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HUM.N - Q2 2023 Humana Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, and thank you for standing by. Welcome to the Second Quarter 2023 Humana Inc. Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to Lisa Stoner, Vice President of Investor Relations. Please go ahead.

Lisa M. Stoner - *Humana Inc. - VP of IR*

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Susan Diamond, Chief Financial Officer, will discuss our second quarter 2023 results and our financial outlook for 2023. Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. Joe Ventura, our Chief Legal Officer, will also be joining Bruce and Susan for the Q&A session.

We encourage the investing public and media to listen to both management's prepared remarks and the related Q&A with analysts. This call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, humana.com, later today.

Before we begin our discussion, I need to advise call participants of our cautionary statement. Certain of the matters discussed in this conference call are forward-looking and involve a number of risks and uncertainties. Actual results could differ materially.

Investors are advised to read the detailed risk factors discussed in our latest Form 10-K, our other filings with the Securities and Exchange Commission and our second quarter 2023 earnings press release as they relate to forward-looking statements, along with other risks discussed in our SEC filings. We undertake no obligation to publicly address or update any forward-looking statements and future filings or communications regarding our

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business or results. Today's press release, our historical financial news releases and our filings with the SEC are all also available on our Investor Relations site.

Call participants should note that today's discussion includes financial measures that are not in accordance with generally accepted accounting principles or GAAP. Management's explanation for the use of these non-GAAP measures and reconciliations of GAAP to non-GAAP financial measures are included in today's press release. Finally, any references to earnings per share or EPS made during this conference call refer to diluted earnings per common share.

With that, I'll turn the call over to Bruce Broussard.

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

Thank you, Lisa, and good morning, everyone, and thank you for joining us.

Today, Humana reported financial results for the second quarter of 2023 with adjusted earnings per share of $8.94, in line with our expectations. Results for the quarter include the impact of the higher-than-anticipated Medicare Advantage utilization recently disclosed, which has stabilized and is tracking in line with our updated expectations, and were supported by in line to slightly positive results from all other lines of business. We reaffirmed our full year 2023 adjusted EPS guidance of at least $28.25, which was an increase by $0.25 with our first quarter earnings release and reflects a 12% increase over 2022.

In addition, we are pleased to raise our guidance for full year individual MA membership growth by an additional 50,000 members. We now anticipate adding approximately 825,000 members in 2023, reflecting an impressive 18% growth rate. Our ability to deliver on our targeted earnings growth rate in 2023, while also achieving significant membership growth, is supported by our continued focus on making disciplined investments, driving productivity and delivering consistent quality, including STARS and Net Promoter Score.

In a moment, Susan will provide additional details on our second quarter performance and full year expectations, including a deeper dive into utilization trends. But first, I'd like to take a few minutes to reinforce the strength of Humana, including our differentiated capabilities that enable our leading platform, while highlighting the continued advancement of our integrated care delivery strategy.

I will start with the strength of our MA platform. The industry-leading individual MA growth we've achieved in 2023 creates significant momentum as we move into 2024 and advance towards our 2025 adjusted EPS target of $37. The growth we've seen in 2023 far exceeds initial expectations, and as previously shared, represents high-quality growth supported by better-than-expected retention and a greater proportion of our new sales coming from competitors than initially planned. We anticipate capturing 40% of the industry growth in 2023, increasing our overall market share by 170 basis points to just over 20% at year-end.

As part of the growth, we've seen a substantial increase in agents as a percentage of total sales. While full year sales are anticipated to be 44% higher in 2023 than in 2022, age-in sales are expected to be 75% higher year-over-year, representing a significant contributor to our successful sales performance.

The improvement in sales through agents further speaks the quality of our growth, as retention for age-ins runs approximately 5% to 8% better as compared to our overall new membership base at their first reenrollment cycle. Further, age-ins initially run a higher benefit expense ratio than average new member as the MA program is structured such that a plan only receives demographic-related risk adjustment payments for these individuals for the initial 18 months, which does not align with their health status and related risk, resulting in a larger margin expansion opportunity on these members over time. Our leading membership growth achieved in 2023, strong fundamentals and best-in-class quality positions as well to sustainable growth at or above the industry rate.

