15 September 2019
Equity Research
Americas | United States

CREDIT SUISSE

Humana Inc.

Lots of Positives, with Some Political Cover Too

HUM

Target price (12M, US$)
315.00

Outperform

Managed Care | Company Visit

- **Hosted Management Meetings and Tour of HUM's Primary Care Clinics in KC.** On September 12 and 13, we hosted HUM for investor meetings in Denver, CO and Kansas City, MO. We also visited two Humana Partners in Primary Care (PIPC) clinics in KC.
- **Holistic Primary Care.** PIPCs offer a full array of primary care (physicians, nurse practitioners, nurse care coordinators, behavioral health specialists, physician assts, referral coordinators, etc.). PIPCs are not urgent care clinics, but are payer-agnostic. Some 40 PIPCs are currently in place in SC, NC, TX, FL, and KC. HUM is open to using outside capital to fund the PIPC expansion over time. PIPCs achieve standalone B/E results in 3-5 yrs. Importantly, Humana's health plan business benefits almost immediately from the rollout of PIPCs, as risk scores for participating MA members are captured more accurately (potentially leading to higher PMPMs) and as disease progression is slowed, helping to bend the medical cost curve. PIPCs are particularly effective managing the care of seniors with multiple co-morbidities, such as COPD, Congestive Heart Failure (CHF) and diabetes.
- **Feeling Good About MA Positioning.** HUM is upbeat about its performance in MA this year, as well as its prospects for continued strong performance next year. Despite the return of the HIF, HUM expects to grow EPS at a "reasonable" rate next year off its 2019 base of $17.25, albeit at less than its LT target of 11-15%. HUM's strong MLR performance this year is allowing it to pull forward $100s of mlns of investments that would have otherwise occurred in 2020, offsetting in part the HIF headwind. Also, HUM is developing a significant business process transformation program, including cost reductions that will be unveiled with 3Q19. Finally, stronger than expected MA enrollment growth this year creates an earnings tailwind for 2020 as these members swing to profitability.
- **Medicaid – Doing Well on Their Own.** HUM is very pleased with its Medicaid wins in Florida and Louisiana. Louisiana was seen as a particularly big win, as HUM was the second highest-rated plan, with it being rated highly on clinical capabilities, population health, network management, social determinant efforts, etc. HUM does not know when the Texas STAR+PLUS Medicaid RFP will be awarded, but is cautiously optimistic about its prospects. Finally, HUM also expects an announcement of the KY Medicaid RFP soon.

Price (13 Sep 19, US$)	274.69
52-week price range	353.98 - 232.89
Market cap (US$ m)	37,258.33
Enterprise value (US$ m)	40,662.83

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Financial and valuation metrics

Year	12/18A	12/19E	12/20E	12/21E
EPS (CS adj.) (US$)	14.56	17.60	18.50	21.00
Prev. EPS (US$)	-	-	-	-
P/E (x)	18.9	15.6	14.8	13.1
Revenue (US$ m)	56,912.0	64,686.8	70,932.0	76,867.4
P/OCF (x)	18.2	11.1	11.3	10.3
ROIC (%)	15.12	16.98	17.00	18.58
Number of shares (m)	135.64	Dividend yield (%)		0.6
BV/share (12/18A, US$ m)	127.5			

Source: Company data, Refinitiv, Credit Suisse estimates

Share price performance

On 13-Sep-2019 the S&P 500 INDEX closed at 3007.39Daily Sep14, 2018 - Sep13, 2019, 09/14/18 = US$337.24

Quarterly EPS	Q1	Q2	Q3	Q4
2018A	3.36	3.96	4.58	2.65
2019E	4.48	6.05	4.60	2.44
2020E	5.36	6.02	4.75	2.37

