HEALTHWAYS: A FINANCIAL ANALYSIS AND RECOMMENDATIONS

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A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College.

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Table of Contents

Abstract

The Accy 420 course at the University of Mississippi serves to provide students who are in both the Patterson School of Accountancy and the Sally McDonnell Barksdale Honors College an alternative route in which to write their theses. The course uses research methods and financial statement analysis to allow students to produce an in-depth analysis on a company of their choosing. Both a written thesis and a presentation are aspects of the course. Through ten weekly chapter submissions, students compose their final thesis made up of general company information, industry and geographical analysis, strategy analysis, financial statement analysis, accounting quality, equity valuation, audit and tax recommendations, and advisory recommendations.

Throughout the analysis of Healthways, Inc., a few main issues for the company have become evident. In Healthways' 2013 Annual Report, the company lists goals in which it anticipates a more than 50 percent increase in revenue for the health systems, hospitals, and physicians market in 2014. They also expect mid-single digits to low double digits growth for its three customer markets and a 20 percent growth rate for businesses with large employers. However, Healthways has shown decreasing revenues, increasing costs of services, and increasing liabilities for the past few years. Another issue that Healthways is facing is the large amount of goodwill shown on its financial statements. Healthways recorded $338,800,000 in net goodwill for December 31, 2013. Goodwill for 2013 made up 45 percent of total assets on the balance sheet. Goodwill has increased due to recent acquisitions, but the company has had a large amount of goodwill for some time. The balance of net goodwill as of December 31, 2008 was $484,596,000. For this project, only years 2009-2013 were looked into for financial analysis.

Throughout this course, I have learned many new skills that will be helpful to me as I transition into my future career. Research skills are the main skills that I have learned from this class, and I believe that they are the most applicable. When the course began, I had never actually looked at a company's 10-K reports before. Now, through analysis, I can easily locate items on 10-Ks and find information in the footnotes quickly. In doing this project, I had to research on different website, for instance Yahoo Finance, in order to find analysts' estimates, stock prices, and industry information. Financial analysis is another skill that the course has taught me. I have learned how to do everything from ratios to valuation models. I have also learned new skills in Microsoft Excel, which employers emphasize as necessary skills.

Company and Industry History

Major Historical Events

Beginning in the 1980s, corporations began to take greater control, and a shift toward privatization of health care commenced as corporations began to integrate the hospital system and enter many health-care-related businesses and consolidate control. In 2010, President Barack Obama signed The Patient Protection and Affordable Care Act that would require all individuals to have health insurance (HealthCare.gov).

With new healthcare reform possibilities, including the Affordable Care Act, Healthways will have to learn to adapt to the political and economic changes ahead. Healthways will be prepared for the change, however, and will not have trouble adapting, especially with Ben Leedle, President and CEO, leading the management team. With over 19 years of leadership experience at Healthways, Leedle has seen the company grow through difficult economic and political changes before, including the most recent economic recession.

Changes in Consumer Tastes and Preferences

For over 30 years, Healthways has been at the forefront of the health industry and healthcare transformation. The company that began with programs to support diabetes care has expanded through a multitude of programs, now serving approximately 68 million people across four continents. A global shift in the way people think about work has been a major cause of the growth. Businesses now realize how connected health and the well being of employees are to their bottom lines. According to a study by the Milken Institute, the cost of productivity to the U.S. economy due to stress-related conditions from work is $1.1 trillion. A study out of Harvard University found that for every dollar a company spends on wellness programs, like the ones Healthways offers consumers, it makes back $3.27 in the form of lower health costs (Huffington Post; Healthways 2013 Annual Report).

Because of the change in needs and strategies by businesses, firms, and individuals, Healthways offers a wide variety of programs. Gallup-Healthways Solution is the collaboration between Gallup and Healthways to create the world's most comprehensive source for well-being measurement. Healthways has partnered with Dr. Dean Ornish, founder of nonprofit Preventive Medicine Research Institute and Clinical Professor of Medicine at the University of California, San Francisco, to create a program for reversing heart disease. The Blues Zone Project is a community well-being initiative that helps people transform their communities through environmental and policy changes (Huffington Post).

History of Marketing/Advertising Campaigns

While marketing for wellness program has been gaining popularity in recent years, marketing for health and well-being is not a recent occurrence. Campus wellness programs gained popularity in the 1970s in the U.S., and the first was established at the University of Wisconsin. It was here that the Lifestyle Assessment Questionnaire, a survey that helps identify lifestyle factors that need improvement, was created. In addition, Bill Hettler, a Health Services staff physician at the university, and his colleagues organized the National Wellness Institute at Seven Points in 1977, which grew to become the first national conference on wellness in 1978. In the late 1970s, Nelson Rockefeller, former governor of New York, commissioned experts to examine health care policy and reform. The result was *Daedalus*, a published issue with wide circulation. Health and wellness marketing gained momentum in today's marketplace with tobacco-free advertising campaigns (National Wellness Institute).

Workforce Diversity

With only two women on the Board of Directors, Healthways doesn't seem as diversified as it should be in the area of gender. Both the Chairman and CEO are male, allowing for very little gender workforce diversity in the top levels of management. However, Healthways has many people on the Board of Directors with different skills and experience, which contributes to the company's overall diversity. For instance, Donato Tramuto, Chairman, is a leader in healthcare technologies; while, Mary Jane England, M.D., has vast experience in health education and health policy (Healthways 2013 Annual Report).

Company Operations

Core Business Lines

Founded and incorporated in Delaware in 1981, Healthways, Inc., provides specialized, comprehensive solutions to help people improve their health and productivity, thus reducing their health-related costs. In order to help people better their well being, Healthways executes five essential elements: purpose, social, financial, community, and physical. Healthways, Inc., is guided by the philosophy that healthier people cost less and are more productive, which drives the company to foster programs that are designed to help people adopt or maintain healthy behaviors, reduce health-related risk factors, and optimize their care for identified health conditions (10-K).

Conduct Business and Generate Revenue

Healthways gains revenue through contracts. Healthways' contracts with health plans and integrated healthcare systems generally range from three to five years with a number of comprehensive strategic agreements extending up to ten years in length. Contracts with self-insured employers typically have two to four-year terms. Some of the contracts allow the customer to terminate early. Healthways currently works with a wide range of customers, including over 150 public and private health funds across the world, 1,200 companies, and other public health organizations and governments (10-K).

Manufacturing Facilities and Corporate Headquarters

Healthways, Inc., World Headquarters is located in Franklin, TN. Other current operating locations include Brazil, Australia, and France (Healthways.com).

The Value Chain

Segment

Well-being Improvement Services

Primary Activities

Inbound logistics

Healthways has an extensive innovation network and partners with leading thinkers in healthcare and technology to create and advance solutions for consumers. Academic partnerships promote research and development and include Agelab, Johns Hopkins University, and Pro-change Behavior Systems, Inc. Wholly owned subsidiaries include MeYou Health, Navvis and Healthways, Ascentia Health Care Solutions, and The Ornish Spectrum. Strategic partnerships include Gallup-Healthways Well-Being Index, Blue Zones, and Dave Ramsey's Financial Wellness. Technology partnerships work to extend the reach of Healthways through technology and include HP and Isobar.

Operations

Healthways consistently provides different programs and innovations to customers. The programs offer regular health and fitness screenings with cholesterol, BMI, and fitness measures and an annual health risk assessment completed by employees. Other programs consist of an online wellness portal that provides access to personalized exercise programs, customized nutrition help, and stress and life management resources.

Outbound logistics

Healthways delivers their services using different methods desired by the individual or business, including venue-based face-to-face interactions, print, phone, mobile and remote devices with unique applications, on-line, social networks, and any combination that helps and benefits the consumer.

Marketing and sales

Healthways differentiates itself from its competitors by emphasizing that its techniques are based on science. Healthways has a large network of partnerships and has award-winning programs designed to drive the change customers want to see.

Service

Healthways provides call centers for customers (10-K, Healthways.com).

Secondary Activities

Purchasing

Healthways uses partnerships for research and development, as well as extending the reach of the company to customers.

Human resources management

Healthways provides employees with opportunities to improve their social, financial, and physical well-beings. Employees thrive in a casual work culture. Employees wear workout clothes to work, and they offer free fitness classes, financial education, walking workstations, and stress reduction classes. Healthways gives generous paid time off that provides flexibility.

Technological development

Healthways works with Hewlett Packard to enhance a platform with greater flexibility and timely innovation at a lower cost. It also partners with Isobar to deliver a unique, total digital experience for Healthways' Well-Being Improvement Solution that drives engagement through online, mobile, and social media platforms.

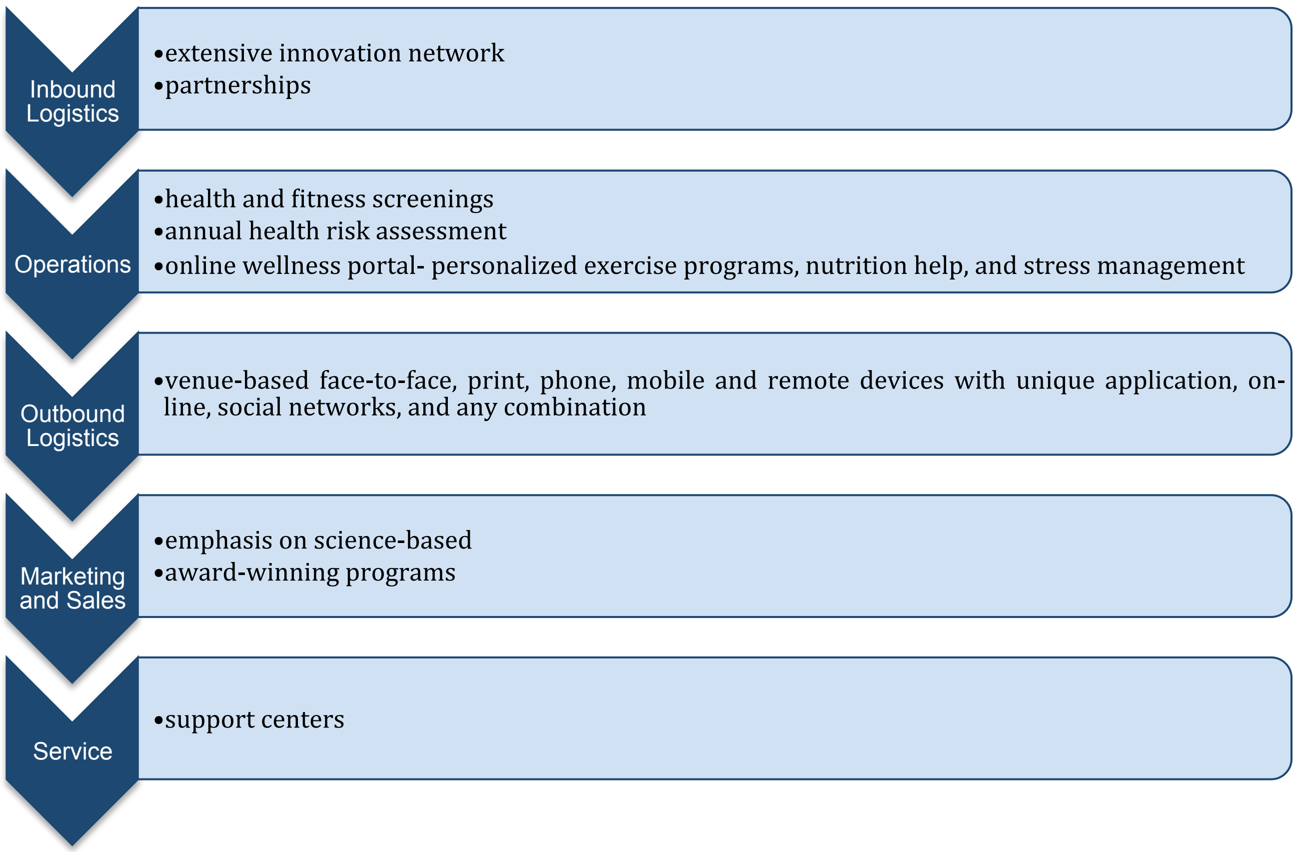
Infrastructure

Healthways has support systems, including call centers, research, administrative, marketing, and management (10-K, Healthways.com).

Business Process Diagram

Well-Being Improvement Services

Healthways is part of the health industry, but its business segment is specifically well-being improvement services.



Board of Directors

Donato Tramuto – Chairman

A leader and pioneer in healthcare technologies, Donato Tramuto was named Chairman of the Healthways, Inc., Board of Directors in June 2014. Tramuto serves as the Chief Executive Officer and Chairman of Physicians Interactive, the leading provider of online and mobile clinical resources and solutions for healthcare professionals. Tramuto has been an innovator in the healthcare world for over 30 years, beginning with his service as Executive Vice President of the Home Health Care Business Unit and Corporate President of Marketing/Healthcare at Caremark. He then went on to help found Protocare, Inc., a large provider of drug development and disease management services, and he served as Chief Executive Officer and President of the Protocare Sciences Division and Corporate Officer of Protocare from 1998 to 2003. He later served as Chief Executive Officer of i3, a part of Ingenix, which is a subsidiary of UnitedHealth Group Incorporated. Tramuto went on to help found Physicians Interactive and has served as its Chief Executive Officer since 2007, becoming Chairman in 2013 when the company was sold successfully. (Reuters)

Ben R. Leedle, Jr. - President and Chief Executive Officer

Leedle has served as Director of Healthways since August 2003, as Chief Executive Officer since September 2003, and as President from May 2002 to October 2008 and April 2011 to present. Previously, Leedle served as Chief Operating Officer of Healthways from September 1999 to August 2003, Executive Vice President from September 1999 to May 2002, and as Senior Vice President of Operations from September 1997 to September 1999. Leedle has nearly 19 years of leadership experience at Healthways and has seen the company develop and grow through different significant periods. Leedle adds a vast knowledge and a multitude of skills that directly correlate with the company to the board of directors because he has been a major part of Healthways for almost two decades. (Reuters)

J. Cris Bisgard, M.D., M.P.H.

Bisgard served as Director of Health Services at Delta Air Lines, Inc., from January 1994 to April 2001. Bisgard is a fellow of the Aerospace Medical Association, the American College of Preventive Medicine, and the American College of Physical Executives. He served as acting Deputy Assistant Secretary of Defense (Health Affairs) from 1981 to 1984. He then retired from the U.S. Air Force in 1986. Bisgard went on to serve as the Corporate Medical Director at Pacific Bell, GTE Corporation, and ARCO. In all, Bisgard has over 30 years of experience in the healthcare industry in both the public and private sectors and has obtained unique skills and qualifications. (Reuters)

Mary Jane England, M.D.

