

Magellan Health, Inc. (MGLN)

\$73.25 (As of 07/06/20)

Price Target (6-12 Months): **\$76.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/05/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: C

Summary

Magellan Health's shares have underperformed its industry in a year's time. Strategic acquisitions and alliances over the years in both its segments, namely Healthcare and Pharmacy Management, led to a healthy inorganic profile through business expansion across different markets, products and service verticals. Magellan Health has entered into a definitive agreement to sell its Magellan Complete Care (MCC) business to Molina Healthcare for \$850 million. Its revenues are under pressure due to weak Behavioral & Specialty Healthcare and Pharmacy Management businesses. The company's low return on equity compared with the industry average adds to the stock's unattractiveness. Suspension of share buybacks and dividend payments are other dampeners.

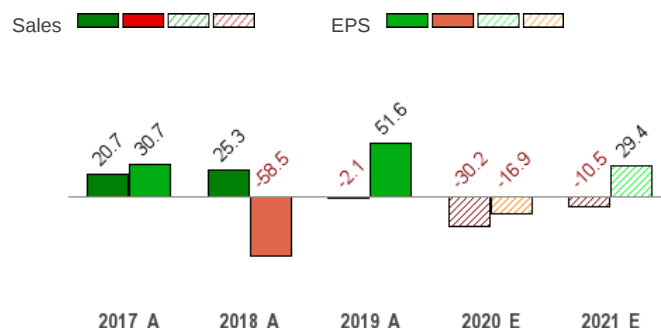
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$81.04 - \$30.60
20 Day Average Volume (sh)	164,940
Market Cap	\$1.8 B
YTD Price Change	-6.4%
Beta	1.22
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<u>Medical - HMOs</u>
Zacks Industry Rank	Top 18% (45 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	69.1%
Last Sales Surprise	1.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	08/04/2020
Earnings ESP	0.0%
P/E TTM	16.4
P/E F1	23.6
PEG F1	1.0
P/S TTM	0.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					4,473 E
2020	1,794 A	1,047 E	1,090 E	1,065 E	4,996 E
2019	1,739 A	1,788 A	1,829 A	1,803 A	7,159 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$4.01 E
2020	\$1.15 A	\$0.50 E	\$0.41 E	\$0.50 E	\$3.10 E
2019	\$0.40 A	\$0.86 A	\$1.23 A	\$1.24 A	\$3.73 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 07/06/2020. The reports text is as of 07/07/2020.

Overview

Founded in 1969, Magellan Health offers healthcare management services in the United States. It is headquartered in Scottsdale, AZ.

The company has two segments, namely, **Healthcare** (contributed 71% of the company's total 2019 revenues) and **Pharmacy Management** segments (39%).

The Healthcare segment is further broken into two reporting units — Behavioral & Specialty Health and Magellan Complete Care (MCC)

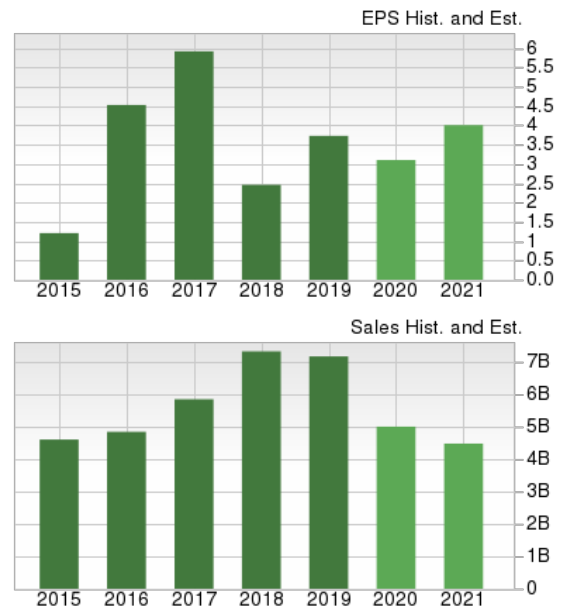
The **Behavioral & Specialty Health** reporting unit's customers include health plans, accountable care organizations, employers, state Medicaid agencies, the United States military and various federal government agencies for which Magellan provides carve-out management services for behavioral health, employee assistance plans (EAPs) and other areas of specialty healthcare including diagnostic imaging, musculoskeletal management, cardiac and physical medicine.

MCC largely focuses on managing care for special populations including individuals with serious mental illness (SMI), dual eligibles, the aged, blind and the disabled (ABD) and other populations with unique and often complex healthcare needs.