- **Specialty Services (Clinics, Home Health, and PBM) Emerging as a Further Growth Driver.** The clinic business discussed above is expected to be a growth driver going forward. Including the 40 or so PIPCs, HUM expects by year-end to have a financial interest or full ownership of some 265 physician and primary clinics, through Conviva, JenCare, and other entities. HUM is evaluating the changing PBM landscape with a view toward taking advantage of emerging opportunities, such as beginning to offer its PBM services externally (unlike the big three, HUM can argue it does not compete with other health plans against their commercial business), it can private label its mail order and other services (as it already does for privately held MedImpact), it is open to adding to its specialty capabilities by buying access to limited distribution drugs, and finally it could consider tuck-in deals involving smaller PBMs with interesting capabilities.
- **With 2020 Ests Seemingly Reasonable, HUM Seen as a Safe Haven In the Midst of the Uncertain Political Backdrop**. HUM will not offer its formal 2020 outlook until late 2019/early 2020. However, management seems clearly more comfortable with the current range of 2020 estimates, partly because they now reflect the HIF headwind and partly because the company's 2019 outperformance is allowing it to set up for a somewhat easier comparison. In addition, at a time when the market is still being roiled by the political backdrop, Humana's lack of substantial large employer commercial exposure would seem to insulate it from the uncertainty created by discussion of Medicare for All and Medicare buy-in, except in the most extreme and highly unlikely outcomes in which MA would be impacted.

Detailed Takeaways

We hosted Humana for investor meetings in Denver, CO and Kansas City, MO as well for a trip to visit Humana's standalone Partners in Primary Care (PIPC) clinic in Independence, MO and its Partners in Primary Care clinic joint venture inside of a Walgreens in Raytown, MO. During the trip, we met with members of management, including the following:

- Brian Kane, Chief Financial Officer
- Amy Smith, VP of Investor Relations
- Renee Buckingham, President – Care Delivery Organization
- Lori Mallory, Market President at Partners in Primary Care in Kansas City
- Dr. Steve Salanski, Regional Medical Director
- Josh Morrell – VP – Population Health Solutions
- Matt Eirich, Chief Growth Officer – Care Delivery Organization
- Nick Judd, Associate VP of Finance and Business Operations - Care Delivery Organization

Partners in Primary Care & Care Delivery Organization

We visited Humana's standalone Partners in Primary Care (PIPC) clinic in Independence, MO and its Partners in Primary Care clinic joint venture inside of a Walgreens in Raytown, MO.

Partners in Primary Care is designed to provide holistic primary care to MA members, as opposed to urgent care or freestanding ER services. The clinics are payer agnostic clinic and are built for repeatability (i.e., franchise model). Its intent is to go into markets that are less mature as a Medicare Advantage marketplace and in communities that typically don't have this type of primary care. Ideal clinic patients who will benefit most are those with serious chronic conditions like COPD, Congestive Heart Failure (CHF) and diabetes.

As per its website, Humana currently has six PIPC centers (two located at Walgreens) in the Kansas City area with two more (both located at Walgreens) expected to open in late 2019. The company also has a PIPC in North Carolina and five in South Carolina with four more (one located at Walgreens) expected to open in late 2019. Humana also has a PIPC in Orlando (via an acquisition). Further, there are three PIPC centers in the Houston, TX area with two expected to open in the next several months in the area.

Independence is one of Humana's largest PIPC's and can hold up to five care teams, while the company's Walgreens locations can hold roughly 1.5-2 care teams. Walgreens is unique in the model in that it has day one risk for its providers, while other locations have a several year path-to-risk arrangement because PIPC needs time to document members and get those members in the proper clinical programs before PIPC is prepared to take risk. Humana believes that Walgreens likes this model, as it wants to be viewed more as a health destination. The company believes the stickiness of patients is similar between the Walgreens PIPC and standalone PIPC's.

A large clinic practice could have three physicians which have 550-750 patients per panel; a Walgreens PIPC would have a smaller panel size. Beyond the practitioner, panels typically include a care coach, referral coordinator, social worker, behavioral health specialist, etc. The care coach is typically a Registered Nurse and helps patients understand issues they face, develops a long-term plan with them, conduct follow-ups, gets patients involved in educational activities about their health, etc. Care coordinators help patients access financial resources that may help them in obtaining what they need for their care – e.g., inhalers, more nutritious meals. While the clinic cannot pay for these things for the patient, it can point the patient toward resources that are available in the community to help. Some Walgreens PIPC locations have a separate pharmacist in place beyond the Walgreens pharmacist. PIPC physicians typically see 13-16 patients per day versus 25 in a normal primary care practice and as many as 50 in an

urgent care setting. The model is designed for physicians and caregivers to spend time with chronically ill seniors with multiple co-morbidities with a target of spending 45 minutes with a patient on a visit versus 5-7 minutes in a traditional primary care setting.