England has served as a Professor at the Department of Community Health Sciences at the Boston University School of Public Health since 2012 and served as ad interim Chair from 2012 until November 2013. England served as Visiting Professor of Health Policy and Management at Boston University School of Public Health from 2011 to 2012. She previously served as President of Regis College in Weston, Massachusetts from 2001 through 2011. From 1990 to 2001, she served as President of the Washington Business Group on Health, a non-profit that represents the interests of large employers on national health policy issues. Prior to 1990, her resume includes serving as Vice President of Prudential Insurance Co., a global insurance provider, Associate Dean at the John F. Kennedy School of Government at Harvard University, Commissioner of Social Services, and Associate Commissioner of Mental Health in Massachusetts. England also serves on the board of directors of NSF International. Through her vast experience in health education and health policy, England provides a distinct knowledge to the board. (Reuters)

William D. Novelli

Novelli has served as a Professor at the McDonough School of Business at Georgetown University since August 2009. Novelli serves as the Chair of the Board of Directors of Campaign for Tobacco-Free Kids. From 2001 to 2009, he served as the Chief Executive Officer of AARP, a nonprofit organization that helps people over age fifty improve their lives. Because of his leadership experience at AARP and as chairman of the board of directors of the Campaign for Tobacco-Free Kids, which helps fight to reduce tobacco use, Novelli has the skills and the understanding of how organizations can promote healthy living and wellness. (Reuters)

Alison Taunton-Rigby, Ph.D.

Taunton-Rigby served as the Chief Executive Officer of RiboNovix, Inc., a private company developing anti-infectives, from 2003 until she retired in 2010. Previously, she served as the Chief Executive Officer of CMT, Inc., a privately held medical device company from 2001 to 2003. From 1995 to 2000, she served as the Chief Executive Officer of Aquila Biopharmaceuticals, Inc., a biotechnology company. From 2004 to 2010, she served as a director on the board of Idera Pharmaceuticals, a biotechnology company. She serves on the boards of directors of Columbia Funds, a mutual fund industry, and Abt Associates, a provider of public policy and business research and consulting. Taunton-Rigby also serves on the Board of Trustees of the Boston Children's Hospital. Because of her experience with different biotechnology companies and research and development, Taunton-Rigby has a grasp on the science behind wellness improvement. (Reuters)

John A. Wickens

Wickens served as National Health Plan President of UnitedHealth Group, Inc., a publicly traded diversified health and well-being company, from January 2004 to February 2006 and South Division President from September 2001 to December 2003. He began working with UnitedHealth Group in 1995. He currently serves as the Vice Chair of U.S.A. Track & Field Foundation and Chair of UnitedHealthcare Children's Foundation. Wicken's experience at UnitedHealth Group for nearly two decades helps provide insight into the healthcare industry and how other companies are managing economic and political challenges. His varied positions on different boards also help add to his knowledge of wellness and health living. (Reuters)

Kevin Wills

Wills has served as Managing Director and Chief Financial Officer of AlixPartners, LLP, a global business advisory firm, since March 2014. Previously, he served as Executive Vice President and Chief Financial Officer of Saks, Inc., a fashion retailer, from May 2007 to November 2013. Prior to that, he served as Executive Vice President of Finance/Chief Accounting Officer of Saks, Inc., from May 2005 to April

2007, and as Executive Vice President of Operations for Parisian, Inc., a retailer, from February 2003 to April 2005. Wills was appointed Senior Vice President of Planning and Administration for Saks Department Store Group in September 1999, Senior Vice President of Strategic Planning in September 1998, and Vice President of Financial Reporting for Saks, Inc., in September 1997, when he joined Saks, Inc. Prior to that, he served as Vice President and Controller for Tennessee Valley Authority and as the Business Assurance Manager for Coopers and Lybrand (currently PricewaterhouseCoopers). Due to his unique experience in retail, Wills has a vastly different set of skills and experiences compared to the other board members. The knowledge that Wills has gained gives Healthways an edge in planning and administration. (Reuters)

Bradley S. Karro

A recent addition to the board, Karro is a Principal of Hillcote Advisors, a firm he founded in July 2008 that focuses on investing in and restructuring healthcare companies. Prior to that, he held senior executive positions in the healthcare industry, including serving as Executive Vice President of Caremark Rx, a prescription benefit management company. Karro joined Medpartners (now Caremark Rx) in 1998 and served at the company through 2007. He was responsible for mergers, acquisitions, integration planning, information technology, and Medicare product development. Karro was appointed as a charter member of the Governor's e-Health Advisory Council in Tennessee, and organization to coordinate initiatives leading towards the adoption of electronic medical records. He previously served on the board of directors of Emageon Inc., and currently serves on the board of directors of Angiotech Pharmaceuticals, Inc. Karro adds a new level of experience in healthcare to the board as the founder of a company that concentrates on investing and restructuring healthcare companies. (Morningstar)

Paul H. Keckley, Ph.D.

Keckley has served as the Managing Director of Navigant Center for Healthcare Research and Policy Analysis since March 2014. In addition, he is an expert on health industry trends and U.S. health system reform and is the Editor of "The Keckley Report", which he began publishing in September 2013. Keckley has over 35 years of experience in the health industry and has served as an expert commentator for national media coverage of healthcare reform, CEO of four health care companies funded by private investors, a leader in management at Vanderbilt Medical Center, and Executive Director of the Deloitte Center for Health Solutions in Washington, D.C., a position he held form 2006 to 2013. Keckley currently serves on the boards of directors of the Ohio State University Medical Center, Healthcare Financial Management Leadership Council, Western Governors University Advisory Board, and Lipscomb University College of Pharmacy. He is also a member of the Health Executive Network and advisor to the Bipartisan Policy Center. As a new member to Healthways' Board of Directors, Keckley has the expertise to make Healthways more competitive than ever before, both politically and economically.

As an expert in health industry trends and health reform, Keckley is a specialist in the industry and has the media attention to shed more light on wellness improvement. (Morningstar)

Conan J. Laughlin

Laughlin serves as the Founder, Portfolio Manager, and Managing Member of North Tide Capital, a Boston-based investment firm launched in September 2011 with over $1 billion in assets and a dedicated focus on healthcare. Laughlin has covered the healthcare industry as an equity research analyst since 1995. From 2005-2011, he was a portfolio manager and sub-advisor to Millennium Management LLC, a multi-billion dollar investment firm in New York. Prior to that, he was a senior analyst covering the healthcare sector in the Asset Management group at American Express in Boston. Prior to 2002, he spent seven years as a sell-side analyst at Morgan Stanley Dean Witter, SG Cowen, and Deutsche Bank Alex. Brown. Laughlin, another recent addition to the board in 2014, adds knowledge of the healthcare sector from the view of an equity research analyst and can help Healthways in the area of economic factors. (Morningstar)

Board of Directors Overview

The current Board of Directors for Healthways, Inc., is incredibly diverse in the different backgrounds and skillsets acquired by its members. Every member of the board brings a unique knowledge and expertise from their many years of experience. With his expertise in healthcare technologies and innovation, Donato Tramuto leads the board as Chairman. With nearly two decades of leadership experience within Healthways, Ben Leedle is able to give a distinct insight into the growth of the company. Bisgard has unique qualifications from his time serving as Deputy Assistant Secretary of Defense (Health Affairs); however, Mary England specializes in health education and health policy. William Novelli understands how other organizations promote wellness; still, Alison Taunton-Rigby provides knowledge into the science behind the wellness. John Wickens has experience to help manage economic and political challenges; whereas, Kevin Wills has unique experiences in retail and the knowledge to execute and plan. The newest additions to the board bring in new capabilities and different ways to promote healthy living. Bradley Karro can apply the knowledge he gained from founding Hillcote Advisors to focus on investing and restructuring healthcare companies. With his expertise in health industry trends and health reform and the media attention he's gained from healthcare reform, Paul Keckley can make Healthways more competitive. Conan Laughlin adds new information to healthcare from the view of an equity research analyst.

While each board member adds a vast amount of knowledge on the health industry, the Board of Directors could use someone with more expertise in the fields of health and wellness and the science behind it. For instance, an expert with more knowledge of the effects that will occur from the implementation of these programs would be a great source of information. Healthways partners with Johns Hopkins University, so getting someone with specialist knowledge and research skills would be a great addition to Healthways' Board of Directors.

Strategic Analyses

Mission Statement

Dedicated to creating a healthier world one person at a time, Healthways uses the science of behavior change to produce and measure positive change in well-being for customers, which include employers, integrated health systems, hospitals, physicians, health plans, communities and government entities. Healthways provides highly specific and personalized support for each individual and their team of experts to optimize each participant's health and productivity and to reduce health-related costs (10-K).

Strategy

Healthways strategy reflects its mission to enhance the well-being of its customers, and, as a result, reduce overall health-related costs and improve employee productivity. Healthways' solutions are designed to improve health by helping customers to:

Adopt or maintain healthy behaviors;

Reduce health-related risk factors; and

Optimize care for identified health conditions.

The company's strategy includes the ongoing expansion of its value proposition that healthier people perform better and cost less through total population management capabilities. Healthways continues to enhance its well-being solutions to extend its reach and effectiveness and to meet the increasing demand for well-being services (10-K).

Niche market

Healthways has a focused, or niche market, strategy. They represent a subset of the healthcare market, or the wellness segment, and their focus is on specific products and programs. The prices are dependent on specific needs of each customer.

Threats

Healthways faces external threats to its operations, such as political policy changes, economic conditions, and increased competition. As the wellness and health industries continue to grow, new entrants to the market will require Healthways to differentiate itself further from its competitors. Additional health solutions, increased health assessments, and new technology are all aspects that will need to be implemented for Healthways to overcome the threats. During times of economic distress, businesses will be less likely to expand their wellness programs, ultimately leading to decreased revenue for Healthways. Political policy changes could affect how Healthways does business in the future.

Goals

Healthways expects growth in revenue and profitability for 2014 compared to 2013 in all core customer markets: health systems, hospitals and physicians, large employers, commercial health plans, Medicare Advantage plans, and international. The company anticipates a more than 50 percent increase in revenue for the health systems, hospitals and physicians market. They also anticipate direct business with large employers will grow at least 20 percent and will increase as a percentage of overall revenue mix. Healthways goals for 2014 further includes percentage growth in the mid-single digits to low double digits for its three other customer markets, including continuing profitable growth within each of the countries where it does business outside of the U.S. (Healthways 2013 Annual Report).

Assessing Demand for Products

Because Healthways' customers are companies and hospitals, demand for Healthways' services is tied to their clients' own success. Companies would put money towards raising revenues instead of spending money on wellness programs, even though the programs would save the company money in the long run.

Assessing Supply of Inputs

As new technological advances continue to be developed at Healthways, production will increase. For instance, Healthways, along with Gallup, has developed the world's most comprehensive well-being measurement system, which will allow Healthways to assess the needs of its customers better than ever before.

Major Competitor Analyses

The healthcare industry is highly competitive and subject to change in how services are provided. Because of Healthways' depth of well-being improvement services, the company has an advantage on competitors. Healthways provides strategic relationships, information technology, data integration capabilities, and comprehensive training techniques. Some of Healthways' major competitors include Pacific Health Care Organization, Inc.; National Health Partners; PhyHealth Corp; Wellness Center USA, Inc.; Carbon Green, Inc.

Pacific Health Care Organization, Inc. provides specialty workers compensation-managed services. It is involved in managing and administering health care organizations and medical provider networks. Nation Health Partners is a national healthcare membership organization that creates and sells membership programs. Its programs provide an alternative to people who seek to reduce healthcare costs not covered by insurance (Yahoo Finance).

Geopolitical Risks

Because Healthways serves clients around the globe, it needs to take into consideration certain geopolitical risks that could affect operations and the bottom line. Germany has a rise in anti-EU political parties, which hinders the government's ability to pass much needed reforms. Weak incumbents in some countries could also prove to be geopolitical risks for Healthways' operations. Brazil's President Dilma Rousseff was reelected on October 26, 2014, to a second four-year term. However, her win with 51.6 percent of the vote is the closest in Brazilian electoral history. She is now tasked with leading a divided country, while trying to change an underperforming economy. Inflation is up, the country is in a recession, and public spending has gone too far (Time).

Porter's Competitive Forces

Rivalry Among Existing Firms

While there are a number of competitors within the healthcare industry, especially in Nashville, Tennessee, Healthways focuses on wellness and health improvement makes them unique within their industry as a smaller segment. Even the closest competitors do not come close to Healthways' revenue per year. As the industry continues to grow, Healthways will grow as well, following increased need for wellness programs increases in businesses and hospitals. As a company based on science, Healthways has differentiated itself from its competitors and has increasingly gained new partnerships, which allows them to offer unique products and programs.

Threat of New Entrants

The rate of growth of the healthcare industry could prove threatening to Healthways' business efforts; however, because the company is part of the niche market, it could be shielded from the intensity of the growth.

Determinants of Buyer Power

As more companies and businesses realize that implementing wellness programs saves money in the long run, the demand for Healthways' services will continue to rise.

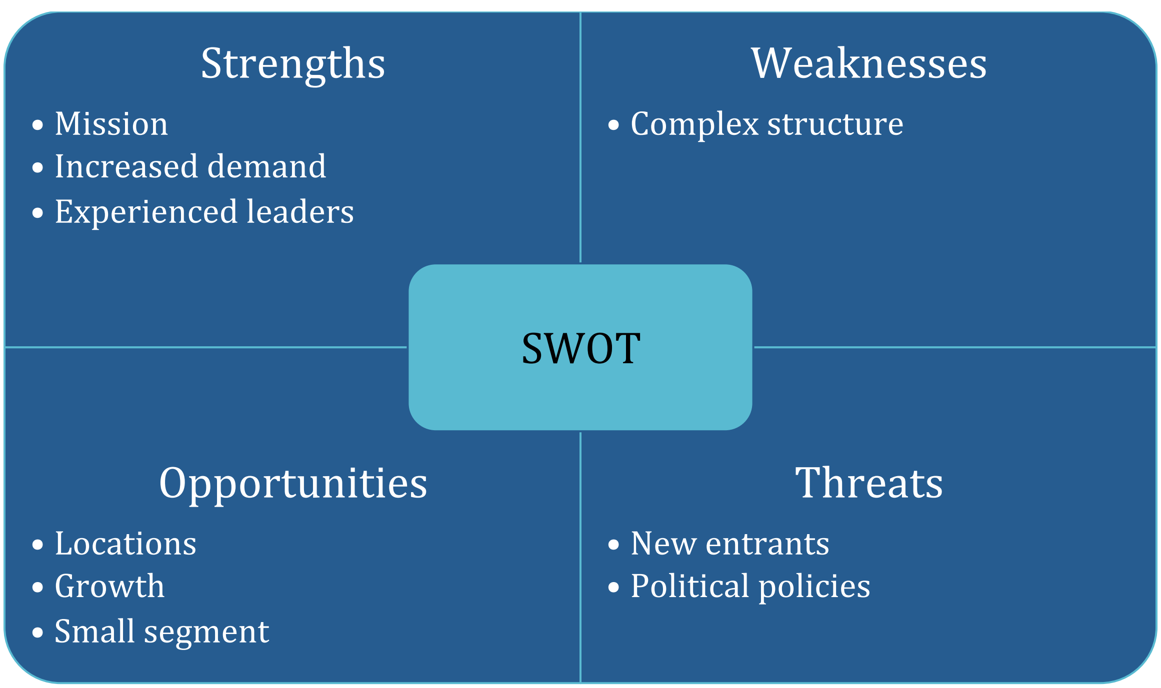
Threat of Substitute Products

Because Healthways is a large, independent global provider of well-being improvement solutions, the quality of the services is greater than that of its competitors. As such, the prices reflect that quality, so competitors who can offer lower prices would be a threat to Healthways' efforts.

