

Humana Inc. (HUM)

\$313.91 (As of 03/13/20)

Price Target (6-12 Months): **\$330.00**

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:C

Value: C

Growth: D

Momentum: C

Summary

Humana is well-poised for growth on the back of its strong Medicare business, inorganic growth strategy and operating initiatives. The shares of the company have outperformed the industry in a year's time. Its top-line has been witnessing an uptrend for the past several years. Acquisitions, alliances with several companies and dispositions place Humana 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. Nevertheless, we believe that a strong 2020 outlook should instill investor confidence in the stock. However, its escalating expenses weigh on the bottom line. An increase in leverage might lead to heightened financial risk and put stress on margin expansion.

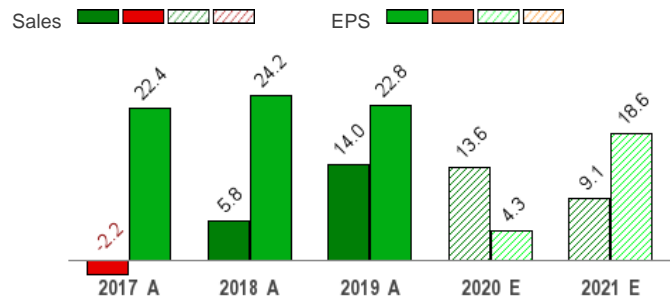
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|--------------------------------|
| 52 Week High-Low | \$385.00 - \$225.65 |
| 20 Day Average Volume (sh) | 1,526,639 |
| Market Cap | \$41.5 B |
| YTD Price Change | -14.4% |
| Beta | 0.89 |
| Dividend / Div Yld | \$2.50 / 0.7% |
| Industry | Medical - HMOs |
| Zacks Industry Rank | Top 43% (108 out of 253) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 3.6% |
| Last Sales Surprise | 0.9% |
| EPS F1 Est- 4 week change | 0.0% |
| Expected Report Date | 04/29/2020 |
| Earnings ESP | 0.4% |
| P/E TTM | 17.6 |
| P/E F1 | 16.8 |
| PEG F1 | 1.2 |
| P/S TTM | 0.6 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|----------|----------|----------|----------|----------|
| 2021 | 19,999 E | 20,044 E | 19,818 E | 19,892 E | 80,457 E |
| 2020 | 18,376 E | 18,465 E | 18,340 E | 18,426 E | 73,715 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 | \$5.65 E | \$7.36 E | \$6.20 E | \$2.93 E | \$22.10 E |
| 2020 | \$4.53 E | \$6.33 E | \$5.22 E | \$2.56 E | \$18.64 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 03/13/2020. The reports text is as of 03/16/2020.

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:

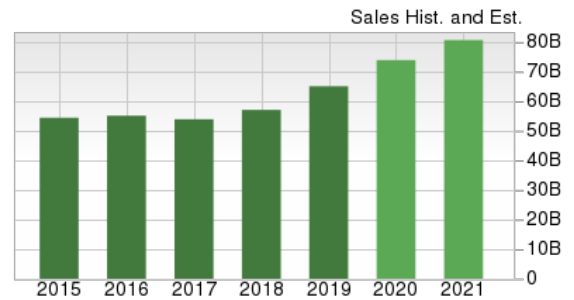
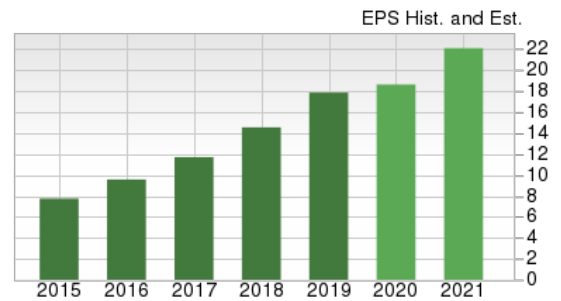
The Retail segment (84.8% of the company's total revenue in 2019): The segment consists of Medicare benefits, which are marketed on a retail basis to individuals. .

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. 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% in 2019, Individual Medicare membership rose 17.1% year over year in the same time frame, which is a positive. The company expects 2020 Individual Medicare Advantage membership growth of 270,000 - 330,000 members, representing 7.5-9.2% growth from the reported 2019 figure. Over the past decade, the company saw maximum growth in Individual Medicare Advantage during 2019.

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:** Humana anticipates adjusted EPS in the band of \$18.25-\$18.75 for 2020, indicating an upside of 3.5% from the prior-year reported figure. Total revenues for the year are anticipated in the range of \$73.9-\$74.5 billion, the midpoint suggesting a 14.3% rise from the year-ago reported number. This strong view should 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. For 2020, the company expects cash flow from operations in the range of \$3.2-\$3.6 billion. 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, which is set to expire Jun 30, 2022. We believe that its financial strength will continue to inspire investors' confidence.

▲ **Price Performance:** In a year, shares of the company have gained 11.2%, outperforming its industry's rally of 2.5%. Moreover, its solid fundamentals like growing revenues on inorganic growth are likely to drive its shares going forward.