Humana plans to test this model before scaling but has seen promising results in some of its more mature markets (e.g., South Carolina). The SC facilities in Greenville and Anderson are the oldest PIPC locations and will go through their fourth open enrollment season (AEP) for MA this fall. Management says it has been satisfied with the margin progression at these facilities. The company believes there is a shortage of good senior primary care – particularly ones able to tie-in the home, such as Humana is able to do with Kindred at Home, which have robust eco-systems for senior care. The company believes there are still too many silos in healthcare and its PIPC initiative is designed to try to break some of this.

Part of Humana's strategy is to tie a hospital, such as St. Luke's in Kansas City, into a narrow network arrangement that includes PIPC. Humana is one of ten payers that PIPC works with across its care delivery organization. Humana has also designed PIPC to be payer agnostic and has contracts with other health plans. The company hopes to be able to flip health plans to capitated risk models after 2-3 years of using the PIPC model. Additionally, the company believes in a full-risk model that it would receive better information from health plans to provide better care to those patients. Humana's primary care model is focused on a value-based revenue model which gets paid a percentage of premiums as opposed to FFS professional fees. By way of background, roughly one-third of Humana's Individual MA members (many of which are in Florida) are in fully-capitated shared risk arrangements.

Humana has built a proprietary network of owned (e.g., PIPC, Conviva, Family Physicians Group), Joint Venture (e.g., JenCare Senior Medical Center), and Alliance (e.g., Iora Health, Oak Street Health) senior-focused primary care centers across the country and plans to have 260-270 centers through these various ownership structures by the end of 2019. These primary care centers serve 8% of Humana's Individual MA members. During our trip, Humana noted that it owns 35% of JenCare, which is very profitable and has robust risk scores; the company highlighted that JenCare is a more physician intensive model. Conviva is a mixed model which operates staff clinics and an MSO. Conviva is a physician driven model, without the use of care coaches, focused on mature health care ecosystems (e.g., 25-35 years of managed care risk activity). Conviva is a legacy model which requires operational focus compared to PIPC which is focused on building an innovative model. Conviva is under a different management team than PIPC. The company is not aggressively adding to Conviva, but would still look at assets. Conviva physicians take risk in MA (largely MA HMO products) and are primarily focused on South Florida and South Texas.

Humana highlights that it has done a good job of recruiting the right type of physicians to PIPCs which are able to succeed in this model. The company offers competitive compensation for its employed physicians relative to the market they are operating in. Its physicians are salaried and are not "owners" in the episode of care, but do receive bonuses related to quality and outcome metrics. The bonuses have the potential to be greater than average for the market. A specific type of physician is attracted to this model – one who wants to spend time with patients and likes working with seniors. The typical workday for a PIPC physician involves eight hours of seeing patients and 2-3 additional hours of administrative work, lab submittals and evaluations, etc.

Over time, the company does not expect to own all of its PIPC centers and may use outside capital to grow the business as the model is perfected, much like a franchise model. The company has staged the rollout of its clinics to manage the impact on its earnings and balance sheet. The company is waiting on proof points such as getting patients into the clinic, getting patients documented, etc., before attempting to scale the model. The company does not expect to buy urgent care clinics and convert them to its model, but sees it better to build from scratch. As per the company's investor day presentation, a fully owned de novo primary care center requires $1-2 mln of initial capex to construct and takes 3-5 years to breakeven with a cumulative EBITDA burn rate of $3-5 mln to breakeven. However, the company sees $2-4 mln of annual EBITDA per fully mature center and sees center members being roughly 2x more

profitable to the health plan than an average member. This enhanced profitability for the health plan is achieved because disease progression for those with severe chronic conditions is slowed, gaps in care are reduced, and risk scores are kept more accurately (potentially increase PMPMs). Bringing in an equity partner to support the development of new clinics could reduce upfront costs while maintaining the benefits on the health plan side. Once clinics reach break-even, profitability scales quickly. Mature margin clinics are expected to have potential margins well above that of the health plan.

