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<p><b>Report Date:</b> April 8, 2020</p> <p><b>Company:</b> eHealth Inc.</p> <p><b>Ticker:</b> EHTH US</p> <p><b>Industry:</b> Insurance</p>	<p><b>Stock Price:</b> \$116.90</p> <p><b>Market Cap:</b> \$3.0 billion</p> <p><b>Float:</b> 94.4%</p> <p><b>Average Daily Volume (30-day):</b> \$96.4 million</p>
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**Summary:**

- EHTH’s highly aggressive accounting masks what we believe is a significantly unprofitable business. Based on variable costs alone, we estimate that EHTH will lose approximately -\$135 from each MA member it enrolled in 2019. If also including fixed costs, our per MA member loss estimate becomes -\$402.
- We adjust 2019 revenue down by \$128 million or 25%. We adjust 2019 operating profit down by \$263 million due to subjective and misapplied mark-to-model accounting, yielding an operating loss of -\$181 million.
- EHTH’s persistence assumptions in its LTV model seem highly aggressive when compared to reality. After ASC 606 went into effect, member churn immediately skyrocketed. We conclude that EHTH is pursuing low quality, lossmaking growth while its LTVs are based on lower churn, pre-growth cohorts.
- We conclude that the key driver of growth since 2018 has been EHTH’s reliance on Direct Response television advertising, which attracts an unprofitable, high churn enrollee.
- To generate this unprofitable growth, EHTH has been incinerating cash, which we expect it to continue to do until this value destruction slows down or stops.
- EHTH management is, in our view, running a massive stock promotion. In addition to using aggressive modeling assumptions, they misleadingly downplay the need for ongoing service and retention. This is the crux of how they justify booking multiple years of revenue at one time. Management also manipulates its presentation of churn to be misleadingly low. EHTH appears to be booking multi-year “tail” revenue at the end of each cohort’s estimated life, which is extremely aggressive in light of the significantly elevated churn. While publicly comparing EHTH to Expedia and Zillow, insiders have sold \$34.9 million of shares since the beginning of 2019.

## 2014 – The Year that Birthed EHTH’s Stock Promotion

There are three years that explain the problems with EHTH – 2014, 2016, and 2018. The foundation for the promotion was laid in 2014 when FASB codified ASC 606, announcing that it would be effective by January 1, 2018.<sup>1</sup> ASC 606, which was intended to rationalize revenue recognition for software companies, would have a perverse impact on how EHTH reports and operates. We think it reasonable to assume EHTH’s new leaders, Messrs. Flanders and Francis, knew of the impending standard when they took over in mid-2016. The promotion took off in 2018, which is when we perceive the company began pursuing higher churn and unprofitable enrollees in order to exploit ASC 606. The goal seems to have been to give the impression that EHTH was growing in a way that made it the “Expedia” or “Zillow” of health insurance.<sup>2</sup>

The new management’s first full year was 2017. This was a year in which growth in MA Approved Applications was barely-existent, but member churn was quite low. We understand that with its low churn, 2017 combined with 2016 to determine the member life assumptions in EHTH’s 2018 LTV revenue model. In 2017, EHTH began testing DR television advertising in-house.

Video killed the radio star. We believe it also killed the three-year life of EHTH’s MA enrollees. In 2018, EHTH underwent a selling explosion, growing available call center capacity by 129%,<sup>3</sup> and focusing on its television advertising.<sup>4</sup> Despite management’s talk of EHTH’s online marketing, we believe the outsize growth of EHTH’s MA business is dependent on “direct response” advertising, such as mailers and ambulance chaser quality TV commercials. Although EHTH’s DR advertising has helped lower the acquisition cost per enrollee, DR advertising draws in less sticky members, who we believe are on the whole quite unprofitable.

In contrast to 2017’s miniscule growth in MA Accepted Applications of only 1.2%, 2018 and 2019 saw respective growth rates of 25.8% and 88.3%. We calculate that the MA churn rate shot up from 36.9% in 2017 to 45.6% 2018 and then 47.0% in 2019.<sup>5</sup> It is obvious that 2018 and 2019 MA enrollee profiles are not comparable to that of 2017.

Interestingly, EHTH recently changed its MA LTV model so that it heavily weights the prior three years in determining the life assumption, ensuring that 2017 remains relevant for another year.<sup>6</sup>

*Table 1: eHealth Medicare Advantage Churn*

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<sup>1</sup> ASC 606 technically went into effect for fiscal years beginning on or after December 15, 2017. See [https://www.fasb.org/jsp/FASB/FASBContent\\_C/CompletedProjectPage&cid=1175805486538](https://www.fasb.org/jsp/FASB/FASBContent_C/CompletedProjectPage&cid=1175805486538)

<sup>2</sup> <https://youtu.be/UBSZLOgVH8w>

<sup>3</sup> 425 agents to 975 agents for AEP, EHTH Q2 2018 Earnings Call.

<sup>4</sup> EHTH Q1 2018 Earnings Call.

<sup>5</sup> The implied churn rate in 2016 was 40.1%.

