

## Humana Inc. (HUM)

**\$419.76** (As of 08/10/20)

Price Target (6-12 Months): **\$441.00**

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: C

### Summary

Humana's earnings per share of \$12.56 beat the Zacks Consensus Estimate by 21.5% and also soared 107.6% year over year on the back of revenues. Its 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.

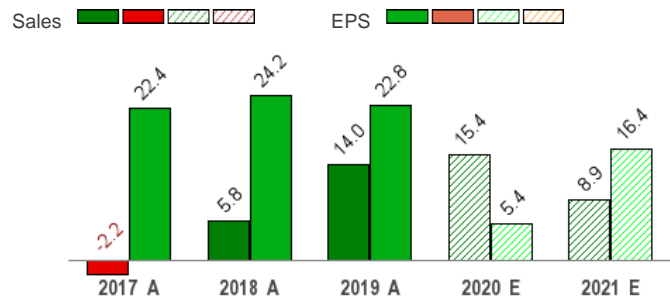
### Price, Consensus & Surprise



### Data Overview

|                            |                                |
|----------------------------|--------------------------------|
| 52 Week High-Low           | <b>\$425.46 - \$208.25</b>     |
| 20 Day Average Volume (sh) | <b>673,976</b>                 |
| Market Cap                 | <b>\$55.5 B</b>                |
| YTD Price Change           | <b>14.5%</b>                   |
| Beta                       | <b>0.86</b>                    |
| Dividend / Div Yld         | <b>\$2.50 / 0.6%</b>           |
| Industry                   | <b>Medical - HMOs</b>          |
| Zacks Industry Rank        | <b>Top 21% (52 out of 253)</b> |

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



|                           |                   |
|---------------------------|-------------------|
| Last EPS Surprise         | <b>21.5%</b>      |
| Last Sales Surprise       | <b>2.5%</b>       |
| EPS F1 Est- 4 week change | <b>-0.2%</b>      |
| Expected Report Date      | <b>11/04/2020</b> |
| Earnings ESP              | <b>-1.4%</b>      |
| P/E TTM                   | <b>16.6</b>       |
| P/E F1                    | <b>22.3</b>       |
| PEG F1                    | <b>1.8</b>        |
| P/S TTM                   | <b>0.8</b>        |

### Sales Estimates (millions of \$)

|      | Q1       | Q2       | Q3       | Q4       | Annual*  |
|------|----------|----------|----------|----------|----------|
| 2021 | 20,688 E | 20,638 E | 20,380 E | 20,187 E | 81,521 E |
| 2020 | 18,935 A | 19,083 A | 18,528 E | 18,585 E | 74,866 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 | \$5.91 E | \$7.49 E  | \$5.76 E | \$2.65 E  | \$21.91 E |
| 2020 | \$5.40 A | \$12.56 A | \$2.81 E | -\$1.24 E | \$18.83 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 08/10/2020. The reports text is as of 08/11/2020.

## 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 2019 with around 17 million members under its medical benefit plans and approximately 5 million members in its specialty product category.

Humana's medical and specialty insurance products allow members to access health care services primarily through its networks of health care providers.

Humana now manages its business through four segments:

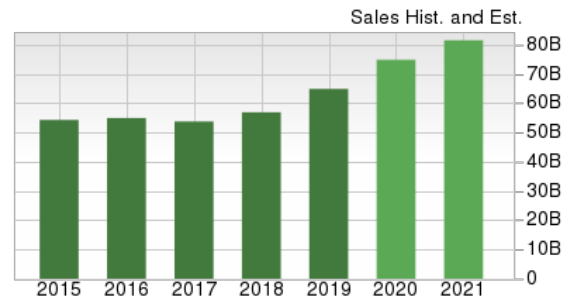
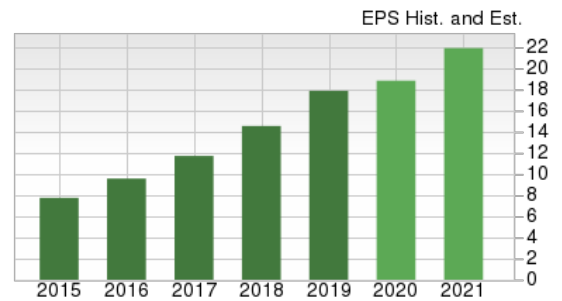
**The Retail segment (84.8% of the company's total revenue in 2019):** The segment consists of Medicare benefits, which are marketed on a retail basis to individuals. .