When the company looks to where it is locating practices, it typically focuses on underserved areas where the disease burden is higher than average and social determinants of health are unmanaged. In the process, the company plugs network gaps where there are no good primary care providers for health plans. The company consults with plans to find locations with care gaps as well as leveraging third party data.

In terms of evaluating performance, the company looks at a host of clinical quality measures related to HEDIS, admissions per 1,000, avoidable admissions, center visits, etc. PIPC strives for one visit per quarter per patient, even from healthy patients. The company notes that it takes more than one visit to capture information that is important to an MA plan. The company believes PIPC is the biggest trend bender it has, as it's a way to control costs. Additionally, on the revenue component of MA, PIPC allows Humana to more accurately code its patients. The company attempts to identify diseases early (e.g., the use of spirometry to identify COPD). Humana notes that the risk score change can have a meaningful impact; PIPC management noted that risk scores could be 25% higher in some instances as everything gets coded appropriately – the higher risk score yields higher PMPM.

When asked about the difference between PIPC and other primary care offerings – either standalone or in conjunction with retail pharmacies, management noted that PIPC is a full service primary care center focused on seniors compared to other clinics, which are typically focused on the commercial population. Other offerings include CVS's Healthy Hubs, as well as a recent announcement of a new offering from WalMart. By way of background, late last week, Walmart confirmed it was opening its first-ever Walmart Health Center in Dallas, Georgia to deliver services including primary care, labs, X-ray and EKG, counseling, dental, optical, hearing, community health (nutrition services, fitness) and health insurance education and enrollment all in one facility. If the pilot clinics succeed, Walmart plans to build more in Georgia and eventually build them nationwide.

According to Humana, PIPC has been approached by major retailers that are interested in its model but the company is trying to balance that interest with capacity and has been careful not to dilute the focus of its clinics away from the senior population.

Design

The Walgreens PIPC we visited is designed with a vestibule so patients can either enter the store or the center. Some newer locations have different designs; this design gives the impression of visiting a physician as opposed to a clinic. The center provides an open care team space which includes a coder working alongside the care team. The coder bumps items of concern to the top of the list for a physician and make suggestions but cannot enter codes.

This location has a clinical pharmacist which is a Walgreens employee that is integrated with the PIPC care team. The company notes that the Walgreens location has received significant additional scripts (particularly first fills) because of the PIPC location but has to compete with the patients mail order benefit.

The Walgreens store was "re-racked" and the PIPC space was retrofitted from the store's previous photo center and refrigerated food section into the clinic space. The clinic represents roughly 2,500 sq. ft. (1,500 sq. ft. for main center) out of the total 15,000 sq. ft. of Walgreens space. The Independence stand-alone PIPC is roughly 10,000 sq. ft.

The Walgreens PIPC patients travel from up to 2.8 miles away, which compares to the Independence standalone PIPC center patient radius of 5.8 miles. The company notes that the Walgreens clinic attracts individuals that typically aren't comfortable in traditional primary care

practice settings. The company believes the convenience and comfort of a retail setting attracts a particular patient.

Most health plans offer a transportation benefit; once those benefits are exhausted, PIPC has a contract with a transportation company (e.g., Uber, Lyft) to bring the patient to the center. This allows patients to do non-pharmacy retail shopping without expending money for transportation.

The centers also offer telepsych capabilities and lab work.

Provider Risk Models

Humana notes that it would make more money if it could lock more lives into risk models because it would lock in a mid-80% MLR; by way of background, the MLR cap for MA is 85%. The company doesn't see this model as a risk to membership retention because the plan does a lot of the marketing, provider support, etc. Humana believes it has a lot of clout in its markets and has seen these enhanced provider relationships as positive. Additionally, Humana believes that its capabilities offered to risk providers are more advanced than the majority of MA plans which brings value to effectively managing patients. There are also capabilities that the health plan provides that the risk provider doesn't have to invest in such as Humana's investment in the Home. There is also a lot of timely data given to providers compared to 3-4 month old data provided by other insurers.

