

Humana Inc. (HUM)

\$410.65 (As of 05/29/20)

Price Target (6-12 Months): **\$431.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/07/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: C

Momentum: B

Summary

Humana's shares have outperformed the industry in a year's time. It is well-poised for growth on the back of its strong Medicare business, inorganic growth strategy and operating initiatives. Acquisitions, alliances with several companies place it well for long-term growth. It has been deploying excess capital via share buybacks and dividends for the past many years on the back of its balance sheet strength. Strong operating cash flows are an added advantage for the company. A strong 2020 outlook instills investor confidence in the stock. However, its escalating expenses weigh on the bottom line. Its weak return on equity also bothers. Its first-quarter 2020 operating earnings per share of \$5.40 beat the Zacks Consensus Estimate by 11.6% and also improved 20.5% year over year on the back of higher revenues.

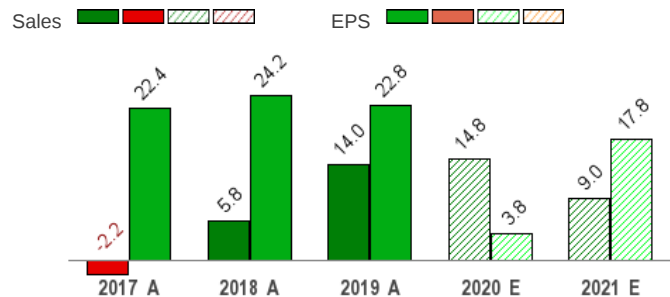
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$412.70 - \$208.25
20 Day Average Volume (sh)	783,042
Market Cap	\$54.3 B
YTD Price Change	12.0%
Beta	0.91
Dividend / Div Yld	\$2.50 / 0.6%
Industry	Medical - HMOs
Zacks Industry Rank	Top 33% (83 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.6%
Last Sales Surprise	3.0%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	NA
Earnings ESP	-6.0%
P/E TTM	21.9
P/E F1	22.1
PEG F1	1.8
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	20,624 E	20,351 E	20,143 E	20,197 E	81,201 E
2020	18,935 A	18,592 E	18,473 E	18,549 E	74,468 E
2019	16,107 A	16,245 A	16,241 A	16,295 A	64,888 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$5.43 E	\$7.64 E	\$6.01 E	\$2.81 E	\$21.85 E
2020	\$5.40 A	\$7.75 E	\$4.48 E	\$1.25 E	\$18.55 E
2019	\$4.48 A	\$6.05 A	\$5.03 A	\$2.28 A	\$17.87 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 05/29/2020. The reports text is as of 06/01/2020.

Overview

Founded in 1964 and headquartered in Louisville, KY., Humana Inc. is one of the largest health care plan providers in the United States. It was organized as a Delaware corporation in the year 1964. It provides health insurance benefits under Health Maintenance Organization (HMO), Private Fee-For-Service (PFFS), and Preferred Provider Organization (PPO) plans. The company also provides other benefits with specialty products including dental, vision, and other supplementary benefits.

It exited 2018 with around 17 million members under its medical benefit plans and approximately 6 million members in its specialty product category.

Humana now manages its business through four segments:

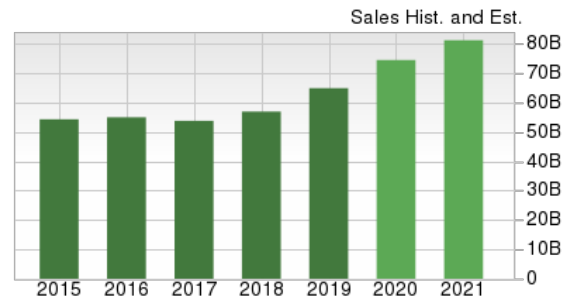
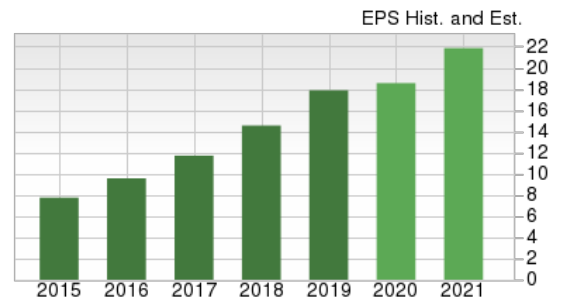
The Retail segment (84.8% of the company's total revenue in 2019): The segment consists of Medicare benefits, which are marketed on a retail basis to individuals. .