**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.



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## 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 now anticipated to be around 330,000-360,000 members, up from the earlier projected range of 300,000-350,000 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 in January, expanding its hospice pharmacy business line. These strategic initiatives set the company for long-term growth.

▲ **2020 Outlook:** Following second-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 330,000-360,000 members. Humana reiterated its expectations for group Medicare Advantage net membership gains. It expects an increase of 90,000 members in 2020, implying growth from the year-ago reported number. This robust outlook should instill investors' confidence in the stock.

▲ **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 six months of 2020, we believe, its financial strength will continue to boost investors' confidence.

▲ **Solid Capital Position:** The company's financial flexibility impresses. Its total debt is 35.1% (down from 39.2% as of Mar 31, 2020) of capital, almost in line with the industry's average of 38.2%. Also, its time interest earned stands at 19.7X, much higher than the industry average of 12.5X. As of Jun 30, 2020, the company had cash, cash equivalents and investment securities of \$20 billion, higher than its long-term debt of \$6 billion. Its solid solvency level impresses.

▲ **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.

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### Reasons To Sell:

▼ **Rising Expenses:** Humana has been witnessing a rise in the operating expenses since 2010 sans 2017 when operating expenses declined 6% owing to the receipt of Humana-Aetna merger termination fee. In the first six months of 2020, the metric again jumped 13.6% 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.

▼ **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 20.2X, higher than its industry average of 15.6X.

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

## Last Earnings Report

### Humana's Q2 Earnings Surpass Estimates, Improve Y/Y

Humana's second-quarter 2020 operating earnings per share of \$12.56 beat the Zacks Consensus Estimate by 21.5%. Moreover, the bottom line soared 107.6% year over year.

This upside can primarily be attributed to higher revenues witnessed by the company. However, Humana faced hospital admissions decline and lower utilization in April, which increased in May and June.

Quarter Ending **06/2020**

| Report Date      | Aug 05, 2020  |
|------------------|---------------|
| Sales Surprise   | <b>2.52%</b>  |
| EPS Surprise     | <b>21.47%</b> |
| Quarterly EPS    | <b>12.56</b>  |
| Annual EPS (TTM) | <b>25.27</b>  |

## Operational Update

Revenues of \$19 billion were up nearly 17.5% year over year. Moreover, the top line surpassed the Zacks Consensus Estimate by 2.5% on the back of better premium revenues from Medicare Advantage along with improved membership in state-based contracts and an increase in per member Medicare Advantage premiums.

Adjusted consolidated pre-tax income of \$2.4 billion surged 122% year over year.

Benefit ratio contracted 800 basis points (bps) to 76.4%.

Operating cost ratio expanded 180 bps to 12.4%.

## Segmental Results

### Retail

Revenues from the Retail segment were \$16.96 billion, up 20% year over year. This can primarily be attributed to premium rise owing to Medicare Advantage along with state-based contracts membership growth and higher per member Medicare Advantage premiums.

Benefit ratio of 78.3% contracted 690 bps year over year on temporary deferral of non-essential care amid the COVID-19 pandemic along with reinstatement of the non-deductible health insurance industry fee in 2020.

The segment's operating cost ratio of 9.7% expanded 120 bps year over year due to reinstatement of the non-deductible health insurance industry fee in 2020 along with COVID-19-related costs.

### Group and Specialty

Revenues from the Group and Specialty segment were \$1.84 billion, down 2% from the prior-year quarter due to reduction in fully-insured group commercial membership.

Benefit ratio contracted 1930 bps year over year to 67% on temporary postponement of non-essential care amid the coronavirus outbreak along with reinstatement of the non-deductible HIF in 2020.

Operating cost ratio expanded 210 bps year over year to 23.8%.

### Healthcare Services

Revenues of \$6.94 billion increased 9% 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 100 bps year over year to 95.1% on the back of operational improvements along with decreased utilization resulting from COVID-19 in the company's provider services business and operating cost efficiencies, driven by the previously disclosed productivity initiatives.

## Financial Update

As of Jun 30, 2020, the company had cash and cash equivalents, and investment securities of \$20 billion, up 33.1% from the level at 2019 end. Debt-to-total capitalization as of Jun 30, 2020 was 35.1%, expanding 310 bps from the level as of Dec 31, 2019.

