

Humana Inc. (HUM)

\$336.24 (As of 01/31/20)

Price Target (6-12 Months): **\$353.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/07/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: B

Summary

Humana's shares have outperformed its industry in a year's time. The company is well-poised for growth on the back of its strong Medicare business, inorganic growth strategy and operating initiatives. Its top-line has been witnessing an uptrend for the past several years. Strategic acquisitions and dispositions have also led to growth. A solid 2019 outlook should instill investor confidence in the company. It has been deploying excess capital via share buybacks and dividends for the past many years on the back of its balance sheet strength. However, its escalating expenses weigh on the bottom line. Increase in leverage might lead to heightened financial risk of the company. A Zacks Rank #3 and an Earnings Estimate of 0.15% leave us positive about its earnings surprise as it is set to report its fourth-quarter results on Feb 5th.

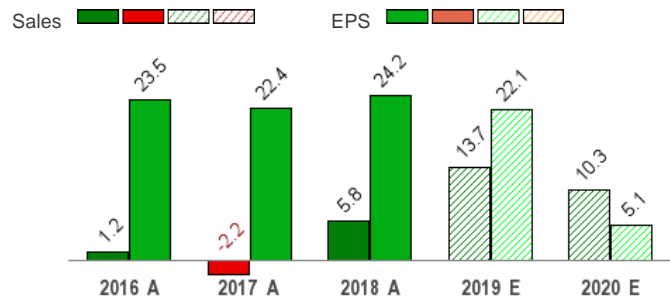
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$376.40 - \$225.65
20 Day Average Volume (sh)	1,017,952
Market Cap	\$44.5 B
YTD Price Change	-8.3%
Beta	0.92
Dividend / Div Yld	\$2.20 / 0.7%
Industry	<u>Medical - HMOs</u>
Zacks Industry Rank	Top 16% (42 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.8%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	02/05/2020
Earnings ESP	0.2%
P/E TTM	18.5
P/E F1	18.0
PEG F1	1.3
P/S TTM	0.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	17,878 E	17,951 E	17,831 E	17,732 E	71,393 E
2019	16,107 A	16,245 A	16,241 A	16,155 E	64,737 E
2018	14,279 A	14,259 A	14,206 A	14,168 A	56,912 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$4.76 E	\$6.15 E	\$4.89 E	\$2.88 E	\$18.68 E
2019	\$4.48 A	\$6.05 A	\$5.03 A	\$2.20 E	\$17.77 E
2018	\$3.36 A	\$3.96 A	\$4.58 A	\$2.65 A	\$14.55 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 01/31/2020. The reports text is as of 02/03/2020.

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:

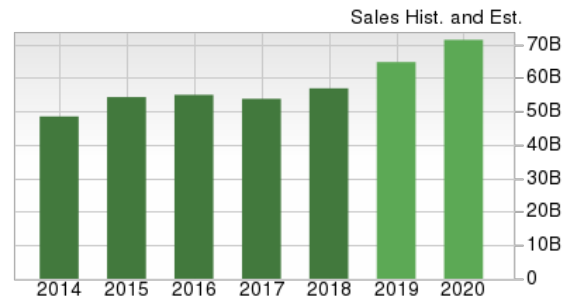
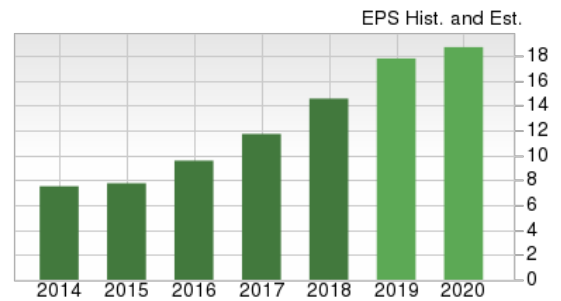
The Retail segment (87.5% of the company's total revenue in 2018): The segment consists of Medicare benefits, which are marketed on a retail basis to individuals. .