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 14.7%, respectively, during 2018 and 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 50.95% in 2019. It currently stands at 41.3%. Also, times interest earned, a ratio that measures the company's ability to pay its interest expenses, declined to 14.8 at the end 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 16.2, higher than its industry's average of 14.7.

Last Earnings Report

Humana's Earnings & Revenues Surpass Estimates in Q4

Humana's fourth-quarter 2019 operating earnings per share of \$2.28 beat the Zacks Consensus Estimate by 3.6%. However, the bottom line declined 14% on a year-over-year basis. This downside is due to the unfavorable impact of higher compensation accruals for the Annual Incentive Plan (AIP) offered to employees at all levels and planned investments in the company's integrated care delivery model.

Quarter Ending **12/2019**

| Report Date | Feb 05, 2020 |
|------------------|--------------|
| Sales Surprise | 0.87% |
| EPS Surprise | 3.64% |
| Quarterly EPS | 2.28 |
| Annual EPS (TTM) | 17.84 |

Operational Update

Revenues of \$16.3 billion were up nearly 15% year over year. Moreover, the top line exceeded the Zacks Consensus Estimate by 0.87%.

Adjusted consolidated pre-tax income of \$322 million decreased 32.9% year over year. Benefit ratio expanded 320 basis points (bps) to 86.6%. Operating cost ratio contracted 180 bps to 13.2%.

Segmental Results

Retail

Revenues from the Retail segment were \$14.21 billion, up 18% 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 86.3% expanded 230 bps year over year due to the 2019 HIF suspension, lower favorable prior-period development in the segment and the shift in Medicare membership mix. The segment's operating cost ratio of 11.6% contracted 130 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 \$1.88 billion, down 1.6% from the prior-year quarter due to a reduction in fully-insured group commercial as well as specialty membership and an unfavorable impact of a commercial risk adjustment (CRA) payable in the fourth quarter, inducing lower small group fully-insured commercial revenues year over year. Benefit ratio expanded 1060 bps year over year to 95.2% due to the effect of HIF suspension in 2019, an unfavorable impact of premium adjustment associated with CRA, lower prior-period development and the effect of continued migration of fully-insured group members.

Operating cost ratio contracted 150 bps year over year to 22.4%.

Healthcare Services

Revenues of \$6.7 billion increased 8% year over year, primarily owing to Medicare Advantage membership growth. Operating cost ratio was flat year over year at 96.8%.

Individual Commercial

Humana exited this business effective Jan 1, 2018.

Financial Update

As of Dec 31, 2019, the company had cash, cash equivalents and investment securities worth \$15.43 billion. Debt-to-total capitalization ratio as of Dec 31, 2019 was 32%, contracting 540 bps from the level on Dec 31, 2018.

Operating cash inflow totaled \$512 million at fourth-quarter end against cash outflow of \$333 million in the fourth quarter of 2018.

Capital Deployment

The company paid out cash dividends worth \$75 million in the quarter under review. In July 2019, its board of directors approved a share repurchase plan worth \$3 billion, which is set to expire Jun 30, 2022. In the same month, the company entered into an agreement with a third-party financial institution to implement a \$1-billion ASR program under the authorization. In the quarter under review, the company repurchased around 3,376,200 shares at an average price of \$296.19 under this plan. As of Feb 4, 2020, it had remaining share buyback authorization of \$2 billion.

2020 Guidance

Following fourth-quarter results, the company unveiled its guidance for 2020. Adjusted EPS is expected in the band of \$18.25-\$18.75.

Also, stand-alone PDP membership is expected to decline by 550,000 members for the period.

Recent News

Humana Announces Quarterly Dividend — Feb 20, 2020

The board of directors at Humana announced a quarterly cash dividend of 62.5 cents per share. The dividend will be paid out on Apr 24, 2020, to shareholders of record as of Mar 31.

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.

Valuation

Humana's shares are down 14.3% and up 11.2% 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 8.2% and 12.8% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 2.5% and down 13.8%, respectively.

The S&P 500 index is down 15.8% in the year-to-date period and down 5.2% in the past year.

The stock is currently trading at 16.2 trailing 12-month price to earnings ratio, which compares to 14.7 for the Zacks sub-industry, 17.9 for the Zacks sector and 15.7 for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.4 and as low as 12.9, with a 5-year median of 19.2. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$330 price target reflects 17.1 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 | 16.22 | 14.71 | 17.95 | 15.74 |
| | 5-Year High | 23.38 | 20.58 | 21.08 | 19.34 |
| | 5-Year Low | 12.87 | 12.48 | 15.81 | 15.18 |
| | 5-Year Median | 19.23 | 16.19 | 18.73 | 17.42 |
| P/S F12M | Current | 0.55 | 0.73 | 2.44 | 2.9 |
| | 5-Year High | 0.81 | 0.86 | 3.84 | 3.43 |
| | 5-Year Low | 0.41 | 0.48 | 2.44 | 2.54 |
| | 5-Year Median | 0.57 | 0.67 | 2.96 | 3 |
| P/B TTM | Current | 3.45 | 3.29 | 4 | 3.65 |
| | 5-Year High | 4.6 | 4.07 | 5.05 | 4.56 |
| | 5-Year Low | 2.1 | 2.46 | 3.45 | 2.85 |
| | 5-Year Median | 3.14 | 3.12 | 4.32 | 3.63 |