<sup>6</sup> EHTH Q4 2019 Earnings Call.

	eHealth Medicare Advantage Churn															
	FY16	1Q17	2Q17	3Q17	4Q17	FY17	1Q18	2Q18	3Q18	4Q18	FY18	1Q19	2Q19	3Q19	4Q19	FY19
Beginning	144,207	191,904	174,561	185,819	195,970	191,904	236,857	218,685	226,048	235,269	236,857	276,357	280,763	291,171	309,180	276,357
Approved Applications	116,681	21,465	21,893	19,572	55,125	118,055	24,620	20,818	19,664	83,376	148,478	40,741	36,576	35,171	167,073	279,561
Implied Churn	(68,984)	(38,808)	(10,635)	(9,421)	(14,238)	(73,102)	(42,792)	(13,455)	(10,443)	(42,288)	(108,978)	(36,335)	(26,168)	(17,162)	(71,559)	(151,224)
Ending	191,904	174,561	185,819	195,970	236,857	236,857	218,685	226,048	235,269	276,357	276,357	280,763	291,171	309,180	404,694	404,694
Churn % (ITM)	44.1%	43.1%	43.5%	36.4%	36.9%	36.9%	36.8%	36.4%	35.3%	45.6%	45.6%	40.3%	42.5%	42.1%	47.0%	47.0%

## Aggressive LTV Life Assumptions

The Company estimates member persistence in order to calculate its health insurance plan LTVs. Among these estimates are:<sup>7</sup>

- Three years for MA plans
- Five years for Medicare Part D prescription drug plans
- Five years for Medicare Supplement plans

We believe that EHTH uses an overly optimistic MA member persistence assumption, which has a material impact on profitability (or lack thereof) of an enrollee. EHTH also discloses that it only breaks even on each MA member after the second year.<sup>8</sup> On the back of aggressive DR advertising, the churn percentages for MA enrollees skyrocketed from 2017 to 2018 and 2019. It is therefore clear that EHTH has been bringing in significantly less sticky MA members since 2017, yet its persistence assumption seems to be based – at least in part – on that lower churn enrollee profile. Moreover, as we show below, EHTH’s presentation to investors of its implied churn is manipulated lower by using a small numerator and a large denominator. We question whether that manipulated methodology factors into the assumptions used in the LTV model. This practice of estimating lifetimes means that EHTH books three years of future sales for an MA application even though it should expect to lose 47% of its members over the first year post-sale. EHTH then expects that commissions from customers who stay for more than three years are at least equal to the sales it booked for the customers who lasted less than the three-year MA life. We believe the company has used its small group of longer-lived customers to justify a three-year life to begin with, as first-year retention at the company is so poor.

However, at the end of the three-year life, EHTH appears to book sales again to further capture “tail” revenue associated with these customers for whom it already has booked a commission. We believe the combination of using a three-year life and then booking additional commission revenue for tail customers overstates expected future cash collections from EHTH’s members and flies in the face of the marked increase in MA churn rates.

EHTH recognizes the commissions to be received over the entirety of its customers’ lives upfront as revenue. It does so by computing customer lifetime values, which are supposed to represent the lifetime commissions to be received for the average customer approved for a specific category of health plan. EHTH then “constrains” the LTVs primarily by reducing them by a percentage that matches EHTH’s estimate for the approved applications that will not

<sup>7</sup> EHTH 2019 10-K, p. 66

<sup>8</sup> November 2019 presentation, p. 33.

convert into paying customers.<sup>9</sup> The constraint on the MA LTV is 7%. EHTH then multiplies the constrained LTVs by the approved applications to report revenue.

The LTVs are highly sensitive to even small changes in the persistence assumption. Based on the 47.0% implied churn in 2019 MA members, the implied life is 2.1 years. To be conservative and company-favorable, we use a 2.34-year remaining life, which is the average of the 2017 through 2019 MA cohorts' implied lives, rather than EHTH's 3.0 years. In our model, this adjustment drops the 2019 MA LTV by 28.1% or \$285.