As we look ahead to 2024, we believe the MA industry will continue to see strong growth, fueled by MA's compelling value proposition compared to original Medicare, providing incremental benefits valued at approximately $2,400 annually.

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Throughout the 2024 MA bid preparation process, we were conscious of the disruption in shopping that's likely to occur in the market due to the benefit reductions expected in the industry as a result of the negative rate environment and the STARS headwind for the certain competitors. As a result of this disruption, we believe Humana has an opportunity for another robust year of membership growth.

Our 2024 product strategy was informed by extensive consumer and broker research and in-depth analytics regarding what Medicare-eligible consumers prefer. We focused on preserving benefits identified as most important, continuing to provide differentiated offerings that focus on improving health outcomes, and selectively enhancing our products with improvements such as increasing the number of members in 2024 that will be on a $0 premium plan. We are also prioritizing maintaining product value for duals, those eligible for Medicare and Medicaid, given the unique health care and social needs of this vulnerable population. Input from our clinical analytics and health equity teams helped inform product design choices that will continue to support the needs of our diverse customer population.

Importantly, we will enter the 2024 selling season in a position of strength, supported by momentum from our compelling 2023 growth and our continued industry-leading quality. The strength is bolstered by strong relationships with our broker partners as well as ongoing efforts to diversify our channel mix. This diversification includes the growth of our internal payer-agnostic channel, which was reinforced by our acquisition of IFG last August. We leveraged our best-in-class sales process and technology to quickly and efficiently integrate IFG, leading to a significant year-over-year channel growth with selling agents increasing by 26% and MA application volume more than doubling. We also take pride in the consistent recognition we received from organizations such as U.S. News and World Report and Forrester for our excellent customer experience and member-centric approach. All in, we are excited about the opportunity ahead.

Turning to Medicaid, our track record of organic success in this space continues and we are pleased to recently announce that Humana has been recommended by the Oklahoma Healthcare Authority to deliver health care coverage to Medicaid beneficiaries across the states, which is anticipated to start in early to mid-2024. After successfully implementing the Ohio and Louisiana contracts in early 2023, we look forward to beginning to serve members in both Indiana and Oklahoma in 2024, bringing our total Medicaid footprint to 9 states and approaching approximately 1.5 million members by year-end 2024.

Now moving to our CenterWell care delivery capabilities. We continue to expand our CenterWell Primary Care platform, now operating 258 centers serving 272,000 patients. Engaging and retaining patients is critical to driving improved health outcomes and advancing towards our $3 million contribution margin target in each center. We've seen improvement in both of these areas, with retention improving 220 basis points year-over-year, while the percentage of patients that have been seen at least once as of June 30 increased from 78% in 2022 to 87% in 2023.

Further, we remain on track to end the year at the high end of our previously-communicated annual center growth of 30 to 50 through a combination of de novo build and programmatic M&A. And I'm pleased with our progress our primary care organization is making to advance our clinical capabilities, driving operational efficiency, and implementing other actions that we believe will largely mitigate the ultimate impact of risk adjustment model changes that will be phased in over the next 3 years.

In Home, we continue to accelerate our value-based strategy, now covering approximately 830,000 members of our MA members under a value-based payment model covering home health, DME and infusion services, and expect to expand this in 2024 and beyond as we are on track towards our goal of covering 40% of our MA members with a value-based model by 2025.

We are seeing solid results from this model. In North Carolina and Virginia where the model was implemented in late 2022. CenterWell Home Health hospital admissions rates are approximately 210 basis points lower than other providers. In addition, our Home business also now manages DME spend under a value-based payment model for an additional 4.5 million Humana MA members, delivering incremental value to our Insurance segment. We expect positive enterprise value creation from the value-based home health model in 2023, and remain on target to drive $110 million to $150 million of annual enterprise value creation by 2025.

Within CenterWell Pharmacy, we continue to advance our clinical capabilities and are seeing a year-over-year increase in adherence measures. We've seen an increase in adherence to hypertension, hyperlipidemia, diabetes, medications ranging from 20 to 30 basis points year-over-year, which helps STARS and clinical outcome measures.

