Apr 17, 2020

Humana Inc. (HUM)

$377.31 (As of 04/16/20)

Price Target (6-12 Months): **$396.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/07/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: C | Growth: D | Momentum: C	**3-Hold** VGM:D

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. 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

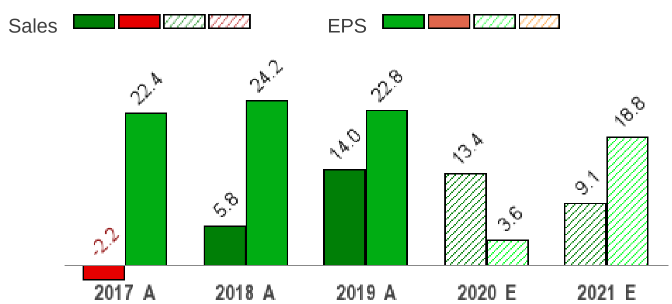
Data Overview

52 Week High-Low	**$385.00 - $208.25**
20 Day Average Volume (sh)	**1,916,400**
Market Cap	**$49.9 B**
YTD Price Change	**2.9%**
Beta	**0.79**
Dividend / Div Yld	**$2.50 / 0.7%**
Industry	**Medical - HMOs**
Zacks Industry Rank	**Top 33% (83 out of 253)**

Last EPS Surprise	**3.6%**
Last Sales Surprise	**0.9%**
EPS F1 Est- 4 week change	**-0.6%**
Expected Report Date	**04/29/2020**
Earnings ESP	**11.4%**

P/E TTM	**21.2**
P/E F1	**20.4**
PEG F1	**1.5**
P/S TTM	**0.8**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	19,999 E	20,044 E	19,818 E	19,892 E	80,281 E
2020	18,376 E	18,438 E	18,287 E	18,369 E	73,584 E
2019	16,107 A	16,245 A	16,241 A	16,295 A	64,888 A

EPS Estimates

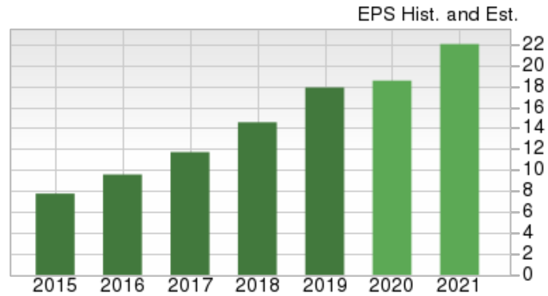
	Q1	Q2	Q3	Q4	Annual*
2021	$5.37 E	$7.43 E	$6.21 E	$3.12 E	$22.01 E
2020	$4.83 E	$7.19 E	$4.79 E	$1.79 E	$18.52 E
2019	$4.48 A	$6.05 A	$5.03 A	$2.28 A	$17.87 A

*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 04/16/2020. The reports text is as of 04/17/2020.

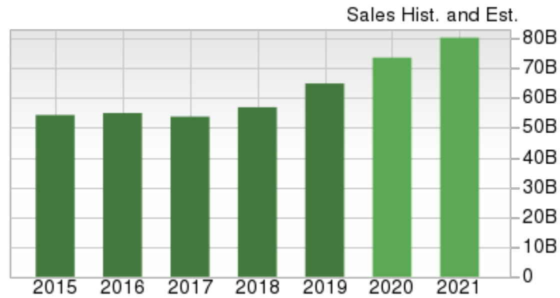
Overview

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:

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

- **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.

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

- **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.

- **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 17.2, higher than its industry's average of 13.2.

Last Earnings Report

Humana's Earnings & Revenues Surpass Estimates in Q4

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

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.

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 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.

Humana Extends Telehealth Services to Fight Coronavirus — Mar 25, 2020

Humana expanded the availability of telehealth services to reduce exposure to risks from the coronavirus outbreak. In these critical times, Humana continues to help its members with an array of added affordable and feasible services, which include early prescription refills, wider coverage of telehealth visits for urgent healthcare, etc. The provisions are applicable to the company's Medicare Advantage, Medicaid and commercial employer-sponsored plans.

Valuation

Humana's shares are up 3% and 56.8% 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 10.6% and 8.2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 18% and down 0.4%, respectively.

The S&P 500 index is down 13.6% in the year-to-date period and 5% in the past year.