Determinants of Supplier Power

As Healthways continues to gain more partnerships, the company will be able to create more programs to satisfy buyers' specific needs.

SWOT Analysis



Strengths

Healthways' main strength is in its purpose and mission. The demand for wellness programs is steadily increasing, and people resonate with what Healthways is trying to accomplish. With Ben Leedle's extensive experience with the company, Healthways has strong leadership to take them through economic and political changes.

Weaknesses

Healthways has a complex structure due to its many partnerships and programs, which could undermine its effectiveness for some customers. In order to be successful, Healthways must maintain relationships within the healthcare industry.

Opportunities

Healthways has many opportunities, especially with the growth of healthcare in Nashville, Tennessee. They are positioned well for the growth in the market as they offer unique services to a small segment of the industry.

Threats

The threats include an increase in competition as the healthcare industry continues to grow. Also, political policies could bring changes to how Healthways conducts business and could decrease revenues.

Financial Analysis

Corporate Wellness Services Industry

The Corporate Wellness Service Industry has experienced rapid growth over the past five years. The industry has revenues of $7.4 billion, with profits of $393.2 million and an annual growth rate in recent years of 5.6 percent. The industry is expected to grow at a rate of 8.8 percent annually to $11.3 billion for the next five years until 2019. According to a 2012-13 study by Willis, fifty percent of businesses reported that they plan to expand their wellness programs, which will help to increase the industry's revenues in the near future. Also, wellness programs are becoming a key differentiator for employee recruitment, causing more businesses to purchase the programs to increase employee retention rates (IBIS World).

Healthways has a more positive performance within the industry compared to some of its competitors. While Healthways' EPS is -0.25 for 2013, National Health Partners, Inc., has an EPS of -0.42. Healthways has a current ratio of 1.47, and NHPR has a current ratio of 0.27. However, compared to Pacific Health Care Organization, Inc., which has an EPS of 2.38 and a current ratio of 6.68, Healthways needs more current assets and a higher net income to match more positively performing competitors (IBIS World, Yahoo Finance).

Asset Composition

Healthways' current assets, as reported on the consolidated balance sheet, include cash and cash equivalents, net accounts receivable, prepaid expenses, other current assets, income taxes receivable, and deferred tax asset for a total of $119,222,000 current assets. Accounts receivable has the highest total of $89,484,000 and is seventy-five percent of current assets.

Long-term assets on the balance sheet include property and equipment, leasehold improvements, computer equipment and related software, furniture and office equipment, capital projects in process, other assets, intangible assets, and goodwill. Long-term assets constitute $629,789,000 of total assets or 84.1 percent. The value of Healthways' total assets is $749,011,000. Each asset on the balance sheet is measured at fair value. The values are therefore sensitive to changes in the operating environment, such as interest rates.

Because long-term assets make up the bulk of Healthways' balance sheet, the company has less liquidity and will not be able to easily pay off debts presently. Financial statements from Dec. 31, 2012, record long-term assets at $606,459,000 or 81.1 percent of total assets. Current assets were recorded at $141,809,000. The results from the comparisons between both years of financial statements shows that long-term assets continue to make up a larger amount of total assets, decreasing liquidity and financial flexibility and making Healthways riskier over time.

Healthways' intangible assets have a net value of $79,162,000 and make up about 10.5 percent of total assets. The intangible assets subject to amortization at December 31, 2013, include customer contracts, acquired technology, patents, distributor and provider networks, perpetual license to survey-based data, and other. Customer contracts comprise the bulk of the intangible assets with a gross carrying amount of $59,574,000.

Net goodwill makes up 45.2 percent of total assets with $338,800,000. In August 2011, Healthways acquired Navvis & Company, a firm that provides counsel and management services to healthcare systems. In April 2012, Healthways acquired Ascentia Health Care Solutions, a firm that supports population health management, patient programs, and enhancement programs. Both purchases, along with an impairment loss from the loss of a long-term contract with CIGNA, contributed to the net goodwill as of December 31, 2013. (2013 10-K)

Source of Financing

Healthways' balance sheet includes current liabilities consisting of accounts payable, accrued salaries and benefits, accrued liabilities, deferred revenue, contract billings in excess of earned revenue, current portion of long-term debt, and current portion of long-term liabilities. Current liabilities total $124,416,000. Accounts payable has the largest total with $33,125,000 or 26.6 percent of total current liabilities.

Long-term liabilities include long-term debt, long-term deferred tax liability, and other long-term liabilities. Long-term debt makes up the largest total of all liabilities with $237,582,000 or 53.2 percent. The value of long-term liabilities is $321,905,000. The value of total liabilities is $446,321,000.

Because long-term liabilities make up 72.1 percent of total liabilities, solvency and financial flexibility decrease further. Since solvency and financial flexibility are decreasing due to both the amount of long-term liabilities and the amount of long-term assets, Healthways is becoming riskier over time.

Stockholders' equity includes common stock ($.001 par value, 120,000,000 shares authorized, 35,107,303 and 33,924464 shares outstanding), additional paid-in capital, retained earnings, treasury stock (at cost, 2,254,953 shares in treasury, and accumulated other comprehensive income. Total stockholders' equity equals $302,690,000. Total liabilities and stockholders' equity equals $$749,011,000. (2013 10-K)

Cash Flows

Net cash flows from operating activities equal $71,528,000. Net cash flows used in investing activities equal a negative $49,893,000. Net cash flows used by financing activities are a negative $19,896,000 (10-K).

Life Cycle Stage

Healthways is presently in the mature life cycle stage of the industry. Net cash flows from operating activities are positive, yet net cash flows from investing and financing are negative. The once rapid growth rate has now begun to slow down, making the life cycle curve appear flatter. At this point, new competitors will enter the market as late entrants. Healthways will need to stress its unique programs in order to separate itself from other wellness companies. As long as Healthways can differentiate itself from its competitors and keep an above average growth rate, the company's future performance will be positive (10-K).

Liquidity

Healthways' cash and cash equivalents make up only 0.34 percent of total assets. However, accounts receivables make up 11.9 percent of total assets. The accounts receivables primarily represent the fees that are contractually due from Healthways providing services. In order to gain sufficient cash flow, Healthways could issue equity; however, it would increase diluted shares and would cause EPS to decrease further. Stock prices would also decrease. Borrowing would increase interest rates and increase the already large portion of debt (10-K).

Current Assets Ratio		
Current Assets	Current Liabilities	Current Assets Ratio
119,222,000	124,416,000	0.96

The low current asset ratio means that current liabilities outweigh current assets. Healthways does not have a positive working capital, meaning the company doesn't have enough current assets to cover current debt.

Debt-to-Equity Ratio		
Total Debt	Total Equity	Debt-to-Equity Ratio
446,321,000	302,690,000	1.47

Times Interest Earned		
Operating Income	Interest Expense	Times Interest Earned
1,902,000	16,079,000	0.12

Interest expense is incredibly high. Healthways is not able to cover its interest expense with operating income. Management or creditors do not desire this low ratio, and the margin of safety in making fixed interest payments is low.

Earnings Per Share		
Net Income	Number of Common Shares Outstanding	Earnings Per Share
As of December 31, 2013		
(8,541,000)	34,489,000	(0.25)
As of December 31, 2012		
8,024,000	33,597,000	0.24

Analyst Forecasts

According to analysts, earnings per share are expected to be 0.4 per share in 2015, 0.66 per share in 2016 and 0.97 per share in 2017. Earnings are expected to grow 47.04 percent in 2015, 65.24 percent in 2016, and 47.87 percent in 2017 before dropping to very little growth in 2018 (Yahoo Finance).

Analyzing EPS Trends

From comparisons between the financial statements, the numerator, or net income, is the factor that changes most drastically through the years, causing the EPS to vary. As of December 31, 2012, net income was positive. However, in 2013, net income was negative, resulting in a negative EPS. The positive net income in 2012 can be explained by the operating income account on the statement of operations. Operating income for 2012 was $28,895,000. In 2013, operating income was only $1,902,000. The low amount of operating income in 2013 caused net income for the year to be negative. In order to have a lower operating income, revenues in 2013 were $13,885,000 lower and cost of services and other expenses were $14,881,000 higher (2013 10-K).

Incentives to Manipulate Earnings

Healthways' management does not have a lot of incentives to manipulate earnings. As one of the largest companies in the corporate wellness industry, Healthways would not need to manipulate earnings to compete against other companies. According to Yahoo Finance, the analysts' estimates are similar to the actual financial data, so influence would not be a big concern. Although Healthways' stock has increasingly grown over the past year, it has remained constant at around $22.28 per share for some time and is on track with the one-year target estimate of $22.50 per share (Yahoo Finance).

Detecting Earnings Manipulation

Overall, Healthways financial data seems consistent and unrestricted by earnings manipulation from management. Revenues have gradually been decreasing from year-to-year. Cost of services have grown steadily since 2010 and are at a company high of $547,387,000. However, looking at Healthways accounts receivable information one could detect earnings manipulation from the constant fluctuations the account presents. Accounts receivable decreased in 2010 before steadily growing until 2012. In 2013, a sharp decrease from $108,337,000 in 2012 to $89,484,000 in 2013 seems disproportionate to the slight decrease in revenues (10-K).

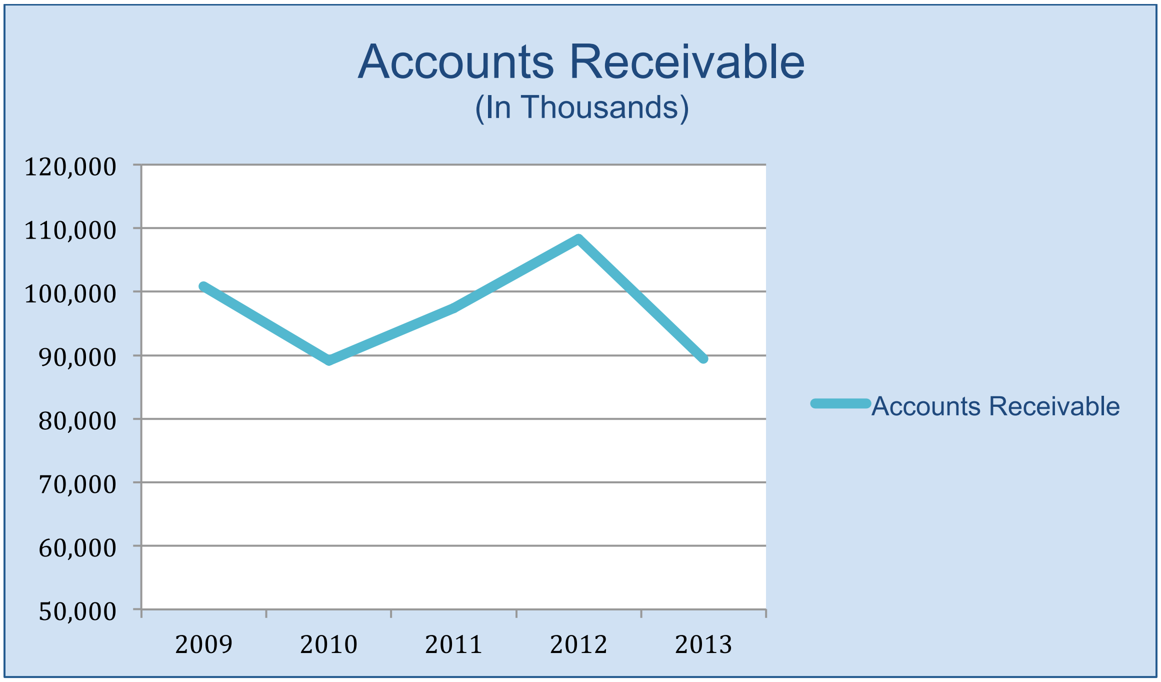
Account Analysis

Healthways' billed receivables primarily represent fees that are contractually due for providing services, net of contractual adjustments and allowances for doubtful accounts. Unbilled receivables represent fees for services based on estimated utilization of fitness facilities, which are billed the following month, and performance-based fees that are billed when performance metrics are met and reconciled with the customer (10-K).

Healthways' property, plant, and equipment account is carried at cost and includes expenditures that increase value or extend useful lives. Depreciation is recognized using the straight-line method over useful lives of three to seven years for computer software and hardware and four to seven years for furniture and other office equipment. Leasehold improvements are depreciated over the shorter of the estimated life of the asset or life of the lease, or two to fifteen years (10-K).

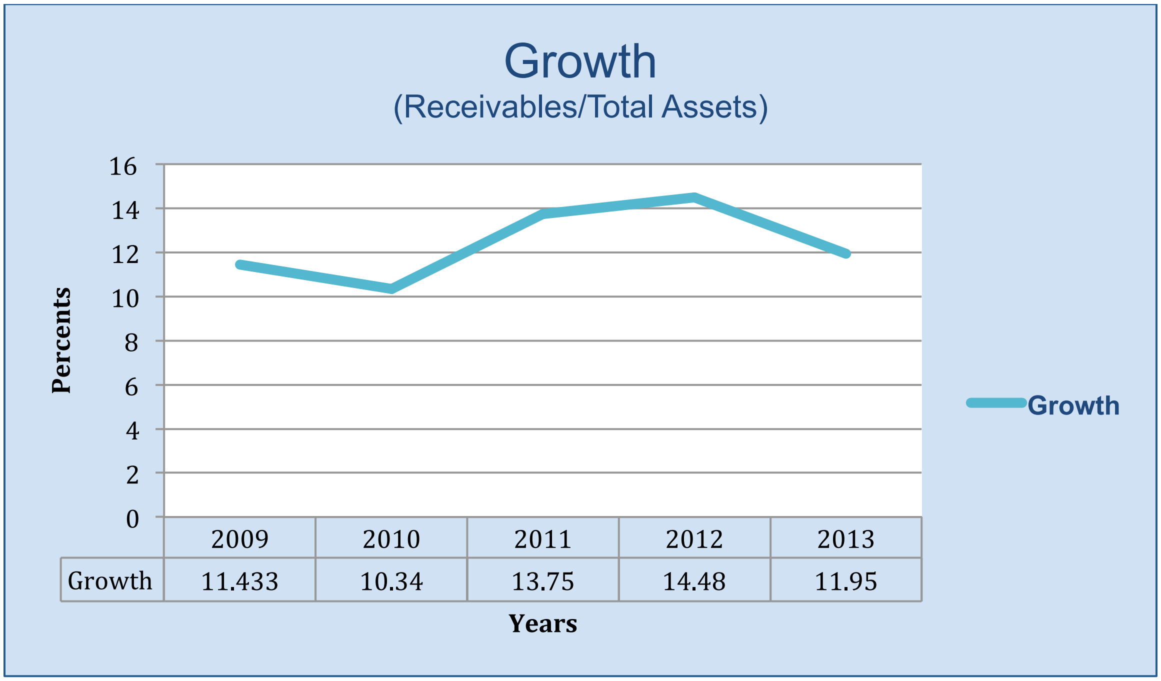
Accounts Receivable

In 2009, the net accounts receivable account was $100,833,000. In 2010, the account decreased to $89,108,000, and then increased in 2011 to $97,459,000. It rose again in 2012 to $108,337,000. However, the account decreased in 2013 to $89,484,000 (10-K).