The Group segment (12.4%): 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 (0.1%): 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:

- ▲ **Price Performance:** In a year's time, shares of the company have gained 9.9% against its industry's loss of 1.3%. Moreover, its solid fundamentals like growing revenues on the back of inorganic growth are likely to help the stock continue its rally going forward.
- ▲ **Medicare Business Poised for Growth:** Humana's Medicare business has been performing strongly from past many quarters. The Medicare Advantage business has been delivering strongly due to operating initiatives of the company. This is evident from 54% Medicare membership growth from 2013 to 2018. Although the same dipped 1.2% in the first nine months of 2019, Individual Medicare membership rose 16.7% year over year in the same time frame, which is a positive. The company expects Individual Medicare Advantage membership at around 5,30,000, up from the previous range of 480,000-500,000. We believe we are competitively positioned in Medicare Advantage based on our early indicators from the annual election period.
- ▲ **Acquisitions and Dispositions:** These strategic initiatives have carved a growth path for the company. Some of the acquisitions made by the company will help 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. These strategic initiatives set the company for long term growth.
- ▲ **2019 Outlook:** Followed by third-quarter 2019 performance, Humana now anticipates adjusted EPS at \$17.75, up from the earlier expectation of \$17.60. This also compared favorably with the reported 2018 figure, reflecting 22% growth year over year. Individual Medicare Advantage membership is now predicted to be around 530000, above the previous projection of 415,000-440,000. Total consolidated revenues are anticipated between \$64.5 billion and \$64.8 billion compared with the earlier guidance of \$64.2-\$64.8 billion. Cash flow from operations is projected in the band of \$4.1-\$4.3 billion, up from the earlier band of \$3.1-\$3.3 billion. This strong view should instill investor 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 again soared 90.4% in the first nine months of 2019. For 2019, the company expects cash flow from operations in the range of \$4.1-\$4.3 billion, reflecting a 93.2% rise from the reported 2018 figure. It has been hiking its dividend since 2011. In February 2019, the company raised dividend by 10% to 55 cents per share. In July 2019, the company's board of directors approved a new \$3-billion share repurchase plan, replacing its previous buyback authorization. We believe that its financial strength will continue to inspire investors' confidence.

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

Reasons To Sell:

▼ **Rising Expenses:** Humana has been witnessing a rise in the operating expenses since 2010. Although during 2017, operating expenses declined 6% due to the receipt of Humana-Aetna merger termination fee, the same again increased 8.7% and 14%, each during 2018 and the first nine months 2019. 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.

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

▼ **Increase in Financial Leverage:** In 2018, the company's total debt rose 23.3% to \$6 billion. Its debt-to-equity ratio rose from 38.3% in 2016 to 59.7% in 2018 and currently stands at 52.3%. Also, times interest earned, a ratio that measures the company's ability to pay its interest expenses, declined to 14.6 at the end of the first nine months of 2019 from 17.6 in 2017. An increase in leverage thus might lead to heightened financial risk for the company and burden on margins.

▼ **Overvalued:** Looking at its current valuation, investors won't agree to pay its premiums. Its current price-to-earnings forward 12 months ratio stands at 17.8, higher than its industry's average of 14.9.

Last Earnings Report

Humana's Q3 Earnings Surpass Estimates, Improve Y/Y

Humana's third-quarter 2019 operating earnings per share of \$5.03 beat both the Zacks Consensus Estimate and the year-over year figure by 9.8%. This upside can primarily be attributed to Medicare Advantage membership growth and higher revenues.

Operational Update

Revenues of \$16.2 billion were up nearly 14.3% year over year. Moreover, the top line surpassed the Zacks Consensus Estimate by 0.5%. Adjusted consolidated pre-tax income of \$869 million decreased 5.7% year over year due to weekday seasonality.

Benefit ratio expanded 300 basis points (bps) to 85%.

Operating cost ratio contracted 210 bps to 11.4%.

Segmental Results

Retail

Revenues from the Retail segment were \$14.09 billion, up 17% year over year. This can primarily be attributed to Medicare Advantage membership strength and higher per member premium along with improved state-based contracts membership. Benefit ratio of 85.9% expanded 270 bps year over year due to 2019 HIF suspension, unfavorable impact from weekday seasonality, lower favorable prior-period development in the segment and the shift in Medicare membership mix. The segment's operating cost ratio of 9.3% contracted 190 bps year over year on the suspension of the health insurance industry fee (HIF) in 2019, better scale efficiencies related to its Medicare Advantage membership and operating cost efficiencies.

Group and Specialty

Revenues from the Group and Specialty segment were \$1.89 billion, down 0.3% from the prior-year quarter due to a reduction in fully-insured group commercial and specialty membership, the impact of a few contractual incentives and also adjustments related to the TRICARE contract of 2018.