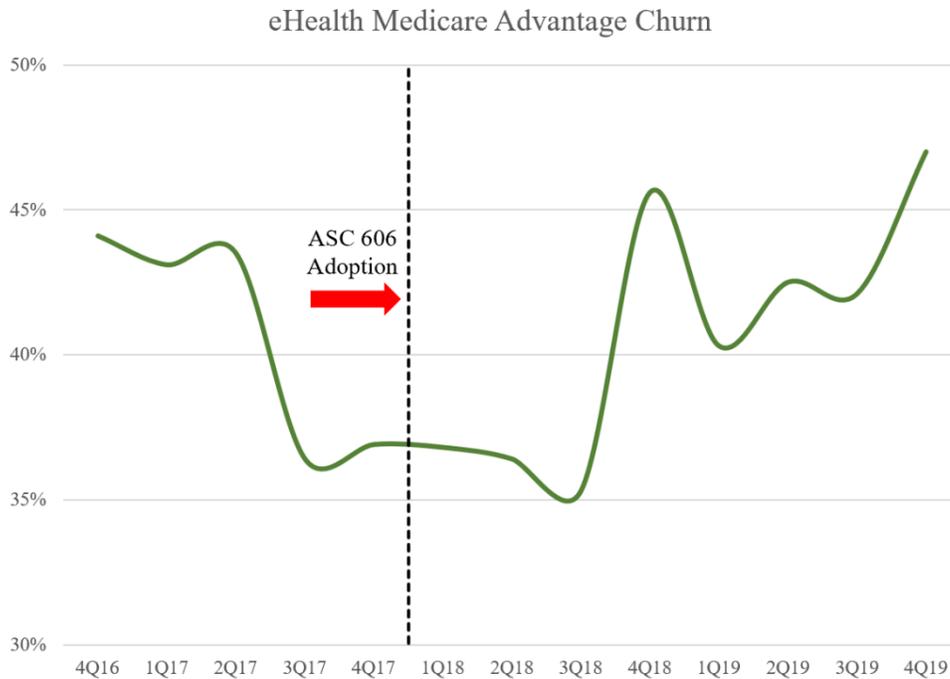
To calculate the implied churn rates for each quarter, we use the following formula:

$$\frac{\text{Initial Estimated Members} - \text{Final Estimated Members}}{\text{Past Four Quarters Average Estimated Members}}$$

Over the past two years, MA implied churn has steadily worsened to 47%, which implies a life of only 2.1 years.

Table 2: eHealth Medicare Advantage Churn

	eHealth Medicare Advantage Churn															
	FY16	1Q17	2Q17	3Q17	4Q17	FY17	1Q18	2Q18	3Q18	4Q18	FY18	1Q19	2Q19	3Q19	4Q19	FY19
Beginning	144,207	191,904	174,561	185,819	195,970	191,904	236,857	218,685	226,048	235,269	236,857	276,357	280,763	291,171	309,180	276,357
Approved Applications	116,681	21,465	21,893	19,572	55,125	118,055	24,620	20,818	19,664	83,376	148,478	40,741	36,576	35,171	167,073	279,561
Implied Churn	(68,984)	(38,808)	(10,635)	(9,421)	(14,238)	(73,102)	(42,792)	(13,455)	(10,443)	(42,288)	(108,978)	(36,335)	(26,168)	(17,162)	(71,559)	(151,224)
Ending	191,904	174,561	185,819	195,970	236,857	236,857	218,685	226,048	235,269	276,357	276,357	280,763	291,171	309,180	404,694	404,694
Churn % (TTM)	44.1%	43.1%	43.5%	36.4%	36.9%	36.9%	36.8%	36.4%	35.3%	45.6%	45.6%	40.3%	42.5%	42.1%	47.0%	47.0%



<sup>9</sup> EHTH 2019 10-K, p. 73

EHTH's persistence assumptions for Medicare Supplement and Medicare Part D also look highly aggressive relative to churn from the 2018 and 2019 cohorts. For Medicare Supplement, EHTH churn implies a life of 4.3 years.

*Table 3: eHealth Medicare Supplement Churn*

	eHealth Medicare Supplement Churn															
	FY16	1Q17	2Q17	3Q17	4Q17	FY17	1Q18	2Q18	3Q18	4Q18	FY18	1Q19	2Q19	3Q19	4Q19	FY19
Beginning	-	23,356	24,654	26,533	29,111	23,356	33,635	58,507	61,316	64,632	33,635	70,426	76,875	80,779	85,821	70,426
Approved Applications	-	4,199	3,179	3,550	5,064	15,992	5,416	5,267	6,985	12,169	29,837	8,631	8,769	9,110	16,178	42,688
Implied Churn	-	(2,901)	(1,300)	(972)	(540)	(5,713)	n/a*	(2,458)	(3,669)	(6,375)	(12,502)	(2,182)	(4,865)	(4,068)	(8,522)	(19,637)
Ending	-	24,654	26,533	29,111	33,635	33,635	58,507	61,316	64,632	70,426	70,426	76,875	80,779	85,821	93,477	93,477
<b>Churn % (TTM)</b>		<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>20.1%</b>	<b>20.1%</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>N/A</b>	<b>21.5%</b>	<b>23.4%</b>	<b>22.3%</b>	<b>23.3%</b>	<b>23.3%</b>

\* Not comparable due to GoMedigap acquisition in January 2018

For Medicare Part D, EHTH churn indicates a life of 4.1 years.