The **Pharmacy Management** segment consists of products and solutions, which provide financial and clinical management of pharmaceuticals. It offers pharmacy benefit management services, pharmacy benefit administration for state Medicaid and other government sponsored programs, pharmaceutical dispensing services, clinical and formulary management programs, medical pharmacy management programs and programs for the integrated management of specialty drugs that treat complex conditions.

These services are available individually, in combination or on a fully integrated manner. The company markets its pharmacy management services to health plans, employers, third-party administrators, state governments, Medicare Part D beneficiaries, government agencies, exchanges, brokers and consultants.

Pharmacy Management enter into contracts with its customers for services using risk-based, gain share or ASO arrangements. In addition, the Pharmacy Management segment provides services to the MCC reporting unit within the Healthcare segment.



Reasons To Buy:

▲ **Strategic Acquisitions:** Over the years, the company has expanded its capabilities through a series of acquisitions. In Healthcare segment, a number of acquisition from 2013-2017 expanded the company's MCC reporting unit. Magellan also increased its presence within the federal marketplace through the acquisition of Armed Forces Services Corporation ("AFSC") in 2016, which falls under the Behavioral & Specialty Health reporting unit. Notably, in pharmacy management, buyouts from 2013-2016 expanded the company's presence in the Pharmacy benefit management market. These transactions expanded its business portfolio, leading to long-term growth.

Magellan Health growth initiatives and strategic buyouts poise the company well for long-term growth.

▲ **Business Streamlining:** Magellan Health has entered into a definitive agreement to sell its Magellan Complete Care (MCC) business to Molina Healthcare for \$850 million. The sale eliminates the risk involved in the company's ability to execute its MCC profitability improvement initiatives and allows the leadership team to focus on the remaining businesses, which provide high returns. The transaction is expected to be completed by the end of the first quarter of 2021. On May 11, 2020, the company announced its decision to exit the Medicare Part D business by this year-end and fully dedicate Magellan Rx's Medicare team to concentrate on continued growth across its health plan and employer Pharmacy Benefit Management business.

▲ **Operational Efficiency Improve:** The company continues to progress well on its operational efficiency improvements. It is working to achieve a more industry competitive administrative cost structure in 2020 and beyond. These initiatives are expected to result in cost improvement of nearly \$30 million by 2021 and nearly \$75 million by 2022. We believe these initiatives will drive margin recovery. The company targets a long-term goal of at least 2% adjusted net income margin (by 2021).

▲ **Favorable Solvency Position:** The company's debt-to-equity ratio declined in 2020, strengthening its balance sheet. Its debt-to-equity ratio of 45.24% is lower than the industry average of 62.4% and was also down from 48.54% as of Dec 31, 2019. Its times interest earned, which shows its interest servicing capability, has improved to 4.2X from 3.24X in the previous quarter. Thus, the company's solvency position looks encouraging.

▲ **Share Price Performance:** In a year's time, the stock has underperformed its industry. Nevertheless, the company's progress on fundamentals should further aid its stock price. The company's long-term earnings growth rate of 18.1% is higher than the industry's growth rate of 13.5%.

Reasons To Sell:

- ▼ **Tepid Revenue Growth:** The company witnessed steady top-line improvement over the years, which is evident from its six-year CAGR of 14.7% (2012-2018). However, for 2019, the same was down 2% year over year. In the first quarter of 2020 revenues increased 3% year over year. For 2020, the company expects total revenues in the band of \$7 billion to \$7.4 billion implying that it will remain at levels consistent with the figure reported in 2019.
- ▼ **Increase in Cost of Care and Low Profitability:** The company experienced a 4.7% increase in cost of care during 2019, which weighed on its margins due to 2.1% revenue dip. Also return on equity (ROE) undermines its growth potential. Its trailing 12-month ROE of 8% compares unfavorably with the industry average of 22.5%, suggesting that it is less efficient in using shareholders' funds .
- ▼ **Tepid Guidance:** For 2020 adjusted earnings per share of \$3.34 to \$4.14 are expected. The mid-point of the guidance indicates that earnings will remain flat year over year. The company also anticipates 2020 segment profit in the range of \$250 million to \$280 million, and revenues for the year in the range of \$7 billion to \$7.4 billion. The mid-point of revenue guidance also suggests no growth year over year.
- ▼ **Absence of Share Buyback and Dividends:** The company made no share repurchases during the fourth quarter of 2019 and in the first quarter of 2020. It also does not expect to pay any dividend in 2020. We perceive this suspension of share buyback and dividend payout not bode well with investors as the concerns about revenue decline and cost escalation persist.

Declining revenues, decline in earnings in Pharmacy business, low profitability makes the stock look unattractive.