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Across these 3 categories, we continue to see that Humana members who utilize CenterWell pharmacy have fewer inpatient admits per 1,000 as compared to non-CenterWell Pharmacy users. In addition, our CenterWell Specialty Pharmacy demonstrates improved patient outcomes by driving longer therapy duration and higher adherence levels. As an example, patients in the Oncology Center of Excellence have a 1.8x longer duration and a 200 basis points better adherence than patients not engaged with the Center of Excellence.

Expansion of our CenterWell assets complement the integration of our individual health service businesses in local markets, which will create further value for our shareholders and for our customers.

Before turning it over to Susan, I'd like to give a brief update on the integration work we currently have underway. Our belief is we can deliver greater member and patient satisfaction, retention and clinical outcome for these members. This is based on our ability to further integrate clinical and operational workflows while delivering a more seamless experience for our common members and patients.

As an example, we estimate drug costs, review plan benefits and screen for patient assistance programs for members in our wholly-owned centers. In addition, our CenterWell Home Health and Primary Care teams review high-risk patients and collaborate on a more comprehensive care plan, prioritizing health-related concerns that go beyond the original home health orders, greatly reducing risk of complications and unnecessary ER visits and avoidable admissions. The primary care physician, the social worker and home health nurse work in coordination with the health plan to take advantage of planned benefits to address health-related social needs like food, housing and security, transportation needs and social isolation.

We will continue to innovate and advance towards a more integrated clinical model that leverages our collective Humana and CenterWell capabilities to deliver improved experiences and health outcomes for our members. We are encouraged by the early results of our integration work, and are actively expanding our focused markets from 2 in 2022 to more than 20 by year-end. We look forward to sharing more on this important work going forward.

In closing, I'd reiterate that Humana's fundamentals are strong, and we are confident in our ability to navigate through the near-term impacts of our higher-than-expected MA utilization while continuing to advance our strategy.

And importantly, we remain committed to our 2025 adjusted EPS target of $37, reflecting a 14% CAGR from 2022 to 2025. Our confidence in our ability to deliver on this compelling earnings growth target is supported by our impressive 2023 membership growth, strong MA positioning in 2024, consistent quality scores and continued growth and integration in CenterWell, all of which is complimented by our continued focus on productivity and disciplined capital deployment.

With that, I'll turn the call over to Susan.

Susan Marie Diamond - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone. Today, we reported second quarter 2023 adjusted earnings per share of $8.94, consistent with internal expectations. Results for the quarter are inclusive of the higher-than-anticipated utilization in our Medicare Advantage business we discussed last month, which as Bruce shared, has stabilized and is tracking in line with our updated estimates. I will provide additional detail on emerging trends in a moment.

The higher-than-anticipated utilization in the quarter was offset by better-than-expected favorable prior year development, a more positive midyear Medicare risk adjustment payment and slightly favorable investment income, as well as other business outperformance, particularly in our Medicaid business. Our performance to date reflects the strength of the enterprise, highlights our ability to successfully navigate near-term uncertainty, and importantly, includes better-than-anticipated individual Medicare Advantage membership growth.

We now expect to add approximately 825,000 members in 2023, reflecting an impressive 18% growth rate, fueling our ability to continue to deliver compelling earnings growth in the future. Further, for the full year, we have reaffirmed our adjusted EPS guidance of at least $28.25, which was

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increased by $0.25 with our first quarter earnings release and reflects a 12% increase over 2022, putting us on a solid path to our 2025 adjusted EPS target of $37.

I will now provide additional details on our second quarter performance and full year outlook, beginning with our Insurance segment. As highlighted in our 8-K filing last month, beginning in early May, we noted the emergence of higher-than-anticipated non-inpatient utilization trends in our Medicare Advantage business. At the same time, we began seeing higher-than-anticipated inpatient utilization diverging from historical seasonality patterns. These trends continued in early June. Based off of this intra-quarter information when we filed the 8-K on June 16, we made the assumption that we would continue to experience moderately higher-than-expected trend for the remainder of the year. We were pleased to see that our June paid claims data received in July reflected positive restatements for the first quarter, as well as stabilizing outpatient utilization levels in April and May. While July claims data is not yet complete, early views support our year-to-date booking levels.