*Table 4: eHealth Medicare Part D Churn*

	eHealth Medicare Part D Churn															
	FY16	1Q17	2Q17	3Q17	4Q17	FY17	1Q18	2Q18	3Q18	4Q18	FY18	1Q19	2Q19	3Q19	4Q19	FY19
Beginning	-	89,597	85,650	88,021	89,424	89,597	114,362	104,595	106,573	109,987	114,362	139,907	146,239	149,312	156,067	139,907
Approved Applications	-	5,132	4,163	3,265	29,058	41,618	4,302	3,417	3,511	50,143	61,373	8,527	7,224	6,933	89,993	112,677
Implied Churn	-	(9,079)	(1,792)	(1,862)	(4,120)	(16,853)	(14,069)	(1,439)	(97)	(20,223)	(35,828)	(2,195)	(4,151)	(178)	(33,582)	(40,106)
Ending	-	85,650	88,021	89,424	114,362	114,362	104,595	106,573	109,987	139,907	139,907	146,239	149,312	156,067	212,478	212,478
<b>Churn % (TTM)</b>		<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>17.9%</b>	<b>17.9%</b>	<b>22.0%</b>	<b>20.7%</b>	<b>18.1%</b>	<b>31.1%</b>	<b>31.1%</b>	<b>19.1%</b>	<b>19.6%</b>	<b>18.1%</b>	<b>24.2%</b>	<b>24.2%</b>

We believe EHTH has taken advantage of its reliance on two statistical models, one for new members and one for aged members. As a result, we believe that the company significantly overstates the remaining customer life on its books in order to arrive at its \$589 million commissions receivable balance.

$$\text{Remaining Life} = \text{Total Life} - \text{Existing Customer Life}$$

In MA, for example, we calculate that EHTH uses 3.35 years of remaining life. This means that EHTH assumes its customers' total lives are well above 3.35 years, due to the fact that the company's book of business has already aged. We, on the other hand, model remaining life of 2.34 years, which is the mean of the implied lives of 2017 through 2019 MA cohort members. The net effect of this extra year of customer life on the books is that we estimate EHTH's constrained LTV for MA members is overstated by 28.2%.

*Table 5: Remaining Customer Life Estimate*

(years)	Remaining Customer Life	
	eHealth	Muddy Waters Estimate
Medicare Advantage	3.35	2.34
Medicare Supplement	5.00	4.64
Medicare Part D	5.00	4.32

*Apparently Sally Struthers Was Unavailable*

We believe the backbone of EHTH's growth in MA Accepted Applications in 2018 and 2019 was a high-churn demographic that responds to DR advertising. Our research made clear that two demographics have particularly high churn in the MA space: Low income enrollees and younger than 65 members who qualify for Medicare because of disability. Low income enrollees tend to churn because once they use the \$0 premium plans, they find them lacking, and are quick to respond to someone else's ad during the next Annual Enrollment Period ("AEP"). The under-65 members generally are able to switch plans every 90 days, rather than only during the AEP. As a result, they are high churn, particularly because carriers are generally not trying hard to retain them because their high utilization of healthcare often makes them unprofitable. Former EHTH executives told us the following:

"It's sort of the dredges of advertising. [EHTH] buy very cheap inventory on cable TV... that tend to just attract an older demographic and demographic that tends to be watching like 10 hours of TV a day, makes less than \$25,000 a year. That's where they get their enormous, through that channel. That is the most effective scale of channel for all of Medicare Advantage because all these people are poor and to get a zero-dollar premium plan that covers everything is a really good deal and they should be on it. And, so that's where they fish, so when you do that, they way that they do, every year around annual enrollment time, there are same people wanting those TV commercials again and eHealth really has no brand loyalty. People don't remember, know they are eHealth customers, they end up becoming [another] customer. eHealth is just some commercial on TV that they see a phone number and it says, "Hey, call in for your free dental and vision." So, they call. So, those people tend to be switchers, right? Next year they are going to see the same commercial and they're going to dial again and they're going to start off the thing, "Where is my fee dental?" The way they did this year. They don't have loyalty..."

... Yeah, I would say the way to answer that question [about whether customer lives are trending down], you are what you eat and that meaning whatever their marketing channels are there will give you an indication of the LTV. If 60, 70% of customers are still coming through DR TV than, yeah, you can look at that three years. That's probably accurate. That's what it was a few years ago... I think if anything, it might be getting worse when I left there was four, five hundred agents. I think two years later they had like fifteen and sixteen hundred agents and they have to feed a lot more people. And, the only way to feed them is through more TV. So, if anything I'd say maybe they're certainly not improving [the persistence] in my book. They might be hurting it even more because of the need to keep those call center agents busy."<sup>10</sup>

"And then whenever you had DR TV and things like that you could drive that mix up like fifty percent of under sixty-five which is not good, desirable mix that the carriers wanted. They usually wanted something under thirty percent or something like that... We started TV probably the last couple of years I was there."<sup>11</sup>

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<sup>10</sup> EHTH Former Executive B.

<sup>11</sup> EHTH Former Executive A.

An advertising measurement company estimates that EHTH has spent approximately \$15 million across two TV ad campaigns that have generated in excess of one billion TV impressions.<sup>12,13</sup> One of the ads invokes multiple late-night TV commercial stereotypes, including a tanned pitchman who looks like a 72-year old Brad Pitt.



