

## Centene Corporation (CNC)

**\$61.94** (As of 06/12/20)

Price Target (6-12 Months): **\$65.00**

Long Term: 6-12 Months

**Zacks Recommendation:**
**Neutral**

(Since: 04/15/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**3-Hold**

Zacks Style Scores:

VGM:A

Value: A

Growth: D

Momentum: A

### Summary

Centene's shares have outperformed its industry in a year's time. The company is likely to grow on rising membership and expansion. It boasts an impressive inorganic growth strategy. It's buyout of WellCare strengthens its position as the largest Medicaid managed care organization in the country with around 22 million members across 50 US states. The same is expected to be slightly dilutive to adjusted earnings per share in 2020. A solid outlook also impresses. Medical membership has been rising over the last several quarters owing to contract wins. However, its operating costs weighs on margins. High debt level increases risk. The company's first-quarter 2020 earnings suffered from lower investment income and incremental interest expense.

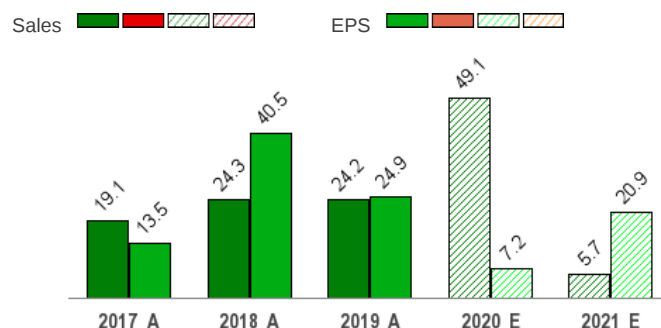
### Price, Consensus & Surprise



### Data Overview

|                            |                                |
|----------------------------|--------------------------------|
| 52 Week High-Low           | \$74.70 - \$41.62              |
| 20 Day Average Volume (sh) | 3,393,901                      |
| Market Cap                 | \$35.9 B                       |
| YTD Price Change           | -1.5%                          |
| Beta                       | 0.71                           |
| Dividend / Div Yld         | \$0.00 / 0.0%                  |
| Industry                   | <a href="#">Medical - HMOs</a> |
| Zacks Industry Rank        | Top 37% (92 out of 252)        |

### Sales and EPS Growth Rates (Y/Y %)



|                           |            |
|---------------------------|------------|
| Last EPS Surprise         | -15.7%     |
| Last Sales Surprise       | 7.0%       |
| EPS F1 Est- 4 week change | 0.0%       |
| Expected Report Date      | 07/28/2020 |
| Earnings ESP              | 0.0%       |
| P/E TTM                   | 15.9       |
| P/E F1                    | 13.1       |
| PEG F1                    | 1.0        |
| P/S TTM                   | 0.4        |

### Sales Estimates (millions of \$)

|      | Q1       | Q2       | Q3       | Q4       | Annual*   |
|------|----------|----------|----------|----------|-----------|
| 2021 | 28,658 E | 29,440 E | 29,981 E | 29,807 E | 117,576 E |
| 2020 | 26,025 A | 28,008 E | 28,579 E | 28,544 E | 111,253 E |
| 2019 | 18,444 A | 18,356 A | 18,976 A | 18,863 A | 74,639 A  |

### EPS Estimates

|      | Q1       | Q2       | Q3       | Q4       | Annual*  |
|------|----------|----------|----------|----------|----------|
| 2021 | \$1.35 E | \$1.64 E | \$1.46 E | \$1.27 E | \$5.73 E |
| 2020 | \$0.86 A | \$1.84 E | \$1.25 E | \$0.89 E | \$4.74 E |
| 2019 | \$1.39 A | \$1.34 A | \$0.96 A | \$0.73 A | \$4.42 A |

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/12/2020. The reports text is as of 06/15/2020.

## Overview

Centene Corporation is a well-diversified, multi-national healthcare company that primarily provides a set of services to the government sponsored healthcare programs. The company serves the under-insured and uninsured individuals through member-focused services. It is also engaged in providing education and outreach programs to inform and assist members in accessing quality, appropriate healthcare services.