The highest value in the net accounts receivable account occurred in 2012, and the increase can be attributed to a higher operating income than in other years with $28,895,000, compared to just $1,902,000 in 2013 and a loss of $129,114,000 in 2011 in operating income (10-K).

In dividing receivables by total assets to account for general growth over time, the company slowed in growth from 2009 with 11.43 percent to 2010 with 10.34 percent. It then increased in 2011 to 13.75 percent and again in 2012 to 14.48 percent. However, general growth decreased in 2013 down to 11.95 percent.



Revenues have been decreasing slowly since 2010; however, the year-over-year rate has remained a constant 0.98 for the past two years. Receivables have been fluctuating between increases in 2011 and 2012 and decreases in 2010 and 2013 (10-K).

Year-Over-Year Change		
Years	Receivables	Revenues
2013/2012	0.83	0.98
2012/2011	1.09	0.98
2011/2010	1.11	0.96
2010/2009	0.83	1.00

Accounts Receivable Turnover

Because Healthways has an accounts receivable turnover ratio of 7.41, the higher ratio means that the company collected its average receivables 7.41 times during the year, or ever 1.6 months. It creates higher efficiency because Healthways is able to collect cash from customers more often during the year.

Accounts Receivable Turnover	
Years	Accounts Receivable Turnover
2013	7.41
2012	6.25
2011	7.07
2010	8.08
2009	7.11

The collection period average steadily increased from 2010 to 2012, so customer payments were slowing, leading to reduced future sales. While sales continued to decrease from 2010 to 2013, the collection period for 2013 decreased to 49.24 instead of increasing as in previous years.

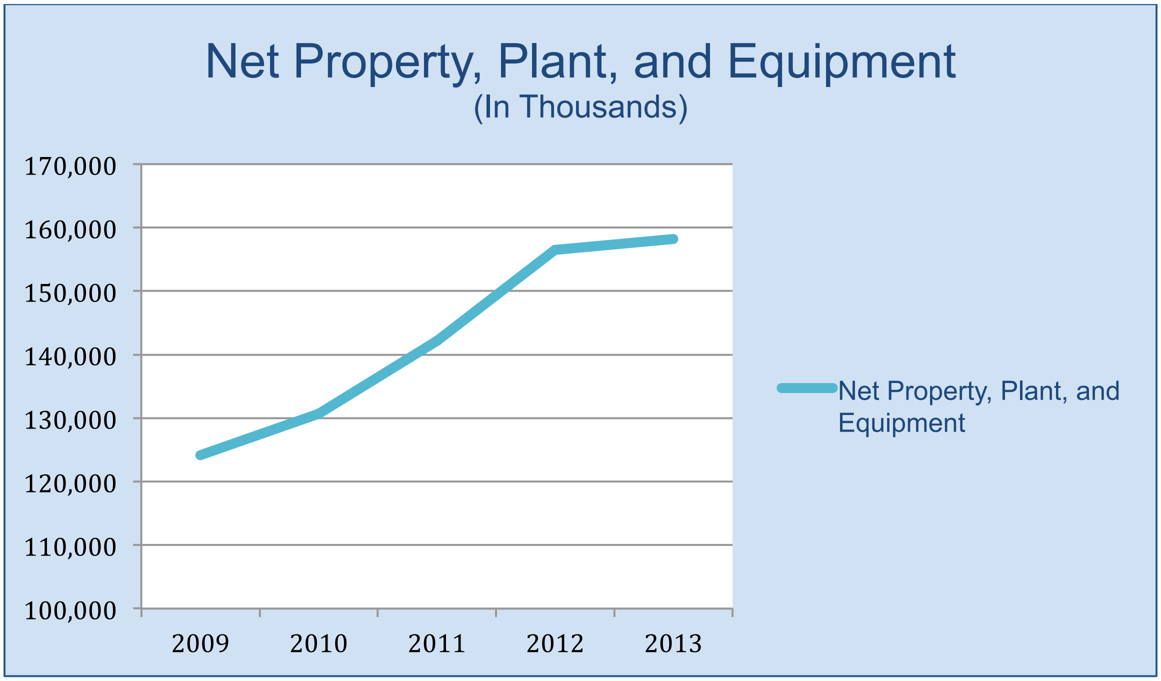
Accounts Receivable Collection Period		
Years	Average Sales per day	Collection Period
2013	$1,817,219	49.24
2012	$1,855,260	58.39
2011	$1,887,027	51.65
2010	$1,973,515	45.15
2009	$1,965,551	51.30

Receivables and Earnings Management

Because sales are not increasing each year and sales are not inflated, channel stuffing seems highly unlikely. While accounts receivables are decreasing, it's ordinary to see in times of economic trouble, such as a recession. However, the sharp decrease from 2012 to 2013 could suggest some earnings management in selling receivables.

Property, Plant, and Equipment

Healthways' property, plant, and equipment account is made up of leasehold improvements, computer equipment and related software, furniture and office equipment, and capital projects in process. Healthways' property, plant, and equipment for 2013 was $375,964,000 with an accumulated depreciation expense of ($217,766,000), making net property plant and equipment $158,198,000. In 2012, PPE was $343,932,000 with ($187,438,000) in accumulated depreciation, bringing net PPE to $156,494. For 2011, PPE equaled $325,489,000 with accumulated depreciation of ($183,301,000), giving a net PPE of $142,188,000. In 2010, PPE was 285,184,000 with ($154,528,000) in accumulated depreciation, totaling $130,656,000 in net PPE. In 2009, PPE equaled $258,205,000 with ($134,046,000) in accumulated depreciation, totaling $124,159,000 in net PPE. Healthways' property, plant, and equipment increased each year, along with an increase in accumulated depreciation each year. Overall net PPE increased each year as well (10-K).



Fixed Asset Turnover Ratio	
Years	Fixed Asset Turnover Ratio
2013	4.19
2012	4.33
2011	4.84
2010	5.51
2009	5.78

Healthways' fixed asset turnover rate has decreased each year. In 2009, the rate was 5.78x. In 2010, the rate dropped to 5.51x, and the rate decreased again in 2011 to 4.84x. In 2012, the rate was 4.33x, and the rate continued its decline to 4.19x in 2013. The steady decrease in the fixed asset turnover rate means that Healthways is not managing their fixed assets efficiently.

Average Age of PPE	
Years	Average Age of PPE
2013	4.13
2012	3.62
2011	3.67
2010	2.93
2009	2.72

Healthways' average age of PPE increased until 2012 when the average decreased from 3.67 to 3.62. From 2009 to 2012, the increase in average age indicates that the company is letting their asset base deteriorate. However, the average age increased in 2013 to 4.13, the highest since 2009.

Average Remaining Useful Life of the Assets	
Years	Average Remaining Useful Life of the Assets
2013	7.12
2012	6.65
2011	6.51
2010	5.41
2009	5.24

Depreciation, as stated under account analysis, is recognized using the straight-line method over useful lives of three to seven years for computer software and hardware and four to seven years for furniture and other office equipment. Leasehold improvements are depreciated over the shorter of the estimated life of the asset or the life of the lease, which ranges from two to 15 years.

Cost of Providing Services

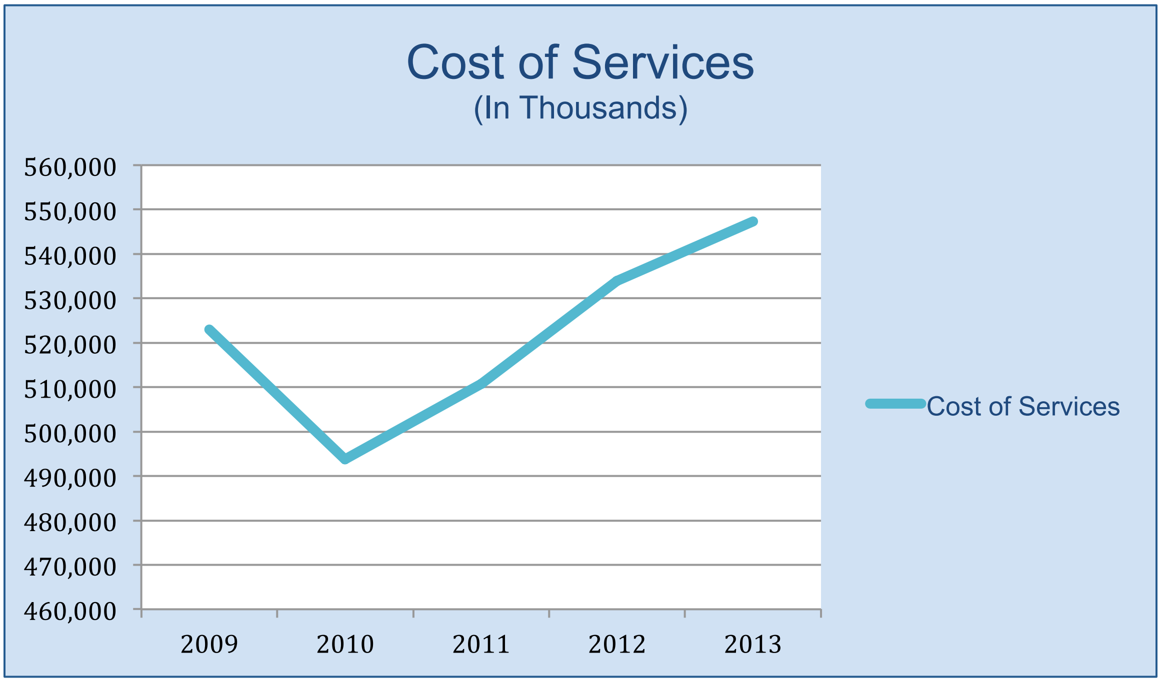
Healthways cost of providing services as a percentage of revenues increased in 2013 to 82.5 percent compared to 78.8 percent in 2012. The reasons for this increase were the impact of two terminated contracts and an increase in support costs. However, the increase in cost of services was slightly offset by decreases in healthcare benefit costs related to a decrease in claims for 2013 and continued economies of scale gained in fitness solutions.

The cost of services as a percentage of revenues increased in 2012 to 78.8 percent compared to 74.2 percent in 2011. The increase was primarily due to the wind-down of a contract and other program terminations with three smaller health plan customers, which carried lower than average cost of services as percentages of revenues. Also, increased costs related to the implementation of new contracts and the launch of new business and an expanded and extended contract contributed to the increase. The increase was partially offset by decreases in cost of services from an increase in performance-based revenues, costs associated with a new contract in 2011 for which Healthways wasn't able to recognize revenue until 2012, and efficiencies from cost management initiatives.

Cost of services as a percentage of revenues for 2011 increased to 74.2 percent from 68.5 percent in 2010. The increase was due to costs associated with new contracts, an increase in implementation expenses, n increased portion of revenue generated by fitness solutions, changes in contract structure of certain incentive-based wellness programs, and costs associated with an initiative to promote member participation.

Cost of services as a percentage of revenues for 2010 decreased to 68.5 percent from 72.9 percent in 2009. The decrease was due to a decrease in the level of shortterm incentive compensation, a decrease in salaries and benefits expense, and cost savings related to certain operational efficiencies.

Healthways' cost of services in 2009 was $522,999,000. In 2010, cost of services decreased to $493,713,000. Since then, the cost of services account has been steadily increasing with $510,724,000 in 2011, $533,880,000 in 2012, and $547,387,000 in 2013 (10-K).



Selling, general, and administrative expenses as a percentage of revenues remained consistent at 9.2 percent for 2013 compared to 9.0 percent in 2012. Expenses decreased in 2012 to 9.0 percent relative to 2011 with 9.4 percent due to cost reductions from a restructuring of Healthways in 2011. Expenses also decreased to 9.4 percent in 2011 compared to 10.1 percent in 2010. The decrease from 2010 to 2011 was due to a decrease in the level of long-term performance-based incentive compensation and cost savings realized during 2011 from restructuring. Expenses for 2009 were 10.0 percent, so very little change from 2010.

Intercorporate Investments

Consolidation has been an important factor in the healthcare industry. While Healthways believes that the size of its membership base provides the economies of scale to compete in a consolidating market, the company cannot be sure that they can effectively compete with companies formed as a result of industry consolidation or retain existing health plan, integrated healthcare system, or employer customers if they are acquired by other entities which already have programs similar to theirs.

The Patient Protection and Affordable Care Act requires the U.S. Department of Health and Human Services to establish a Medicare Shared Savings Program that promotes coordination and consolidation through Accountable Care Organizations. Because of these and other changes, Healthways expects an increase in consolidation in the healthcare industry (Healthcare.gov).

According to financial statements, Healthways has eliminated all intercompany profits, transactions, and balances.