With respect to inpatient activity, the higher than initially anticipated utilization has continued, consistent with our June update. All in, we view the utilization data received in recent weeks as incrementally positive as compared to the assumptions utilized in our June update. That said, we continue to point you to the top end of our full year Insurance segment benefit ratio guidance range of 86.3% to 87.3%, and will continue to monitor emerging trends. This guidance also contemplates the individual Medicare Advantage membership growth post the Annual Election Period, which has included a higher-than-expected proportion of age-ins.

As Bruce discussed, age-ins initially run a higher benefit expense ratio than the average new member, which negatively impacts the current year benefit ratio but results in a larger margin expansion opportunity on these members over time. As previously noted, we anticipate that the higher than originally expected benefit ratio in 2023 will be offset by a variety of factors, including higher-than-expected favorable prior year development, additional administrative expense reductions, higher than previously anticipated investment income and other business outperformance.

And while we would typically not comment on 2024 this early in the year, given the questions in the market regarding pricing resulting from the higher-than-expected utilization in 2023, I would reiterate that our Medicare Advantage pricing contemplated the rate environment, emerging utilization trends and related offsets, as well as the competitive landscape and resulting growth opportunity. As we sit here today, we remain confident that our 2024 pricing, combined with the strength, scale and agility of the organization, will allow us to deliver earnings growth that keeps us on a reasonable trajectory to our 2025 adjusted EPS target of $37. As a result, our intent is to target adjusted EPS growth within our historical long-term target range of 11% to 15% in 2024. We look forward to sharing more on 2024 later this year.

Turning to Medicaid, the business continues to outperform with second quarter results exceeding expectations, driven by favorable membership results, combined with disciplined medical cost management initiatives and lower-than-expected utilization. Redeterminations, which began in the second quarter, are tracking slightly favorable to our initial expectations.

In addition, the Louisiana and Ohio contracts, which were both implemented in the first quarter, are performing as anticipated. At this time, we continue to expect an increase of 25,000 to 100,000 Medicaid members for the full year as the membership gains in Louisiana and Ohio will be largely offset by membership losses resulting from redetermination.

Membership in our stand-alone PDP business is tracking favorable to expectations, driven by better-than-anticipated retention. As a result, we've improved our full year guidance from down approximately 800,000 to down approximately 700,000.

Now turning to CenterWell. The segment has continued to build on a solid start to the year, performing modestly better than expected in the second quarter. Our Primary Care organization continues to report better-than-expected patient growth year-to-date, adding 10,000 patients or nearly 52% growth in our de novo centers and 12,000 patients in our more mature wholly-owned centers, representing 7% growth year-to-date. We now anticipate full year patient panel growth of approximately 27,000 to 30,000 as compared to our original estimate of 20,000 to 25,000 patients, more than doubling the patient growth achieved in 2022.

In addition, our Primary Care organization continues to improve the operating performance in our wholly-owned centers, and we're pleased to report that we estimate we will increase the number of centers that are contribution margin positive from 110 at the end of 2022 to approximately

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125 at year-end 2023, a 14% increase year-over-year. In addition, we expect to increase the number of centers that have reached our $3 million contribution margin target from 31 in 2022 to approximately 40 at the end of 2023, a compelling 30% increase year-over-year.

While we do expect the risk model revision to have an impact on our center contribution margin performance in 2024, as Bruce shared, we are focused on advancing our clinical capabilities, driving operational efficiencies and implementing other actions that we believe will largely mitigate the ultimate impact of the risk adjustment model changes that will be phased in over the next 3 years.

In the Home, total same-store new start of care admissions and our core fee-for-service home health business were up 5.8% year-over-year as of June 30, in line with our expectations of mid-single-digit growth. In addition, in the quarter, we saw episodic admission growth of approximately 10% year-over-year, which is inclusive of the acquisition of Trilogy Health completed in April.

While new start admission growth is strong, we continue to experience pressure on recertifications due to utilization management programs of Medicare Advantage payers. And as expected, our cost per visit continues to run approximately 2% higher year-over-year with continued nursing labor pressure.