The amount of capital held in reserves is still the same as Humana is "still on the hook" for the member; the company still has to maintain 12% of premium.

Medicare Advantage

Humana estimates that it and UNH have the highest retention rates for MA members in the industry. The average MA member is 72 years old and the average MA member stays with Humana for seven years, which includes involuntary termination (i.e., death) of 3-3.5% of membership. Some 60% of Humana's sales go through its internal broker channel, less than 10% of sales come from on-line sign-ups, and the rest is obtained through external brokers. Humana also sells its product in Walmart's.

Humana has seen robust growth in 2019 relative to its internal expectations and relative to the industry which it attributes to product design, added benefits, provider advocates, and its relationship with the broker community, etc. Humana believes it has gotten better at underwriting its new members. In 2012, when the company had a big growth year, it learned that members are generally breakeven in their first year. The company has priced to breakeven for its new members which is coming out largely as expected with some outperformance. For the rest of its book, the company reports it is doing well on cost and revenue.

In 2019, Humana benefited from the change in Minnesota cost plans and was planning that for years; the company underwrote that business for essentially breakeven results. Humana prepared the broker market for several years in advance that this bolus of members would be converting. Most of those cost members converted to traditional Medicare but HUM received a nice share of the conversions to MA. The Minnesota cost conversions will be a headwind to membership growth next year as there won't be a similar opportunity in 2020. Relative to its consolidated sales, the Minnesota cost conversions are not a meaningful number.

On Group MA, the company noted that Group MA margins are a little lower than Individual MA as the market tends to be more competitive. However, HUM noted that Group MA margins grow over time which drives the timing of re-procurements. Humana sees the Group MA market becoming somewhat more competitive but feels good about its 2020 outlook. The company is seeing four players (including Anthem now) compared to three players historically. The entire Group MA market, not just Humana, has a lot of business up for grabs in 2021.

Star Ratings

Star ratings are critical to Humana's results; the company was the highest Star rated plan last year for 2020 with 84% of members in 4-Star or greater plans. Humana believes a lot of its clinical capabilities and investments have paid off. Humana has two 5-Star rated plans and

several 4.5-Star rated plans. The company has worked hard to maintain its "premium" rating and views it as an enterprise wide responsibility. The company is working hard for 2022 Stars at the moment which is based on the 2019 service period.

The company has several contracts with a large number of members so if it were to hypothetically have a 3.76 rated plan go to 3.74, it would lose the star bonus payment. There are mitigating forces for plans that drop in Star ratings. Previously health plans could consolidate contracts but now consolidation leads to rating shifting to the weighted average of contracts that are merged together; group membership can be migrated without penalty because it can be resold easily. Star results are expected in a few weeks.

2019 & 2020 Pricing and Benefit Design

Humana balanced growth and margin for 2019 with the HIF moratorium. Humana had to do the same balance of how much will be taken from benefits, earnings growth, and productivity for 2020. Humana's membership growth has been so dramatic in 2019 (members breakeven in year one and then turn profitable) that the excess membership growth will help defray some HIF costs in 2020 as those members become profitable. The outperformance in 2019 gets Humana to a better baseline and provides the company with extra dollars to invest in offsetting the HIF.

Part of the benefit of the MA outperformance in 2019 is that HUM can pull forward to 2019 investments that would have been made in 2020. Humana's Retail business has outperformed its expectations by hundreds of millions of dollars in 2019 (the company improved its MLR outlook by 50 bps at the midpoint from the start of the year). Humana also plans to pay its employees a higher bonus payment.

Humana notes that its broker relationships are stronger than ever. Humana believes it adjusted 2020 benefits in a smart way and actuarially knows where it gets value back but knows where changes impact membership.

Medicare Plan Finder Update

The update to Medicare Plan Finder makes Stars plans more visible. Humana doesn't think it impacts brokers like EHTH. Humana believes MA products are complicated, and individuals need support in plan selection.

