | 10.43 | 7.40 | | 3.45 | 6.47 | 5.38 | 14,113.36 |
| MOH | Molina Healthcare... | | 1.28 | 50.31 | 3.26B | 89.60 | 1.67 | 6.58 | 3.12 | 1.78 | 0.65 | 3.39 | 2.00 | 9,666.60 |

One of the most important aspects of Anthem's financial documents may be the cash and cash equivalent line on the balance sheet. Currently, Anthem has about $2.15 Billion in cash and cash equivalents, which gives Anthem a lot of freedom moving forward. This is particularly important for financing acquisitions, as internal financing is generally preferred to external financing. In the past few years, insurance companies were focused on understanding the implications of the Affordable Care Act, and as such, were not acquiring many companies. Now that the implications of the law are clearer, having the freedom of cash on hand to engage in acquisitions to expand is encouraging.

## Income Statement

| In Millions of USD (except for per share items) | 12 months ending 2014-12-31 | 12 months ending 2013-12-31 | 12 months ending 2012-12-31 | 12 months ending 2011-12-31 |
|---|---|---|---|---|
| Revenue | - | - | - | - |
| Other Revenue, Total | - | - | - | 0 |
| Total Revenue | 73,923.10 | 71,122.40 | 61,535.00 | 60,804.00 |
| Cost of Revenue, Total | - | - | - | - |
| Gross Profit | - | - | - | - |
| Selling/General/Admin. Expenses, Total | 11,748.40 | 9,952.90 | 8,680.50 | 8,435.60 |
| Research & Development | - | - | - | - |
| Depreciation/Amortization | 220.9 | 245.3 | 233 | 239.4 |
| Interest Expense(Income) - Net Operating | - | - | - | - |
| Unusual Expense (Income) | 130.1 | 244.2 | 37.8 | 93.3 |
| Other Operating Expenses, Total | - | - | - | - |
| Total Operating Expense | 68,954.30 | 66,679.50 | 57,164.90 | 56,415.80 |
| Operating Income | 4,968.80 | 4,442.90 | 4,370.10 | 4,388.20 |
| Interest Income(Expense), Net Non-Operating | - | - | - | - |
| Gain (Loss) on Sale of Assets | - | - | - | - |
| Other, Net | - | - | - | - |
| Income Before Tax | 4,368.10 | 3,840.20 | 3,858.30 | 3,957.90 |
| Income After Tax | 2,560.10 | 2,634.30 | 2,651.00 | 2,646.70 |
| Minority Interest | - | - | - | - |
| Equity In Affiliates | - | - | - | - |
| Net Income Before Extra. Items | 2,560.10 | 2,634.30 | 2,651.00 | 2,646.70 |
| Accounting Change | - | - | - | - |
| Discontinued Operations | - | - | - | - |
| Extraordinary Item | - | - | - | - |
| Net Income | 2,569.70 | 2,489.70 | 2,655.50 | 2,646.70 |
| Preferred Dividends | - | - | - | - |
| Income Available to Common Excl. Extra Items | 2,560.10 | 2,634.30 | 2,651.00 | 2,646.70 |
| Income Available to Common Incl. Extra Items | 2,569.70 | 2,489.70 | 2,655.50 | 2,646.70 |
| Basic Weighted Average Shares | - | - | - | - |
| Basic EPS Excluding Extraordinary Items | - | - | - | - |
| Basic EPS Including Extraordinary Items | - | - | - | - |
| Dilution Adjustment | - | - | - | - |
| Diluted Weighted Average Shares | 285.9 | 303.8 | 324.8 | 365.1 |
| Diluted EPS Excluding Extraordinary Items | 8.95 | 8.67 | 8.16 | 7.25 |
| Diluted EPS Including Extraordinary Items | - | - | - | - |
| Dividends per Share - Common Stock Primary Issue | 1.75 | 1.5 | 1.15 | 1 |
| Gross Dividends - Common Stock | - | - | - | - |
| Net Income after Stock Based Comp. Expense | - | - | - | - |
| Basic EPS after Stock Based Comp. Expense | - | - | - | - |
| Diluted EPS after Stock Based Comp. Expense | - | - | - | - |
| Depreciation, Supplemental | - | - | - | - |
| Total Special Items | - | - | - | - |
| Normalized Income Before Taxes | - | - | - | - |
| Effect of Special Items on Income Taxes | - | - | - | - |
| Income Taxes Ex. Impact of Special Items | - | - | - | - |
| Normalized Income After Taxes | - | - | - | - |
| Normalized Income Avail to Common | - | - | - | - |
| Basic Normalized EPS | - | - | - | - |
| Diluted Normalized EPS | 9.22 | 9.26 | 8.39 | 7.42 |