Source: <https://www.ispot.tv/ad/I8u0/ehealthinsurance-services-all-in-one-medicare-coverage>

### *EHTH Deliberately Obscures the Increasing Churn*

We see EHTH as taking pains to pull the wool over investors' eyes with respect to recent churn rates. EHTH has published its own churn rates, which in our view materially understate the churn. EHTH manipulates these metrics by using an aggressively small numerator and a misleadingly large denominator. We question whether this manipulation of the churn rate flows into the assumptions in EHTH's LTV model.

Below is a slide from the most recent investor presentation showing lower churn metrics seven to 10 percentage points lower than we calculate. One glance shows the absurdity of EHTH's methodology (which we describe below): **The denominator used to calculate churn is actually greater than the Estimated Ending Membership in the two most recent quarters!**

<sup>12</sup> <https://www.ispot.tv/ad/over/ehealthinsurance-services-this-card>

<sup>13</sup> <https://www.ispot.tv/ad/I8u0/ehealthinsurance-services-all-in-one-medicare-coverage>

# Medicare Advantage Plan Member Turnover Trend Since Q4 2018

	Q4 18	Q1 19	Q2 19	Q3 19	
Estimated Beginning Membership <sup>(1)</sup>	235,269	276,357	280,763	291,171	
Approved Members <sup>(2)</sup>	83,376	40,741	36,576	35,171	
Estimated Total New Paying Members from Approved Members <sup>(3)</sup>	76,180	39,087	34,614	33,284	
Less Estimated Future Quarters Paying Members from Approved Members <sup>(4)</sup>	(15,920)	(5,476)	(3,968)	(3,278)	
New Paying Members from Approved Members <sup>(5)</sup>	60,260	33,611	30,646	30,006	
Plus					
New Paying Members from Prior Quarters Approved Members <sup>(6)</sup>	2,557	15,920	5,476	3,968	
<b>New Paying Members<sup>(7)</sup></b>	<b>62,817</b>	<b>49,531</b>	<b>36,122</b>	<b>33,974</b>	
Estimated Ending Membership <sup>(8)</sup>	276,357	280,763	291,171	309,180	← Est. Ending
Medicare Advantage Plan Member Turnover <sup>(9)</sup>	21,729	45,125	25,714	15,965	
Trailing Twelve Month Member Turnover <sup>(10)</sup>	95,065	89,357	102,403	108,533	
Average Trailing Twelve Month Estimated Membership Plus New Paying Members <sup>(11)</sup>	262,856	276,949	296,491	316,501	← Churn Denominator
<b>Trailing Twelve Month Member Turnover Rate<sup>(12)</sup></b>	<b>36%</b>	<b>32%</b>	<b>35%</b>	<b>34%</b>	
Trailing Twelve Month Approved to Paid Ratio <sup>(13)</sup>	91%	92%	93%	93%	Avg = 92%

EHTH also aggressively states the numerator. EHTH defines churn as follows:

$$\frac{\text{Initial Estimated Members} + \text{New Paying Members (Est.)} - \text{Final Estimated Members}}{\text{Average TTM Estimated Members} + \text{New Paying Members (Est.)}}$$

The numerator EHTH uses to calculate churn, in our view, is aggressive. EHTH is double-dipping by constraining the model for applicants who it estimates do not turn into paying members. This flows into New Paying Members. It should be noted that in this calculation, New Paying Members has an outsize effect on the numerator at 212.8% of the numerator. Therefore, a relatively small adjustment downward in this number has a large effect on the resulting calculation.

We see this as aggressive because when EHTH calculates its revenue for reporting purposes, it constrains the LTV for applications that do not convert into paying customers. Therefore, it is aggressive to also impose a similar constraint on the Approved Members.

EHTH uses a misleadingly large customer pool as the denominator. The company adds New Paying Members to Estimated Members, which does not make sense, as it ignores the customers dropping out over the course of the quarter. In fact, the EHTH customer base given by New Paying Members plus Estimated Members seemingly never exists in any given quarter. Taking the average Estimated Member count over the period, as we did, would be an appropriately conservative methodology. However, we think the company clings to this outsized customer total for a simple reason: when it comes to churn, EHTH needs to make the numbers. This twisted method of calculating churn begs the question: When EHTH uses a three-year persistence assumption, is it based on this means of calculating churn?

## Costs That Make MA Members Unprofitable

Against a constrained MA LTV of \$728, we apply total costs of \$863 to arrive at a 2019 per member loss of -\$135. There are two sets of costs: Upfront and ongoing. As we discuss infra, management minimizes the extent of ongoing costs because pretending there is no need to

service or act to retain existing customers is central to EHTH’s improper application of ASC 606.

We estimate that EHTH has ongoing costs of service and retention of \$96 per MA member per year, which includes commissions paid to partners. On a 2.34-year remaining life, that totals \$226. These service costs are not only important because of their impact on the LTV, but they also show how aggressive EHTH is in applying ASC 606. We include in this figure \$45 of costs (\$19 per year) for ongoing commissions that EHTH is obligated to pay channel partners.