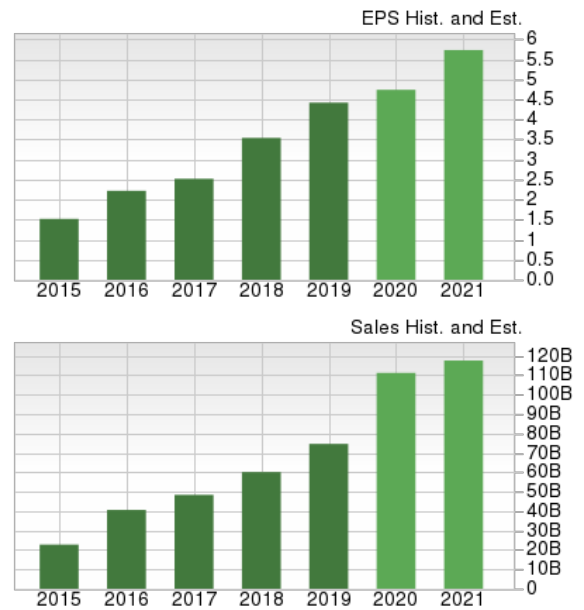
Centene is now a \$100-billion plus enterprise catering healthcare services to more than 24 million members across 50 states. The recent acquisition of WellCare Health leveraged the company's position as the largest Medicaid managed care organization in the country. The combined entity now has 22 million members. In 2019, the company retained its market-leading position nationwide, serving 1.8 million exchange members across 20 states at the year-end.

Through a diversified product portfolio and expanding geographic reach, Centene continues to deliver results by executing on our strategy, growing premium and service revenues profitably. This is evidenced by organic growth within its existing states, new Medicaid contracts, new contract awards in innovative healthcare services, key acquisitions to enhance its medical management platform and participation in Health Insurance Marketplaces. Centene acquired Health Net on Mar 24, 2016 which became its wholly owned subsidiary.

Founded as a single health plan in Wisconsin in 1984, Centene has established itself as a national leader in healthcare services. The company operates in two segments: Managed Care and Specialty Services.

**Managed Care (83.8% of total revenues in 2019):** This segment provides health plan coverage to individuals through Government subsidized programs, including Medicaid. The Managed Care segment also includes the operations previously included in Health Net's Western Region Operations Segment.

**Specialty Services (16.2%):** This segment consists of its specialty companies offering diversified healthcare services and products to state programs, correctional facilities, healthcare organizations, employer groups and other commercial organizations. The Specialty Services segment also i



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## Reasons To Buy:

▲ **Growing Top Line:** Centene has been witnessing consistent and significant revenue growth since 2002. The company's top line witnessed a CAGR of 34.6% from 2015 to 2019. Its 2019 revenues shot up mainly on the back of the Fidelis Care buyout, growth in the Health Insurance Marketplace business and expansions plus new programs across many states in 2018 and 2019. In the first quarter of 2020, its top line improved 41% year over year on the back of WellCare buyout. For 2020, the company expects its revenues in the range of \$110-\$112.4 billion, the midpoint being 45.5%, higher than the 2019 reported figure. This upside could primarily be backed by membership growth, expansion of contracts and other investments.

Centene's leading position in the industry is largely supported by its prudent operating performance, strong inorganic growth and solid fundamentals. A solid 2019 guidance also impresses.

▲ **Inorganic Growth:** Centene's mergers and acquisitions strategy is mainly targeted at expanding the company's markets and increasing its Medicaid membership. Certain acquisitions like Community Medical Holdings, MHM Services and Fidelis Care have contributed to its revenues and helped it expand its capabilities. In the second quarter of 2019, the company completed the acquisition of QCA Health Plan, Inc. and also made a substantial investment in RxAdvance. In July, it also purchased additional stakes in Ribera Salud, which makes the company own 90% interest in the acquired entity. This clearly shows the company's constant efforts in strengthening its international portfolio. The acquisitions and partnerships should bolster the company's operations, aiding long-term growth.

▲ **Acquisition of WellCare:** Centene has acquired WellCare (in January 2020). The consolidated entity now has a wider scale and diversification with more than 12 million Medicaid and around 5 million Medicare members. In total, it has around 22 million members across 50 US states. The transaction is expected to generate adjusted earnings per share accretion of approximately mid-single digits during 2021 with long-term growth opportunities and cost reduction across markets and products. The same is expected to be slightly dilutive to adjusted earnings per share in 2020.

▲ **Membership Growth:** Medical membership of the company has been rising over the past several quarters due to contract wins and expansion across different regions. In 2018 and 2019, the metric rose 14.7% and 8.8% each year over year. As of Mar 31, 2020, managed care membership came in at 23.8 million, up 61% year over year. We expect this trend to continue on the back of certain contract gains as well as the WellCare buyout.

▲ **Price Performance:** In a year's time, the stock has outperformed its industry. Moreover, its solid fundamentals, such as inorganic growth strategy and the rising top line would likely help the stock continue its rally going forward.