## Balance Sheet

| In Millions of USD (except for per share items) | As of 2014-12-31 | As of 2013-12-31 | As of 2012-12-31 | As of 2011-12-31 |
|---|---|---|---|---|
| Cash & Equivalents | 2,151.70 | 1,582.10 | 2,475.30 | 2,201.60 |
| Short Term Investments | - | - | - | - |
| Cash and Short Term Investments | - | - | - | - |
| Accounts Receivable - Trade, Net | - | - | - | - |
| Receivables - Other | - | - | - | - |
| Total Receivables, Net | - | - | - | 1,049.70 |
| Total Inventory | - | - | - | - |
| Prepaid Expenses | - | - | - | - |
| Other Current Assets, Total | - | - | - | - |
| Total Current Assets | - | - | - | - |
| Property/Plant/Equipment, Total - Gross | 3,408.40 | 3,159.90 | 2,891.70 | 2,465.00 |
| Accumulated Depreciation, Total | -1,820.50 | -1,683.50 | -1,477.50 | -1,237.10 |
| Goodwill, Net | 17,082.00 | 16,917.20 | 16,889.80 | 13,858.70 |
| Intangibles, Net | 7,958.10 | 8,441.00 | 8,665.50 | 7,931.70 |
| Long Term Investments | 21,626.00 | 20,813.80 | 19,989.30 | 18,494.90 |
| Other Long Term Assets, Total | 1,795.60 | 2,259.70 | 1,899.00 | 1,296.20 |
| Total Assets | 62,065.00 | 59,574.50 | 58,955.40 | 52,163.20 |
| Accounts Payable | 3,651.80 | 3,426.30 | 3,098.70 | 3,124.10 |
| Accrued Expenses | - | - | - | - |
| Notes Payable/Short Term Debt | 400 | 400 | 250 | 100 |
| Current Port. of LT Debt/Capital Leases | 625 | 518 | 557.1 | 1,274.50 |
| Other Current liabilities, Total | 1,581.50 | 1,064.90 | 634 | 924.2 |
| Total Current Liabilities | - | - | - | - |
| Long Term Debt | 14,127.20 | 13,573.60 | 14,170.50 | 8,465.70 |
| Capital Lease Obligations | - | 0 | 0.3 | - |
| Total Long Term Debt | 14,127.20 | 13,573.60 | 14,170.80 | 8,465.70 |
| Total Debt | 15,152.20 | 14,491.60 | 14,977.90 | 9,840.20 |
| Deferred Income Tax | 3,226.00 | 3,325.20 | 3,222.90 | 2,724.00 |
| Minority Interest | - | - | - | - |
| Other Liabilities, Total | 2,897.00 | 2,692.10 | 2,990.10 | 3,513.70 |
| Total Liabilities | 37,813.70 | 34,809.30 | 35,152.70 | 28,875.00 |
| Redeemable Preferred Stock, Total | - | - | - | - |
| Preferred Stock - Non Redeemable, Net | - | - | - | - |
| Common Stock, Total | 2.7 | 2.9 | 3 | 3.4 |
| Additional Paid-In Capital | 10,062.30 | 10,765.20 | 10,853.50 | 11,679.20 |
| Retained Earnings (Accumulated Deficit) | 14,014.40 | 13,813.90 | 12,647.10 | 11,490.70 |
| Treasury Stock - Common | - | - | - | - |
| Other Equity, Total | -341.1 | -252.8 | -53.3 | -0.3 |
| Total Equity | 24,251.30 | 24,765.20 | 23,802.70 | 23,288.20 |
| Total Liabilities & Shareholders' Equity | 62,065.00 | 59,574.50 | 58,955.40 | 52,163.20 |
| Shares Outs - Common Stock Primary Issue | - | - | - | - |
| Total Common Shares Outstanding | 268.11 | 293.27 | 304.72 | 339.37 |