We allocate 20% of EHTH’s Customer Care and Enrollment and Technology and Content expenses to retention of existing members. We allocate 10% of Marketing & Advertising expense to retention efforts. These ongoing costs come out to \$51.3 million across the entire business. After these costs are allocated to each segment by its revenue contribution, they come to \$96 per member for MA.

*Table 6: Retention and Service Expense Allocation*

(\$millions)	<u>eHealth Ongoing Expenses</u>		
	Total (2019)	Allocation	Ongoing
Cost of Revenue	2.7	0%	0.0
Marketing and Advertising	150.2	10%	15.0
Customer Care and Enrollment	134.3	20%	26.9
Technology and Content	47.1	20%	9.4
General and Administrative	64.2	0%	0.0
Acquisition Cost	0.0	0%	0.0
Change in Fair Value of Earnout Liability	24.1	0%	0.0
Restructuring Charges	0.0	0%	0.0
Amortization of Intangibles	2.2	0%	0.0
<b>Total Ongoing Expenses</b>			<b>51.3</b>

Source: eHealth 2019 10-K, p. 75

Upfront costs, on the other hand, are the Marketing and Advertising as well as Customer Care and Enrollment expenses not assigned to ongoing costs. They total \$242.7 million, or, when allocated proportionally by revenue, \$637 per MA member each year.

*Ongoing Costs = Ongoing Performance*

The crux of EHTH’s application of ASC 606 is that EHTH books multiple years of commission revenue by claiming that no further performance on its part is necessary in order to collect these commissions. This ignores the reality that EHTH needs to provide ongoing service to members and conduct outreach to them in order to retain them. We therefore wholly disagree with EHTH’s recognizing more than one year of commissions in each period.

EHTH pretends that ongoing service needs, which carry real costs, do not exist. According to the company’s accounting, the sole performance obligation is:

“the approval of an application from health insurance carriers, which we define as our customers.”<sup>14</sup>

<sup>14</sup> EHTH 2019 10-K, p. 80

EHTH wants to have its cake and eat it too. On the commission side, it recognizes commissions that it says are probable. It fails to take service and retention into account because they are not legal obligations. Management actively misleads investors about the need for further service:

“The costs attached to each of the receivable balances have essentially been absorbed as we generate the revenue in any particular quarter. So as the cash comes in, there is no additional cost attached to that. And the reason that those receivables are there is because there is no meaningful service component attached to them either.”

– Scott Flanders Q1 2018 Earnings Call

Mr. Flanders has doubled down on that misleading statement by discussing a focus on improving retention efforts, but misleadingly dismissing it as being a de minimis cost and effort (emphasis added):<sup>15</sup>

“And the opportunities for us to significantly improve retention rates in that 90-day period post-sale are both substantial and reflect a lot of near-term opportunity that we are very much focused on at the moment. **No incremental costs associated** with that kind of opportunity and to the extent that we're successful in meaningfully changing that amount of churn, that will ultimately reflect in meaningfully higher LTVs for Medicare customers in the relatively near future. The second piece of the retention pie that we're going after is that post-90 day, so more of a relational aspect with customers. Here again, an area that the company has historically not placed much of any focus on in terms of proving out the value proposition that we as a company have and continuing to help that customer manage their Medicare insurance purchase and to basically make sure that they are in the right plan at whatever point they are in their life or economic cycle, and to keep them as eHealth customers throughout the process rather than going elsewhere to buy another plan when things change for them. Here again, a very small investment, well under **\$1 million, for us to put some of the technology and other high-value engagement tools in place** to help these folks recognize that eHealth is a valuable part of their insurance purchasing and management process and keeping them in the boat.”

We view these statements as disingenuous because customers are not obligated to renew their policies. EHTH has to fight to retain business because the industry is highly competitive, and plans change regularly.

Former EHTH executives also dispute management's notion, stating or agreeing that ongoing retention and service takes resources and costs average \$50 to \$100 per MA member per year. They described in practical terms EHTH's typical MA service and retention (emphasis added):

“And, especially with Medicare enrollments season and sign up period, during Medicare open enrollment, there's often times where if you enroll somebody in October, there is a very high chance that that person could get signed up by another broker or even by the carrier. And, switch them off of your broker record. So, essentially you wouldn't get the credit for that, the person. So, that was one frequent activity, like how do we make sure

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<sup>15</sup> EHTH Q2 2018 Earnings Call.

with that close rate from essentially the sale, to enrollment, to payment, is high. So, you always want to maximize that and then beyond that of course it's the retention activities after the initial enrollment or say after each year, after each quarter, whatever is appropriate, let you keep on continuing, offering essentially value add... Again, it's not a huge burden art but it's essentially just to check in. So, making sure okay, you're still in the right plan or given changes to your plan or changes to the provider network in your area might actually be the switch plans or something. So, I think there's lot of efforts focused on that and even more so with the 606... "... I'm sure it does add a little bit to it [cost] because **if you're talking about retention call, you might be looking at an outbound call, maybe 15 minutes or something like that, 15 to 30 minutes** versus an enrollment call is anywhere from 30 minutes to an hour so your cost should be a little bit lower on that front."<sup>16</sup>

"A lot of those touch points and investments were during with a combination of reminders via email and then our call center is being able to follow up and maintain the book of members over time."<sup>17</sup>

An executive with a competing online broker quantified his company's annual retention expenses for members as likely between \$25 and \$50, and definitely less than \$100.

