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DATE: September 20, 2019

TO: Amy J. Malm
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FROM: Michael A. Mancusi-Ungaro (Analyst)

SUBJECT: The Acquisition of Control of WellCare Health Insurance Company of Wisconsin, Inc. and WellCare Health Plans of Wisconsin, Inc. by Centene Corporation (Case No. 19-C43297)

The purpose of this memorandum is to summarize the results of OCI's analysis with respect to the above-referenced Form A filing performed in accordance with the criteria set forth in s. 611.72, Wisconsin Statutes.

Form A Filing Contact

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Executive Summary

This Form A Statement concerns the proposed acquisition of WellCare Health Plans, Inc. (hereinafter also, "WellCare") by Centene Corporation (hereinafter also, "Centene"). WellCare is the ultimate controlling parent of many individual health insurance operations located throughout the United States, and specifically, two newly created Wisconsin domiciled insurers: WellCare Health Plans of Wisconsin, Inc. ("WHPWI") and WellCare Health Insurance Company of Wisconsin, Inc. ("WHICW") (together the "Domestic Insurers"). In addition to the proposed acquisition of WHPWI and WHICW, Centene Corporation owns several Wisconsin domiciled insurance, managed healthcare and other entities, including: Bankers Reserve Life Insurance Company of Wisconsin, Managed Health Services Insurance Corporation, MHS Travel and Charter, Inc., Centene Management Company, LLC and Pinnacle Senior Care of Wisconsin, LLC.

Of these Centene entities, Centene Management Company, LLC, Bankers Reserve Life Insurance Company of Wisconsin and Managed Health Services Insurance Corporation are the largest, and when combined with the newly incorporated WellCare operations, WHPWI and WHICW, domestically will offer products throughout Wisconsin. On September 20, 2019, transaction counsel for WellCare notified the OCI that it's two recently licensed subsidiaries, WHPWI and WHICW, will not commence operations in Wisconsin by January 1, 2020 and instead are targeting a January 1, 2021 start date. As such, the confidential financial projections provided at exhibit CE-3 will be amended and replaced shortly after Form A hearing scheduled for September 24, 2019.

This proposed transaction increases the debt Centene will have outstanding on closing. This debt is expected to be primarily in the form of notes. Using conservative figures, debt service and principal repayment will amount to approximately $15 billion over the next five to seven years. Initial estimates of indebtedness indicate that the surviving entity could quite possibly have a debt to equity ratio of over 40%. As indicated in the Form A and discussions with Transaction Counsel from Skadden Arps, bridge financing is expected to be utilized only if the proposed debt offering by Centene or other funds sufficient to pay the Merger Consideration are not available prior to the closing (which is not anticipated). Provided a public or private debt offering is utilized to finance the Merger Consideration, and assuming all of the existing WellCare indebtedness remains outstanding, Centene's debt-to-capital ratio is expected to be approximately 40% at closing, and Centene intends to use its earnings and cash flows to achieve its targeted debt-to-capital ratio in the mid-to-upper 30% range within 12 to 18 months following the closing. This would be in line with other entities within their peer-group, many of which have been involved in recent business combinations, such as CVS – Aetna.

Based on audited financial statements for certain entities and the disclosures Centene Corporation made to its shareholders informing them of the financial impact of this transaction, it appears that Centene Corporation will be able to meet its financial obligations regarding indebtedness.

The Transaction

The transaction described in the Form A is complex because it involves two separate mergers involving two newly created merger subsidiaries, appropriately called "Merger Sub I" and "Merger Sub II."

Essentially, Merger Sub I will be merged with and into WellCare with WellCare surviving the First Merger as a wholly owned subsidiary of Centene. Immediately after the First Merger, WellCare will be merged into Merger Sub II with Merger Sub II being the surviving corporation and renamed WellCare Health Plans, Inc. Following the mergers, Centene will directly own 100% of the issued and outstanding shares of capital stock in WellCare Health Plans, Inc. and will also subsequently indirectly own 100% of the issued and outstanding shares of capital stock of WellCare Health Plans of Wisconsin, Inc. and WellCare Health Insurance Company of Wisconsin, Inc.