**Cash Flows**

| In Millions of USD (except for per share items) | 12 months ending 2014-12-31 | 12 months ending 2013-12-31 | 12 months ending 2012-12-31 | 12 months ending 2011-12-31 |
|---|---|---|---|---|
| Net Income/Starting Line | 2,569.70 | 2,489.70 | 2,655.50 | 2,646.70 |
| Depreciation/Depletion | 106.5 | 107.9 | 107.1 | 95.7 |
| Amortization | 744.5 | 800.9 | 633.6 | 541.5 |
| Deferred Taxes | 30.7 | 59.1 | 127.5 | 74.3 |
| Non-Cash Items | 257.3 | 624.8 | 213 | 185.9 |
| Changes in Working Capital | -339.4 | -1,034.90 | -1,001.40 | -169.7 |
| Cash from Operating Activities | 3,369.30 | 3,047.50 | 2,735.30 | 3,374.40 |
| Capital Expenditures | -714.6 | -646.5 | -544.9 | -519.5 |
| Other Investing Cash Flow Items, Total | -260.3 | -1,587.90 | -4,006.70 | -422.5 |
| Cash from Investing Activities | -974.9 | -2,234.40 | -4,551.60 | -942 |
| Financing Cash Flow Items | 592 | 409.3 | -279 | 13.2 |
| Total Cash Dividends Paid | -480.7 | -448 | -367.1 | -357.8 |
| Issuance (Retirement) of Stock, Net | -2,697.50 | -1,095.40 | -2,386.00 | -2,794.80 |
| Issuance (Retirement) of Debt, Net | 763.7 | -583.7 | 5,121.00 | 1,120.20 |
| Cash from Financing Activities | -1,822.50 | -1,717.80 | 2,088.90 | -2,019.20 |
| Foreign Exchange Effects | -7.1 | 2.2 | 1.1 | -0.4 |
| Net Change in Cash | 564.8 | -902.5 | 273.7 | 412.8 |
| Cash Interest Paid, Supplemental | 575.9 | 597.2 | 479.1 | 432.9 |
| Cash Taxes Paid, Supplemental | 1,659.00 | 1,172.00 | 1,188.20 | 1,153.90 |

## Competitive Analysis

**Porter's Five Forces**

*Industry Rivalry*

In the United States, the top three health insurance companies in terms of size are United Healthcare, Anthem Blue Cross, and the Kaiser Foundation. The players' market shares are 11.7%, 9.75%, and 7.66%, respectively. Although there are at least 125 insurance companies in the United States, the top five insurance companies own essentially 30% of the market, with the remaining groups holding less than 3% each. With the Affordable Care Act and the introduction of the Health Insurance Marketplace, comparing plans is easier than it used to be and insurance companies will be competing on value and number of options given to customers.

Because information is more readily available to customers, insurance companies will likely try to bid down prices to entice more customers. Fortunately for Anthem, their large size and economies of scale give them the opportunity to negotiate better deals with healthcare networks to lower Anthem's healthcare costs and better keep up with a potential pricing war with competitors. Additionally, Anthem's size and brand name compared to its competitors can provide an advantage in that it signals reliability to customers choosing between a well-known health insurance company and a less well-known insurance company. Overall, Anthem's biggest concerns are the other two large insurance companies who have similar scale advantages and will prove to be competitors with regards to future healthcare acquisitions.

*Bargaining Power of the Buyers*

There are at least 125 insurance companies in the United States, and while this seems like a large number of insurance companies, these options do not necessarily exist evenly across all states. An extreme case is Rhode Island where there are only two health insurance choices in the state's exchange, Blue Cross and Blue Shield of Rhode Island and the Neighborhood Health Plan of Rhode Island.

Prior to the Affordable Care Act, bargaining power of the buyers of health insurance was lower than it is today. This was due to a lack of clear information about health insurance options and how those options compared to the competition. With the Affordable Care Act, the government has required that companies offer better value services by establishing minimum medical loss ratios of 80%, meaning that insurance companies must use at least 80 cents of every premium dollar toward paying for costs of care and of running the business. Additionally, companies are now required to provide a clear explanation of benefits in the same format as other insurance companies on the Health Insurance Marketplace, where customers can easily compare insurance plans. The government also provides a fairly simple, and theoretically unbiased, measure of comparing health insurance options by giving health insurance companies "metal" rankings, ranging from bronze, silver, and gold to catastrophic. The ease of comparing plans after the Affordable Care Act means that buyers of health insurance have more information and can make decisions based more on the actual value of the product, rather than solely based on factors such as reputation, meaning health insurance companies will have to compete more on value to win customers.