Last Earnings Report

Magellan Q1 Earnings Top on Lower Medical Utilization

Magellan Health, Inc.'s first-quarter 2020 earnings of \$1.15 per share beat the Zacks Consensus Estimate by 69.12% as well as the year-ago bottom line of 40 cents.

Moreover, revenues of \$1.79 billion for the quarter ended Mar 31, 2020 surpassed the Zacks Consensus Estimate by 1.61% and also rose 2.9% year over year. The top line trumped the consensus estimate in all the last four quarters.

Segmental profit soared 64% year over year to \$74.8 million. The company gained from reduced levels of medical utilization toward the end of March due to a decline in elective services across its healthcare businesses.

Healthcare segment's profit of \$62.1 million was up 35% year over year, driven by favorable prior-period development and utilization results, particularly in the MCC Magellan Complete Care of Virginia and New York as well as in the reinstatement of the Health Insurer Fee.

Pharmacy Management segment's profit of \$20.9 million skyrocketed 152% year over year on the back of improved gross margins from the company's PBM business as well as a strong performance within its specialty drug management portfolio.

Total costs and expenses rose 5.6% year over year to \$1.76 billion due to higher cost of care, direct service costs and other operating expenses plus depreciation and amortization.

Capital Position

Cash flow from operations for the quarter was \$31.7 million, down 10.5% year over year.

As of Mar 31, 2020, the company's cash and cash equivalents totaled \$383.9 million, up 18% from the level on Dec 31, 2019.

As of Mar 31 2020, total assets of the company increased 4.3% to \$3.2 billion from the figure at 2019 end.

Total stockholder's equity inched up 2.4% sequentially to \$1.43 billion as of Mar 31, 2020.

2020 Guidance

The company reaffirmed its earlier provided guidance for 2020, which calls for net revenues in the band of \$7-\$7.4 million, adjusted net income in the range of \$83-\$103 million, segmental profit between \$250 million and \$280 million and adjusted EPS in the \$3.34-\$4.14 bracket.

Business Update

On Apr 30, the company announced the sale of its Magellan Complete Care unit to Molina Healthcare Inc. for \$850 million in cash. Also, the latter entered into multiple long-term agreements with Magellan Health including the purchase of new medical pharmacy and musculoskeletal management services for more than 3 million Molina members and also retained it for behavioral health, radiology and musculoskeletal management services in certain MCC markets.

Quarter Ending 03/2020

Report Date	May 11, 2020
Sales Surprise	1.61%
EPS Surprise	69.12%
Quarterly EPS	1.15
Annual EPS (TTM)	4.48

Recent News

Magellan Health Expands Telehealth Services Amid COVID-19 Outbreak — Mar 20, 2020

Magellan Healthcare, the behavioral and specialty healthcare segment of the company, expanded telehealth services and implemented additional initiatives to support clients during the novel coronavirus (COVID-19) pandemic.

Magellan Healthcare revised its operations to permit all credentialed and contracted behavioral health providers to conduct telehealth video sessions for all routine services and certain psychological testing, applied behavior analysis (ABA), intensive outpatient programs (IOP) and partial hospitalization program (PHP) services. Providers are able to use a number of HHS OCR-approved platforms to perform their telehealth video sessions. Magellan is also allowing telephone-only sessions when a member has no access to a video platform. These alternative approaches will ensure members that they get proper care in times of urgency.

Magellan Health's Arizona Unit Provides Medicare Advantage D-SNP Plan — Jan 7, 2020

Magellan Health's unit Magellan Complete Care of Arizona has enhanced its current offerings and now provides a new Medicare Advantage Dual Special Needs Plan (D-SNP) for 2020.

Magellan Health's Virginia Arm Offers Medicare Advantage D-SNP Plan — Jan 2, 2020

Magellan Health's subsidiary Magellan Complete Care of Virginia has expanded its range of current offerings and now renders a Medicare Advantage Dual Special Needs Plan (D-SNP) for 2020.

Valuation

Magellan Health shares are down 7% and 0.06% in the year-to-date period, and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Medical sector are down 1.4% and 1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector is up 15.6% and 2.6%, respectively.

The S&P 500 index is down 1% in the year-to-date period and up 7.4% in the past year.

The stock is currently trading at 20.53x trailing a forward 12-month earnings, which compares with 15.68x for the Zacks sub-industry, 23.12x for the Zacks sector and 22.72x for the S&P 500 Index.

Over the past five years, the stock has traded as high as 44.59x and as low as 8x with a 5-year median of 16.73x. Our Neutral recommendation indicates that the stock will perform worse with the market. Our \$76 price target reflects 21.56x forward earnings.