Of our \$96 allocation to ongoing costs, by adding back technology and content and revenue sharing expenses, we attribute \$60 to human-led customer service and retention activities, which matches the low end of the \$50 to \$100 per MA member per year range cited by the former employee. We also learned that customer service agents receive bonuses for retaining employees, which presents an additional ongoing retention cost. We do not account for such bonuses in our retention costs figure.

We estimate that EHTH has annual commission obligations that average \$45 over the lifetime of each MA member (\$19 per year). We understand that approximately 15% to 20% of all EHTH's enrollees are referred through marketing partnerships, and these marketing partnerships are overwhelmingly concentrated in the MA and Medicare Supplement categories.<sup>18</sup> Of such partnerships, we understand that approximately 60% require EHTH to pay revenue share over the life of the member.<sup>19</sup> We further understand that the share paid to the partner is approximately 15% to 25% of the commissions received. Based on our conversations with former employees and industry executives, we attribute about 2% of annual EHTH operating expenses, or \$8.7 million, to such costs. The MA share of such expenses works out to approximately \$19 per estimated MA member in 2019, or \$45 per MA member over 2.34 years.

*Table 7: eHealth Ongoing Costs From Revenue Sharing Partnerships*

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<sup>16</sup> EHTH Former Executive A.

<sup>17</sup> EHTH Former Executive C.

<sup>18</sup> Partnerships were 90% concentrated in the MA and Medicare Supplement segments, per an interview with a former EHTH employee, April 2020.

<sup>19</sup> Assuming 17.5% of year-end 2019 members, at the midpoint, were referred through partnerships, of which 60% entered through multiyear revenue-sharing agreements, yields approximately 120,000 EHTH members for whom eHealth has an obligation to share annual commissions.

<b>Impact of Ongoing Partnership Revenue Share on LTV and Costs</b>									
	Members, YE2019	% Via Partners	% Licensed Partners	Members Via Licensed Partners	LTV (\$)	Rev Share	LTV Impact (\$)	Life	Annual Unit Cost (\$)
Medicare Advantage	404,694	37%	60%	89,033	1,013	20%	45	2.34	19
Medicare Supplement	93,477	37%	60%	20,565	979	20%	43	4.64	9
Medicare Part D	212,478	3%	60%	4,250	238	20%	1	4.32	0
Small Business	42,638	17%	60%	4,264	159	20%	3	3.00	1

Source: eHealth 2019 10-K, eHealth Former Employee. Note: Assumes no partner contribution in Individual and Family, Short-Term, Dental, Vision, or Other.

## EHTH’s Medicare Advantage Business is Actually Unprofitable

On a unit basis, we conclude the EHTH’s MA business is significantly loss-generating. Rather than reflecting “investment for growth”, we believe that EHTH’s greatly increasing cash burn shows how value destructive EHTH’s pursuit of MA member growth at breakneck speed is.

Our adjusted 2019 MA enrollee loss on variable costs only is -\$135. We first adjust for the impact of a 2.34-year remaining life, which results in a \$285 decrease in LTV. We then allocate the remaining (i.e., current) operating expenses to MA by the percentage of revenue MA represents for EHTH. Then we divide that number by the number of 2019 MA Estimated Members. This yields an average current year expense of \$96 per 2019 MA enrollee, which comes to \$226 over a 2.34-year life. Finally, we subtract acquisition costs net of operating expenses classed as retention and service costs, which total \$637 per member. The result is that EHTH loses -\$135 on every MA member who submits an application.

Table 8: eHealth MA Unit Economics

<b>eHealth Medicare Advantage Unit Economics</b>	
Stated LTV	\$ 1,013
Life Impact	\$ (285)
<b>Adjusted LTV</b>	<b>\$ 728</b>
Retention & Service Cost Impact	\$ (226)
Acquisition Costs	\$ (637)
<b>Contribution Margin</b>	<b>\$ (135)</b>

The unit economics of the business appear even worse after adding an additional dose of reality. When including annual fixed costs in the calculation, we estimate **the company will lose -\$402** on every MA customer.

Table 9: eHealth MA Unit Economics Inclusive of Fixed Costs

<b>EHTH MA Unit Economics, Including Fixed Costs</b>	
Contribution Margin	\$ (135)
Fixed Costs	\$ (267)
<b>Unit Profit</b>	<b>\$ (402)</b>

EHTH management has consistently been unable to meet its forecasts of when the company will generate positive operating cash flow. These repeated misses and the resulting cash incineration show the value destruction that is occurring through EHTH’s pursuit of growth at all costs.