*Bargaining Power of Suppliers*

Here the real question is *who* are the suppliers. People don't really purchase anything tangible from insurance companies (the insurance companies negotiate deals with healthcare providers and help pay for healthcare services in exchange for monthly premiums and/or deductibles and co-pays). So, insurance companies profit by negotiating lower healthcare costs for their customers. Thus, it would seem that the variety of healthcare companies are the suppliers. Given the wide range of healthcare suppliers, there are many companies to negotiate lower prices with, and scale is a major benefit in being able to negotiate lower prices. A large insurance company that makes a certain healthcare center or doctor/group of doctors a preferred practice can push large numbers of people to get their health needs taken care of at these locations, which justifies the deal those healthcare providers give to the insurance companies. Basically healthcare service providers lower their prices in exchange for insurance companies sending more people to their practice.

There are a lot of options when it comes to people choosing where to take care of their health needs. Factors that affect their choices are distance from locations of residence, quality of care, and cost of care. While insurance companies are only affecting a consumer's healthcare costs (and healthcare flexibility), cost is still a very important aspect of a consumer's healthcare choice. There are many healthcare suppliers and a few large insurance companies, which gives insurance companies a lot of bargaining power (though healthcare costs are inflated largely in part *because* healthcare companies know that insurance companies will negotiate a lower price for their services). Ultimately, it is the larger health insurance companies who hold the bargaining power of the suppliers in this industry.

*Threat of Substitutes*

Health insurance is now required by law in the United States, meaning every citizen is required to have health insurance. There are no substitutes for health insurance.

*Threat of New Entrants*

Since the top five health insurance companies hold about 30% of the market, while the rest of the insurance companies in the US hold such small market shares, it seems like it would be difficult for the smaller insurance companies to take over large percentages of the market and truly compete with the top companies.

First of all, providing insurance for consumers is a complicated business with constantly changing rules, regulations, and a confusing healthcare industry to deal with. In addition to the complicated nature of the business, there are economies of scale the large insurance companies enjoy, including holding long-term contracts with corporations to provide a certain company's health insurance plan to its employees, having developed relationships with healthcare providers, and having maintained brand name recognition and subsequent trust in the services provided by that brand name.

Besides the fact that it would take a long time for a new entrant to truly break into the market and compete with these economies of scale, a new insurance company would have incredibly high costs associated with starting the company, and would have to provide competitive value to customers without the benefits of the economies of scale previously mentioned. Ultimately, it seems like an expensive and difficult endeavor to enter the health insurance market and truly compete with the larger insurance companies, such as Anthem.

"New" threats may more realistically come from the third through fifth largest insurance companies, which each own about 3% market share and have the brand name recognition and experience to capture more market share.

**SWOT Analysis**

<table>
<tr>
<td>Strengths<br>• Size<br>• Earnings growth<br>• Decreasing operating expenses<br>• Strategic acquisitions and partnerships<br>• Efficient capital management<br>• Independent license for marketing products under BCBSA<br>• Increasing customer base<br>• Strong capital and cash positions<br>• Aggressively buying back stock<br>• Positive operating revenue outlook<br>• Strong benefit expense ratio<br>• Increasingly strong government business segment (Medicare/Medicaid)<br>• Breadth of offerings<br>• Higher than industry average ROE<br>• Net income relatively resistant to recessions</td>
<td>Weaknesses<br>• Increasing debt-to-capital ratio<br>• Has competitors with greater brand recognition<br>• Drop of revenues in Commercial and Specialty Business segment<br>• Social pressures to decrease the cost of health care<br>• Low rates of member satisfaction<br>• Negative public views of Anthem’s rates for small businesses<br>• Negative opinion of increased premium rates<br>• Increasing tax expenditures</td>
</tr>
<tr>
<td>Opportunities<br>• Capture the increasingly aging population<br>• Acquisition of competitors<br>• Capitalize on increased enrollment due to health care reform<br>• Implementation of new technology to decrease operating expenses<br>• Utilizing trends towards mobile fitness devices to decrease benefit expenses<br>• Expansion into underrepresented states</td>
<td>Threats<br>• Changes to required ratios and increased regulation caused by recent healthcare reforms<br>• Increasing medical cost trends<br>• Competitive threats from peers with greater market share<br>• Negative press resulting from denial of coverage<br>• Digital data breaches<br>• Logistic complications of increasing enrollment<br>• Changes in market share during implementation of healthcare reform<br>• Possible reduction in Medicare funding</td>
</tr>
</table>

*Strengths*

One of Anthem's greatest strengths is its size. It is currently the third largest health insurance company in the United States and with size comes economies of scale. Besides this strategic strength, Anthem is also financially strong, as they are experiencing earnings growth, they are decreasing operating expenses, have a higher than industry average return on equity, have strong capital and cash positions, and their net income is relatively resistant to recessions because people always need healthcare and health patterns do not tend to change with economic conditions. All of these factors combined might explain why Anthem has been buying back so much of its own stock lately.