Medicaid

On the topic of state reverifications, Humana notes that it hasn't seen much membership attrition in Florida which is its main current market with any substantial size. The company notes that it received some auto-assigns in Medicaid in Florida and sees an opportunity to grow in LTSS.

Humana continues to expand in Medicaid. The company views Louisiana as a big win for the company in Medicaid as it was the second highest rated plan after non-profit AmeriHealth (see our note reviewing the Louisiana Medicaid Scoresheets). The company notes that it was rated highly on clinical capabilities, population health, network management, social determinant efforts, etc. While the company is pleased with the results of the Florida and Louisiana Medicaid RFPs because it acknowledges Humana's capabilities, the company recognizes that it is difficult to displace incumbents in states.

Humana is not sure why the Texas STAR+PLUS RFP awards have been delayed. The company is awaiting the announcement of the Kentucky Medicaid RFP awards in October where it currently is 100% reinsured to CareSource; Humana is reevaluating that arrangement. Humana CareSource currently manages roughly 142K out of the total 1.3 mln Medicaid lives in the state. Humana is also currently bidding on other Medicaid RFP's.

With respect to acquisitions, Humana is looking for tuck-in acquisitions and would look for single state assets although the company indicated it wouldn't rule anything out. Humana doesn't need to go out and buy a big Medicaid plan because of the 2021 DSNP rule.

Over time, Humana wants to build a Medicaid platform because it believes: 1) its clinical capabilities work well for ABD and LTSS, 2) over time there will be convergence between Medicaid and Medicare with CMS creating a linkage with DSNP and maybe coordinating even tighter with Medicare and Medicaid, and 3) it's an offensive opportunity when a company is large in a state's Medicaid program because it has a roster to identify dually eligible members to sell DSNP to - HUM believes UNH has done well on that aspect. Humana has grown DSNP more than 40K through Q2 and has the highest DSNP growth percentage in the state, but is behind UNH on an absolute basis.

CNC/WCG Divestitures

Humana would be willing to look at divestiture from the CNC-WCG deal but notes that those which have been announced are relatively small in size. Also, it would be difficult for Humana to absorb any divestitures in Florida given its current presence.

DSNP

On DSNP linkage to Medicaid, CMS did not go in the direction of requiring a Medicare plan to have a Medicaid plan in the state to offer DSNP. Instead, CMS said Medicare plans are in compliance if the plan shares information with the state.

Humana attributes its DSNP growth to being more thoughtful on benefit design (differentiated supplemental benefits) as well as technology investments that enabled Humana to target members. Other than UNH, no other MCO goes after DSNPs in a thoughtful way. Humana believes UNH has mined its Medicaid book well for DSNPs. DSNPs largely come through the same broker channel. Humana notes that the bulk of UNH's MA growth is related to DSNP - roughly 118K members out of 248K individual MA enrollment growth are DSNP lives.

Humana likes DSNP members because they are higher acuity members which create an opportunity for revenue and margin through active care management.

Pharmacy/PBM & Medicare Part D Strategy

Medicare Part D has been an important part of Humana's strategy. PDP has become a commodity product but the profit around PDP is key. The company believes it was a pioneer in the low priced product with Walmart several years ago. However, the market has caught on and gone low in its price. Humana has a big bolus of membership in its Walmart plan and CMS limits plans to three products per region which has made it difficult for the company to introduce a new low priced plan that can attract a new healthier population - such as what WCG has done. CVS has done that to some extent as well, but that is largely to drive members into its stores. HUM would instead have to lower the price of its existing plan and take a financial hit. This fall, Humana will try to change that dynamic and create new plans in that three slot framework that will stem its enrollment decline and put it back on a path for growth. The company intends to provide more details on this on its 3Q19 earnings call.

Part D provides Humana with some insurance earnings and significant mail order profits in its Pharmacy/Healthcare Services business. Part D is also a significant conversion opportunity for the company's MA business. Humana is seeing that conversion increase over time and notes that the benefit from PDP to MA conversions was more significant in 2019 than the benefit from the Minnesota cost plan conversions.