Benefit ratio expanded 560 bps year over year to 86.3%, due to the impact of weekday seasonality in the quarter under review, effect of HIF suspension in 2019, lower prior-period development, effect of the continued migration of fully-insured group members, and dental network contracted rates. Operating cost ratio contracted 170 bps year over year to 21.9%.

Healthcare Services

Revenues of \$6.6 billion increased 11% year over year, primarily owing to Medicare Advantage membership growth. Operating cost ratio expanded 10 bps year over year to 96.2%.

Individual Commercial

Humana exited this business effective Jan 1, 2018.

Financial Update

As of Sep 30, 2019, the company had cash, cash equivalents and investment securities of \$16.36 billion. Debt-to-total capitalization ratio as of Sep 30, 2019 was 34.3%, contracting 310 bps from Dec 31, 2018. Operating cash inflow totaled \$2.4 billion at third-quarter end, up 8.3% year over year.

Capital Deployment

The company paid out cash dividends worth \$74 million in the quarter under review. In October 2019, it declared a cash dividend of 55 cents per share, payable Jan 31, 2020 to its shareholders of record as of Dec 31, 2019. In July 2019, its board of directors approved a share repurchase plan worth \$3 billion, set to expire Jun 30, 2022. It also entered into an agreement in July this year with a third-party financial institution to implement a \$1.00-billion ASR program under the authorization. In the quarter under review, the company repurchased around 2,695,900 shares under this plan. As of Nov 5, 2019, it had remaining share repurchase authorization of \$2 billion.

2019 Guidance

After third-quarter results, the company revised its 2019 guidance. Adjusted EPS is now expected to be approximately \$17.75. The 2019 individual Medicare Advantage membership is anticipated to be around 530,000 members.

Quarter Ending 09/2019

Report Date	Nov 06, 2019
Sales Surprise	0.55%
EPS Surprise	9.83%
Quarterly EPS	5.03
Annual EPS (TTM)	18.21

Recent News

Humana to Take Over Enclara for Enriched Healthcare — Dec 16, 2019

Humana entered into a definitive agreement to purchase the privately held Enclara Healthcare, a leading hospice pharmacy and benefit management provider, from Consonance Capital Partners and Enclara management. Expected to close in the first half of 2020, the deal will likely have an immaterial impact on 2020 earnings.

Humana's Alliances to Offer Relief to Members With CKD — Dec 11, 2019

Humana signed contracts with Monogram Health and Somatus to boost its care management portfolio. The two specialized care management companies would help Humana provide customized services to its Humana Medicare Advantage and Commercial members, who suffer kidney disease and reside in four states.

Humana Inks In-Network Deal With Mountain View Group — Nov 26, 2019

Humana entered into an agreement that offers its members in-network access to Mountain View Medical Group in Colorado Springs.

Humana Teams Up With Epione Health — Nov 25, 2019

Humana collaborated with Epione Health to provide patient-centric experience to Humana Medicare Advantage Members in Oklahoma. The deal is expected to result in better health outcomes of patients.

Humana Lowers Health Care Costs Via Medicare Advantage Value-Based Care Plans — Nov 21, 2019

Humana has reduced overall health care expenditure for its Medicare Advantage beneficiaries affiliated to primary care physicians on value-based payment models.

Humana Expands Tie-Up With agilon Health — Nov 20, 2019

Humana has announced its value-based care agreements with agilon health through which physicians and medical groups manage the transition from fee-for-service reimbursement on behalf of three independent physician practices in Ohio and Texas.

Valuation

Humana's shares are up 9.9% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are down 1.3% and 0.4%, respectively.

The S&P 500 index is up 18% in the past year.

The stock is currently trading at 17.71X trailing 12-month price to earnings ratio, which compares to 14.89X for the Zacks sub-industry, 20.68X for the Zacks sector and 18.51X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.38X and as low as 12.87X, with a 5-year median of 19.21X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$353 price target reflects 18.59X price to earnings ratio.