The Group segment (13.5%): This comprises employer group commercial fully-insured medical and specialty health insurance benefits, including dental, vision, and other supplemental health and voluntary insurance benefits, and also administrative services only products..

The Healthcare Services (1.7%): The segment consists of services offered to the company's health plan members as well as to third parties, including pharmacy solutions, provider services, home-based services, and clinical programs, and also services and capabilities to advance population health.

Also, there is Other Businesses category that includes businesses, which are not separately reportable because they do not meet the quantitative thresholds.

The company exited the individual commercial business effective Jan 1, 2018.



Reasons To Buy:

▲ **Medicare Business Poised for Growth:** Humana's Medicare business has been performing strongly from past many quarters. This is evident from 54% Medicare membership growth from 2013 to 2018. Although the same dipped 1% in 2019, Individual Medicare membership rose 17.1% year over year in the same time frame, which is a positive. The full-year individual Medicare Advantage membership is anticipated to be around 300,000-350,000 members, higher than the previous range of 270,000-330,000 members. Over the past decade, the company saw maximum growth in Individual Medicare Advantage during 2019, which is pretty impressive.

Humana's acquisitions and dispositions, efficient capital deployment and strong Medicare business position it for long-term gains. Its solid 2019 outlook also impresses.

▲ **Acquisitions and Dispositions:** These strategic initiatives have carved a growth path for the company. Some of the acquisitions made by the company has helped it achieve long-term growth. These include the purchase of Family Physicians Group, Your Home Advantage, Curo and a share in Kindred at Home, which has helped the company to deepen its reach in the home health and hospice market. The company has witnessed a busy first half of 2018 with the launch of Conviva, the acquisition of Orlando-based Family Physicians Group. In 2018, the company sold its long-term care insurance business to KMG American Corp. It also closed the Enclara deal, expanding its hospice pharmacy business line. These strategic initiatives set the company for long-term growth.

▲ **2020 Outlook:** Following first-quarter results, the company reaffirmed its adjusted EPS projection of \$18.25-\$18.75 for 2020, indicating an upside of 3.5% from the prior-year reported figure. The full-year individual Medicare Advantage membership is anticipated to be around 300,000-350,000 members. Humana reiterated its expectations for group Medicare Advantage net membership gains. It now expects a year-over-year increase of 90,000 members in 2020. However, for its stand-alone PDP business, it anticipates a membership decline of 550,000. Although it withdrew its full-year Medicaid membership outlook, we expect this strong outlook to instill investors' confidence in the company.

▲ **Capital Deployment:** Humana has been efficiently deploying excess capital for the past several years. Although the company's operating cash flows, which have been rising over the last several quarters, declined in 2018, it soared 143.2% in 2019. It has been hiking its dividend since 2011. In February 2020, the company hiked its quarterly dividend by 14%. Although it didn't buy back shares in the first quarter, we believe, its financial strength will continue to boost investors' confidence.

▲ **Solid Capital Position:** The company's financial flexibility impresses. Its total debt is 39.2% (up from 32% sequentially as of Dec 31, 2020) of capital, almost in line with the industry's average of 39%. Also, its time interest earned stands at 15.3X, much higher than the industry average of 10.3X. As of Mar 31, 2020, the company had cash, cash equivalents and investment securities of \$17.55 billion, higher than its long-term debt of \$6 billion. The company also has access to an additional \$2 billion under its credit agreement and it further increased its liquidity level with the issuance of \$1.1 billion in senior notes and \$1 billion drawn under one-year term loan bank commitment.