From a quality perspective, we have seen significant improvement in STAR ratings for CenterWell Home Health over the last year, increasing the percent of our branches with a 4.5 star or above rating from 18% in January 2022 to 50% today.

Further, as Bruce highlighted, we're seeing positive results as we continue expansion of our value-based Home model, tracking towards our goal of covering 40% of our Medicare Advantage membership by 2025 while also expanding the stand-alone components in certain markets to accelerate value creation.

Finally, our Pharmacy business performed well in the quarter, benefiting from higher-than-expected individual Medicare Advantage membership growth as well as favorable drug mix. As anticipated, year-to-date mail order penetration for our Medicare membership is 40 basis points lower than prior year as a result of retail pharmacy co-pays now largely being on par with mail order benefits. We continue to provide awareness and education of the benefits of mail order for a large block of new members to drive increased penetration throughout the year.

Investment income slightly outperformed expectations in the quarter, and we now anticipate that investment income will increase by approximately $500 million year-over-year, up from our original expectation of a $450 million year-over-year increase.

From a capital deployment perspective, we initiated open market repurchases in March and have completed approximately $800 million in repurchases to date, taking advantage of the recent dislocation in the stock price relative to our confidence in the long-term earnings outlook of our business, underpinned by our strong Medicare Advantage platform and the continued build-out and integration of our CenterWell assets. We now expect share repurchases of approximately $1.5 billion in 2023, up from our original expectations of $1 billion. With our strong cash flows and decreasing debt-to-cap ratio, we've accelerated the share repurchase while maintaining sufficient capital for normal course M&A activity.

Lastly, with respect to earnings seasonality, we expect the percentage of third quarter earnings to be approximately 25%. In addition, we expect the third quarter Insurance segment benefit expense ratio to be 87%, consistent with current consensus estimates, before increasing in the fourth quarter consistent with historical seasonality patterns.

Before closing, I want to echo Bruce's sentiment that Humana's fundamentals are strong, and we are pleased with our ability to grow individual MA membership by 18% in 2023 while guiding to a robust 12% year-over-year in adjusted EPS. We are confident in our ability to leverage the strength and scale of the enterprise to navigate through the near-term impacts of the higher-than-expected Medicare Advantage utilization while continuing to advance our strategy. And importantly, we remain committed to our 2025 adjusted EPS target of $37, reflecting a 14% CAGR from 2022 to 2025.

With that, we will open the lines up for your questions. In fairness to those waiting in the queue, we ask that you limit yourself to one question. Operator, please introduce the first caller.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Stephen Baxter with Wells Fargo.

Stephen C. Baxter - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Appreciate all the color, a lot to digest there. So the commentary on 2024 bids was very helpful. It sounds like, at least to my hearing, that if the higher trend that you see in MA persists for the balance of the year, you believe your bids would fully reflect that. Just making sure we have that point right. And then obviously in June, you did talk about some pretty significant operating cost offsets that you expected will allow you to deliver on EPS this year despite the higher MLR. I guess how do we think about these potential cost offsets into next year? Are those still largely an opportunity for you if you need them as an offset?

Susan Marie Diamond - *Humana Inc. - CFO*

Sure. Stephen. So to your first question, in terms of 2024, we are assuming that the higher trend that we've seen in 2023 will continue into 2024. So that is contemplated in our current commentary. I would say that as we said in our June commentary, we did -- when we saw the emerging trends, we did not fully embed and make a change reflective of the higher trend we were estimating at that time in our bid. And there's a variety of reasons for that, as we said. If the emerging trend would continue to persist, there would be other assumptions that you would want to revisit in terms of whether there's risk adjustment offsets, did your view of claim trend incrementally in 2024 change in light of that higher trend. So for a variety of reasons, we were clear that we did not fully embed that into the '24. Also recognizing that we do continue to believe there is a disproportionate growth opportunity in '24, and wanted to make sure that we were positioned to take advantage of that -- or it to occur.

As we've continued to evaluate the trends relative to what we saw in June, as we said today, we are more confident in our estimates going into 2024 and able to evaluate our pricing actions now that we've seen stabilizing trends. So that's certainly a positive. We've also done a lot of work over the last number of weeks to assess and what is that impact on '24, and how do we feel about other available levers and assumptions. And based on everything we know today, we wanted to affirm in our commentary that we do feel confident in our ability to deliver an EPS progression in '24 that's consistent with our historical range, knowing that, that was a question that was raised in June based on our intra-quarter commentary. So we do feel comfortable with that.