The table below shows summary valuation data for HUM

Valuation Multiples - HUM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.71	14.89	20.68	18.51
	5-Year High	23.38	20.58	21.22	19.34
	5-Year Low	12.87	12.48	15.85	15.18
	5-Year Median	19.21	16.22	18.91	17.46
P/S F12M	Current	0.62	0.72	2.76	3.43
	5-Year High	0.81	0.86	3.82	3.43
	5-Year Low	0.41	0.48	2.42	2.55
	5-Year Median	0.55	0.67	2.94	3
P/B TTM	Current	3.84	3.43	4.42	4.42
	5-Year High	4.6	4.07	5.01	4.55
	5-Year Low	2.1	2.46	3.42	2.85
	5-Year Median	3.11	3.1	4.29	3.62

As of 01/31/2020

Industry Analysis Zacks Industry Rank: Top 16% (42 out of 255)



Top Peers

The Joint Corp. (JYNT)	Outperform
Anthem, Inc. (ANTM)	Neutral
Centene Corporation (CNC)	Neutral
CVS Health Corporation (CVS)	Neutral
Molina Healthcare, Inc (MOH)	Neutral
Select Medical Holdings Corporation (SEM)	Neutral
UnitedHealth Group Incorporated (UNH)	Neutral
Magellan Health, Inc. (MGLN)	Underperform

Industry Comparison Industry: Medical - Hmos				Industry Peers		
	HUM Neutral	X Industry	S&P 500	ANTM Neutral	CNC Neutral	UNH Neutral
VGM Score	A	-	-	A	A	A
Market Cap	44.53 B	2.43 B	23.55 B	67.27 B	25.99 B	258.12 B
# of Analysts	11	4.5	13	10	11	12
Dividend Yield	0.65%	0.00%	1.81%	1.21%	0.00%	1.59%
Value Score	A	-	-	B	A	B
Cash/Price	0.34	0.24	0.04	0.36	0.25	0.05
EV/EBITDA	12.06	9.66	13.97	8.36	11.76	12.53
PEG Ratio	1.30	1.10	1.97	0.75	0.91	1.34
Price/Book (P/B)	3.84	3.63	3.21	2.12	2.10	4.27
Price/Cash Flow (P/CF)	17.89	12.20	13.36	10.86	13.53	14.91
P/E (F1)	18.00	16.00	18.42	11.81	13.07	16.54
Price/Sales (P/S)	0.71	0.57	2.60	0.65	0.36	1.07
Earnings Yield	5.56%	6.09%	5.43%	8.46%	7.64%	6.05%
Debt/Equity	0.46	0.59	0.72	0.56	0.56	0.61
Cash Flow (\$/share)	18.79	4.64	6.92	24.42	4.64	18.28
Growth Score	A	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	23.12%	18.66%	10.68%	14.19%	32.24%	24.05%
Proj. EPS Growth (F1/F0)	5.14%	9.92%	7.59%	15.50%	8.58%	8.99%
Curr. Cash Flow Growth	16.31%	15.46%	10.81%	16.15%	52.48%	14.76%
Hist. Cash Flow Growth (3-5 yrs)	7.02%	12.24%	8.78%	8.80%	52.29%	19.53%
Current Ratio	1.83	1.11	1.22	1.65	1.01	0.69
Debt/Capital	31.62%	37.51%	42.99%	35.92%	36.09%	38.94%
Net Margin	4.06%	4.06%	11.69%	4.61%	1.87%	5.71%
Return on Equity	22.32%	16.16%	17.33%	16.34%	15.54%	25.55%
Sales/Assets	2.24	1.43	0.55	1.36	2.17	1.43
Proj. Sales Growth (F1/F0)	10.28%	8.66%	4.12%	13.41%	7.59%	8.66%
Momentum Score	B	-	-	C	C	A
Daily Price Chg	-2.04%	-1.12%	-1.98%	-0.23%	-1.12%	-3.04%
1 Week Price Chg	-2.63%	-0.11%	-1.09%	-2.66%	3.21%	-1.90%
4 Week Price Chg	-7.43%	-2.56%	-2.11%	-11.83%	1.50%	-6.85%
12 Week Price Chg	6.70%	6.47%	2.15%	-5.18%	18.31%	6.23%
52 Week Price Chg	8.82%	-5.66%	14.15%	-12.45%	-3.79%	0.83%
20 Day Average Volume	1,017,952	223,825	1,808,632	1,507,639	5,220,454	3,815,944
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-1.17%	-0.09%	0.00%
(F1) EPS Est 4 week change	-0.00%	0.00%	0.00%	-1.11%	0.50%	0.15%
(F1) EPS Est 12 week change	-0.56%	-1.08%	-0.09%	-1.54%	-1.08%	0.05%
(Q1) EPS Est Mthly Chg	-1.31%	-1.31%	0.00%	-2.31%	-2.68%	-11.09%

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	A
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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