▲ **Price Performance:** In a year, shares of the company have outperformed its industry's. Moreover, its solid fundamentals like growing revenues on inorganic growth are likely to continue drive its shares going forward.

Reasons To Sell:

▼ **Rising Expenses:** Humana has been witnessing a rise in the operating expenses since 2010 sans 2017 when operating expenses declined 6% due to the receipt of Humana-Aetna merger termination fee. In the first quarter of 2020, it jumped 17% year over year. The company expects to witness an elevation in benefit expenses, which will induce overall higher operating expenses. Rising expenses are likely to hurt the bottom line.

▼ **Weak ROE:** The company's weak return on equity is another concern. The metric now stands at 21%, lower than the industry's average of 22.5%.

▼ **Overvalued:** Looking at its current valuation, investors won't agree to pay its premiums. Its current price-to-earnings forward 12-month ratio stands at 20.6X, higher than its industry average of 16.3X.

Rising operating expenses and increase in financial leverage leading to financial risk continue to bother the company.

Last Earnings Report

Humana's Earnings Beat Estimates in Q1, Improve Y/Y

Humana's first-quarter 2020 operating earnings per share of \$5.40 beat the Zacks Consensus Estimate by 11.6%. Moreover, the bottom line improved 20.5% year over year.

This upside can primarily be attributed to higher revenues witnessed by the company.

Operational Update

Revenues of \$18.9 billion were up nearly 17.6% year over year. Moreover, the top line surpassed the Zacks Consensus Estimate by 3% on the back of higher premium revenues from improved membership and per member premiums in its Medicare Advantage and state-based contract businesses.

Adjusted consolidated pre-tax income of \$1 billion increased 28.9% year over year on the back of solid segmental results, led by a robust Medicare Advantage.

Benefit ratio contracted 110 points (bps) to 85.1%.

Operating cost ratio expanded 90 bps to 11.3%.

Segmental Results

Retail

Revenues from the Retail segment were \$16.76 billion, up 20% year over year. This can primarily be attributed to higher premiums owing to membership strength and higher per member premiums in its Medicare Advantage and state-based contract businesses.

Benefit ratio of 86.6% contracted 170 bps year over year on the back of reinstatement of the non-deductible health insurance industry fee in 2020, engagement of Medicare Advantage members, continued shift in Medicare membership mix and an improved Medicare Advantage membership, etc.

The segment's operating cost ratio of 9.2% expanded 100 bps year over year due to reinstatement of the non-deductible health insurance industry fee in 2020.

Group and Specialty

Revenues from the Group and Specialty segment were \$1.87 billion, down 1.1% from the prior-year quarter due to a reduction in fully-insured group commercial membership.

Benefit ratio expanded 270 bps year over year to 79.1% due to the impact of deliberate pricing and benefit design changes in the commercial business as well as weekday seasonality including the leap-year impact on the first quarter.

Operating cost ratio expanded 120 bps year over year to 23.1%.

Healthcare Services

Revenues of \$7.09 billion increased 16% year over year, primarily owing to Medicare Advantage membership growth, better pharmacy revenues on the company's allowance of early prescription refills and additional pharmacy revenues associated with the Enclara Healthcare buyout.

Operating cost ratio contracted 60 bps year over year to 96%.

Financial Update

As of Mar 31, 2020, the company had cash, cash equivalents and investment securities of \$17.55 billion, up 14% from the level at 2019 end. Debt-to-total capitalization as of Mar 31, 2020 was 39.2%, expanding 720 bps from the level as of Dec 31, 2019.

For the first quarter, cash flows provided by operating activities came at \$474 million, down 47.1% year over year.