As of 03/13/2020

Industry Analysis Zacks Industry Rank: Top 43% (108 out of 253)



Top Peers

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

| Industry Comparison Industry: Medical - Hmos | | | | Industry Peers | | |
|--|-------------|------------|-----------|----------------|-------------|-------------|
| | HUM Neutral | X Industry | S&P 500 | ANTM Neutral | CNC Neutral | UNH Neutral |
| VGM Score | C | - | - | B | D | A |
| Market Cap | 41.48 B | 2.55 B | 19.05 B | 68.21 B | 37.30 B | 258.05 B |
| # of Analysts | 11 | 4.5 | 13 | 10 | 11 | 12 |
| Dividend Yield | 0.70% | 0.00% | 2.31% | 1.18% | 0.00% | 1.59% |
| Value Score | C | - | - | B | B | B |
| Cash/Price | 0.31 | 0.31 | 0.05 | 0.36 | 0.38 | 0.05 |
| EV/EBITDA | 7.35 | 7.49 | 11.57 | 7.63 | 12.21 | 12.52 |
| PEG Ratio | 1.07 | 0.93 | 1.68 | 0.78 | 0.94 | 1.29 |
| Price/Book (P/B) | 3.45 | 2.46 | 2.56 | 2.16 | 2.08 | 4.26 |
| Price/Cash Flow (P/CF) | 13.94 | 10.96 | 10.18 | 11.07 | 9.52 | 14.89 |
| P/E (F1) | 14.86 | 13.42 | 14.94 | 12.06 | 13.42 | 16.51 |
| Price/Sales (P/S) | 0.64 | 0.53 | 2.02 | 0.65 | 0.50 | 1.07 |
| Earnings Yield | 5.94% | 7.34% | 6.67% | 8.29% | 7.46% | 6.05% |
| Debt/Equity | 0.41 | 0.58 | 0.70 | 0.56 | 1.08 | 0.61 |
| Cash Flow (\$/share) | 22.51 | 6.68 | 7.01 | 24.42 | 6.68 | 18.28 |
| Growth Score | D | - | - | A | D | A |
| Hist. EPS Growth (3-5 yrs) | 24.18% | 19.46% | 10.85% | 14.87% | 31.44% | 24.05% |
| Proj. EPS Growth (F1/F0) | 4.30% | 9.40% | 5.99% | 15.35% | 7.20% | 9.01% |
| Curr. Cash Flow Growth | 17.03% | 14.42% | 6.15% | 16.15% | 45.38% | 14.76% |
| Hist. Cash Flow Growth (3-5 yrs) | 12.98% | 13.62% | 8.52% | 12.87% | 49.67% | 19.53% |
| Current Ratio | 1.82 | 1.61 | 1.24 | 1.65 | 1.57 | 0.69 |
| Debt/Capital | 29.21% | 37.43% | 42.57% | 35.92% | 51.92% | 38.94% |
| Net Margin | 4.17% | 4.17% | 11.64% | 4.61% | 1.77% | 5.71% |
| Return on Equity | 20.89% | 16.89% | 16.74% | 16.34% | 15.18% | 25.55% |
| Sales/Assets | 2.25 | 1.43 | 0.54 | 1.36 | 2.09 | 1.43 |
| Proj. Sales Growth (F1/F0) | 13.60% | 11.13% | 3.54% | 13.62% | 42.35% | 8.66% |
| Momentum Score | C | - | - | F | F | D |
| Daily Price Chg | 7.12% | 6.32% | 8.21% | 5.51% | 11.27% | 8.64% |
| 1 Week Price Chg | 14.81% | 1.88% | -0.67% | 9.76% | 10.45% | 11.34% |
| 4 Week Price Chg | -17.44% | -11.68% | -22.67% | -9.55% | -3.52% | -9.98% |
| 12 Week Price Chg | -14.14% | -11.74% | -20.46% | -9.35% | 2.75% | -7.66% |
| 52 Week Price Chg | 12.18% | 0.83% | -10.79% | -11.49% | 7.06% | 7.41% |
| 20 Day Average Volume | 1,526,639 | 528,305 | 3,061,271 | 2,444,369 | 7,742,157 | 6,675,031 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | -0.55% | -0.24% | 0.00% |
| (F1) EPS Est 4 week change | 0.00% | -0.50% | -0.32% | -0.50% | -1.68% | 0.00% |
| (F1) EPS Est 12 week change | -0.24% | -1.01% | -0.65% | -1.68% | -1.01% | 0.16% |
| (Q1) EPS Est Mthly Chg | -1.43% | -1.65% | -0.62% | -1.65% | -18.48% | 0.00% |

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 | C |
| Growth Score | D |
| Momentum Score | C |
| VGM Score | C |

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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