At the effective time of the merger, each share of common stock of WellCare that is issued and outstanding immediately prior to the effective time of the First Merger (with limited exceptions) will be converted into the right to receive 3.38 validly issued, fully paid and nonassessable shares of common stock of Centene and $120 in cash, without interest. WellCare restricted stock will be converted to Centene restricted stock. Using March 26, 2019 closing stock prices, the transaction was valued at $17.3 billion and following the consummation of the merger transactions, Centene's existing stockholders will own approximately 71% of the combined company and WellCare's existing stockholders will own 29% of the combined company.

The Insurers

WellCare Health Plans, Inc. owns two newly created Wisconsin insurers. WellCare Health Insurance Company of Wisconsin, Inc. is a newly incorporated accident and health insurer that is not currently writing any business in Wisconsin.

WellCare Health Plans of Wisconsin, Inc. is a newly incorporated health maintenance organization that is not currently writing any business in Wisconsin. Both WHICW and WHPW are expected to start writing health insurance business in the first quarter of 2021.

Centene also owns the following entities domiciled or incorporated in Wisconsin: Bankers Reserve Life Insurance Company of Wisconsin, Managed Health Services Insurance Corporation, MHS Travel and Charter, Inc., Centene Management Company, LLC and Pinnacle Senior Care of Wisconsin, LLC. Managed Health Services Insurance Corporation, Centene Management Company, LLC and Pinnacle Senior Care of Wisconsin, LLC currently operate in Wisconsin.

The Identity and Background of the Applicant

Centene Corporation, 7700 Forsyth Boulevard, St. Louis, Missouri 63105, is a multi-national healthcare company that operates two primary business segments: Managed Care and Specialty Services. The Managed Care segment provides health plan coverage to individuals through government subsidized and commercial programs. The Specialty Services segment provides diversified healthcare services and products to its Managed Care segment and external customers.

As disclosed in the Form A: "As of the date of this Form A, no filings made with the SEC show a person holding 10% or more of the voting securities of Centene except for The Vanguard Group, Inc. ("Vanguard"), which held approximately 10.07% of Centene Common Stock as of December 31, 2018. No person is projected to hold 10% or more of the outstanding Centene Common Stock immediately after the Closing except for Vanguard, which is projected to hold approximately 10.0% of Centene Common Stock immediately after the Closing. Centene has been informed by Vanguard that Vanguard intends to file disclaimers of affiliation or control in respect of each of the Domestic Insurers with the Wisconsin Office of the Commissioner of Insurance."

Nature, Source and Amount of Consideration

Per the Form A, the present transaction has a value of $17.3 billion based on the closing price of publicly traded securities on March 26, 2019. The cash component of the $17.3 billion is approximately $6.06 billion. Centene expects to finance the cash component of the merger consideration, discussed above, through the public offering of unsecured senior notes or other private placement financing yielding approximately $6.65 billion in aggregate gross cash proceeds, assuming all of the existing WellCare indebtedness remains outstanding (which is currently anticipated). There is no financing condition to closing in the merger agreement. In addition to the merger consideration, Centene may be assuming or would otherwise expect to refinance approximately $1.95 billion in existing WellCare debt.

Importantly, "assuming all of the existing WellCare indebtedness remained outstanding, the pro forma debt to capital ratio of Centene is expected to be approximately 40% at closing." To give the Applicant flexibility, Centene entered into the second amended and restated debt commitment letter, dated April 23, 2019 with Barclays Bank PLC and others to provide up to $8.35 billion in bridge financing, inclusive of an amount sufficient to refinance WellCare's outstanding senior notes, if such notes are not assumed, in the event that proceeds of the proposed debt offering and other sources of cash are not sufficient to pay the merger consideration.