Growth

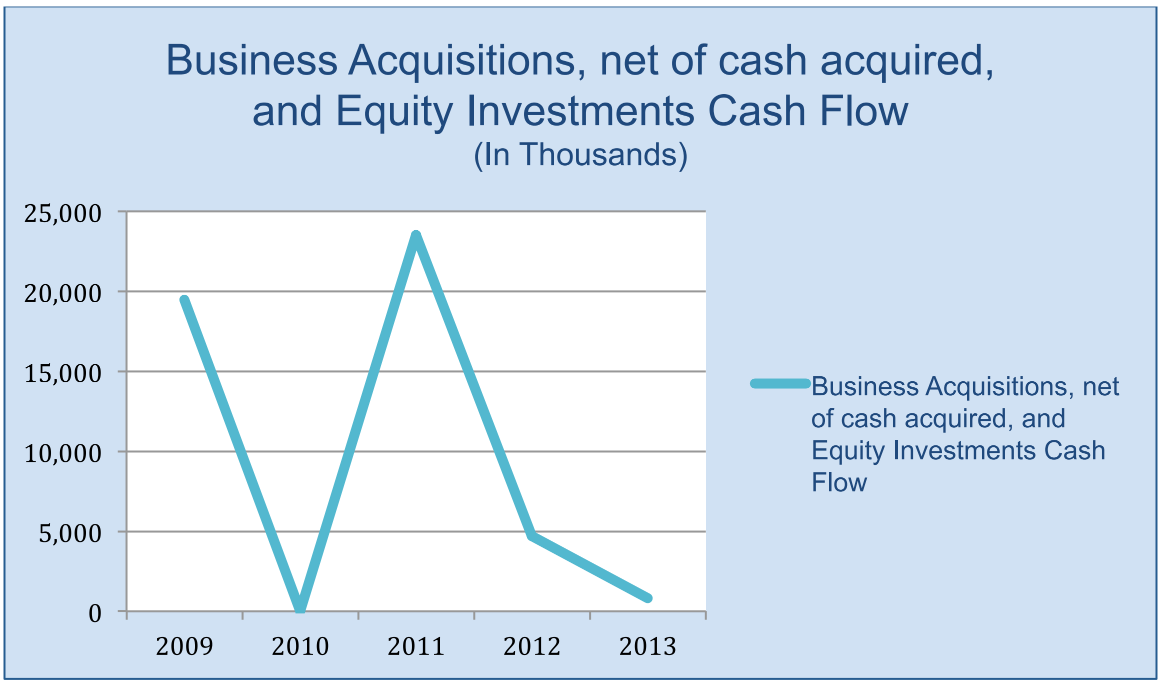
While Healthways does grow organically by acquiring new customers and growing within the healthcare industry, the company also grows through acquisitions. Business acquisitions, net of cash acquired, and equity investments totaled

$830,000 in 2013, $4,693,000 in 2012, $23,523,000 in 2011, $0 in 2010, and $19,486,000 in 2009.

In October 2009, Healthcare acquired HealthHonors, a behavioral economics company that specializes in behavior change science and optimized use of incentives, for a net cash payment of $14.5 million and a multi-year earn-out arrangement with an acquisition date fair value of $3,000,000.

On August 31, 2011, Healthways acquired Navvis, a firm that provides strategic counsel and change management services to healthcare systems, for approximately $23.7 million in cash and $3.3 million in common stock.

In April 2012, Healthways acquired Ascentia Health Care Solutions, a firm that supports and promotes health management, patients centered programs, payer strategies, and physician practice enhancement programs, for $5,500,000 in cash and 14,409 unregistered shares of common stock (10-K).



Income Effects of Intercorporate Investments

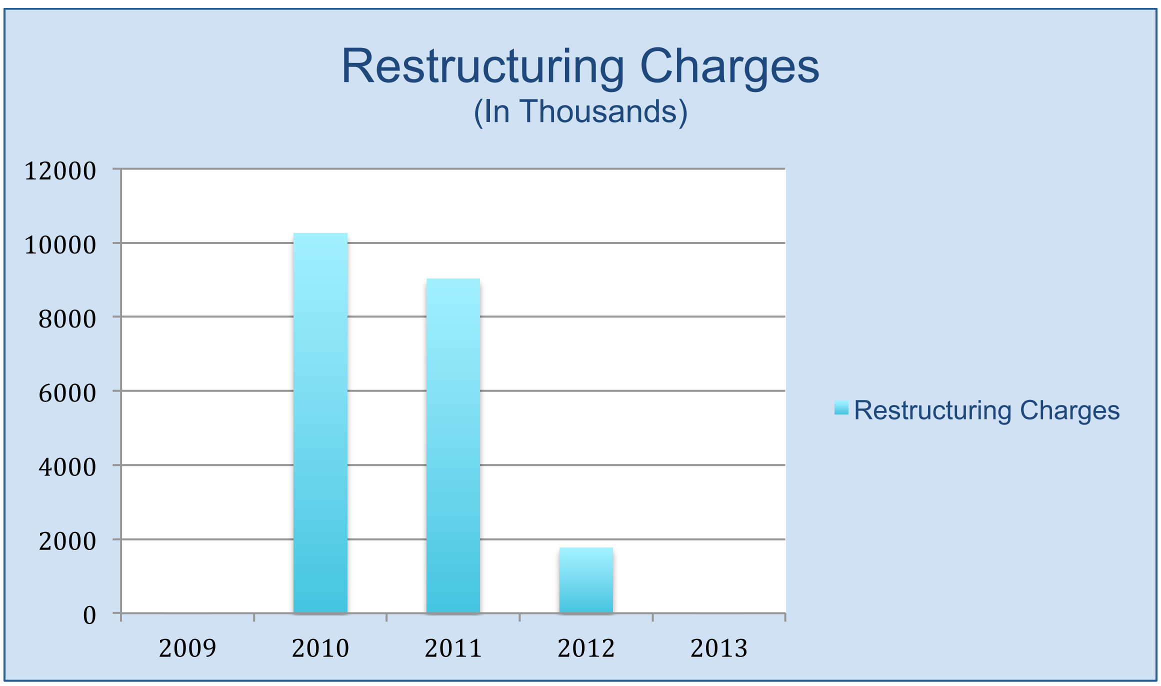
In 2011, Healthways recorded a goodwill impairment loss of $182.4 million, and it is the only goodwill impairment loss in Healthways' financial statements. Due to the non-recurring nature of the goodwill impairment, it should not be included in forecasts. Healthways does not report interest revenue, unrealized holding gains or losses, or realized holding gains or losses on its financial statements, and therefore, should not be included in forecasts (10-K; Yahoo Finance).

Restructuring Charges

Healthways had restructuring and related charges in 2010, 2011, and 2012. In 2010, restructuring charges were $10,258,000. In 2011, the charges were $9,036,000. In 2012, the restructuring charges were $1,773,000. Healthways did not have any restructuring charges in 2013.

In November 2010, Healthways began restructuring, which was largely completed in 2010. It focused on aligning resources with current and emerging markets and consolidating operating capacity. In November 2011, restructuring began, which was largely completed in 2011. It concentrated on aligning Healthways' capacity requirements and organizational structure following CIGNA's decision to wind-down its contract beginning in 2012. In 2012 restructuring began in December and was largely completed in 2012. It focused on capacity realignment. Through December 31, 2012, Healthways had incurred cumulative net cash and non-cash charges of approximately $1.8 million related to this restructuring, which consisted of one-time termination benefits (10-K).

Although restructuring charges for 2010 and 2011 were high and reflect past problems, the low restructuring charge in 2012 and zero restructuring charges in 2013 show that no on going issues persist.



Foreign Currency

Healthways enters into foreign currency options and forward contracts in order to minimize their earnings exposure to fluctuation in foreign currency exchange rates. As a result of Healthways investment in international initiatives, the company has a foreign currency exchange rate risk. Because a significant portion of these risks are economically hedged with currency options, forward contracts, and international initiatives are not yet material to the results of operations, a ten percent change in foreign currency exchange rates would not have a material impact on results of operations.

Healthways' foreign currency exchange contracts do not qualify for hedge accounting treatment under GAAP. The company routinely monitors foreign currency exposures to maximize the overall effectiveness of the foreign currency hedge positions. Healthways' financial records show no foreign currency transactions, only translations.

Healthways recorded a foreign currency translation adjustment loss of $755,000 in 2013. It recorded a foreign currency translation adjustment of $80,000 in 2012, and an adjustment loss of $70,000 in 2011. An adjustment of $656,000 was recorded in 2010 (10-K).

Dividends

Healthways "has never declared or paid a cash dividend on common stock. The company intends to retain any earnings to finance the growth and development of the business and does not expect to declare or pay any cash dividend in the future." The Fifth Amended Credit Agreements limits and restricts the payment of dividends. Healthways entered into the Fifth Amended Credit Agreement on Jun 8, 2012. It provides the company with a $200 million revolving credit facility that expires on June 8, 2017. Its also provides a $200 million term loan facility that matures on June 8, 2017, $110 million of which remained outstanding at December 31, 2013, and an uncommitted incremental accordion facility of $200 million (10-K 2013).

While Healthways does not have dividends to show a strong future performance to its shareholders, the company believes that its reinvestment strategies will, through stock price appreciation, lead to greater returns for investors. Investors hope that the reinvestment of earnings for expansion and new projects will yield greater returns via rising stock price.

Share Repurchases

Healthways' financial statements show no signs of share repurchasing. From 2012 to 2013, the number of shares outstanding increased and the earnings per share decreased. Both are opposite effects from what would happen from share repurchasing. From 2011 to 2012, the number of shares outstanding again increased, but the earnings per share sharply increased due to an impairment loss in 2011. From 2010 to 2011, the number of shares outstanding did decrease; however, the loss on earnings per share was drastic due to the impairment loss. The number of shares outstanding increased from 2009 to 2010, and the earnings per share increased due to a restructuring charge in 2010. (10-K)

Stock Splits

Healthways has no history of stock splits in recent years (10-K; Yahoo Finance).

Pensions

Healthways does not have defined benefit plans, but instead, offers a defined contribution plan or 401k. Healthways' 401k Retirement Savings Plan is available to all employees. Employees can contribute up to a certain percentage of their base compensation as defined by the plan. Healthways' matching of contributions is subject to vesting requirements. Contributions from the company under the 401k plan totaled $3.1 million in 2013, $2.9 million in 2012, and $3.5 million in 2011.

Employees can save up to 75 percent of their base salaries up to the IRS-imposed limit. Healthways then matches employee contributions at 52 cents per dollar for the first six percent they defer. A portion is paid in Healthways stock, and the match is applied annually. Employees are always 100 percent vested in their contributions, but Healthways' match is a longer-term incentive (10-K; Healthways.com).

Healthways' 401k places the investment risk on its employees. Healthways' records do not list a pension expense, so comparing annual pension expenses with the annual contributions by the company is not realistic.

Operating and Non-operating Items in the Income Statement

Revenues
Cost of services
Selling, general and administrative expenses
Depreciation and amortization
Impairment loss
Restructuring and related charges
Operating Income
Interest expense
Income (loss) before income taxes
Income tax expense
Net Income

Operating and Non-operating Items in the Balance Sheet

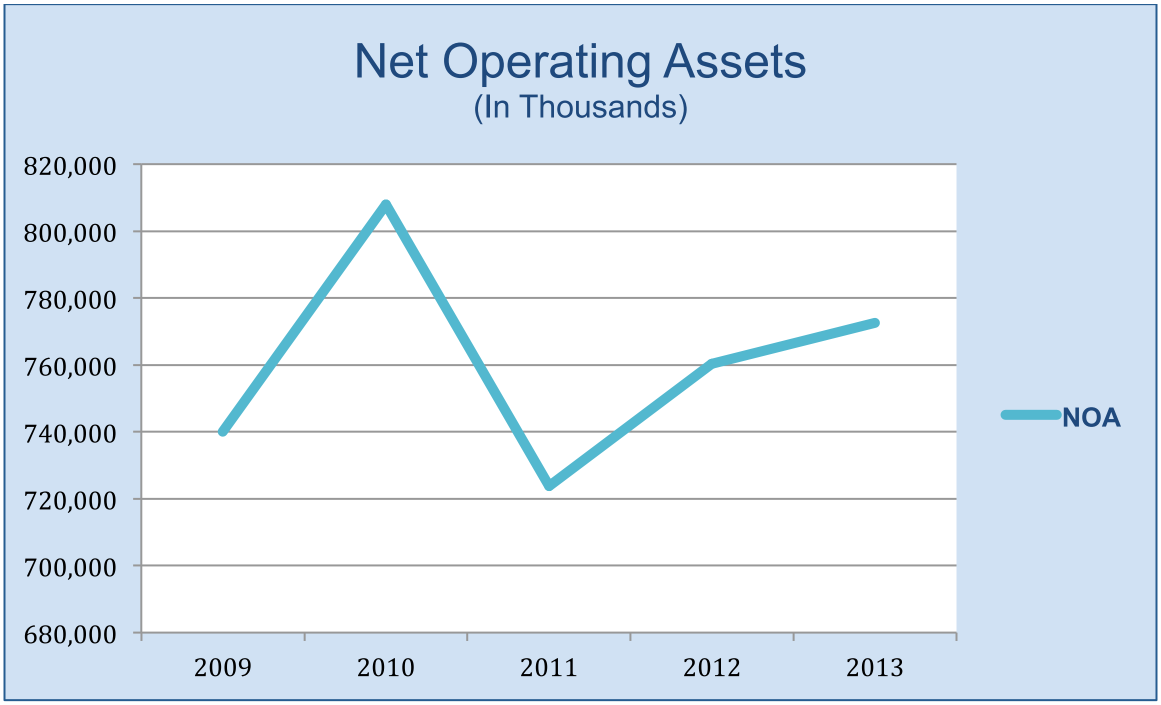
Cash and cash equivalents
Accounts Receivable, net
Prepaid expenses
Other current assets
Income taxes receivable
Deferred tax assets

Leasehold improvements
Computer equipment and related software
Furniture and office equipment
Capital projects in process
Other assets
Intangible assets, net
Goodwill
Accounts Payable
Accrued salaries and benefits
Accrued liabilities
Deferred revenue
Contract bills in excess of earned revenue
Current portion of long-term debt
Current portion of long-term liabilities
Long-term debt
Lon-term deferred tax liability
Other long-term liabilities

Statutory Rate (In Thousands)			
Year	Income tax expense (benefit)	Income (loss) before income taxes	Statutory Rate
2013	(5,636)	(14,177)	39.75%
2012	6,722	14,746	45.59%
2011	(15,386)	(142,307)	10.81%
2010	30,445	77,775	39.14%
2009	10,137	20,511	49.42%

Net Operating Profit After Tax (In Thousands)			
Year	NOPBT	Tax on operating profit	NOPAT
2013	(14,177)	12,027	(26,204)
2012	14,746	(290.4)	15,036
2011	(142,307)	20,663	(162,970)
2010	77,775	36,111	41,664
2009	20,511	16,424	4,087

Net Operating Assets (In Thousands)					
Balance Sheet Operating Items	2013	2012	2011	2010	2009
Operating Assets					
Accounts receivable, net	89,484	108,337	97,459	89,108	100,833
Prepaid expenses	9,228	9,727	11,417	12,577	10,433
Other current assets	6,857	7,227	1,412	3,064	4,945
Income taxes receivable	1,402	5,920	6,065	8,695	6,452
Deferred tax asset	9,667	8,839	10,314	11,272	24,197
Leasehold improvements	37,463	40,679	41,622	40,662	40,609
Computer equipment and related software	290,392	267,902	239,732	207,077	166,448
Furniture and office equipment	22,881	23,552	26,324	27,328	28,096
Capital projects in process	25,228	11,799	17,811	10,117	23,052
Other assets	53,629	21,042	10,797	14,733	11,498
Intangible assets, net	79,162	90,228	92,997	94,255	71,704
Goodwill	338,800	338,695	335,392	469,265	496,446
Total operating assets	964,193	933,947	891,342	988,153	984,713
Operating Liabilities					
Accounts Payable	33,125	26,343	22,578	22,555	29,171
Accrued salaries and benefits	20,157	24,909	35,617	39,157	58,212
Accrued liabilities	32,065	39,234	28,639	31,532	25,004
Deferred revenue	4,496	5,643	9,273	5,931	4,639
Contract billings in excess of earned revenue	17,411	14,793	13,154	18,814	70,440
Long-term deferred tax liability	33,320	36,053	26,964	23,050	14,617
Other long-term liabilities	51,003	26,602	31,351	39,140	42,615
Total operating liabilities	191,577	173,577	167,576	180,179	244,698
Net operating assets (NOA)	$772,616	$760,370	$723,766	$807,974	$740,015



Operating Return		
Year	RNOA	
2013	(0.03)	-3 percent
2012	0.02	2 percent
2011	(0.23)	-23 percent
2010	0.05	5 percent
2009	0.01	1 percent

Operating Returns (RNOA) was higher for those years with higher NOPAT. Net operating assets for all five years did not fluctuate enough to cause big differences in RNOA, so the differences came from NOPAT.