*Weaknesses*

While the company has an increasing debt-capital ratio, the risk of default is likely still very low as the company has fairly strong financial numbers, as was mentioned above. Additionally, the stability of the health insurance industry when compared to economic conditions is encouraging as it is unlikely a recession will result in the insurance company's inability to pay back its debt. Additional weaknesses are reputational and concern the potential for low member satisfaction, negative views of Anthem's rates for small businesses, and concerns about information security given Anthem's recent cyber security attack.

*Opportunities*

On a larger scale, Anthem has opportunity for growth due to the increasingly aging population. While this group is more prone to health issues, if Anthem recognizes that and charges the right amounts for older individuals, providing value-based insurance plans and additional coverage beyond Medicare could prove a profitable opportunity. Additionally, Anthem can acquire competitors to increase enrollment numbers, and on a smaller scale, Anthem could utilize various forms of technology to decrease operating expenses and better manage their customers' health care.

*Threats*

The main threat Anthem and the rest of the health insurance industry face is regulatory pressure from the United States government. Changing the medical loss ratio requirements could further reduce profitability in the industry. Additionally, within the industry, competition from peers with greater market share could bid higher for potential acquisition targets or steal customers away from Anthem.

## Strategic Recommendations

With the introduction of the Affordable Care Act, insurance companies now face tight regulations on per-customer profitability. With the regulations on medical loss ratios requiring that at least 80 cents for every dollar of revenue earned from customers be used for medical expenses, there is not much room to improve profitability per individual, as Anthem already has a medical loss ratio between 80% and 85%. At this point, Anthem should continue to maintain profitability levels per person in that range, preferably closer to the 80% range and reassess its strategy for per-individual profitability if the ratio slips further from 80%.

Since profitability per person is capped due to this regulation, and it is possible that further, stricter, regulations could raise the minimum medical loss ratio in the future, it is particularly important for Anthem to find alternative ways to profit. Anthem can do this in two ways. The first is by increasing the amount of insurance services sold, which Anthem can do by increasing the number of people who are insured by Anthem and by cross-selling insurance products within existing Anthem customers. The second way in which Anthem can find alternative ways to profit is by branching out from its core competency and investing in health care technology that can function as a form of product revenue as well as cost-savings through promoting a healthier lifestyles of insured individuals.

In order to increase the quantity of individuals insured by Anthem, the company has three options. The first option is to acquire smaller health insurance companies. The second option is to encourage the 12% of Americans who still don't have health insurance and are currently paying penalties to change their minds and become insured by Anthem, and third option is to steal customers from other insurance companies. Of all of the options, the first option seems like the most efficient and realistic way to increase Anthem insurance membership as the other two options require convincing many people to change, while the acquisition requires convincing a few people to sell their company.

In terms of going through the whole acquisition process, Anthem is very familiar with acquiring companies and merging existing infrastructure, so the main question is how should Anthem choose acquisition targets? First of all, Anthem should consider acquisition targets outside of the 14 states in which it currently does business. By doing this, Anthem allows more individuals the opportunity to purchase insurance through Anthem Blue Cross. Theoretically, if Anthem acquired a smaller insurance company in a state in which it already operated, it would be adding customers who purposely did not choose to be insured by Anthem Blue Cross, and they risk losing those customers to a competing insurance company.

The second way Anthem should narrow down acquisition targets is by considering a number of factors that could influence potential for customer growth. The main factors to consider are total available population in the state, competing health insurance companies, legal restrictions (such as anti-trust regulation), and poverty levels (as they are associated with health insurance churn rates).

Total available population is important as it gives an upper bound to the amount of new customers Anthem can acquire once it enters a new state. There is a big difference between insuring a maximum of about 27 million people in Texas to insuring a maximum of almost 600,000 people in Wyoming. Understanding the competitive landscape in a potential acquisition territory is also important. Whether Anthem will be competing for customers against other larger insurance companies or smaller ones changes whether or not Anthem will have an advantage in the state. Ideally, Anthem would be the largest player in the state after an acquisition so it could take advantage of its economies of scale, but anti-trust regulations may hinder that strategy. It should also be noted that some individuals may prefer smaller insurance companies to larger ones, so social attitudes towards large businesses should also be taken into consideration when considering the competitive landscape.

