

1Q18 Earnings: Health Payers (AET, ANTM, CI, HUM and UNH)

TABLE 1: Health Payer Coverage

	Mkt. Price	Fwd.	YTD	Viola Advisory		Upside Potential		Dividend Yield
	5/24/18	P/E		Rating	PT	52-Week High	PT	
AET	177.05	14.6	-2.0%	Buy	205.00	10%	16%	1.12%
ANTM	230.62	13.7	2.0%	Hold	250.00	16%	8%	1.26%
CI	175.81	12.1	-13.2%	Buy	200.00	29%	14%	0.02%
HUM	293.59	17.6	16.7%	Buy	300.00	0%	2%	0.70%
UNH	242.77	17.0	9.8%	Buy	270.00	3%	11%	1.30%

Source: Yahoo Finance, Estimize.com, YCharts.com and Viola Advisory LLC

TABLE 2: 1Q18 Earnings Results

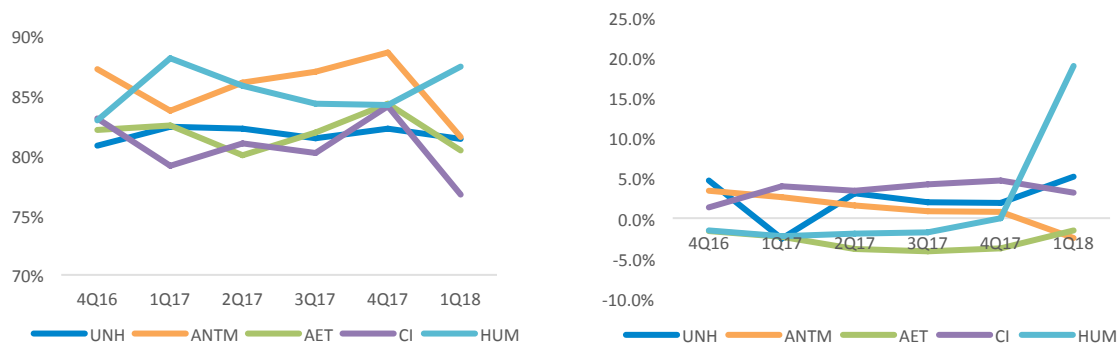
	1Q18 Results			2Q18 Guidance			1Q18 Results			2Q18 Guidance		
	EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
AET	3.19	2.97	beat	n/a	3.39	n/a	15.22B	15.32B	miss	n/a	15.64B	n/a
UNH	3.04	2.92	beat	n/a	3.04	n/a	55.19B	54.86B	beat	n/a	56.16B	n/a

	1Q18 Results			FY18 Guidance			1Q18 Results			FY18 Guidance		
	EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
ANTM	5.41	4.91	beat	> 15.30	15.13	beat	22.3B	22.52B	miss	91-92B	91.34B	beat
HUM	3.36	3.19	beat	13.70-14.10	13.87	in-line	14.28B	14.19B	beat	55.8-56.4B	56.1B	in-line
CI	4.11	3.37	beat	12.85-13.25	12.84	beat	11.42B	11.03B	beat	44.3-44.7B	44.34B	beat

Source: Company earnings release and Estimize.com

Key Health Payer Metrics:

FIGURE 1: Medical Cost Ratio (left) and Medical Enrollment Growth (right)



Source: Company earnings release

TABLE 3: Medical Cost Ratio

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
UNH	81%	82%	82%	81%	82%	81%
ANTM	87%	84%	86%	87%	89%	82%
AET	82%	83%	80%	82%	84%	80%
CI	83%	79%	81%	80%	84%	77%
HUM	83%	88%	86%	84%	84%	87%

Source: Company earnings release

TABLE 4: Medical Enrollment Growth

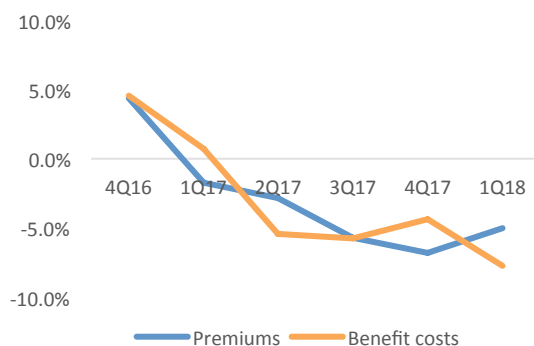
	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
UNH	4.7%	-2.5%	3.1%	2.0%	1.9%	5.2%
ANTM	3.4%	2.6%	1.6%	0.9%	0.8%	-2.5%
AET	-1.6%	-2.4%	-3.9%	-4.1%	-3.8%	-1.5%
CI	1.3%	4.0%	3.4%	4.2%	4.7%	3.2%
HUM	-1.5%	-2.3%	-1.9%	-1.8%	0.0%	19.0%