In application follow up questions, the OCI asked transaction counsel to compare the debt levels projected by the Applicant once it acquires WellCare and other major healthcare firms of comparable size. The chart, summarized below and attached to this memorandum as Exhibit 1, was sourced from public SEC filings and other sources in the public domain. Standard & Poor's and Moody's did not change their ratings of Centene in reaction to the announced acquisition. Ratings as of August 23, 2019 remain unchanged at BB+ and Ba1, respectively.

A study of Centene and WellCare's existing, issued debt with various maturity dates shows that interest rate risk remains elevated, as shown by the table below. The interest rate risk is considered elevated because if interest rates were to rise more quickly than expected, the annual interest payments may exceed the figures estimated below.[1]

Current Weighted Average Interest Rate Calculation
Borrowing and Annual Interest in Millions

[1] Centene pays a fixed interest rate on the majority of its debt.

	Borrowing	Rate	Annual Interest	Weighted Interest Rate
Centene 2021 Senior Notes	$1,400	5.625%	$ 78.75	0.52%
Centene 2022 Senior Notes	$1,000	4.750%	$ 47.50	0.31%
Centene 2024 Senior Notes	$1,000	6.125%	$ 61.25	0.40%
Centene 2025 Senior Notes	$1,200	4.750%	$ 57.00	0.38%
Centene 2026 Senior Notes	$1,800	5.375%	$ 96.75	0.64%
Centene Credit Revolver	$284	4.420%	$ 12.55	0.08%
Centene Mortgage Note	$57	5.140%	$ 2.93	0.02%
Centene Construction Loan	$63	5.08%	$ 3.20	0.02%
Wellcare Senior Notes 2025	$1,200	5.250%	$ 63.00	0.42%
Wellcare Senior Notes 2026	$750	5.375%	$ 40.31	0.27%
Wellcare Credit Revolver	$200	1.350%	$ 2.70	0.02%
Centene-Wellcare Senior Bridge[2]	$6,200	5.73%	$ 355.26	2.34%
Debt Issuance Costs and Offsets	($194)			
	$14,960		$ 821.20	5.42%

Additionally, Centene produced a table comparing the Centene/WellCare combination to United Health Group, Cigna, CVS, Humana and Anthem. Importantly, if Centene issues new debt or, alternatively, draws on the bridge loan, Centene will have a Debt to Capital ratio[3] of 40%. Debt to EBITDA would be 3.1 and EBITDA to Interest Expense[4] would be 5.6.

	Centene & WellCare	UnitedHealth Group		Cigna		CVS		Humana		Anthem	
	At Closing	2018	6/30/2019	2018	6/30/2019	2018	6/30/2019	2018	6/30/2019	2018	6/30/2019
Debt / Equity Ratio (Debt divided by Equity)		0.7	0.8	1.0	0.9	1.3	1.2	0.6	0.5	0.7	0.6
Debt / Capital (Debt divided by Debt + Equity)	40.0%	40.2%	43.1%	50.9%	47.2%	55.6%	53.6%	37.4%	32.5%	40.2%	38.5%
Debt / EBITDA Ratio (Debt divided by EBITDA)	3.1	1.9	4.0	8.9	6.3	10.9	8.6	2.1	2.4	2.8	4.4
EBITDA / Interest Expense (EBITDA divided by Interest Expense)	5.6	13.8	13.1	9.6	7.1	2.6	5.3	13.0	19.6	9.2	11.7

To reach these figures, Centene used the following assumptions, which were edited to include additional competitor information:

Assumptions:

- As noted during Centene's December 2018 Investor Day conference call, Centene's interest expense is expected to be between $400 million and $420 million in 2019 (midpoint of $410 million used for this analysis).

[2] The Bridge Loan is not expected to be drawn and is considered a “Plan B” should more economic debt financing options become unavailable.
[3] Debt Divided by the quantity debt plus equity.
[4] EBITDA divided by interest expense.