▲ **Solid 2020 Outlook:** The company provided its updated 2020 outlook after releasing first-quarter earnings. For 2020, it expects its revenues in the range of \$110-\$112.4 billion, the midpoint being 45.5%, higher than the 2019 reported figure. Adjusted EPS is anticipated between \$4.56 and \$4.76 per share, the midpoint indicating a 5.4% hike from the 2019 reported figure. A solid guidance instills investors' confidence in the stock.

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## Reasons To Sell:

- ▼ **High Financial Leverage:** The company's balance sheet position remains a concern. Long-term debt at Centene has been rising since 2005, mainly because the company's acquisitions are financed majorly by borrowings. Its total debt reflects 42.2% of its capital, higher than the industry's average of 38.8%. Also, its time interest earned stands at 3.5X, much lower than the industry's average of 10.3X, and also tumbled from 2019-end average of 5.3x. As of Mar 31, 2020, the company has cash and cash equivalents of \$10.7 billion, much lower than its long-term debt of \$17.2 billion. Thus, its inadequate financial flexibility is a concern for investors.
- ▼ **Increasing Costs:** The company's bottom line is hurt by higher operating costs. Since 2007, total operating costs have been increasing significantly. In 2018 and 2019, total operating expenses rose in the respective percentages of 24.3% and 24.2% year over year (almost equal to the increase in revenues), stemming mainly from higher medical costs, selling, general and administrative (SG&A) expenses, amortization of acquired intangible assets and a premium tax expense. In the first quarter, the metric again soared by almost 46% year over year. The company expects the costs to be significantly higher in the third and the fourth quarter due to intensity of utilization rates and other investments.
- ▼ **Weak ROE:** Centene's return on equity undermines its growth potential. The company's trailing 12-month ROE of 11.5% compares unfavorably with the industry average of 22.5%, indicating that it is less efficient in utilizing shareholders' funds.

Centene's financial results suffer from rising level of debt and increasing costs. Its reducing cash flow from operations also remain a concern. Its low return on equity also bothers.

## Last Earnings Report

### Centene's Q1 Earnings Miss Estimates, Decline Y/Y

Centene reported first-quarter 2020 adjusted earnings per share of 86 cents, missing the Zacks Consensus Estimate by 14.9% due to lower investment income and incremental senior note interest expense. The bottom line also tumbled 38.1% year over year.

For the first quarter, total revenues rose 41% to \$26 billion from the year-ago period, primarily aided by the WellCare buyout, growth in Health Insurance Marketplace business, expansions and new programs across many states in 2019 and 2020 as well as the reinstatement of the health insurer fee in 2020. However, this upside was offset by the Illinois health plan divestiture and the timing of pass through payments from New York to some extent.

Meanwhile, the top line surpassed the Zacks Consensus mark by almost 7%.

### Quarterly Operational Update

As of Mar 31, 2020, managed care membership came in at 23.8 million, up 61% year over year.

Health Benefit Ratio (HBR) for the reported quarter was 88% compared with 85.7% in the prior-year period. This increase can be attributable to the Health Insurance Marketplace business, WellCare buyout, new or expanded markets, partly offset by the reinstatement of the health insurer fee.

Adjusted Selling, General & Administrative (SG&A) expense ratio was 8.6% for the quarter compared with 9.5% for the same period last year. This year-over-year contraction of 90 basis points can be attributed to the WellCare acquisition and leveraging of costs over higher revenues.

### Financial Update

As of Mar 31, 2020, the company's cash and cash equivalents totaled \$9.3 billion, down 23.2% from the figure at 2019 end.

As of Mar 31, 2020, total assets were up 62.1% to \$66.4 billion from the level at 2019 end.

Centene's long-term debt summed \$17.2 billion, up 25.8% year over year.

Net cash flow used in operating activities as of Mar 31, 2020 was \$240 million compared with the cash flow provided by operating activities of \$1.3 billion a year ago.

### Highlights

In January 2020, Centene acquired WellCare Health for a total value of \$19.6 billion.

### 2020 Outlook

The company now expects revenues in the range of \$110-\$112.4 billion.

Adjusted EPS is anticipated between \$4.56 to \$4.76 per share.

Quarter Ending 03/2020

|                  |              |
|------------------|--------------|
| Report Date      | Apr 28, 2020 |
| Sales Surprise   | 6.96%        |
| EPS Surprise     | -15.69%      |
| Quarterly EPS    | 0.86         |
| Annual EPS (TTM) | 3.89         |

## Recent News

### Centene Raises 2020 EPS Guidance Amid the Present Volatility — Jun 12, 2020

Centene updated its guidance for 2020. Lifted earnings guidance during the prevalent market uncertainty definitely underlines the company's strong operating results and cash flow generation abilities.

