

Centene Corporation (CNC)

\$65.49 (As of 02/21/20)

Price Target (6-12 Months): **\$69.00**

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:D

Value: B

Growth: D

Momentum: F

Summary

Centene's earnings per share of 73 cents, missed the Zacks Consensus Estimate by 1.4%. However, the bottom line improved 5.8% year over year on the back of higher revenues. It is likely to grow on rising membership and expansion. The company 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. Medical membership has been rising over the last several quarters owing to contract wins. It is well-poised for growth on the back of contract wins and expansion across different regions. Its shares have underperformed its industry in a year's time. However, its operating costs weighs on margins. High debt level increases risk.

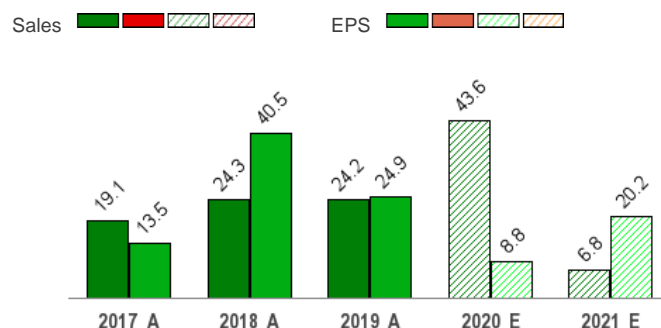
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$68.64 - \$41.62
20 Day Average Volume (sh)	6,098,233
Market Cap	\$27.1 B
YTD Price Change	4.2%
Beta	0.95
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical - HMOs
Zacks Industry Rank	Top 20% (51 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-1.4%
Last Sales Surprise	2.2%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	NA
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	27,701 E	28,036 E	28,667 E	28,562 E	114,512 E
2020	24,833 E	27,026 E	27,374 E	27,426 E	107,198 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	\$1.58 E	\$1.56 E	\$1.45 E	\$1.16 E	\$5.78 E
2020	\$1.23 E	\$1.34 E	\$1.26 E	\$1.03 E	\$4.81 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.

P/E TTM	14.8
P/E F1	13.6
PEG F1	1.0
P/S TTM	0.4

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/21/2020. The reports text is as of 02/24/2020.

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.

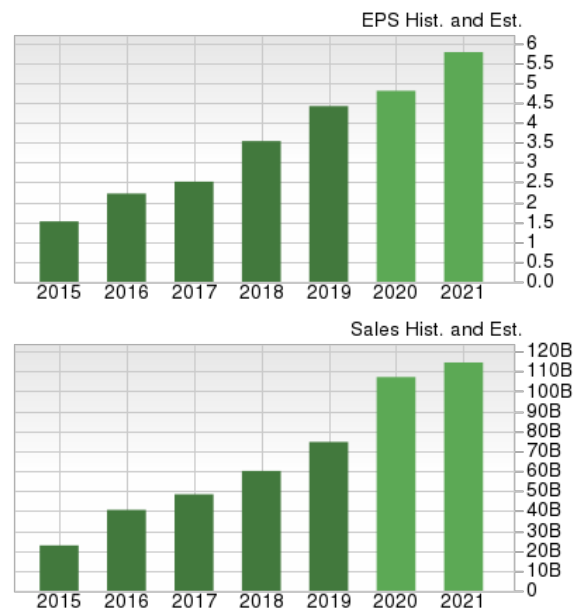
Centene is now a \$100-billion plus enterprise catering healthcare services to more than 24 million members across 50 states. The recent acquisition of WellCare Health leveraged the company's position as the largest Medicaid managed care organization in the country. The combined entity now has 22 million 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



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. This upside could primarily be backed by membership growth, expansion of contracts and other investments.
- ▲ **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. We expect this trend to continue on the back of certain contract gains as well as the pending WellCare buyout. Moreover, in August 2019, the company announced the expansion of its offerings in the 2020 Health Insurance Marketplace by penetrating 10 markets to gain a strong foothold in the marketplace business. For 2020, management expects its peak enrollment to be 2.2 million members, up 10% from 2019's peak enrollment.
- ▲ **Price Performance:** In a year's time, the stock has underperformed its industry. However, its solid fundamentals, such as inorganic growth strategy and the rising top line would likely help the stock bounce back going forward.

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.