I. Aetna (AET): BUY @ \$205 PT

1Q18 Summary: We believe Aetna is one of the best managed companies in the health payer space with a medical cost ratio (“MCR”) of 80%, one of the lowest in the peer group next to Cigna’s (CI) 77% MCR and UnitedHealth Group’s (UNH) MCR of 81%. Furthermore, Aetna’s medical enrollment growth has gradually improved in 1Q18 with just a slight decline of -1.5% y/y. This is due to the rapid growth of Medicare Advantage membership, which expanded by 19.3% y/y in 1Q18. Aetna is the 5th largest health insurance payer in the Medicare space with roughly 2.5M members. We believe government programs like Medicare will be one of the fastest growth segments in the healthcare industry in the short term.

Additional Data Points:

FIGURE 2: Premium vs. Benefit Cost Growth: AET



Source: Company earnings release

TABLE 5: Aetna Premium vs. Benefit Cost Growth

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Premiums	4.4%	-1.8%	-2.8%	-5.7%	-6.8%	-5.0%
Benefit Costs	4.5%	0.7%	-5.5%	-5.7%	-4.3%	-7.7%

Source: Company earnings release

- Aetna’s y/y premium growth has declined steadily over the last 5 quarters but may have bottomed out in 4Q17. Premiums still declined by 5.0% y/y in 1Q18 but the rate of decline was much slower compared to the last two quarters (see Figure 2 and Table 5).
- Despite annual declines in premium growth, management successfully maintained tight control over benefit costs, lowering its y/y growth to roughly negative 8% in 1Q18 (see Figure 2 and Table 5).
- The slower growth of benefit costs relative to premium growth produced a medical cost ratio (“MCR”) of ~80% for AET in 1Q18, one of the best efficiency ratios in the peer group next to Cigna’s (CI) MCR of 77% and UnitedHealth Group’s (UNH) 81% MCR.

- Aetna’s MCR for its commercial group segment fell from 79.3% in 1Q17 to 77.5% in 1Q18 while the MCR for its Government group dropped from 85.3% in 1Q17 to 82.6% in 1Q18. The decline in both commercial and government MCRs dropped AET’s overall average MCR from 82.5% in 1Q17 to 80.4% in 1Q18.

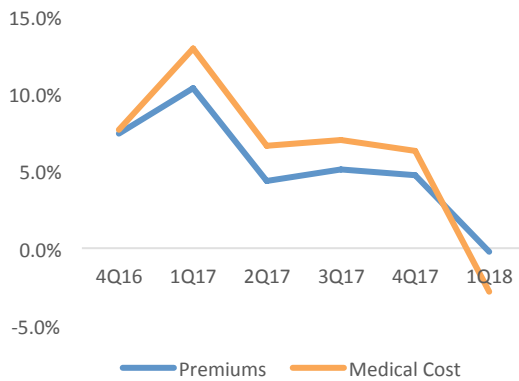
- Commercial group membership enrollment has declined to its slowest pace of -0.6% in 1Q18, a gradual improvement since bottoming out at -4.5% growth in 2Q17.
- Medicare Advantage enrollment grew an impressive 19.3% y/y in 1Q18 up from 8.3% y/y in 1Q17.

II. Anthem (ANTM): Hold @ \$250 PT

1Q18 Summary: Anthem’s growth rate of premiums continues to remain sluggish driven by the decline in membership in its commercial/specialty business segment. However, management kept the pace of benefits cost growth in line thus substantially reducing the MCR to 82% in 1Q18. On the positive side, Anthem continues to exhibit good momentum in Medicare membership growth with Medicare members growing by around 16% y/y in 1Q18.

Additional Data Points:

FIG. 3: Premium vs. Medical Cost Growth: ANTM



Source: Company earnings release

TABLE 6: Anthem Premium vs. Medical Cost Growth

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Premiums	7.4%	10.3%	4.3%	5.1%	4.7%	-0.2%
Medical Costs	7.7%	12.9%	6.6%	7.0%	6.3%	-2.8%