The table below shows summary valuation data for MGLN

Valuation Multiples - MGLN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.53	15.68	23.12	22.72
	5-Year High	44.59	20.68	23.12	22.72
	5-Year Low	8	12.59	15.93	15.15
	5-Year Median	16.73	16.19	18.63	17.42
P/S F12M	Current	0.18	0.37	2.53	3.07
	5-Year High	0.41	0.84	3.84	3.44
	5-Year Low	0.11	0.33	2.25	2.54
	5-Year Median	0.28	0.53	2.95	3.01
P/B TTM	Current	0.95	3.44	4.49	4.44
	5-Year High	2.1	4.07	5.03	4.54
	5-Year Low	0.57	2.46	3.43	2.85
	5-Year Median	1.41	3.1	4.29	3.62

As of 07/06/2020

Industry Analysis Zacks Industry Rank: Top 18% (45 out of 251)



Top Peers

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

Industry Comparison Industry: Medical - Hmos				Industry Peers		
	MGLN	X Industry	S&P 500	CI	CNC	UNH
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	2	3
VGM Score	A	-	-	B	C	B
Market Cap	1.83 B	1.90 B	22.04 B	69.86 B	38.59 B	287.18 B
# of Analysts	3	7	14	13	12	13
Dividend Yield	0.00%	0.00%	1.89%	0.02%	0.00%	1.65%
Value Score	A	-	-	A	A	B
Cash/Price	0.40	0.30	0.07	0.08	0.28	0.09
EV/EBITDA	7.02	8.46	12.81	8.11	14.49	13.32
PEG Ratio	0.99	1.30	2.94	0.93	0.93	1.49
Price/Book (P/B)	1.28	2.09	3.01	1.56	1.63	4.79
Price/Cash Flow (P/CF)	8.05	11.02	11.87	6.98	9.98	16.57
P/E (F1)	23.50	16.70	21.54	10.28	13.66	18.61
Price/Sales (P/S)	0.25	0.62	2.35	0.45	0.47	1.17
Earnings Yield	4.23%	5.68%	4.39%	9.73%	7.32%	5.37%
Debt/Equity	0.45	0.60	0.76	0.71	0.72	0.60
Cash Flow (\$/share)	9.10	6.68	6.94	27.12	6.68	18.28
Growth Score	A	-	-	B	D	B
Hist. EPS Growth (3-5 yrs)	0.94%	23.51%	10.90%	19.22%	29.09%	24.13%
Proj. EPS Growth (F1/F0)	-16.80%	4.63%	-9.51%	8.05%	10.39%	7.66%
Curr. Cash Flow Growth	14.08%	14.42%	5.51%	138.17%	45.38%	14.76%
Hist. Cash Flow Growth (3-5 yrs)	3.37%	13.62%	8.55%	31.41%	49.67%	19.53%
Current Ratio	1.75	1.36	1.30	0.67	1.14	0.75
Debt/Capital	31.15%	38.01%	44.46%	41.65%	42.08%	38.53%
Net Margin	1.02%	3.86%	10.62%	3.19%	1.03%	5.59%
Return on Equity	8.02%	17.56%	15.75%	15.05%	11.47%	24.86%
Sales/Assets	2.30	1.40	0.55	0.99	1.87	1.40
Proj. Sales Growth (F1/F0)	-30.22%	9.65%	-2.57%	10.27%	48.75%	6.88%
Momentum Score	C	-	-	F	F	C
Daily Price Chg	0.34%	0.42%	1.12%	-0.61%	0.17%	1.53%
1 Week Price Chg	5.64%	5.03%	3.66%	2.93%	11.33%	3.97%
4 Week Price Chg	-4.77%	-1.49%	-7.12%	-12.28%	-0.82%	-2.16%
12 Week Price Chg	38.21%	14.38%	11.84%	6.68%	2.27%	14.91%
52 Week Price Chg	0.78%	-5.62%	-6.03%	17.07%	29.98%	22.18%
20 Day Average Volume	164,940	417,943	2,400,079	1,648,622	4,971,799	3,375,094
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.10%	0.38%	0.15%
(F1) EPS Est 4 week change	0.00%	0.14%	0.00%	-0.10%	3.57%	0.15%
(F1) EPS Est 12 week change	-17.90%	-0.94%	-8.26%	-0.25%	2.60%	-1.64%
(Q1) EPS Est Mthly Chg	0.00%	-5.73%	0.00%	-1.17%	-15.40%	-2.43%

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	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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