Reasons To Sell:

- ▼ **High Financial Leverage:** Long-term debt at Centene has been rising since 2005, mainly because the company's acquisitions are financed majorly by borrowings. Apart from long-term debt, interest expenses, which have been escalating since the past several years, were up 35% and 20% year over year in 2018 and 2019, respectively. The company's times interest earned tumbled from 17.2% in 2015 to 5.33% in 2019, which is a persistent concern. Increase in debt might induce elevated interest burden, thereby weighing on the margin.
- ▼ **Increasing Costs:** Apart from the increasing level of debt, 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.
- ▼ **Weak ROE:** Centene's return on equity undermines its growth potential. The company's trailing 12-month ROE of 15.2% compares unfavorably with the industry average of 23.4%, indicating that it is less efficient in using 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 Q4 Earnings Miss Estimates, Improve Y/Y

Centene reported fourth-quarter 2019 adjusted earnings per share of 73 cents, missing the Zacks Consensus Estimate by 1.4%. However, the bottom line improved 5.8% year over year on the back of higher revenues.

For the fourth quarter, total revenues rose 14% to \$18.9 billion from the year-ago period, primarily aided by growth in the Health Insurance Marketplace business, expansions and new programs across many states in 2019 as well as the company's recent buyouts in Spain. Moreover, the top line surpassed the Zacks Consensus Estimate by 2.2%. However, this upside was offset by the health insurer fee moratorium to some extent.

Quarter Ending **12/2019**

Report Date	Feb 04, 2020
Sales Surprise	2.19%
EPS Surprise	-1.35%
Quarterly EPS	0.73
Annual EPS (TTM)	4.42

Quarterly Operational Update

As of Dec 31, 2019, managed care membership came in at 15.2 million, up 8% year over year.

Health Benefit Ratio (HBR) for the reported quarter was 88.4% compared with 86.8% in the prior-year period. This increase can be attributable to the Health Insurance Marketplace business as well as the health insurer fee moratorium.

Adjusted Selling, General & Administrative (SG&A) expense ratio was 9.5% for the fourth quarter of 2019 compared with 9.9% for the same period last year. This contraction of 40 basis points year over year can be attributed to higher revenues and lower variable compensation costs in 2019.

Financial Update

As of Dec 31, 2019, the company's cash and cash equivalents totaled \$12.1 billion, up 127% from the figure at 2018 end.

As of Dec 31, 2019, total assets were up 32.7% year over year to \$40.9 billion.

Centene's long-term debt summed \$13.6 billion, up 105% year over year.

Net cashflow provided by operating activities as of Dec 31, 2019 was \$1.5 billion, up 20.2% year over year.

Highlights

In January 2019, Centene acquired WellCare Health for a total value of \$19.6 billion.

Full Update

For 2019, the company came up with adjusted EPS of \$4.42, up 25% year over year. Total revenues for the year grew 24% year over year to \$74.6 billion.

Recent News

Centene Completes Acquisition of WellCare Health — Jan 23, 2020

The company completes the pending buyout of WellCare Health.

Centene Declares Final Results of Exchange Offers for WellCare Health's Notes — Jan 21, 2020

Centene announced the final results of offers made to exchange notes issued by WellCare Health for up to \$1,950,000,000 aggregate principal amount of new notes to be issued by Centene and cash and associated consent solicitations made by Centene on behalf of WellCare to adopt certain proposed amendments.

Centene and WellCare Receive Pending State Approvals — Dec 5, 2019

Centene along with WellCare received the pending approvals from The Illinois Department of Insurance, the New Jersey Department of Banking and Insurance and the New Jersey Division of Medical Assistance and Health Services in relation to its merger.

Valuation

Centene's shares are up 4.2% and 2.3% 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 up 1.8% and 2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 9.2% and 1.7%, respectively.

The S&P 500 index is up 3.6% in the year-to-date period and 18.6% in the past year.

The stock is currently trading at 13.2x trailing 12-month price to earnings, which compares to 16.3x for the Zacks sub-industry, 21.24x for the Zacks sector and 19.09x for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.1x and as low as 8.8x, with a 5-year median of 15x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$69 price target reflects 1.93X earnings.