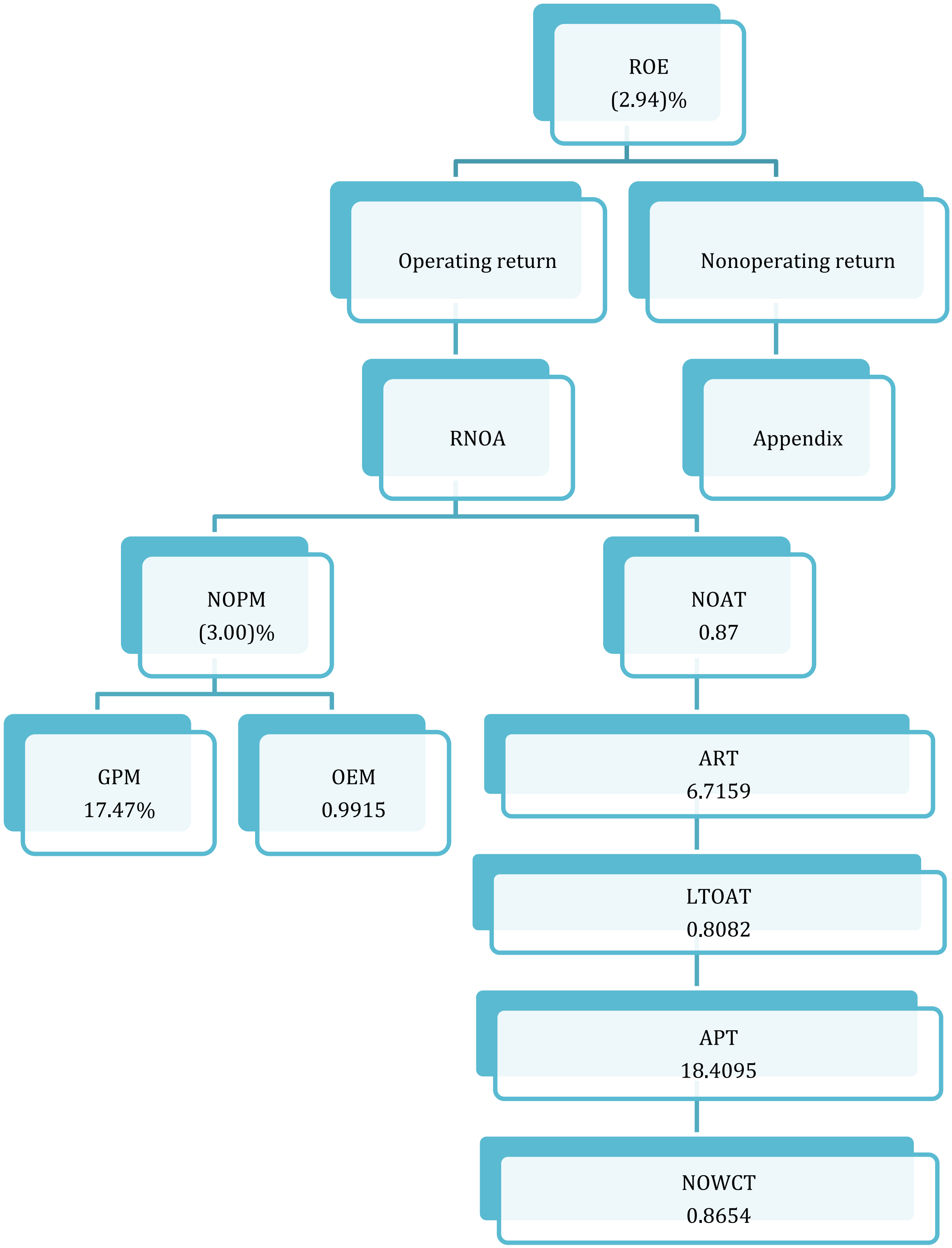
Return on Equity (In Thousands)			
Year	Net Income	Avg. stockholders' equity	ROE
2013	(8,541)	290,755.50	(2.94)%
2012	8,024	272,268.50	2.95%
2011	(157,693)	348,278.50	(45.28)%
2010	47,330	404,059	11.71%
2009	10,374	365,805.50	2.84%

The ROE was higher for those years with higher net incomes. Years with net income losses had lower ROE percentages.

Net Operating Profit Margin (In Thousands)			
Year	NOPAT	Revenues	NOPM
2013	(26,204)	663,285	(3.95)%
2012	15,036	677,170	2.22%
2011	(162,970)	688,765	(23.66)%
2010	41,664	720,333	5.78%
2009	4,087	717,426	0.57%

Net Operating Asset Turnover (In Thousands)			
Year	Revenues	Average NOA	NOAT
2013	663,285	766,493	0.87
2012	677,170	742,068	0.91
2011	688,765	765,870	0.90
2010	720,333	773,994.50	0.93
2009	717,426	737,832.50	0.97

2013 ROE Disaggregation



Macroeconomic Trends

Stock Market

According to stock information on the Nasdaq stock exchange, the market is currently down 0.42 percent. However, the level of the stock market has remained relatively constant. The market has climbed out of the recent recession, yet it is not thriving. Healthways stock has also grown at a constant rate since the beginning of the year. It shifts between $18 and $21. Currently, Healthways' stock is up 2.59 percent at $20.21. Healthways' stock is up compared to other companies in the health care management industry. The market remains constant, so the economy remains constant, allowing Healthways to slowly grow in its industry (Yahoo Finance).

Corporate Profits

Companies with strong corporate profits see a rise in GDP growth as sales increase and job growth rises. Because Healthways is part of the corporate wellness industry, corporate profits are a big determinant in getting customers for the company. As corporate profits increase, businesses have more money to spend on the health and well being of their employees. Healthways has shown through its programs that companies will save money in the long run by employing Healthways' services, adding to its customers' corporate profits.

Interest Rates

The federal funds rate has remained relatively constant with no major increases or decreases in recent years. The rate is currently at 12 percent. Because the rate has had no major fluctuations, banks and other lenders have been able to lend money at constant rates, allowing borrowers to be more confident when taking out loans. Businesses are able to grow and expand. Because of the constant rate, more companies will be able to borrow money. In turn, more companies will be able to use this money to help expand and grow their business, and one way to do this is to invest in the welfare of employees through the health programs Healthways offers. As a company, Healthways will also be more confident in borrowing money to expand and keep up with increased competition if the need arises (New York Fed).

Changes in Gross Domestic Product

By looking at the gross domestic product for different countries, it is easy to estimate how the countries are doing in regards to economic health. The gross domestic product for the United States in 2013 was $16,768,100 million. Healthways also has current operations in Brazil, France, and Australia. Brazil's 2013 GDP was $2,245,673 million. France had $2,806,428 million in GDP. Australia's 2013 GDP was $1,560,372 million. All of the countries where Healthways has current operations are all in the top 15 of GDP rankings for 2013, and the countries where Healthways has active business development are also doing well economically. The United States ranked number one, followed by France at number five, Brazil at number seven, and Australia at number twelve. According to this information, all of the countries have high gross domestic products and healthy economies. Because of this, businesses in all of the countries have increased revenues, and therefore, can afford to spend more on health care and corporate wellness programs offered by Healthways (The World Bank).

Level of New Business Startups

Healthcare startups have boomed over the last few years with venture funding deals growing some 200 percent between 2010 and 2014. Health reforms, an aging population demanding more and better care, and new technology are all contributors to the boom. Startup Health dubbed last year "The Year Digital Health Broke Out." Funding in healthcare had a 125 percent increase with $165 billion invested in new healthcare ventures.(Fortune- "Health Care Startups are Booming").

Many of the new healthcare startups are smaller businesses. A small business is defined as having fewer than 500 employees. Almost 28 million small businesses are located in the US, and over 50 percent of the working population works in a small business. Small businesses have generated over 65 percent of the net new jobs since 1995, and approximately 543,000 new businesses get started each month. Small businesses generally hire more employees than large corporations, so small businesses contribute to trying to decrease the unemployment rate (Forbes- "16 Surprising Statistics About Small Businesses").

According to a recent NY Times article, an unprecedented number of startup companies are valued at $1 billion or more today. A year from now that number is projected to increase to more than 100 startups. David S. Rose, CEO of Gust, says that venture capital investors funded about 1,500 startups last year, making funding for early-stage startups more available than ever. The cost of entry for a startup today is at an all-time low, allowing entrepreneurs to easily and affordably begin their companies. Communication, mobile platforms, and location-based services are all increasing with the ever-growing popularity of social media, allowing entrepreneurs to build a brand and grow a business at a low cost and with high interactivity. Large corporations that are having trouble innovating and growing with recent changes routinely buy startups for new technology and products. The percent of Baby Boomers who start businesses has grown from 14.3 percent in 1996 to 23.4 percent last year. Overall, the entrepreneur era means that more and more people will take advantage of the opportunity to create new business startups (Forbes- "A New Era for Entrepreneurs and Startups Has Begun").

For Healthways, the macroeconomic trend of new business startups means a growing economy to thrive in, but the company will have to face increased competition, especially in the healthcare and corporate wellness industries. As more companies seek to better health care for employees, Healthcare will see an increase in revenues. However, costs will also increase. As the economy grows from startups, Healthways will need to expand with new technology and programs to keep up with growing trends.

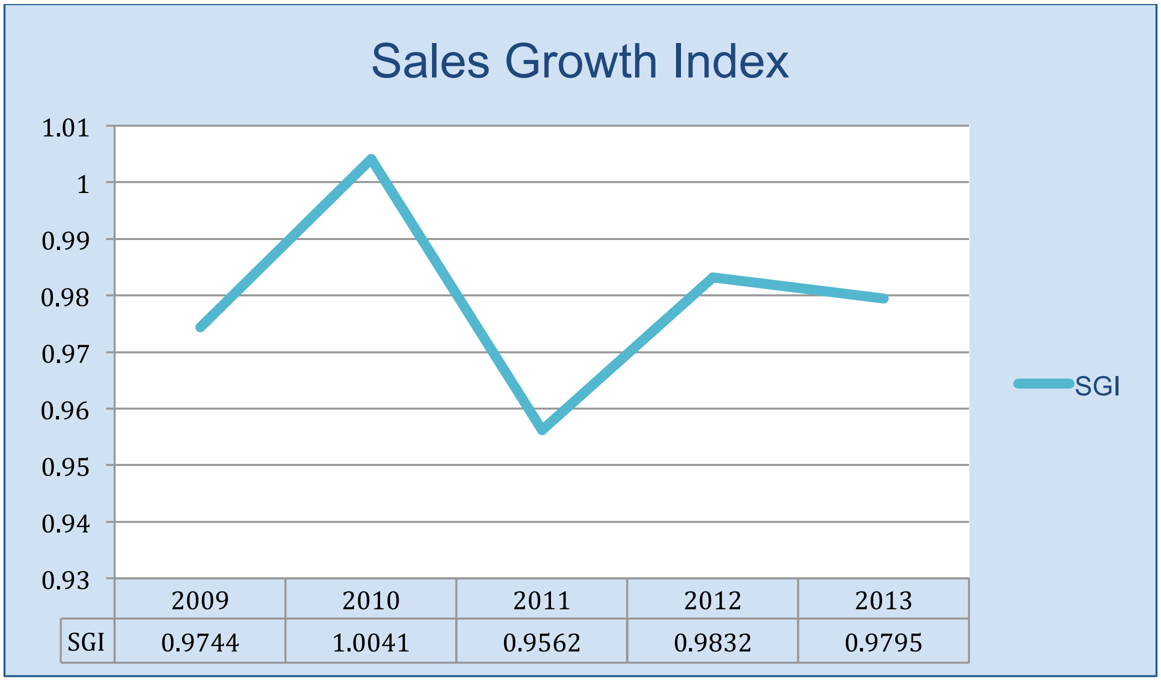
Revenue Recognition

Changes to Revenue Recognition

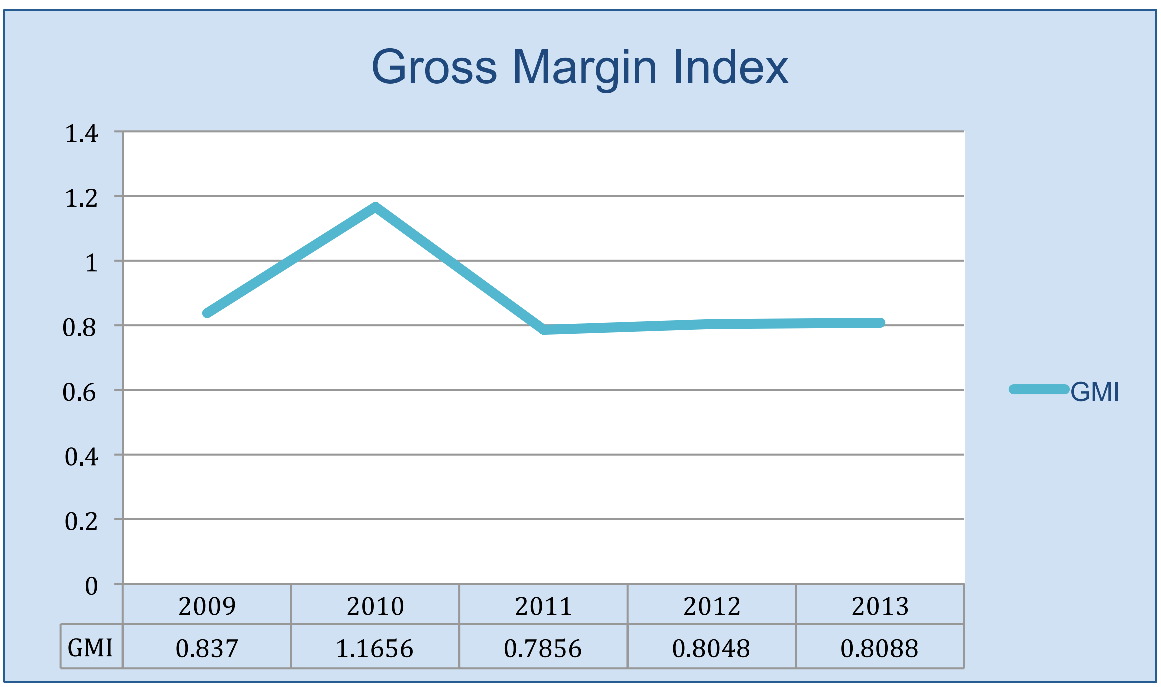
According to Dusty Stallings, CPA and a member of PwC's national professional services group, some companies plan to use the full retrospective method under the new revenue recognition policy, which requires public entities to restate two comparative years prior to the implementation date on Dec. 15, 2016. It would give investors a full understanding of trends with the new policy. The first step to implementation is creating a team and a plan. A structure needs to be in place to analyze the change and implement it. The next step is making sure everyone understands the new standard. Comparing notes with peers in industry groups is one way to go about it. The AICPA is updating various industry audit and accounting guides to reflect the changes, so it will be a good resource for those with questions. Another step is analyzing contracts and revenue streams. Companies will have to consider systems, training, and education implications. Most importantly, companies will need to plan now in order to move quickly to address changes once the policy is in place (Journal of Accountancy).