The stock is currently trading at 19.2x forward 12-month earnings value, which compares to 15.03x for the Zacks sub-industry, 20.43x for the Zacks sector and 18.65x for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.38x and as low as 12.73x, with a 5-year median of 19.2x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $396 price target reflects 20.15x forward 12-month earnings value.

The table below shows summary valuation data for HUM

Valuation Multiples - HUM

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	19.2	15.03	20.43	18.65
	5-Year High	23.38	20.58	21.1	19.34
	5-Year Low	12.73	12.48	15.81	15.18
	5-Year Median	19.2	16.14	18.82	17.44
P/S F12M	Current	0.66	0.73	2.59	3.09
	5-Year High	0.81	0.86	3.84	3.43
	5-Year Low	0.41	0.48	2.26	2.55
	5-Year Median	0.57	0.67	2.96	3
P/B TTM	Current	4.14	3.38	3.54	3.69
	5-Year High	4.6	4.07	5.05	4.55
	5-Year Low	2.1	2.3	2.9	2.85
	5-Year Median	3.15	3.13	4.3	3.64

As of 04/16/2020

Industry Analysis **Zacks Industry Rank:** Top 33% (83 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	D	-	-	A	C	A
Market Cap	49.85 B	2.08 B	19.06 B	68.54 B	42.75 B	283.08 B
# of Analysts	11	4.5	14	10	11	12
Dividend Yield	0.66%	0.00%	2.26%	1.40%	0.00%	1.45%
Value Score	C	-	-	B	B	C
Cash/Price	0.33	0.33	0.06	0.43	0.33	0.06
EV/EBITDA	9.31	8.20	11.49	7.67	13.96	13.60
PEG Ratio	1.47	0.94	2.09	0.84	1.04	1.47
Price/Book (P/B)	4.15	2.32	2.55	2.17	2.39	4.73
Price/Cash Flow (P/CF)	16.76	11.13	10.06	11.13	10.91	16.33
P/E (F1)	20.37	14.39	17.56	12.31	15.26	18.34
Price/Sales (P/S)	0.77	0.62	1.94	0.66	0.57	1.15
Earnings Yield	4.91%	6.75%	5.57%	8.13%	6.55%	5.45%
Debt/Equity	0.41	0.58	0.70	0.56	1.08	0.60
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%	10.92%	14.87%	31.44%	24.05%
Proj. EPS Growth (F1/F0)	3.65%	8.01%	-3.36%	13.64%	8.02%	7.70%
Curr. Cash Flow Growth	17.03%	14.42%	5.93%	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	1.82	1.61	1.24	1.65	1.57	0.75
Debt/Capital	29.21%	37.22%	42.78%	35.92%	51.92%	38.53%
Net Margin	4.17%	4.17%	11.64%	4.61%	1.77%	5.59%
Return on Equity	20.89%	16.89%	16.74%	16.34%	15.18%	24.86%
Sales/Assets	2.25	1.40	0.54	1.36	2.09	1.40
Proj. Sales Growth (F1/F0)	13.40%	12.17%	-0.14%	12.88%	44.30%	7.25%
Momentum Score	C	-	-	D	B	B
Daily Price Chg	6.72%	1.95%	-0.20%	8.53%	5.55%	5.95%
1 Week Price Chg	17.24%	18.25%	16.01%	19.26%	21.65%	15.09%
4 Week Price Chg	47.28%	26.57%	14.56%	35.33%	35.91%	35.77%
12 Week Price Chg	3.78%	-9.87%	-22.94%	-10.70%	7.10%	-0.34%
52 Week Price Chg	56.76%	-7.20%	-15.02%	13.45%	51.14%	34.58%
20 Day Average Volume	1,916,400	310,992	3,220,598	2,483,484	5,427,915	6,096,793
(F1) EPS Est 1 week change	-1.27%	-0.11%	0.00%	-1.90%	-0.23%	-0.83%
(F1) EPS Est 4 week change	-0.63%	-0.31%	-7.09%	-2.45%	1.13%	-1.17%
(F1) EPS Est 12 week change	-0.87%	-0.87%	-9.32%	-4.15%	-0.68%	-1.13%
(Q1) EPS Est Mthly Chg	13.62%	5.86%	-10.68%	3.65%	23.06%	8.07%

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	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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