In terms of 2023, as we described, there are a number of offsets to the higher trend we're seeing this year. Some favorable prior year development, investment income and certainly administrative expense reductions. Some of those things will certainly carry forward into next year. Admin, as an example, will be a continued positive relative to what we would have expected at the time of pricing as well as likely investment income. Some of the prior period development we would view as more onetime this year and so not necessarily carrying forward into next year. But based on everything we have visibility to right now, as we said, we feel comfortable that in 2024, we will be able to deliver that earnings progression and EPS progression consistent with our historical targeted range.

Operator

Our next question will come from A.J. Rice with Credit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

Thanks for the comments about the retention with the age-in population. It seems like to me, a key factor in the next couple of years, hitting ultimately your '25 target is the retention of all these members you've gotten this year and then whether the progression you normally see and

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profitability plays out. Can you just sort of remind us historically what the trend is, A, on retention? And B, on how the profits step up over time? And do you think there's any reason on this population you've added this year when either of those metrics might be different than normal?

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

A.J. I'll take the first part, and maybe Susan can take the profit trajectory.

On the retention area, I think as we've talked on a number of calls over the last few years, we've spent a lot of effort in improving the retention and we really look at it in a few areas. First is just in the benefit design. It's an important area where people will focus on and as both this year is a demonstration of that. But I think, in previous years where we've really been able to design our benefits for the segments that we want to continue to grow and retain. And that, I think, is an important area where we'll continue going forward. And as we've mentioned on a number of occasions, we feel very confident about our positioning for 2024.

The second is in the area of our experience and our customer experience, both in the service area and then, obviously, in the claims management area that we have. And as you can see from our Net Promoter Score and the continued accolades we get from third parties that we have -- are leading the industry in all those areas. And that we've seen also referring back to the brokers where they feel confident in both recommending us as a result of our benefits, but also recommending us as a result of our service side. Because they have told us on a few occasions that their confidence is less in some of our competitors as a result of recommending a plan and then ultimately not being able to service that plan.

And so I would just end by saying our benefit design is really important, and that's more segment specific. And then secondarily, the service experience that we provide and the ability to continue to do that both in a positive way from the customer point of view but also from an efficient way.

Susan Marie Diamond - *Humana Inc. - CFO*

A.J. To add to what Bruce said on the retention, we have commented historically that we do see typically higher disenrollment rates in the earlier years of tenure, particularly year 1 and 2. So the longer we retain that book, as you said, should provide some incremental benefit. So last -- the 2023 high growth and if we're able to see high growth again in '24 as we continue to see that block mature, hopefully, in the outer years, you will start to see some of that incremental improvement as we retain that book longer.

As Bruce commented in his comments about the age-ins, that is, I would say, incrementally positive because we do see that earlier tenure years, they do retain at a higher rate if we get them their initial eligibility versus subsequently. So that, I would say, is incrementally positive as well relative to our historical.

On the profit progression, what we typically said is it takes about 3 years for either an age-in or a -- other new member to reach mature contribution margin. Age-ins start much lower, obviously, because of the risk adjustment and reimbursement dynamics there, and so there's a larger opportunity for expansion over that 3-year time frame. But we consider, in the aggregate, the new member cohort to take about 3 years. So for the age-in block, it's usually disproportionately in the second year of retention because they need about 18 months of Medicare claims activity before they convert to full diagnosis-based risk adjustment. So we should see a positive impact from that in 2025 for the higher age-ins we get in '23, and then incrementally from there as well.

Operator

Our next question will come from Justin Lake with Wolfe Research.

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Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

First, just, Bruce, I appreciate your commentary on 2024 in expecting a strong industry growth, and you outperform it. Can you give us a little more color there in terms of the -- maybe relative to the, let's say, 7% to 8% we think the industry is going to grow this year? How do you think it grows next year?