Inappropriate Revenue Recognition

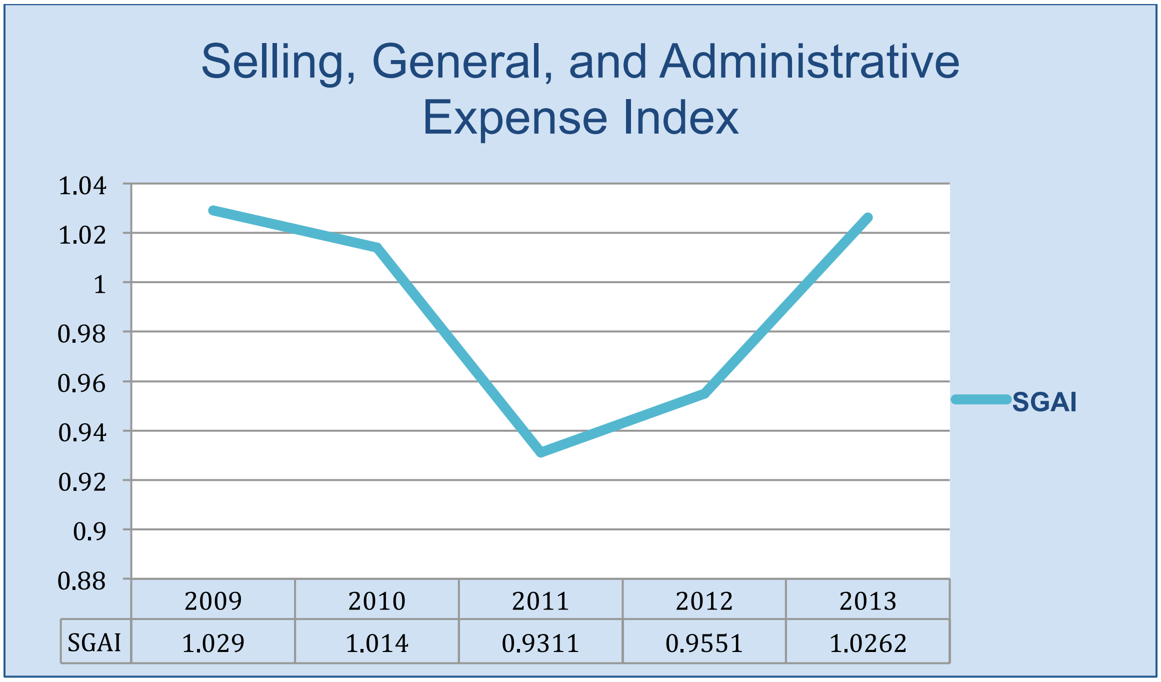
Healthways does not participate in channel stuffing. The company has no inventory listed on financial statements, so sending goods to distributors and stuffing the channel would not be something Healthways would need to do. Having no inventory would also make it difficult to participate in barter transactions, unless Healthways was exchanging services. Even then, Healthways would have to be given services in exchange because it would not accept inventory as a means of exchange. Bill and hold transactions would also be difficult for Healthways because the business is based on services, not on delivery of goods. Also, Healthways is not a "go-between" company, so reporting at gross when they should be reporting at net would be more difficult for them than a company like Priceline.



Healthways' sales figures constantly fluctuate with increases in 2010 and 2012 and decreases in 2011 and 2013. The largest increase in sales growth was from 2009 to 2010 with 0.0297. The largest decrease was from 2010 to 2011 with 0.0479.



Healthways' gross margin index was only greater than one in 2010, meaning that the company's gross margins deteriorated and management is motivated to show better numbers. This led to the large decrease in 2011 and the consistency in 2012 and 2013.



Healthways' SGAI was less than one in 2011 and 2012, which means that sales were increasing faster than expenses. One explanation for the increase in revenue could be earnings manipulation, meaning management overstated revenues to increase earnings.

Analysts' Forecasts

Meeting Earnings Targets

Healthways has been constantly meeting analysts' forecasts. However, Healthways can miss the estimates for some forecasted numbers. Reports for the third quarter in 2014 showed that Healthways met profit expectations but missed revenue forecasts. The company reported net income of $2 million and a profit of 5 cents per share, instead of the estimated 8 cents per share. Recently, Healthways has also been meeting forecasted estimates. For fourth quarter 2014, financial statements, Healthways reported an EPS of $0.07 and adjusted EPS of $0.25, meeting analysts' forecasts (Yahoo Finance).

Earnings Management

Why Managers Use Earnings Management

Because managers want to maintain earnings, they may attempt to smooth earnings out of concern for their jobs. A recent article in Fraud Magazine told a story about a company trying to find a chief accountant to hire. Each interviewee was given financial information and asked, "What are the net earnings?" Every candidate but one computed the net earnings, but none of them got the job. The candidate who got the position answered the question by replying, "What do you want the net earnings to be?" (Fraud Magazine).

The story makes the argument that managers participate in earnings management in order to keep their jobs secure. Having smooth earnings shows how managers can maintain earnings without major fluctuations. When current earnings are low and future earnings are expected to be better, managers shift the earnings from the future to the present. For example, Healthways' managers could expect future earnings to be better due to an increase in revenues or a decrease in costs from the application of new technologies or new programs, costing customers more. When current earnings are good and future earnings are expected to be low, managers shift earnings from the present to the future. For example, Healthways future costs could decrease due to costs associated with buying new technology or the non-collection of receivables. The earnings management acts as a safety for managers.

Methods of Earnings Management

Earnings management involves selecting GAAP methods with concern for appearance rather than reality. It also includes subtle techniques, such as changing reported earnings through "performance timing." One way to maintain earnings and increase sales is to use optimistic estimates of collectability to overstate earnings. Another way to manipulate receivables is to understate the allowance for doubtful accounts to decrease expenses and increase earnings. Another way to use earnings management is to use optimistic estimates of the life and salvage value of depreciable assets, reducing depreciation expense. Healthways has a large depreciation expense, so increasing or decreasing depreciation expense would cause managers to manipulate a large account.

Equity Valuation

Operating Leases

Comparing the adjusted computations to the unadjusted numbers, there are some key differences. The NOAT has decreased by 0.9. And the FLEV has increased from 0.9394 to 1.2157. Other numbers have shown very little differences. RNOA has decrease slightly from 0.15% to 0.13%. The NOPM has remained constant through the adjustment with 0.17%. Managers prefer to structure lease contracts as operating rather than as capital leases because the asset and liability are not reported on the balance sheet and there is not depreciation or interest expense recorded, making income higher.

Discount Rate	
N	Amount
0	-1,231
1	1,199
2	66
	1,265
	=IRR (values, guess) 2.62%

Present Value of the Operating Lease Payments			
Year	Operating Lease Payment	Discount Factor 0.0262	Present Value
1	13,198	0.9745	12,861
2	11,781	0.9496	11,187
3	10,764	0.9253	9,960
4	10,198	0.9017	9,196
5	10,707	0.8787	9,408
Thereafter	10,707	2.5892	27,723
			$80,335

Adjusted Computations (In Thousands)			
	Unadjusted	Adjustment	2013 Adjusted
NOA	772,616	+80,335	$852,951
NNO	252,160	+80,335	$332,495
NOPAT	(26,204)	+8,926 (13,198)	(30,476)
RNOA			(3.00)%
NOPM			(3.95)%
NOAT			0.78
FLEV			1.2157

WACC

In computing WACC, a six percent equity spread was used because of the signs of growth that Healthways and the corporate wellness industry have shown for future periods.

Computing Cost of Equity	
Risk-free Rate	2.5%
Beta	-0.17
Equity Spread	6%
Cost of equity	1.48%

Cost of debt	
$16,079/[(251,922,000+290,335,000)/2]	5.93%
After-tax cost of debt	
5.93% x (1-39.75%)	3.57%

Equity Weight	
302,690,000/(302,690,000+251,922,000)	54.58%
Debt Weight	
1-0.5458	45.42%

WACC	
[54.58%*1.48%]+[45.42%*3.57%]	**2.43%**

Valuation Models

When using the discounted cash flow model and residual operating income model, a terminal growth rate of one percent was used, along with a forecasted growth rate of 6% due to Healthways' signs of future growth, as well as, signs of future growth in the corporate wellness industry. The DCF model is the widely accepted model. Cash flows are unaffected by accrual accounting, and FCFF is intuitive. On the other hand, ROPI focuses on value drivers and uses both balance sheet and income statement data.

Discounted Cash Flow (DCF) Model

The discounted cash flow model shows that the value of Healthways' stock is lower than the actual selling price.

Discounted Cash Flow Model	Reported	Forecasted				Terminal Period
	2013	2014	2015	2016	2017	
(In Thousands)						
Sales Growth	-2.05%	6%	6%	6%	6%	1%
		1	2	3	4	
FCFF	21,635	22,933	24,309	25,314	27,314	27,587
PV of Horizon FCFF		22,389	23,169	23,977	24,813	
Cum. PV of horizon FCFF	$94,348					
PV of terminal FCFF	1,929,161					
Total firm value	$2,023,509					
Less NNO	252,160					
Firms equity value	$1,771,349					
Shares outstanding	33,924,000					
Stock value per share	$0.05					
Trading price at 5/2/2013	$13.83					

Residual Operating Income (ROPI) Valuation Model

The Residual Operating Income Valuation Model shows that the valuation of Healthways' stock is lower than the actual selling price.

Residual Operating Income Model	Reported	Forecasted				Terminal Period
	2013	2014	2015	2016	2017	
(In Thousands)						
Sales Growth	-2.05%	6%	6%	6%	6%	1%
NOPM	(3.95)%					
NOAT	0.78					
Sales	663,285	703,082	745,267	789,983	837,382	845,756
NOPAT	(26,204)	(27,772)	(29,438)	(31,204)	(33,077)	(33,407)
NOA	852,951	901,387	955,471	1,012,799	1,073,567	1,084,303
		1	2	3	4	
Required Return		20,727	21,904	23,218	24,611	26,088
ROPI		(48,499)	(51,342)	(54,422)	(57,688)	(59,495)
PV of Horizon ROPI		(47,348)	(50,124)	(53,131)	(56,391)	(58,084)
Cum. PV of horizon ROPI	(265,078)					
PV of terminal ROPI	(4,061,818)					
Total firm value	(4,326,896)					
Less NNO	252,160					
Firm equity value	(4,579,056)					
Shares outstanding	33,924,000					
Stock value per share	$0.13					
Trading price at 5/2/2013	$13.83					

Management's Assertions					
Balance Sheet Accounts	Existence or Occurrence	Completeness	Rights and Obligations	Valuation or Allocation	Presentation and Disclosure
Cash and cash equivalents	The cash and cash equivalents account must be checked by outside sources, for example the bank, to verify existence.	All cash and cash equivalents have been appropriately recorded.	The company has a right to use its cash and cash equivalents.	The bank reconciliation must match the cash account on the book balance.	All cash and cash equivalents have been properly classified, and the notes properly detail which items are included in cash equivalents.
Accounts Receivable, net	The accounts receivable exist, and a confirmation request is sent to customers who either admit or dispute that they owe a balance to the company.	The accounts receivable may be incomplete if the company has not recorded sales. Tracing cash inflows to sales can check completeness.	The accounts receivable belong to the company unless there is a factoring arrangement, which can be found by looking at cash receipts for factor payments.	The accounts receivable balance must be recorded correctly, along with the reduction for accounts that will be uncollectible.	The account is disclosed adequately net of contractual adjustments and allowances for doubtful accounts.
Prepaid expenses	Auditors can confirm the prepaid expense with the other company involved	The prepaid expense account should contain all and only prepaid accounts.	The company has a right to current prepaid assets because the costs have already been	The account should only contain amounts that will be expensed in the	All prepaid expenses should be properly disclosed in the current asset section of the balance sheet

	in the transaction.		paid for but not used up.	current year and should be reduced as expires.	net of expired costs.
Balance Sheet Accounts	Existence or Occurrence	Completeness	Rights and Obligations	Valuation or Allocation	Presentation and Disclosure
Deferred tax asset	Deferred tax assets can be measured by looking at previous years financial statements.	Deferred tax assets should include accruals and reserves, deferred compensation, share-based payments, net operating loss carry forwards, cash conversion derivative, etc.	The company has a obligation to record on the income statement in order to reduce the tax later on.	Deferred tax assets should reflect the net tax effects of temporary differences between the carrying amounts of assets used for financial reporting and amounts used for income tax purposes.	Deferred tax assets should be appropriately stated on the balance sheet, and notes should reflect the carrying amounts of the assets used for financial reporting purposes.
Property and equipment	Property and equipment should be physically accounted for to make sure that they align with balance sheet accounts.	The account should list the net values of all leasehold improvements, computer equipment and related software, furniture and office equipment, and capital projects in process.	The company is entitled to all property and equipment, including leasehold improvements, computer equipment and related software, furniture and office equipment, and capital	Depreciation on property and equipment is recognized using the straight-line method over useful lives of three to seven years for furniture and other office equipment. Leasehold improvements are	All property and equipment accounts should be adequately disclosed less accumulated depreciation. The notes should discuss methods of depreciation for each account under property and equipment.