Capital Deployment

The company did not complete any open-market transactions in the quarter under review.

It paid out cash dividends worth \$73 million in the quarter under review. In February 2020, it declared a cash dividend of 62.5 cents per share, payable Apr 24, 2020 to its shareholders of record as of Mar 31, 2020. This new dividend indicates a hike of 14% from the previously announced payout.

2020 Guidance

After first-quarter results, the company revised its 2019 guidance. Adjusted EPS is now expected in the range of \$18.25-\$18.75. The full-year individual Medicare Advantage membership is anticipated to be around 300,000-350,000 members.

Humana reaffirmed its expectations for group Medicare Advantage net membership gains. It now expects a year-over-year increase of 90,000 members in 2020. For its stand-alone PDP business, it anticipates a membership decline of 550,000.

Quarter Ending 03/2020

Report Date	Apr 29, 2020
Sales Surprise	3.04%
EPS Surprise	11.57%
Quarterly EPS	5.40
Annual EPS (TTM)	18.76

Recent News

Humana Wins Contract to Serve in Home State of Kentucky — May 30, 2020

Humana has been chosen by the Kentucky Cabinet for Health and Family Services (CHFS) to continue providing services for children and adults across the health company's home state of Kentucky through the Department for Medicaid Services.

Humana to Waive Expenses Related to Coronavirus Treatment — Mar 30, 2020

Humana has decided to waive out-of-pocket costs regarding coronavirus-related treatment for its members. Enrollees of Medicare Advantage plans, fully-insured commercial members, Medicare Supplement and Medicaid will gain traction from this initiative by the company. This waiver is applicable to all COVID-19 medical expenses and FDA-approved medicines or vaccines when the same will be available.

Humana Completes Aggregate \$1.1 Billion Debt Offering — Mar 27, 2020

Humana completed its public offering of \$1.1 billion in senior notes. The notes consist of \$600 million of its 4.5% senior notes due 2025 at 99.875% of the principal amount and \$500 million of 4.875% senior notes due 2030 at 99.788% of the principal amount.

Humana Takes Steps to Boost COVID-19 Treatment Capacity — Mar 26, 2020

Humana is taking measures to enhance administrative requirements for treating members with coronavirus. Care transitions are provided to patients infected with coronavirus as well as those hospitalized in settings of COVID-related limits on health system capacity.

Valuation

Humana's shares are up 12% and 64.1% 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 0.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 20% and 7.2%, respectively.

The S&P 500 index is down 5.4% in the year-to-date period and up 11.1% in the past year.

The stock is currently trading at 20.61x forward 12-month earnings, which compares to 16.33x for the Zacks sub-industry, 23.33x for the Zacks sector and 22.09x for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.38x and as low as 11.04x, with a 5-year median of 19.18x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$431 price target reflects 21.63x forward earnings.

The table below shows summary valuation data for HUM

Valuation Multiples - HUM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.61	16.33	23.33	22.09
	5-Year High	23.38	20.58	23.33	22.09
	5-Year Low	11.04	12.48	15.92	15.23
	5-Year Median	19.18	16.1	18.95	17.49
P/S F12M	Current	0.7	0.79	2.81	3.43
	5-Year High	0.81	0.86	3.75	3.43
	5-Year Low	0.38	0.48	2.21	2.55
	5-Year Median	0.57	0.67	2.92	3
P/B TTM	Current	4.39	3.59	4.28	4.17
	5-Year High	4.6	4.07	5.05	4.55
	5-Year Low	2.1	2.3	2.93	2.85
	5-Year Median	3.17	3.16	4.3	3.64

As of 05/29/2020

Industry Analysis Zacks Industry Rank: Top 33% (83 out of 254)