Source: Company earnings release

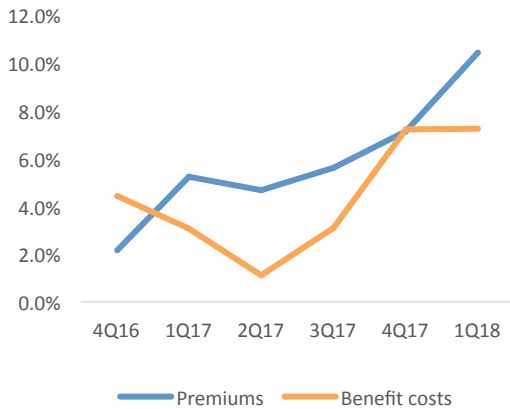
- Anthem’s pace of premium (74% of total revenue) growth continues to decline steadily from 10.3% y/y in 1Q17 to a growth of minus 0.2% y/y in 1Q18. However, management has kept the pace of growth of benefits expenses (down 2.8% y/y in 1Q18) roughly in line with the decline in premium growth (see Figure 3 and Table 6).
- Management’s ability to keep the pace of benefits growth in line with the growth in premiums enabled them to bring down Anthem’s MCR from 87% in 4Q16 to 82% in 1Q18 (see Figure 1 left and Table 3).
- However, the drop in MCR may not be due to greater efficiency measures but rather from the 3.6% decline in membership enrollment in the company’s commercial/specialty business segment (76% of total members). Membership for commercial/specialty business fell by 1.1M members from 1Q17.
- The decline in memberships also caused commercial/specialty business revenue to drop by around 12% y/y.
- Anthem continues to exhibit good momentum in Medicare membership growth with Medicare members growing by around 16% y/y in 1Q18 driven by the rise in Medicare Advantage Part D members (up 36.5% y/y).

III. Cigna (CI): Buy @ \$200 PT

1Q18 Summary: We view Cigna as one of the best managed health payers in the U.S. commercial health insurance space. Its commercial MCR stood at a record low of 73.7% while its government MCR was at 84.5% for a blended average of 76.7% for 1Q18. We believe the company still has a long runway in the Medicare space where it ranks No. 8 among its peer group in terms of Medicare enrollment. However, with CMS (Centers for Medicare and Medicaid Services) looking to grow the number of participating health payers in its Program, we are confident Cigna can grow its Government market share.

Additional Data Points:

FIGURE 4: Premium vs. Benefit Cost Growth: CI



Source: Company earnings release

TABLE 7: Cigna Premium vs. Benefit Cost Growth

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Premiums	2.1%	5.2%	4.7%	5.6%	7.1%	10.4%
Benefit Costs	4.4%	3.1%	1.1%	3.1%	7.2%	7.2%

Source: Company earnings release

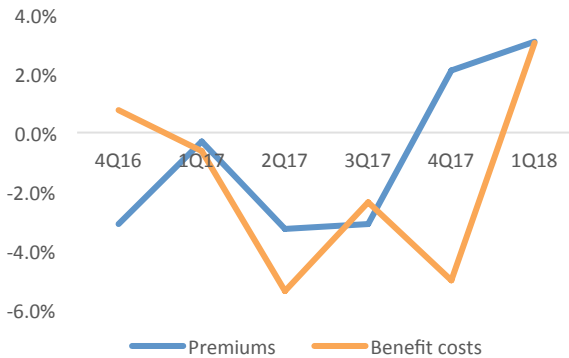
- Cigna’s premiums grew an impressive 10.4% y/y in 1Q18 (see Figure 4 and Table 7) driven by the rapid growth of Global Health care revenues (80% of total revenues) which grew 9.7% y/y and Global Supplemental benefits (10% of total revenues) which expanded by 21.2% y/y in 1Q18.
- Benefit cost growth was flat at 7.2% y/y in 1Q18. Management’s ability to outpace premium growth relative to its benefit costs enabled the company to achieve a MCR of 77%, the most efficient rating in the peer group for 1Q18 (see Figure 1 left and Table 3).
- U.S. commercial customer base (88% of total medical customers) grew a respectable 3.7% y/y in 1Q18, however, government enrollment (3% of total medical customers) fell by 3.6% y/y with Medicare enrollment dropping by around 2% y/y and Medicaid enrollment shrinking by 16% y/y.

IV. Humana (HUM): Buy @ \$300 PT

1Q18 Summary: After spending several quarters in a negative growth phase, Humana’s premium growth curve appears to have bottomed out in 3Q17 and has posted impressive positive gains in both 4Q17 (+2.4% y/y) and 1Q18 (+3.8% y/y). We believe the company can sustain its premium growth in the short run as the result of its recent TRICARE win and the continued growth momentum of both its individual and group Medicare plans. We believe CMS will continue to increase its Medicare spend for 2018 and 2019 as it looks to add more private sector participation to lower its existing cost base.

Additional Data Points:

FIGURE 5: Premium vs. Benefit Cost Growth: HUM



Source: Company earnings release

- Humana’s pace of premium growth accelerated in both 4Q17 and 1Q18 (see Figure 5 and Table 8), more than likely the result of its TRICARE (U.S. military health service contract) win from UNH. Benefit costs also expanded to 3.0% y/y in 1Q18, keeping pace with the growth of premiums.
- The TRICARE win could be a mixed blessing as the addition of roughly 2.9M military personnel (36% of total members) from 4Q17 to 1Q18 (up 92% q/q) grew military services revenue by around 28% y/y as well as operating costs, which grew by about 13% y/y, for 1Q18.
- Humana has the highest MCR in the peer group, at 87%, for 1Q18. The pace of growth was roughly flat from 1Q17 (see Figure 1 left and Table 3).