- WellCare Financing: Estimated based on approximately $6.4 billion of long-term fixed-rate debt Centene expects to issue to partially fund the proposed acquisition and assumption of $1.95 billion of existing WellCare debt. The calculation of interest expense on the long-term debt assumes maturity tranches between eight and 10 years and an estimated weighted average annual interest expense of 5.73%. Actual interest rates and maturities will depend on market conditions and the ultimate completion of the Centene debt financing transaction.

Calculation of Estimated Future Interest Expense:

2019 Centene Interest Expense (guidance midpoint)	$	410
Rollover of Existing WellCare Debt (CNC/WellCare S-4)	$	107
Estimated Interest Expense (CNC/WellCare - S-4 May 2019) for Issuance of New Debt - Assumptions Noted Above	$	375
Total Estimated Interest Expense, post-closing	**$**	**892**

Competitor Analysis:	**6/30/2019 Interest Expense (Annualized)**	**Net Income for 12 months Ended 6/30/19**	**Interest Expense As % of Net Income**
UnitedHealth Group	$1,636	$12,988	13%
Cigna	1,760	3,692	48%
CVS	3,108	4,328	72%
Humana	244	2,505	10%
Anthem	742	4,074	18%
Centene/WellCare**	892	1,798	50%

** Pro forma combined

From the table produced above, the OCI has determined that the debt levels, if the bridge loan is not fully drawn, will be within the range of Centene's close competitors but Centene's exposure to interest rate risk will remain elevated so long as approximately $8.760 billion in debt remains outstanding.

The Applicant's Form D Filing

On June 3, 2019, the Applicant's outside legal counsel filed a Form D notification with the OCI stating its intention to 1) add both WellCare Health Insurance Company of Wisconsin, Inc. and WellCare Health Plans of Wisconsin, Inc. as a party to an existing tax sharing agreement and, 2) terminate an existing tax sharing agreement between the same Wisconsin WellCare insurers and its previous parent, WellCare Health Plans, Inc.

The Centene Corporation Tax Sharing Agreement is dated as of December 31, 2002 and was created to allocate tax liabilities among Centene and its members including 1) U.S. federal consolidated income tax returns which Centene prepares and files on behalf of the members to the agreement and 2) certain state or local tax returns filed on a consolidated, combined or unitary basis. Since WellCare Health Plans, Inc. and the Wisconsin Domestic Insurers will become members of the consolidated Centene Group once the merger is approved and closed, it was determined that the previously filed WellCare Tax Allocation Agreement effective as of January 1, 2019 would no longer be needed. Additionally, making WHPWI and WHICW signatories to the Centene Tax Sharing Agreement is expected to have no impact on policyholder surplus of the Wisconsin Domestic Insurers.

The new tax sharing agreement contain standard terms and conditions and it is recommended that in addition to approving the Form A, the subsequently filed Form D should also be approved.

The Applicants Future Plans

As stated in the Form A, Centene has no present plans or proposals to cause the domestic insurers to declare an extraordinary dividend or liquidate the domestic insurers, to sell the assets of the domestic insurers, to merge the domestic insurers with any person or make any other material changes to the domestic insurers' business operations, corporate structure or management. But paragraphs later, Centene states:

"After the Closing, as part of the ongoing integration of the operations of Centene's and WellCare's respective health businesses, Centene may choose, from time to time, to (i) combine the operations of two or more of its subsidiaries (including the Domestic Insurers) through a merger or other mechanism if such subsidiaries operate in the same state or other geographic area or (ii) terminate existing intercompany agreements within the WellCare group and enter into new intercompany agreements. Any such transactions would be implemented subject to required insurance regulatory approvals, as appropriate and as required by law, and would be effected in compliance with all applicable statutory and regulatory requirements."

Additionally, there are plans to add each of the domestic insurers to Centene's Tax Sharing Agreement. As previously noted, a Form D was filed with the OCI.