This leading U.S. healthcare provider expects its adjusted EPS for 2020 between \$4.76 and \$4.96. Prior to this, concurrent with first-quarter 2020 earnings release, Centene had anticipated its adjusted annual earnings between \$4.54 and \$4.76 per share. The midpoint of this new guidance indicates an improvement of nearly 10% from the 2019 reported figure.

Further, Centene projects its current-year revenues in the \$109.5-\$111.9 billion band. The midpoint of this guided range implies a rise of 49.1% from the 2019 reported figure. Previous view estimated the company's revenues within \$110-\$112.4 billion.

### Centene Takes Initiatives to Fight the Coronavirus Outbreak — Mar 12, 2020

Centene recently extended its coverage to combat the novel coronavirus spread. It took this initiative in collaboration with other major issuers and the aid of the White House Coronavirus Task Force.

### Centene Unit Gets Correctional Contracts — Mar 4, 2020

Centene's subsidiary Centurion received notice from the Delaware Department of Correction of the Department that states its intent to award two contracts to Centurion for medical and behavioral health services. The three-year contracts are expected to begin Apr 1, 2020 and consist of two two-year renewal options.

## Valuation

Centene's shares are up 5.4% and 28% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 1.8% and up 0.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 20% and 7.4%, respectively.

The S&P 500 index is down 5.4% in the year-to-date period and up 11% in the past year.

The stock is currently trading at 11.92x forward 12-month earnings value, which compares to 15.07x for the Zacks sub-industry, 22.07x for the Zacks sector and 21.93x for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.18x and as low as 8.87x, with a 5-year median of 14.7x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$65 price target reflects 12.51x forward earnings.

The table below shows summary valuation data for CNC

| Valuation Multiples - CNC |               |       |              |        |         |
|---------------------------|---------------|-------|--------------|--------|---------|
|                           |               | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M                  | Current       | 11.92 | 15.07        | 22.07  | 21.93   |
|                           | 5-Year High   | 27.18 | 20.58        | 23.16  | 22.11   |
|                           | 5-Year Low    | 8.87  | 12.48        | 15.92  | 15.23   |
|                           | 5-Year Median | 14.7  | 16.05        | 19.04  | 17.49   |
| P/S F12M                  | Current       | 0.31  | 0.73         | 2.68   | 3.43    |
|                           | 5-Year High   | 0.5   | 0.86         | 3.75   | 3.44    |
|                           | 5-Year Low    | 0.19  | 0.48         | 2.21   | 2.54    |
|                           | 5-Year Median | 0.3   | 0.67         | 2.92   | 3.01    |
| P/B TTM                   | Current       | 1.52  | 3.33         | 4.1    | 4.16    |
|                           | 5-Year High   | 5.27  | 4.07         | 5.07   | 4.55    |
|                           | 5-Year Low    | 1.34  | 2.3          | 2.93   | 2.84    |
|                           | 5-Year Median | 2.22  | 3.17         | 4.29   | 3.66    |

As of 06/12/2020

## Industry Analysis Zacks Industry Rank: Top 37% (92 out of 252)



## Top Peers

| Company (Ticker)                          | Rec          | Rank |
|-------------------------------------------|--------------|------|
| Anthem, Inc. (ANTM)                       | Neutral      | 3    |
| Cigna Corporation (CI)                    | Neutral      | 3    |
| Humana Inc. (HUM)                         | Neutral      | 2    |
| Molina Healthcare, Inc (MOH)              | Neutral      | 2    |
| Select Medical Holdings Corporation (SEM) | Neutral      | 4    |
| UnitedHealth Group Incorporated (UNH)     | Neutral      | 3    |
| Magellan Health, Inc. (MGLN)              | Underperform | 3    |
| Universal Health Services, Inc. (UHS)     | Underperform | 5    |