TABLE 8: Humana Premium vs. Benefit Cost Growth

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Premiums	-3.1%	-0.3%	-3.3%	-3.1%	2.1%	3.1%
Benefit Costs	0.8%	-0.6%	-5.4%	-2.4%	-5.0%	3.0%

Source: Company earnings release

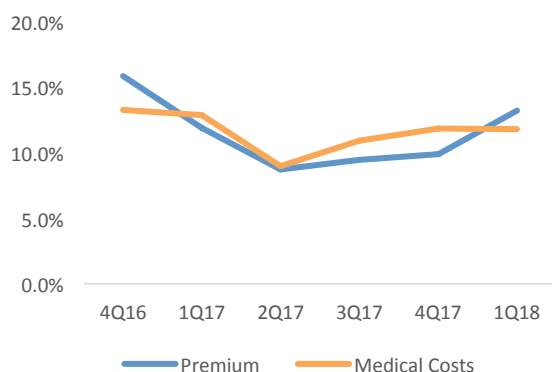
- Humana is the third largest health insurer in terms of Medicare Part D members (5.1M members), behind UnitedHealth (5.4M members) and CVS Health (5.5M members).
- Individual Medicare Advantage (MA) revenues (63% of total revenues) grew 7.1% y/y and Group MA revenues (11% of total revenues) also grew by 15.6% y/y in 1Q18. Medicare stand-alone Prescription Drug Plan (PDP) revenues fell by around 5% in 1Q18.
- Overall retail revenue growth, which comprise around 85% of total revenues and is largely Medicare plan based, grew by an impressive 5.8% y/y in 1Q18.

V. UnitedHealth Group (UNH): Buy @ \$270 PT

1Q18 Summary: UnitedHealth Group is the largest health insurance payer in the peer group ranking No. 2 in total Medicare enrollment and No. 3 Pharmacy Benefit Manager (PBM - OptumRx) in terms of prescription market share. We believe UNH is also one of the most efficiently managed health payers (81% MCR) with the most diversified revenue stream in the health payer space. The company also has a highly scalable platform that it can leverage to gain additional Medicare market share as CMS increasingly looks to shift provider reimbursement from a fee-for-service setting to more value-based positive health outcomes.

Additional Data Points:

FIGURE 6: Premium vs. Medical Cost Growth: UNH



Source: Company earnings release

- UNH premium growth curve appears to have bottomed in 2Q17 and heading gradually upward as 1Q18 premium growth accelerated at 13.2% y/y. Management, to its credit, kept benefit cost growth tightly in line with the growth of premium (see Figure 6 and Table 9).
- Tight cost management along with good benefit plan design enabled an 81% MCR for 1Q18, usually within the 81-82% range since 4Q16 and among the most stable within the peer group (see Figure 1 left and Table 3).
- UNH segment revenue (Commercial/US Government health plans) grew 13.3% y/y while Optum segment revenue (PBM and Primary Care Physician Groups) grew at a healthy 29.2% y/y in 1Q18.

TABLE 9: UNH Premium vs. Benefit Cost Growth

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Premiums	15.8%	11.9%	8.7%	9.4%	9.9%	13.2%
Medical Costs	13.2%	12.8%	9.0%	10.9%	11.8%	11.8%

Source: Company earnings release

- UNH segment earnings growth weakened slightly to 12.5% y/y (down from 15% y/y in 1Q17) due to the loss of the TRICARE contract within its U.S. commercial segment. Optum segment earnings continued to outperform growing at a 29.2% y/y pace from 15.6% y/y in 1Q17.
- UNH has the most diversified revenue stream within the health payer peer group. Commercial health insurance plans (HIPs) comprise 30% of total revenues and grew at 5.3% y/y for 1Q18. Medicare and retirement HIPs make up 42% of total revenues and grew 14.3% y/y while Community and State HIPs comprise 23% of total revenues and grew 19.2% y/y in 1Q18.
- OptumRx (PBM) revenues comprise 68% of total Optum revenue and grew at 7.8% y/y while OptumHealth (PCP groups) make up 24% of total Optum revenue and grew a healthy 21.7% y/y in 1Q18.
- Commercial medical member enrollment (55% of total medical members) fell by 625K members (due to TRICARE) while Medicare Advantage (MA) membership (10% of total members) grew 10.6% y/y in 1Q18. Medicaid enrollment (14% of total medical members) grew 8% y/y in 1Q18.
- UNH international medical member enrollment grew by an impressive 46.3% y/y in 1Q18.
- Medicare Part D (stand-alone) prescription drug plans continue to underperform and had a negative growth rate of 3.7% y/y in 1Q18.

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