In the June quarter, cash flows provided by operating activities came in at \$3.1 million, up 114% year over year.

## Capital Deployment

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

It paid out cash dividends worth \$83 million in the period.

## 2020 Guidance

After announcing second-quarter results, the company reaffirmed its 2019 guidance. Adjusted EPS is still expected in the range of \$18.25-\$18.75.

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The full-year individual Medicare Advantage membership is now anticipated to be around 330,000-360,000 members, up from the earlier projected range of 300,000-350,000 members.

Humana reiterated its expectations for group Medicare Advantage net membership gains. It 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.

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## Recent News

### Humana's Initiatives to Help Dental Providers Manage Costs - Jun 15, 2020

Humana announced initiatives to support participating dental providers in meeting heavy expenses related to their continuing businesses during the coronavirus pandemic. On resuming more dental procedures, the company will pay an extra \$7 per Humana member dental claim. This is applicable to all fully-insured Humana dental members.

The company remains committed to cater this service to its members, which will assure that its dental provider partners can afford the purchase of Personal Protective Equipment (PPE), an essential kit for the safety of patients.

Per the new announcement, at the end of each month, the dental provider partners will receive a stipend from the company, depending on the number of claims made by Humana members in that period.

### Humana's Unit to Launch Primary Care Centers for Seniors — Jun 2, 2020

Humana subsidiary Partners in Primary Care recently announced the first phase of its three-year expansion project. It will open 20 new senior-focused primary care centers in a year's time with eight in Las Vegas and two in the Shreveport-Bossier City, LA. The company also has plans to penetrate further in Houston with 10 more centers.

### 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.

## Valuation

Humana's shares are up 15% and 44% 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 0.5% and 2.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 20% and 11%, respectively.

The S&P 500 index is up 5% in the year-to-date period and 19% in the past year.

The stock is currently trading at 20.27x forward 12-month earnings, which compares to 16.02x for the Zacks sub-industry, 22.12x for the Zacks sector and 22.75x for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.59x and as low as 11.04x, with a 5-year median of 19.12x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$441 price target reflects 21.29x 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       | 20.27 | 16.02        | 22.12  | 22.75   |
|                           | 5-Year High   | 22.59 | 20.58        | 23.16  | 22.75   |
|                           | 5-Year Low    | 11.04 | 12.48        | 15.89  | 15.25   |
|                           | 5-Year Median | 19.12 | 16.02        | 18.97  | 17.58   |
| P/S F12M                  | Current       | 0.7   | 0.8          | 2.81   | 3.66    |
|                           | 5-Year High   | 0.81  | 0.86         | 3.41   | 3.66    |
|                           | 5-Year Low    | 0.38  | 0.48         | 2.21   | 2.53    |
|                           | 5-Year Median | 0.59  | 0.69         | 2.9    | 3.04    |
| P/B TTM                   | Current       | 3.85  | 3.27         | 4.39   | 4.67    |
|                           | 5-Year High   | 4.6   | 4.07         | 5.07   | 4.67    |
|                           | 5-Year Low    | 2.1   | 2.3          | 2.93   | 2.83    |
|                           | 5-Year Median | 3.23  | 3.19         | 4.29   | 3.72    |