Lastly, recent research by Health Affairs, a leading peer-reviewed health care journal, suggests that churn rates for insurance companies are highest in low poverty-level areas. The study looks primarily at what factors affect eligibility for Medicaid and Marketplace coverage, and how that can affect churn rates in the insurance industry. If Anthem chooses a state with low poverty levels, it can capitalize on churn rates by poaching customers from other insurance companies while simultaneously making an effort to avoid losing customers due to the higher churn rates by offering incentives to keep Medicaid and marketplace customers once they are no longer eligible for those programs. Thus, if Anthem can benefit from churn rates by poaching customers from other insurance companies and also manage to not lose as many customers as its competitors, Anthem could benefit from choosing to enter a state with low-poverty levels and subsequently high churn rates.

Given these factors, New Jersey is a prime state to choose as it has nearly nine million potential members and is the second lowest poverty state in the country, with a poverty rate of only 6.8% compared to the worst state, Mississippi, with a 20.1% poverty rate. The next step would be to determine the competitive landscape and clear any potential antitrust issues with the appropriate authorities before choosing a specific acquisition target.

While acquiring smaller health insurance companies can grow Anthem's customer base, it is also possible to increase the number of plans sold by cross-selling products within existing customers. In addition to health insurance, Anthem also offers life, dental, vision, and disability insurance. By either bundling insurance plans or offering discounts to current members who purchase multiple plans through Anthem, they can increase the amount of services sold, thus increasing overall profitability.

Additionally, besides increasing overall profitability by adding new members and selling more insurance products, Anthem can expand its product offerings by selling products related to health care that are not regulated by the Affordable Care Act. In 2012, Anthem expanded their product offerings by acquiring 1-800-Contacts, a leading contact retailer in the United States. Currently, Anthem benefits by earning profits from selling contacts through 1-800-Contacts and by offering discounts on those contacts to those insured by Anthem, encouraging customer loyalty.

This team suggests considering a similar investment in the wearable technology industry. An example of wearable technology would be a bracelet that could count the number of steps taken during a day or measure an individual's heart rate, oxygen levels, temperature, etc. This information would then be available on a computer or other similar device to track visually and numerically, showing an individual's general health levels, habits, and progress on a given goal. The wearable technology market is estimated to be worth $14 Billion and is estimated to grow to be worth $70 Billion by 2024. It is relevant to note that the market includes wearable technology for health care, safety, sports, military, and fashion, though health care is expected to be one of the largest segments. Even if Anthem can only capture 1% of the market, that would be worth $700 Million.

If Anthem were to enter the wearables technology market, there would be three ways to enter. One way would be to start by building prototypes from scratch. Given that Anthem's core competency is in health insurance, rather than in developing a popular and functional technological product, this option is strategically ruled out. The second option is to acquire a company that already has a prototype and sell the product through Anthem's health care providers. This is a feasible possibility, but it depends on the negotiated acquisition price. Currently, many technology companies are considered overvalued, making this option seem less attractive.  Lastly, Anthem could partner with another company that specializes in producing wearable technology designed to monitor and improve an individual's health. This seems to be the best option, as it would be lower-cost and would provide benefits for both parties. On the insurance side, if Anthem could sell the product at a discount to its members, it would provide yet another perk of choosing Anthem insurance, which could increase customer satisfaction and loyalty. On the wearable technology side, a smaller company partnered with Anthem could use Anthem's brand name and relationships with health care offices and hospitals as possible product distribution channels. This would give a smaller wearable technology firm an edge in the health care specific wearable technology market when competing with larger technology companies, such as Apple and Google who are also developing wearable technology. In fact, a major risk associated with investing in wearable technology would be if Google decided to give out high-quality wearable technology for free because they earn so much value just by collecting users' information. While this is a risk, if Anthem could utilize its healthcare connections to make a given wearable technology a preferred piece of technology to its customers, by integrating it into an individual’s daily healthcare routine by having Anthem doctors promote the product and integrate the product into their healthcare systems, Anthem could take advantage of their unique position as a health insurance company in the growing wearable technology market.

Ultimately, Anthem should continue managing its profit margins as is to maintain the approximately 80% market loss ratio allowed by the Affordable Care Act. Because this regulation does not allow Anthem to increase profitability per person further, Anthem has to find ways to increase profitability in other ways. The three ways mentioned in this report are to expand Anthem's national presence by acquiring smaller insurance companies in states in which Anthem does not yet operate, to cross-sell Anthem's insurance products, and to explore investment opportunities in health care products, such as the wearable technology market.