Top Peers

Company (Ticker)	Rec	Rank
Anthem, Inc. (ANTM)	Neutral	3
Centene Corporation (CNC)	Neutral	3
CVS Health Corporation (CVS)	Neutral	2
The Joint Corp. (JYNT)	Neutral	3
Magellan Health, Inc. (MGLN)	Neutral	4
Molina Healthcare, Inc. (MOH)	Neutral	3
Select Medical Holdings Corporation (SEM)	Neutral	3
UnitedHealth Group Incorporated (UNH)	Neutral	3

Industry Comparison Industry: Medical - Hmos				Industry Peers		
	HUM	X Industry	S&P 500	ANTM	CNC	UNH
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	2	-	-	3	3	3
VGM Score	A	-	-	A	A	B
Market Cap	54.29 B	2.16 B	21.48 B	74.15 B	38.37 B	289.11 B
# of Analysts	10	4.5	14	10	11	12
Dividend Yield	0.61%	0.00%	1.96%	1.29%	0.00%	1.42%
Value Score	A	-	-	A	A	B
Cash/Price	0.33	0.31	0.06	0.37	0.28	0.09
EV/EBITDA	10.11	9.00	12.56	8.57	14.42	13.41
PEG Ratio	1.79	1.36	2.87	0.90	0.95	1.50
Price/Book (P/B)	4.39	2.28	2.92	2.34	1.62	4.83
Price/Cash Flow (P/CF)	18.24	12.04	11.74	12.04	9.92	16.68
P/E (F1)	22.14	16.64	21.35	13.23	13.97	18.77
Price/Sales (P/S)	0.80	0.64	2.27	0.68	0.47	1.17
Earnings Yield	4.52%	5.67%	4.52%	7.56%	7.15%	5.33%
Debt/Equity	0.49	0.60	0.76	0.60	0.72	0.60
Cash Flow (\$/share)	22.51	6.68	6.96	24.42	6.68	18.28
Growth Score	C	-	-	A	D	B
Hist. EPS Growth (3-5 yrs)	25.08%	23.51%	10.87%	15.82%	29.09%	24.13%
Proj. EPS Growth (F1/F0)	3.82%	4.09%	-10.48%	14.33%	7.26%	7.50%
Curr. Cash Flow Growth	17.03%	14.42%	5.39%	16.15%	45.38%	14.76%
Hist. Cash Flow Growth (3-5 yrs)	12.98%	13.62%	8.55%	12.87%	49.67%	19.53%
Current Ratio	1.66	1.36	1.29	1.53	1.14	0.75
Debt/Capital	32.90%	38.01%	44.54%	37.49%	42.08%	38.53%
Net Margin	3.86%	3.86%	10.59%	4.38%	1.03%	5.59%
Return on Equity	21.02%	17.56%	16.26%	16.38%	11.47%	24.86%
Sales/Assets	2.22	1.40	0.55	1.39	1.87	1.40
Proj. Sales Growth (F1/F0)	14.76%	9.71%	-2.53%	13.91%	49.06%	7.00%
Momentum Score	B	-	-	B	A	B
Daily Price Chg	1.69%	0.00%	-0.11%	0.94%	-0.97%	0.29%
1 Week Price Chg	-0.95%	1.44%	4.99%	-0.35%	-5.62%	-0.35%
4 Week Price Chg	7.55%	4.88%	4.40%	4.77%	-0.50%	4.23%
12 Week Price Chg	10.81%	10.15%	-2.75%	2.42%	10.93%	7.74%
52 Week Price Chg	65.68%	8.47%	0.07%	5.86%	16.23%	25.20%
20 Day Average Volume	783,042	330,277	2,425,602	1,126,499	3,015,844	4,015,595
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.24%	0.00%	-1.70%	0.77%	-0.07%	-0.23%
(F1) EPS Est 12 week change	-0.47%	-1.12%	-16.00%	-0.89%	-1.36%	-1.45%
(Q1) EPS Est Mthly Chg	7.79%	3.44%	-3.25%	10.95%	7.77%	0.00%

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.

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	C
Momentum Score	B
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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