Humana's PBM grows with its MA and PDP membership base, but the company sees an opportunity to deepen the penetration with existing members and think about third party opportunities on the PBM and pharmacy side.

On pharmacy, Humana highlights that it's not subject to the rebate rule as it has to pass through rebates in Medicare. Humana is focused on growing its market share on the mail order and specialty side. The company will look to do that either by leveraging its mail order facility to sell to third parties or by looking to increase its specialty presence by acquiring assets to get access to Limited distribution drugs. Many specialty drugs are LDDs which Humana doesn't have access to currently.

A lot of Humana's technology investments are focused on building a better mail order experience. The company notes that it's important to compete not just on benefit design (e.g., by offering $0 copay at mail for generics vs $8-12 for going to a pharmacy) but to improve to the experience absent a financial incentive.

The company highlighted that one challenge is the high priced gene therapy drugs which are difficult to price for in a given year. A concern is that a plan could spend millions of dollars on one of these therapies and then lose the enrollee to another health plan in the following year. Humana notes that Hep C drugs were $90K per treatment and cost the company $1.5 bln in one year ($1 bln of which was covered by CMS through reinsurance).

HIF

Humana believes there is bipartisan support on repealing the HIF. The company pointed to a bill for a 2-year delay which has Democrat and Republican support. However, there needs to be a vehicle which the bill could be attached to; Humana believes the bill could potentially be attached to the Medicare extenders at the end of the year.

Humana won't grow at its 11-15% earnings target growth rate in 2020 because of the HIF. Humana expects reasonable growth in 2020 off of its $17.25 baseline. The company refuted the idea that its earnings will decline in 2020 because of the HIF.

Healthcare Services

Humana's Healthcare Services business generates north of $1 bln of EBITDA for the company. Most of Humana's Healthcare Services business is captive on Humana's own membership base, except for PIPC and Kindred at Home which are payer agnostic. Kindred, which is the largest hospice company in the U.S., takes mostly FFS Medicare patients. Humana will look to expand its MA block with Kindred. Humana currently owns 40% of Kindred at Home and will own 100% eventually. There is some talk of carving-in hospice into Medicare, which is currently carved-out.

Miscellaneous

Q2 Results for MCOs

With respect to the Q2 results posted by the managed care group, most of the noise in the quarter occurred in business lines in which the company has little exposure – Medicaid, public exchanges, and middle market commercial. It's possible that there are Medicaid mix issues in some states, but Humana hasn't seen this issue in Florida. In Florida, the state has done some recertification and membership has shaken out among plans. However, Humana hasn't seen a decline in its membership in Florida Medicaid.

Humana management noted it is on track to deliver top line growth in the mid-teens and bottom line growth north of 20%. The company believes its shares are undervalued at a significant discount to their normal trading range relative to the S&P 500, which was a driver behind the company's recently announced accelerated share repurchase (ASR).

Capital Deployment

Humana doesn't believe it needs to do M&A but will evaluate attractive asset that come to market. The company views its stock as very cheap given its top line and bottom line growth. An acquisition would have to be compelling for Humana, particularly if it required shares. From a dividend payout ratio perspective, Humana's current payout is lower than its peers, which is a function of its growth. Dividends are Humana's fourth use of capital behind organic growth, M&A, and share repurchase. Humana has grown its dividend at a double-digit rate, largely in-line with earnings growth recently. Humana hasn't made a commitment to a specific payout ratio, but management says the company will continue to increase its dividends.

