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Healthways merger falls through

'Data and reporting' error cited as reason for no deal

By TODD PACK
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Healthways Inc. has called off a $307.5 million merger with LifeMasters Supported SelfCare Inc. over a "data and reporting error" that affected the value of the deal.

After the announcement early Monday morning, Healthways' stock fell $1.91, or 4.28 percent, closing at $42.69 a share.

Jefferies & Co. stock analyst Arthur Henderson blamed the decline in part on the company's decision to wait until 4 p.m. today to discuss the collapse of the deal in a conference call with stock analysts.

"People may be thinking, 'What else are they going to tell us?'" said Henderson, who still rates Healthways stock a "buy."

The deal would have helped Nashville-based Healthways expand quickly into Medicare, one of California-based LifeMasters' key markets. Healthways, the nation's largest disease management company, has focused more on commercial health plans and Medicare.

Healthways announced the deal in May, but in August it

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BEN R. LEEDLE, JR.
"We are naturally disappointed," the Healthways CEO said.

Healthways Inc.

Headquarters: Nashville.

Clients: As of May 31, Healthways provided services to more than 2.2 million people through health plans, employers and government.

Monday's stock price: $42.69, down $1.91 a share.

LifeMasters Supported SelfCare Inc.

Headquarters: South San Francisco, Calif.

Clients: Nearly 600,000 people receive its services.

Investors: privately held, but backers include Intel Corp., Lightspeed Venture Partners, Pacific Venture Group and Knotty & Co.

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said the deal was on hold because of a recently discovered reporting error concerning a key contract.

The companies wouldn't discuss details of the contract, but Henderson speculated that the error could concern LifeMasters' contract with Aetna, a major insurer.

"Aetna is their biggest contract," Henderson said. "It would have to be something pretty significant" for Healthways to cancel the deal, he said.

In a joint statement, the companies said the error affected LifeMasters' financial results and earnings projections that Healthways used to determine the purchase price.

"Despite the best efforts of both companies, an agreement on a revised valuation ... could not be reached," the companies said in the statement.

Ben R. Leedle Jr., Healthways' president and chief executive, said in a statement, "We are naturally disappointed that we are unable to complete the merger."

David Strand, president and chief executive of the privately held LifeMasters, the fourth-largest disease management company, said he also was disappointed but added, "We will continue our deep commitment to helping individuals achieve and maintain optimal health."

Insurance companies, employers and other groups use disease management companies to help patients manage chronic diseases such as diabetes.

A Healthways spokesman said company executives would have no additional comment until an analysts' call after the markets close this afternoon. A spokeswoman for LifeMasters, based in South San Francisco, Calif., also declined comment.

Despite the developments, Henderson kept his "buy" rating on Healthways stock and said, "If anything, we view the termination as a favorable event," because it avoids potential integration problems with LifeMasters' operations and because Healthways unearthed the error before closing a deal.

Stifel, Nicolaus & Co. analyst Thomas Carroll, who recently downgraded Healthways stock from "buy" to "hold," in part because of questions about the LifeMasters deal, said in a research note on Monday he sees the collapse of the deal as "disappointing but certainly not disastrous."

"LifeMasters provided growth visibility but, in our view, was not a requirement for Healthways to succeed in 2007," Carroll said. Still, the analyst said ending the deal could hurt earnings by 8 cents to 10 cents a share in 2007.

The analysts said investors also are uncertain about a pair of Medicare pilot projects, including one in which the company is a subcontractor to Cigna. Healthways will receive about $20 million in the fourth quarter if the company meets certain performance goals. Healthways has said it expects to meet the goals. ■

Todd Pack covers the business of health care. He can be reached at