| Industry Comparison Industry: Medical - Hmos |           |            |           | Industry Peers |         |           |
|----------------------------------------------|-----------|------------|-----------|----------------|---------|-----------|
|                                              | CNC       | X Industry | S&P 500   | HUM            | SEM     | UNH       |
| Zacks Recommendation (Long Term)             | Neutral   | -          | -         | Neutral        | Neutral | Neutral   |
| Zacks Rank (Short Term)                      | 3         | -          | -         | 2              | 4       | 3         |
| VGM Score                                    | A         | -          | -         | A              | A       | A         |
| Market Cap                                   | 35.87 B   | 1.92 B     | 21.47 B   | 50.07 B        | 2.10 B  | 270.43 B  |
| # of Analysts                                | 11        | 4          | 14        | 10             | 2       | 12        |
| Dividend Yield                               | 0.00%     | 0.00%      | 1.96%     | 0.66%          | 0.00%   | 1.51%     |
| Value Score                                  | A         | -          | -         | A              | B       | B         |
| Cash/Price                                   | 0.28      | 0.30       | 0.06      | 0.33           | 0.03    | 0.08      |
| EV/EBITDA                                    | 13.62     | 8.39       | 12.36     | 9.12           | 9.35    | 12.58     |
| PEG Ratio                                    | 0.95      | 1.23       | 2.92      | 1.65           | 1.08    | 1.40      |
| Price/Book (P/B)                             | 1.52      | 2.14       | 2.96      | 4.05           | 2.16    | 4.51      |
| Price/Cash Flow (P/CF)                       | 9.28      | 10.88      | 11.51     | 16.82          | 5.48    | 15.60     |
| P/E (F1)                                     | 12.82     | 16.20      | 20.86     | 20.41          | 16.20   | 17.56     |
| Price/Sales (P/S)                            | 0.44      | 0.58       | 2.25      | 0.74           | 0.38    | 1.10      |
| Earnings Yield                               | 7.65%     | 5.93%      | 4.55%     | 4.90%          | 6.17%   | 5.70%     |
| Debt/Equity                                  | 0.72      | 0.60       | 0.76      | 0.49           | 4.53    | 0.60      |
| Cash Flow (\$/share)                         | 6.68      | 6.68       | 7.01      | 22.51          | 2.87    | 18.28     |
| Growth Score                                 | D         | -          | -         | C              | B       | B         |
| Hist. EPS Growth (3-5 yrs)                   | 29.09%    | 23.51%     | 10.87%    | 25.08%         | 8.16%   | 24.13%    |
| Proj. EPS Growth (F1/F0)                     | 7.26%     | 4.26%      | -10.81%   | 3.82%          | -21.77% | 7.50%     |
| Curr. Cash Flow Growth                       | 45.38%    | 14.42%     | 5.46%     | 17.03%         | 10.32%  | 14.76%    |
| Hist. Cash Flow Growth (3-5 yrs)             | 49.67%    | 13.62%     | 8.55%     | 12.98%         | 14.27%  | 19.53%    |
| Current Ratio                                | 1.14      | 1.36       | 1.29      | 1.66           | 1.18    | 0.75      |
| Debt/Capital                                 | 42.08%    | 38.01%     | 44.75%    | 32.90%         | 83.78%  | 38.53%    |
| Net Margin                                   | 1.03%     | 3.86%      | 10.54%    | 3.86%          | 2.90%   | 5.59%     |
| Return on Equity                             | 11.47%    | 17.56%     | 16.08%    | 21.02%         | 18.74%  | 24.86%    |
| Sales/Assets                                 | 1.87      | 1.40       | 0.55      | 2.22           | 0.77    | 1.40      |
| Proj. Sales Growth (F1/F0)                   | 49.06%    | 9.71%      | -2.60%    | 14.79%         | -3.24%  | 7.00%     |
| Momentum Score                               | A         | -          | -         | B              | A       | B         |
| Daily Price Chg                              | 2.79%     | 0.63%      | 1.48%     | 1.39%          | 1.62%   | 0.50%     |
| 1 Week Price Chg                             | -1.72%    | 0.75%      | 7.51%     | -5.06%         | 16.73%  | 2.30%     |
| 4 Week Price Chg                             | -5.92%    | 0.39%      | 9.78%     | -1.84%         | 12.86%  | -1.88%    |
| 12 Week Price Chg                            | 15.56%    | 31.01%     | 27.11%    | 47.83%         | 18.57%  | 29.73%    |
| 52 Week Price Chg                            | 15.26%    | 4.12%      | -5.42%    | 48.68%         | 3.70%   | 16.41%    |
| 20 Day Average Volume                        | 3,393,901 | 389,078    | 2,634,935 | 903,733        | 820,597 | 4,369,461 |
| (F1) EPS Est 1 week change                   | 0.00%     | 0.00%      | 0.00%     | 0.00%          | 0.00%   | 0.00%     |
| (F1) EPS Est 4 week change                   | 0.00%     | 0.00%      | 0.00%     | 0.33%          | 0.00%   | 0.00%     |
| (F1) EPS Est 12 week change                  | 0.42%     | -0.14%     | -15.86%   | -0.14%         | -29.20% | -1.45%    |
| (Q1) EPS Est Mthly Chg                       | 0.00%     | 0.00%      | 0.00%     | 7.39%          | 0.00%   | 0.00%     |

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

|                |   |
|----------------|---|
| Value Score    | A |
| Growth Score   | D |
| Momentum Score | A |
| VGM Score      | A |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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