Companies Mentioned *(Price as of 13-Sep-2019)*
Anthem, Inc. (ANTM.N, $253.08)
CVS Health (CVS.N, $64.06)
Centene Corporation (CNC.N, $45.4)
Cigna Corporation (CI.N, $160.85)
Diplomat Pharmacy (DPLO.N, $5.65)
Humana Inc. (HUM.N, $274.69, OUTPERFORM, TP $315.0)
Molina Health (MOH.N, $114.96)
UnitedHealth Group Inc. (UNH.N, $233.61)
Walgreens Boots Alliance (WBA.OQ, $55.99)
Walmart Inc. (WMT.N, $117.43)
WellCare Health Plans, Inc. (WCG.N, $267.18)

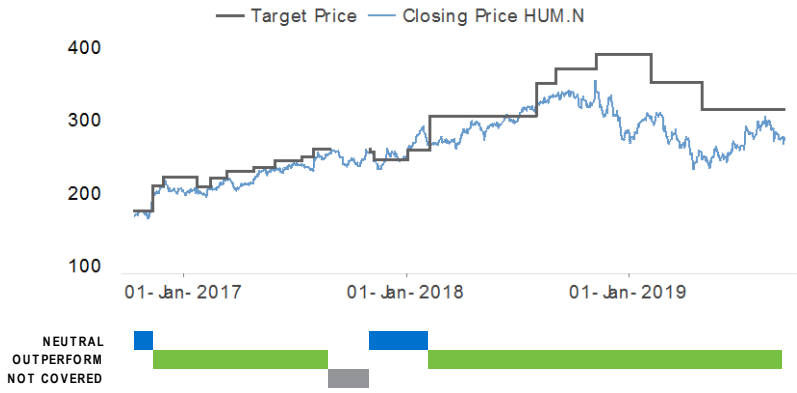
Disclosure Appendix

Analyst Certification

A.J. Rice, Jailendra Singh, Eduardo Ron and Caleb Harris, CPA each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Humana Inc. (HUM.N)

HUM.N Date	Closing Price (US$)	Target Price (US$)	Rating
12-Oct-16	168.44	175.00	N
11-Nov-16	193.19	210.00	O
28-Nov-16	208.00	222.00	
23-Jan-17	205.02	208.00	
14-Feb-17	205.97	220.00	
13-Mar-17	219.18	230.00	
25-Apr-17	217.97	235.00	
31-May-17	232.26	245.00	
13-Jul-17	238.06	250.00	
02-Aug-17	241.09	260.00	
28-Aug-17	255.07		NC
02-Nov-17	256.35	256.00	N *
09-Nov-17	247.46	246.00	
03-Jan-18	251.28	259.00	
08-Feb-18	262.37	306.00	O
02-Aug-18	321.70	350.00	
04-Sep-18	333.09	370.00	
08-Nov-18	339.59	390.00	
07-Feb-19	303.97	352.00	
02-May-19	247.38	315.00	



** Asterisk signifies initiation or assumption of coverage.*

Effective July 3, 2016, NC denotes termination of coverage.

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Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.
Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.
Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.
**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and Asia stocks (excluding Japan and Australia), ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark (India - S&P BSE Sensex Index); prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned where an ETR is greater than or equal to 7.5%; Underperform where an ETR less than or equal to 5%. A Neutral may be assigned where the ETR is between -5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 18 May 2015, ETR ranges for Outperform and Underperform ratings did not overlap with Neutral thresholds between 15% and 7.5%, which was in operation from 7 July 2011.*

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Analysts' sector weightings are distinct from analysts' stock ratings and are based on the analyst's expectations for the fundamentals and/or valuation of the sector* relative to the group's historic fundamentals and/or valuation:
Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.
Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.
Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.
**An analyst's coverage sector consists of all companies covered by the analyst within the relevant sector. An analyst may cover multiple sectors.*

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Global Ratings Distribution

Rating	Versus universe (%)	Of which banking clients (%)
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Neutral/Hold*	39%	(27% banking clients)
Underperform/Sell*	12%	(23% banking clients)
Restricted	2%	

**For purposes of the NYSE and FINRA ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Target Price and Rating
Valuation Methodology and Risks: (12 months) for Humana Inc. (HUM.N)

Method: Our $315 target price and Outperform rating for HUM are based on 17x our 2020 EPS estimate. We believe this premium to the group is warranted given the company's high exposure to the fast-growing MA business. We rate HUM Outperform as we expect its total return to exceed its peers.

Risk: Downside risks to our $315 target price and Outperform rating for HUM are a pick-up in utilization trends and a slowdown in MA enrollment/penetration trends.

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See the Companies Mentioned section for full company names
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