June 2010

Case Study: United American Healthcare

In creating a case study, the case writer can chose a subject based on many different rationales. One can illustrate a particularly tricky dilemma, an emerging trend, or an interesting angle on a timeless issue.

In illuminating the case of United American Healthcare Corporation (NASDAQ: UAHC), we have none of these, nothing subtle or thought-provoking. Instead, we find **a situation that has just about every egregious and shameful example of board and management deceit and incompetence** that a hardened activist can think of. This one has everything:

- a wrecked core managed healthcare business
- wasted corporate assets
- wildly excessive executive compensation
- entrenched management overseen by complacent directors
- serial CFO turnover
- poor external communication
- shady acquisitions
- questionable deals favoring one investor over all others
- open hostility toward shareholders.

The 2009 Annual Meeting is finally scheduled for June 29, 2010, after the board rescheduled it twice.

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Declining Operations at UAHC

UAHC pioneered managed care services for Medicaid patients. It started its corporate life in 1985, and effectively ended it in April 2008 when it lost the last of its managed care contracts.[1] At that point it had no business at all, or at least no ongoing source of revenues.

This situation did not stop UAHC from continuing to operate like an ongoing business, though. Since June 30, 2008 it ran through about $14 million in cash with no corresponding revenues, and converted positive equity of a little more than $4 million on that date into a deficit of close to $9 million as of March 31, 2010.[2]

It's not clear, though, how they spent that sum, since the company shows only "marketing, general and administrative" on its financial statement. In the fiscal year ended June 30, 2009 UAHC did pay the top three executives almost $1 million before equity compensation, and paid another $600,000 to the seven directors. Through the first nine months of FY 2010, they spent another almost $5 million on marketing, general, and administrative, almost two years after they learned that they would lose their last managed care contract.

Whatever business the company had or has, directors and management appears to have made it worse over the years. They steadily turned a profit of $0.69/share in 2004 into a loss of $1.02/share in 2009, with each successive year worse than the previous one. And, through the first nine months of FY 2010, the company lost $0.50/share, again more than a year after they learned that they would have no ongoing revenues.

They spent this money, and incurred these losses, even after going through three CFOs in less than one year. One served about five months, and abruptly resigned without explanation to investors. The company disclosed these changes to investors days after they occurred.[3]

[1] Form 8-K, April 22, 2008
[2] Form 10-K, September 24, 2009; and Form 10-Q, May 17, 2010
[3] Form 8-K, August 31, 2009; and Form 8-K, January 21, 2010

Board of Directors' Poor Response

How did the Board of Directors respond to this situation? Pretty poorly, by any objective measure. They approved new retention agreements for the CEO and CFO in October 2008, months after the business ceased generating revenues. They continue to entrench themselves and management, with a classified board of directors, daunting advance notice requirements, and other customary protections that favor directors and executives over investors. They also will spend an estimated $550,000 on legal, proxy solicitation, and other expenses associated with the 2009 annual meeting, which they have delayed seven months, resisting the efforts of investors to elect independent directors.[4]

Investors have tried to intervene. At the annual meeting in November 2008, shareholders negotiated to place a significant long-term investor, Bruce Galloway of Strategic Turnaround Equity Partners (Strategic), on the board. He alone among directors has declined to accept any compensation (except expense reimbursement) for his board service. Investors have also demanded reductions in expenses to preserve cash. Then, things started getting interesting.

Two different independent investors, Strategic and Lloyd Miller, another long-term holder, nominated candidates for election at the 2009 annual meeting, which should have occurred in November 2009. In January 2010 the company finally scheduled that meeting for April 2010. They then moved the meeting date to July 30, 2010, and moved it again to June 29, 2010. Whatever the motivation, these changes served to allow directors and management that many more months of service and compensation.

It gets worse. A third investor, John Fife, disclosed a 10% investment in November 2009. Fife started to acquire his shares only one month before, shortly after independent investors nominated their candidates. He then nominated his own slate of candidates in January 2010. In a series of meetings in February and March 2010, Fife and the company negotiated a deal in which Fife would support management in exchange for the right to sell his stake, at the time approximately 24% of the shares, to the company for a significant premium. He would have only the possible obligation to make a single $600,000 investment in the company. Strategic has filed a lawsuit to block this transaction.[5]

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[4] UAHC Proxy Statement, June 10, 2010
[5] UAHC Proxy Statement, April 1, 2010

Recent Developments

Two other problems, for investors that is, developed since Fife and UAHC announced their deal. Earlier this month, Fife announced that he has transferred most of his stake to the Dove Foundation, a charitable trust. According to the Strategic lawsuit, Fife did this in order to avoid provisions in the UAHC articles of incorporation and state corporate law preventing greenmail and limiting the ability of a controlling shareholder such as Fife to take advantage of minority owners.

Second, last week the company announced that they plan to acquire Pulse Systems, a medical devices company.[6] According to UAHC, this deal represents the first step of the company's strategy to rebuild its business after losing the managed care contracts over two years ago. As strategic and financial moves go, it seems pretty bad.

The board chair of Pulse Systems, a private company, is none other than John Fife. Fife's private equity firm also has a significant stake in the company, although as a private company UAHC investors know little about Pulse right now. UAHC has disclosed that Pulse had revenues of $9.2 million in 2009, but nothing else. The most recent UAHC filings on the deal reveal that the company will publish Pulse's financial statements in 71 days, or long after the deal is supposed to have closed.

UAHC has disclosed only some of the terms of the transaction, including the payment of almost $16 million, between purchase price, loans to Pulse, repayment of Pulse debt, and redemption of Pulse preferred shares. UAHC will also issue 1.6 million of its own shares to Pulse investors, significantly diluting current investors by about 20%. Shareholders do need to approve these new shares, and if they don't UAHC has agreed to pay Pulse another $1.6 million. Because Pulse Systems is private, and UAHC has disclosed few of the terms, investors have no way to evaluate the transaction themselves. Needless to say, UAHC acquired Pulse Systems without a shareholder vote.

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No one knows how this affair might end. The Strategic lawsuit seeks, among other things, an injunction against the various transactions between UAHC and Fife and his affiliates, with hearings ongoing. And, the company's annual meeting is currently scheduled to take place June 29. At that point investors will finally have a say in these matters, through the election of three directors. Investors could attain control over the seven-person board of directors at this annual meeting, and start to put an end to their misery.

[6] UAHC Proxy Statement, June 24, 2010

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