EHTH management has repeatedly had move the goalposts regarding when it expects to generate positive operating cash flow:

- In March 2018, Dave Francis said that he expected the Medicare business to become cash flow positive “certainly by 2019”. 2019 company operating cash flow was in fact negative.
- In February 2019, CFO Derek Yung gave 2019 cash used in operations guidance of -\$17 million to -\$20 million. The operating cash burn turned out to be -\$71.5 million.
- In February 2019, Mr. Yung also said that management was “targeting” positive OCF for 2020. Only one year later, in February 2020, Mr. Yung said that management expects 2020 cash used in operations to be -\$52 million to -\$55 million.

Apologists for the company might justify this inability to reach OCF breakeven as a sign of growth. Our response is that the company is prodigiously incinerating cash to grow, and member churn has skyrocketed.

### **We Adjust 2019 Revenue Down by 25%**

This adjustment assumes that EHTH may apply ASC 606 as it does, which is a proposition with which we wholly disagree. Regardless, we start with a lower LTV for 2019 MA enrollees of \$728. Multiplying the LTV difference by 404,694 2019 MA Estimated Members yields a revenue haircut of \$115 million from MA alone. Overstated receivables computed similarly across the remainder of the business bring total revenue inflation to \$128 million.

*Table 10: Revenue and Profit Impact of eHealth Misstatements*

<b><u>eHealth Adjusted 2019 Operating Figures</u></b>	
<i>(\$millions)</i>	
Stated Revenue	506.2
Remaining Life Overstatement	<u>(127.9)</u>
<b>Adjusted Revenue</b>	<b>378.3</b>
Stated Operating Profit	81.4
Remaining Life Overstatement	(127.9)
Retention & Service Cost Impact	<u>(135.0)</u>
<b>Adjusted Operating Profit</b>	<b>(181.5)</b>

EHTH’s overstatement of future commissions booked as upfront revenue by approximately \$128 million, detailed above, means that sales are exaggerated by 33.8%. Meanwhile, after stripping out the inflated commissions and adjusting for ongoing costs of approximately \$135 million, the company’s operating profit swings to a deep loss, reflecting a lossmaking underlying business

model.

## We View EHTH as Little More than a Stock Promotion

It is telling that when Mr. Flanders, who had no prior operational experience in healthcare, accepted the CEO job, he brought in an equity analyst as his number two, soon thereafter making him the COO.<sup>20</sup> We found no information to suggest that Dave Francis has an expertise in operating call centers, marketing to consumers, or U.S. government relations. As an equity analyst, however, he presumably knows how to “tell a story”. That story became “We’re the Expedia / Zillow of health insurance”, and when paired with an accounting standard that practically begs for aggressive assumptions and a growth at all costs approach, the stock has ripped on the back of fantasy revenue and earnings. Given that EHTH is already changing its model to ensure 2017 stays relevant, we wonder how long management can keep this charade up – particularly when consistently burning cash. Recent selling by insiders, especially Mr. Flanders (who sold 15% of his stake in January 2020 alone), makes that question all the more pressing.

<b>Share Sales at eHealth Since Late 2018</b>				
<b>Name</b>	<b>Date</b>	<b>Shares Sold</b>	<b>Net Price (\$)</b>	<b>Net Value Monetized</b>
Scott Flanders	1/24/2020	89,278	113.37	10,121,720
Scott Flanders	1/22/2020	31,722	100.28	3,181,082
Robert Hurley	12/2/2019	1,500	92.26	138,390
Robert Hurley	11/1/2019	1,500	69.39	104,085
Robert Hurley	10/1/2019	1,500	66.51	99,765
Robert Hurley	9/3/2019	1,500	82.84	124,260
Michael Goldberg	8/23/2019	11,104	97.58	1,083,485
Michael Goldberg	8/22/2019	7,013	102.15	716,360
Michael Goldberg	8/21/2019	4,057	102.21	414,673
David Francis	8/12/2019	2,000	109.54	219,071
Scott Flanders	8/7/2019	14,313	107.01	1,531,589
Robert Hurley	8/1/2019	1,500	103.74	155,610
Randall Livingston	8/1/2019	15,000	102.66	1,539,868
Ian Kalin	7/30/2019	5,500	84.40	464,200
David Francis	7/30/2019	1,000	103.00	103,000
Timothy Hannan	7/30/2019	19,785	89.17	1,764,193
Scott Flanders	7/30/2019	99,516	92.24	9,179,010
Robert Hurley	7/9/2019	6,000	89.95	539,700
Robert Hurley	7/1/2019	1,500	87.82	131,730
Robert Hurley	6/3/2019	1,500	70.34	105,510
Michael Goldberg	5/30/2019	8,750	70.00	612,500
Scott Flanders	5/10/2019	34,005	59.25	2,014,820
Michael Goldberg	5/8/2019	7,500	51.03	382,724
Robert Hurley	5/1/2019	1,500	60.47	90,705
Michael Goldberg	3/5/2019	2,337	40.24	94,041
<b>Total</b>				<b>34,912,091</b>
<b>Scott Flanders</b>				<b>26,028,220</b>

<sup>20</sup> See EHTH 2017 Investor and Analyst Day.