			projects in process, to carry out necessary daily operations.	depreciated over the shorter of estimated life of the asset or the life of the lease.	
Balance Sheet Accounts	Existence or Occurrence	Completeness	Rights and Obligations	Valuation or Allocation	Presentation and Disclosure
Intangible assets, net	Intangible assets exist through documentation and outside sources can help with proof of the existence of such intangible assets, for example the patent office.	The intangible assets account should include customer contracts, acquired technology, patents, distributor and provider networks, a perpetual license, and other intangible assets.	The company has a right to use and record all intangible assets.	Items are amortized on a straight-line basis over estimated useful lives ranging from two to 25 years.	Intangible assets should be listed properly net of amortization. The notes should include a list of all assets that fall under the intangible assets account, along with methods for amortization.
Goodwill, net	Goodwill exists and is recognized for the excess of the purchase price over the fair value of tangible and identifiable intangible net assets of businesses the	Goodwill is complete based on appropriate factors involved in the discounted cash flow model and market-based approach in determining the correct fair value	The company has the right and obligation to record and measure goodwill on businesses that they acquire.	The company estimates the fair value of each reporting unit using a combination of a discounted cash flow model and a market-based approach and	Goodwill should be estimated at the fair value of each reporting unit on the balance sheet and should be reviewed for impairments.

	company acquires.	amount to report.		reconciles the aggregate fair value of the reporting units to the consolidated market capitalization.	
Balance Sheet Accounts	Existence or Occurrence	Completeness	Rights and Obligations	Valuation or Allocation	Presentation and Disclosure
Accounts payable	The use of secondary sources, such as the other business or customer involved in the transaction, should be used to validate the accounts payable account on the books.	The accounts payable account should be linked to purchases made by the company over the course of doing business in order to check the completeness of the account.	The company has an obligation to pay off any accounts payable.	Accounts payable should be recorded consistently at gross or net amounts.	The accounts payable account should be disclosed as an obligation in the current liabilities section of the balance sheet.
Accrued liabilities	Confirming with outside sources can check the existence of accrued liabilities and the rates at which they are accrued.	Accrued liabilities should include all expenses that the company has incurred but has not yet paid.	The company has an obligation to pay for any and all accrued liabilities within the required date or period.	Accrued liabilities should be presented according to the appropriate rate.	Accrued liabilities should be presented appropriately in the current liability section, and notes should disclose what liabilities are parts of the account.

Current portion of long-term debt	Secondary sources, like creditors, should be used to validate amounts and rates.	The account should include all portions of debt due within the period.	The company has an obligation to pay off any and all current portions of debt plus interest.	The current portion of long-term debt should be debt owed within the current period.	The current portion of long-term debt should be disclosed properly under the current liabilities section. Notes should include all information on interest rates.
Balance Sheet Accounts	Existence or Occurrence	Completeness	Rights and Obligations	Valuation or Allocation	Presentation and Disclosure
Long-term debt	Secondary sources, like creditors, should be used to validate amounts and rates.	The account should include all portions of debt not due within the current period.	The company has an obligation to pay off any and all long-term debt plus interest.	Long-term debt should be debt owed not within the current period.	The long-term debt account should be disclosed properly under the long-term liabilities section of the balance sheet. Notes should include all information on interest rates.

Audit Risk

The Fraud Triangle

The fraud triangle is made up of three factors: pressure, rationalization opportunity. Managers who commit fraud are usually under pressure either personal events or from work compensation that motivates them to commit Upper management employees often have a relatively low salary with the b their compensation coming from bonuses tied to how well the company perf Fraud takes place when the opportunity to commit fraud is present. Weak in controls, no separation of duties, indifferent management, and ineff monitoring of management are just some of the different opportunities prese fraud. In order to commit fraud, managers must rationalize their actions common rationalization is that the employee is "just borrowing the money. fraud usually starts off small but escalates until the employee is unable to pay the money. Another rationalization is that the employee "deserves the extra m The employee thinks that he or she is underpaid for the amount of hours put i rationalizes the committing of fraud as something he or she deserves (' Finance).

Audit Risk: Property and Equipment

The property and equipment account is made up of leasehold improver computer equipment and related software, furniture and office equipment capital projects in process. The entire account totals $375,964,000 b accumulated depreciation, or 50 percent of all assets. With accumu depreciation of $217,766,000, the property and equipment account $158,198,000 and makes up 21 percent of total assets. Because property equipment is a large, economically significant account on Healthways' balance any misstatements will be material (10-K).

Managers under pressure to perform well could commit fraud under the pro and equipment account by changing residual values and useful lives. One te auditor can perform to check the property and equipment account is to ob summary analysis of changes in property owned and reconcile to ledgers. An test would be to make a physical inspection of all major acquisitions of propert equipment. An internal control in place to help comfort the external auditor be limited access to assets and records in ensuring that ledgers and journa maintained in accounting. Another internal control would be segregation of as subsidiary ledgers can be maintained to keep track of depreciation and cu values of property and equipment.

Audit Risk: Long-Term Debt

The long-term debt account totals $237,582,000 or 58 percent of all liabilities on the balance sheet. Because of the high percentage, long-term debt is a major balance sheet account, and any misstatements would be material. Pressure from performance could make managers commit fraud when the opportunity arose by changing long-term debt to influence the debt-to-equity ratio. In order to change the company's leverage. One test that could be used by auditors is to recompute all ratios, for instance the debt-to-equity ratio, and compare to previous years financial statements. Another test that could be used is the tracing of transactions to locate the source of the debt and any previous payments. One internal control that the auditor should take into account is segregation of duties. It would ensure that no one employee would have complete control over the recording and authorization of the debt. Another internal control would be authorization of activities. It would allow for a formal approval system for all debt (10-K).

Corporate Tax

Country Comparisons

Compared to the United States, the corporate tax rates in the other countries where Healthways has operations are relatively similar. All of the tax rates are between 30 and 40 percent with Australia at the lower end with 30 percent and the United States at the upper end with 40 percent (Global Corporate Tax Rates Table).

Corporate Tax Rates	
Healthways' Major Revenue Earning Countries	2013 Corporate Tax Rates (In Percentages)
United States	40
Brazil	34
France	33.33
Australia	30

Tax Credits for Corporate Wellness Industry

Tax Credits for the corporate wellness industry have been present in many states in recent years. In Massachusetts, a recent wellness tax credit of up to $10,000 was part of legislation. The credit is in the amount of up to 25 percent of the cost of implementing an employee wellness program. In Indiana, the mandated Small Employer Qualified Wellness Program Tax Credit provided a credit of 50 percent of the costs incurred by the business to implement the program (Wellness Tax Credit).

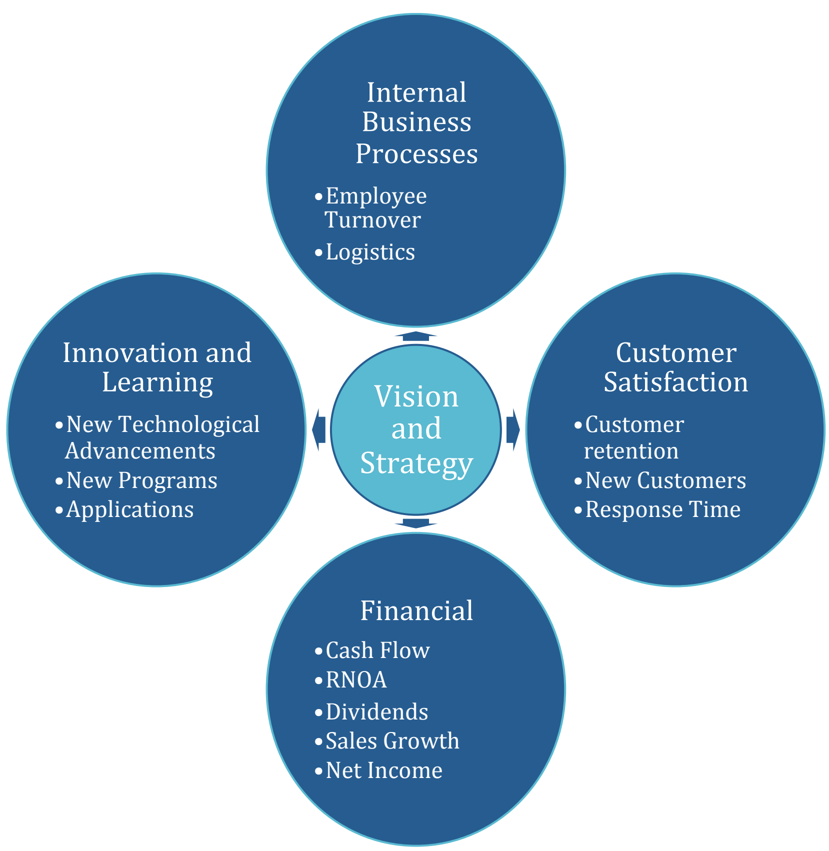
Recommendation to Legally Minimize Worldwide Tax Expense

In order to legally minimize the worldwide effective tax rates, managers could be diligent about charging out expenses to foreign operating offices. Reducing the taxes paid in the foreign country by pushing down expenses that belong in that foreign country has many benefits. First, it helps avoid a situation of having excess foreign tax credits that may expire. Second, it could potentially reduce your worldwide effective tax rate, which is what management is after (International Business Services).

Advisory Recommendations

Healthways' Balanced Scorecard

The balanced scorecard assesses how Healthways is working to meets its goals through performance measures to ensure that the company is creating value for shareholders. The four man categories are financial, customer satisfaction, internal business processes, and innovation and learning. Learning and innovation eventually builds upon internal processes, which in turn improves customer satisfaction and leads to an improved financial performance overall.



Customized Technological Advancements

Because Healthways must differentiate itself from competitors in a growing health industry, it is important that Healthways maintain and surpass consumer expectations in technological advancements within the company. Healthways has always been at the forefront of technology and must continue this trend. In 2011, Healthways signed a ten-year, $380 million applications and technology services outsourcing agreement with HP to support growth and expand value to Healthways' customers. With the agreement, HP provides application development and management services to further the development of the company's applications and technology infrastructure (10-K).

Healthways already utilizes Embrace, a technology platform that offers a level of integration, providing informed outreach to customers. Embrace provides a central home for population health data and allows customers the ability to connect with the company. The agreement with HP serves to increase the functions of this mission-critical application by supporting an increased volume of customers and an increased market demand for multiparty integration. HP utilizes its information technology infrastructure library based enterprise service management platform to provide the solutions (10-K).

Along with new technology, Healthways has implemented a technology advisory council within the company that serves to provide tools, updates, and software information to keep Healthways up-to-date and secure. Members of the Technology Advisory Council include Healthways' technology staff and representatives from partner firms: Microsoft, Oracle, MCI, Concerto, Cisco, Dell, CDW, and HP (10-K).

While Healthways is working to improve technological advancements, it needs to make sure that it is offering customized applications for customers. For instance, a mobile application would allow customers to store individualized data and a way to easily contact Healthways for solutions to health questions. Customized features could include a health tracker, a data table with initial health assessment information, nutrition guidance, etc. Specialized technology for consumers is one way Healthways can make sure it is differentiating itself for competitors. Healthways would need to work closely with HP to make sure that the applications were secure, especially since personal health data could be stored.

New, customized applications would add to the innovation of Healthways, which would in turn help with internal business processes as Healthways could better communicate and interact with customers. Customer satisfaction would then be greatly improved with faster response times, and customer retention rates would increase due to satisfaction with the applications. Overall, Healthways would see an increase in revenues from customized advancements and would realize a much-needed increase in assets to Healthways' balance sheet.

Continue with Existing Outsource Agreements

Healthways has been increasing and applying new advancements to its company over the past few years, and entering into outsourcing agreements, for example, the agreement with HP. Because Healthways' agreement with HP is relatively recent and extends for ten years, unless terminated earlier, it is in Healthways best interest to not enter into any agreements based on technology until 2021 or until the current agreement has been terminated. It is also best that Healthways not enter into any more outsourcing agreements until the obligations due to HP are paid off.

Outsourcing obligation payments to HP are $23,017,000 in 2014, $40,020,000 in 2015-2016, $36,154,000 in 2017-2018, $43,025,000 in 2019 and after. All remaining payments will be approximately $291.6 million in total. The agreement allows Healthways to terminate all or a portion of the services after the first two years provided they pay termination fees (10-K).

Healthways already has a competitive advantage by outsourcing to HP. The company also needs to time to work on the security of the Embrace program and other applications that are developed since personal health data will be present on the applications. No outsourcing will decrease contract obligations and decrease liabilities, which are already too high and have made Healthways risky over time. The debt-to-equity ratio that Healthways currently operates at is 1.47, showing that Healthways is being financed with too much debt and not enough equity. The current ratio is 0.96, meaning that there are not enough current assets to cover debt. Holding back on any more contractual obligations will give Healthways the opportunity to pay off its obligations without adding more on.

Continuing with existing outsource agreements pertains to the financial side of the balanced scorecard. Healthways must focus on lowering its debt-to-equity ratio and liabilities before it can agree to outsource any more projects or aspects of the company.

New Acquisitions

While Healthways is confident on the forefront of technology with its HP agreement for future years, the company still needs to continue to grow and differentiate itself with specialized, science-base programs. In August 2011, Healthways acquired Navvis & Company, a firm that provides strategic counsel and change management services to healthcare systems. In April 2012, Healthways acquired Ascentia Health Care Solutions, a firm that supports and promotes population health management, patient centered programs, payer strategies, and physician practice enhancement program (10-K).

Because of these acquisitions, net goodwill on Healthways financial statements is $338,800,000, making up 45 percent of total assets. While Healthways already has a very large amount of goodwill on its financial statements, an increase in assets would still add value to Healthways and increase stock values. However, Healthways needs to be careful in future acquisitions to not overvalue a company. Overvaluing a company will cause Healthways to buy it at a premium, which is why goodwill is already so high. Acquisitions are necessary for Healthways, as it helps make them more competitive in the industry and a more valuable company. For instance, Navvis' does business with six of the ten largest health systems in the U.S., making it a big acquisition for Healthways and contributing not only to Healthways' health systems, but also its brand (10-K).

Acquisitions also allow Healthways to respond to the growing demand from health plan providers and businesses as the wellness industry continues to see increased growth. In order to compete with new entrants to the market, Healthways must maintain its marketing as a leader in science-based, award-winning programs, and gaining other companies makes these programs possible. Healthways' wellness programs and health assessments are the main items that customers are focused on when going into business with Healthways, and they must keep them up-to-date with the latest improvements and a strong innovation network. New, innovative projects help with growth, which leads to more efficient operations and increased customer satisfaction with new programs. Overall, it leads to an increase in goodwill and assets, which increase Healthways' total value as a company and increases stock values.

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