The 611.72(3) Standard

Wisconsin Statute s. 611.72(3)(am) creates a five-part test for the Commissioner to use when evaluating the merger of a domestic stock insurance company. It reads, in relevant part:

> **(am)** The commissioner shall approve the plan if the commissioner finds…that it would not violate the law or be contrary to the interests of the insureds of any participating domestic corporation or of the Wisconsin insureds of any participating nondomestic corporation and that:
>
> **1.** After the change of control, the domestic stock insurance corporation or any domestic stock insurance corporation controlled by the insurance holding corporation would be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed;
>
> **2.** The effect of the merger or other acquisition of control would not be to create a monopoly or substantially to lessen competition in insurance in this state;
>
> **3.** The financial condition of any acquiring party is not likely to jeopardize the financial stability of the domestic stock insurance corporation or its parent insurance holding corporation, or prejudice the interests of its Wisconsin policyholders;
>
> **4.** The plans or proposals which the acquiring party has to liquidate the domestic stock insurance corporation or its parent insurance holding corporation, sell its assets, merge it with any person or make any other material change in its business or corporate structure or management, are fair and reasonable to policyholders of the domestic stock insurance corporation or in the public interest; and
>
> **5.** The competence and integrity of those persons who would control the operation of the domestic stock insurance corporation or its parent insurance holding corporation are such that it would be in the interest of the policyholders of the corporation and of the public to permit the merger or acquisition of control.

These five requirements are analyzed below.

s. 611.72(3)(am)1: After reviewing the documents provided by the Applicant in its Form A filing, OCI staff believes that the Applicant is able to satisfy s. 611.72(3)(am)1. Centene has a history of operating profitable insurance operations in the State of Wisconsin and the OCI does not believe this transaction will endanger its history of compliant operations.

s. 611.72(3)(am)2: It is OCI's opinion that a Form E challenge is not necessary at this time as this transaction involves an acquisition of control of WellCare's two Wisconsin-domiciled insurers, which have not yet written any business. Accordingly, the holding company system led by Centene Corporation will not gain any market share directly as a consequence of the proposed acquisition of control. OCI's examination of the potential competitive effects concluded that approving the acquisition would not violate the competitive standards set forth in s. Ins 40.025(4), Wis. Adm. Code.

s. 611.72(3)(am)3: Paragraph 3 requires that the financial condition of any acquiring party is not likely to jeopardize the financial stability of the domestic insurance corporation or its parent insurance corporation, or prejudice the interest of its Wisconsin policyholders. After reviewing the documents provided by the Applicant, it did not appear that Centene's post-closing debt levels would jeopardize the financial condition of WellCare's recently incorporated, non-active insurance subsidiaries and OCI will monitor compliance with s. 611.72(3)(am)3 going forward.

s. 611.72(3)(am)4: Paragraph 4 requires that the post-transaction plans to change the business structure be "fair and reasonable to policyholders of the domestic stock insurance corporation or in the public interest." Review of the Form A and its supporting documents raise no concerns that certain customers would be prejudiced post-transaction as the domestic insurers are in a strong financial position and the risk to customers is minimal given implicit support from Centene Corporation. Compliance with s. 611.72(3)(am)4 is expected and not a significant concern at this time.

s. 611.72(3)(am)5: Paragraph 5 requires that OCI review the biographical affidavits of the proposed officers and directors of the Applicant and this review did not raise any concerns.

Conclusion

The acquisition of control of WellCare Health Insurance Company of Wisconsin, Inc. and WellCare Health Plans of Wisconsin, Inc. by Centene Corporation should be approved. Furthermore, the addition of the Domestic Insurers as signatories, upon the acquisition of control, to the Tax Sharing Agreement dated December 31, 2002, by and among Centene Corporation and its signatory affiliates and the Termination Agreement to the Amended and Restated Income Tax Allocation Agreement, as filed under cover of a letter to Michael Mancusi-Ungaro, OCI, from Cheryl Bunevich, Skadden, Arps, Slate, Meagher & Flom LLP, dated June 3, 2019 should be approved.