As of 08/10/2020

## Industry Analysis Zacks Industry Rank: Top 21% (52 out of 253)



## Top Peers

| Company (Ticker)                          | Rec        | Rank |
|---|------------|------|
| Select Medical Holdings Corporation (SEM) | Outperform | 1    |
| Anthem, Inc. (ANTM)                       | Neutral    | 3    |
| Centene Corporation (CNC)                 | Neutral    | 3    |
| CVS Health Corporation (CVS)              | Neutral    | 3    |
| The Joint Corp. (JYNT)                    | Neutral    | 2    |
| Magellan Health, Inc. (MGLN)              | Neutral    | 3    |
| Molina Healthcare, Inc (MOH)              | 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)                      | 3       | -          | -         | 3              | 3         | 3         |
| VGM Score                                    | A       | -          | -         | A              | A         | A         |
| Market Cap                                   | 55.53 B | 2.34 B     | 23.56 B   | 70.13 B        | 36.51 B   | 303.25 B  |
| # of Analysts                                | 11      | 8          | 14        | 11             | 12        | 13        |
| Dividend Yield                               | 0.60%   | 0.00%      | 1.71%     | 1.36%          | 0.00%     | 1.57%     |
| Value Score                                  | A       | -          | -         | A              | A         | B         |
| Cash/Price                                   | 0.36    | 0.30       | 0.07      | 0.45           | 0.39      | 0.08      |
| EV/EBITDA                                    | 9.73    | 9.40       | 13.39     | 7.44           | 12.50     | 14.17     |
| PEG Ratio                                    | 1.80    | 1.52       | 2.92      | 0.85           | 0.92      | 1.52      |
| Price/Book (P/B)                             | 3.85    | 2.21       | 3.18      | 2.04           | 1.45      | 4.56      |
| Price/Cash Flow (P/CF)                       | 18.64   | 11.42      | 12.69     | 11.42          | 9.44      | 17.46     |
| P/E (F1)                                     | 22.26   | 15.93      | 22.16     | 12.44          | 12.91     | 19.25     |
| Price/Sales (P/S)                            | 0.79    | 0.62       | 2.55      | 0.62           | 0.40      | 1.22      |
| Earnings Yield                               | 4.49%   | 5.73%      | 4.33%     | 8.04%          | 7.75%     | 5.19%     |
| Debt/Equity                                  | 0.42    | 0.59       | 0.77      | 0.58           | 0.66      | 0.60      |
| Cash Flow (\$/share)                         | 22.51   | 6.68       | 6.94      | 24.42          | 6.68      | 18.28     |
| Growth Score                                 | A       | -          | -         | A              | A         | A         |
| Hist. EPS Growth (3-5 yrs)                   | 26.89%  | 26.09%     | 10.41%    | 18.14%         | 28.45%    | 25.29%    |
| Proj. EPS Growth (F1/F0)                     | 5.37%   | 10.32%     | -6.51%    | 15.32%         | 10.37%    | 9.68%     |
| Curr. Cash Flow Growth                       | 17.03%  | 14.42%     | 5.26%     | 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                                | 1.69    | 1.46       | 1.34      | 1.64           | 1.22      | 0.84      |
| Debt/Capital                                 | 29.59%  | 37.57%     | 44.59%    | 36.58%         | 39.94%    | 38.56%    |
| Net Margin                                   | 4.96%   | 4.51%      | 10.13%    | 5.24%          | 1.70%     | 6.90%     |
| Return on Equity                             | 26.70%  | 19.01%     | 14.59%    | 19.44%         | 14.07%    | 29.28%    |
| Sales/Assets                                 | 2.15    | 1.39       | 0.51      | 1.39           | 1.74      | 1.36      |
| Proj. Sales Growth (F1/F0)                   | 15.38%  | 8.58%      | -1.54%    | 14.93%         | 48.27%    | 5.33%     |
| Momentum Score                               | C       | -          | -         | B              | F         | C         |
| Daily Price Chg                              | 0.44%   | 0.67%      | 0.91%     | 0.79%          | -1.99%    | 0.65%     |
| 1 Week Price Chg                             | 6.50%   | 2.88%      | 2.30%     | 1.04%          | -1.49%    | 4.71%     |
| 4 Week Price Chg                             | 9.92%   | 7.78%      | 8.54%     | 8.26%          | -0.83%    | 6.47%     |
| 12 Week Price Chg                            | 6.98%   | 7.88%      | 13.68%    | -0.40%         | -7.00%    | 8.77%     |
| 52 Week Price Chg                            | 42.43%  | 2.27%      | 3.71%     | -1.11%         | 31.31%    | 31.21%    |
| 20 Day Average Volume                        | 673,976 | 238,689    | 2,015,804 | 1,214,398      | 3,011,970 | 2,923,347 |
| (F1) EPS Est 1 week change                   | -0.24%  | 0.00%      | 0.00%     | 0.00%          | 0.00%     | 0.00%     |
| (F1) EPS Est 4 week change                   | -0.24%  | 0.00%      | 1.67%     | 0.18%          | -0.87%    | 1.54%     |
| (F1) EPS Est 12 week change                  | 0.78%   | 1.41%      | 2.27%     | 0.89%          | 2.67%     | 1.93%     |
| (Q1) EPS Est Mthly Chg                       | 5.20%   | -3.63%     | 0.67%     | -5.73%         | -9.11%    | -22.95%   |



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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   | A |
| Momentum Score | C |
| 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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