The table below shows summary valuation data for CNC

Valuation Multiples - CNC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.23	16.3	21.24	19.09
	5-Year High	27.18	20.58	21.24	19.34
	5-Year Low	8.87	12.48	15.82	15.17
	5-Year Median	15.02	16.24	18.87	17.47
P/S F12M	Current	0.25	0.77	2.84	3.51
	5-Year High	0.46	0.86	3.84	3.51
	5-Year Low	0.17	0.48	2.45	2.55
	5-Year Median	0.3	0.67	2.97	3
P/B TTM	Current	2.14	3.53	4.63	4.83
	5-Year High	5.27	4.09	5.05	4.9
	5-Year Low	1.44	2.44	3.42	2.85
	5-Year Median	2.34	3.11	4.32	3.61

As of 02/21/2020

Industry Analysis Zacks Industry Rank: Top 20% (51 out of 255)



Top Peers

Select Medical Holdings Corporation (SEM)	Outperform
Anthem, Inc. (ANTM)	Neutral
Cigna Corporation (CI)	Neutral
Humana Inc. (HUM)	Neutral
Magellan Health, Inc. (MGLN)	Neutral
Molina Healthcare, Inc. (MOH)	Neutral
Universal Health Services, Inc. (UHS)	Neutral
UnitedHealth Group Incorporated (UNH)	Neutral

Industry Comparison Industry: Medical - Hmos				Industry Peers		
	CNC Neutral	X Industry	S&P 500	HUM Neutral	SEM Outperform	UNH Neutral
VGM Score	D	-	-	C	A	A
Market Cap	27.10 B	2.79 B	24.03 B	48.95 B	3.79 B	285.93 B
# of Analysts	11	4.5	13	11	2	12
Dividend Yield	0.00%	0.00%	1.76%	0.60%	0.00%	1.43%
Value Score	B	-	-	B	A	B
Cash/Price	0.48	0.27	0.04	0.30	0.04	0.05
EV/EBITDA	8.93	8.67	14.08	9.10	12.06	13.77
PEG Ratio	0.92	1.19	2.08	1.48	1.45	1.43
Price/Book (P/B)	2.14	4.15	3.29	4.07	4.22	4.73
Price/Cash Flow (P/CF)	9.78	11.65	13.42	16.42	10.93	16.49
P/E (F1)	12.44	16.91	19.00	19.83	20.30	18.30
Price/Sales (P/S)	0.36	0.69	2.64	0.75	0.69	1.18
Earnings Yield	7.34%	5.46%	5.26%	5.04%	4.93%	5.46%
Debt/Equity	1.08	0.58	0.70	0.41	4.61	0.61
Cash Flow (\$/share)	6.70	6.70	7.03	22.51	2.58	18.28
Growth Score	D	-	-	C	A	A
Hist. EPS Growth (3-5 yrs)	31.44%	19.46%	10.84%	24.18%	3.97%	24.05%
Proj. EPS Growth (F1/F0)	8.74%	9.95%	7.09%	4.30%	12.10%	9.01%
Curr. Cash Flow Growth	45.38%	13.35%	6.72%	17.03%	16.18%	14.76%
Hist. Cash Flow Growth (3-5 yrs)	49.67%	12.98%	8.25%	12.98%	12.24%	19.53%
Current Ratio	1.57	1.61	1.22	1.82	1.21	0.69
Debt/Capital	51.92%	37.43%	42.37%	29.21%	84.99%	38.94%
Net Margin	1.77%	4.17%	11.56%	4.17%	2.72%	5.71%
Return on Equity	15.18%	16.86%	16.80%	20.89%	17.38%	25.55%
Sales/Assets	2.09	1.43	0.55	2.25	0.77	1.43
Proj. Sales Growth (F1/F0)	43.62%	13.47%	3.90%	13.60%	3.56%	8.66%
Momentum Score	F	-	-	D	D	D
Daily Price Chg	-0.37%	0.00%	-0.83%	-0.36%	8.13%	-0.23%
1 Week Price Chg	2.82%	1.41%	1.65%	6.39%	7.28%	3.31%
4 Week Price Chg	-3.72%	1.17%	-0.37%	1.68%	15.14%	0.66%
12 Week Price Chg	8.36%	3.13%	3.74%	8.11%	25.94%	7.40%
52 Week Price Chg	3.12%	3.30%	14.14%	20.19%	82.24%	13.15%
20 Day Average Volume	6,098,233	403,477	1,992,841	1,080,792	908,811	3,816,883
(F1) EPS Est 1 week change	-0.10%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.02%	-0.02%	-0.02%	-0.24%	2.96%	0.04%
(F1) EPS Est 12 week change	-0.75%	-0.75%	-0.17%	-0.19%	2.96%	0.20%
(Q1) EPS Est Mthly Chg	-3.63%	-0.06%	-0.48%	-3.45%	0.00%	-0.06%

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	B
Growth Score	D
Momentum Score	F
VGM Score	D

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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