And then any early commentary on 2025 STARS? I know you've gotten a bunch of data there. I know the -- it's still not perfect, but any thoughts on how your 2025 STAR performance is shaping up going into October? It would be helpful, too.

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

And in regards to just the industry growth rate, Justin, I would say we still feel confident that it's going to be like historical years. We see the demographics continuing in the age-in side. We see the value proposition continuing to maintain a fairly healthy difference between MA and Medicare fee-for-service. And then third, we do see segments like the duals as being underpenetrated. And we believe that as we progress into a higher penetration into the industry, we'll continue to see other segments being highly penetrated. You've seen this year in our results that age-ins are starting to become more and more part of that. And so we do see the growth continuing, and we are confident that we'll see that for the foreseeable future.

Relative to STARS, it is an early -- it's -- we haven't got all our results, but we feel pretty good about where we stand as a result of what we see preliminarily. Obviously, we haven't seen the comparative measurements and how you stack up with the industry, but I would say that we feel pretty good about our existing analysis.

Operator

Our next question will come from Nathan Rich with Goldman Sachs.

Nathan Allen Rich - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I wanted to ask about how you believe your kind of benefits will compare to the market overall? Obviously, you're coming off of a year where you significantly increased benefits for '23. What does that look like for 2024?

And I know it's early, but it would be helpful if -- to get your sense of how you're thinking about margins for the Insurance segment in 2024, given the moving pieces with utilization, the risk and risk model changes, redeterminations? Any kind of early view would be great.

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

I'll take the benefit side, and I'll let Susan discuss the margin side.

On the benefits, we -- as I mentioned, we have really been thoughtful around how do we adjust the benefits appropriately considering the funding that's in the marketplace and as a result of the reduction and from the latest rate notice. And so we've tried to really do a significant amount of research around where are the priorities for the Medicare beneficiaries and what do they value most by particular segments, whether that's in the military, whether that's duals, whether that's age-ins, et cetera. And we feel really good about that research and feel that we are going to come out with a value proposition that is going to meet the mark for each of those segments, considering the funding side. And as you can see in our commentary, we made a comment about that we did increase zero premium plans this year and coverage more. We felt that was a really important benefit that people are looking for. And in addition, in our duals population, we continue to ensure that we are providing the ample amount of support for supplemental benefits, because we do find that lifestyle is an important part of them to continue to improve their health outcomes.

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Relative to our competitors, we've gotten an early view on it. It's always the most positive view, and we feel we're in a good position. And I just want to remind everyone, last year, we weren't the cheapest in every market. What we find with our brand, our relationships with our brokers, our quality scores, our experience and our STAR scores specifically, we find that we compete when we are within shouting distance between the various different plans. So we don't have to lead the industry in every benefit, we have to be close. And what we see when we do that as a result of our stability of our platform that we are able to take a significant amount of the market share there.

So benefits are important, but I would just emphasize, we've never been pride ourselves on being the cheapest. We want to be in the range where it's competitive and people are having to make a decision between a few plans, but we always went out as a result of the quality and the ability to service our members.

Susan Marie Diamond - *Humana Inc. - CFO*

And one thing I would add to that too as you think about '24, as Bruce mentioned, some of the competitors do have incremental pressure from STARS. And so what we've consistently heard is, there will likely be some area of focus for certain competitors. Duals is a great example where a few have indicated that they will put their focus and potentially make some investment there.

What's interesting about that is, as we commented in '23, we, for a number of years, have lagged the industry in non-dual growth but outperformed on duals, which allowed us on the overall average to be in line or better than the industry. The non-dual population is the much larger population, and so the ground we made up in '23 and our ability to outpace the market in non-dual growth, we were particularly excited about and want to make sure that we maintained into 2024. And I think based on what we're hearing and seeing, we feel very optimistic about how we're positioned. And we've also seen and heard positive feedback from the brokers, which we've previewed some of our 2024 changes with as well. So that -- all of that speaks to some optimism for '24.

On your question about '24 margins, it's really too early to give that type of commentary. Typically, we'll give you a little bit more commentary on our third quarter call. As I said in my comments, we did think it was important though, in light of the emerging experience and commentary this year, to give confidence over where we thought we would be from an overall perspective and our confidence that we will deliver against our historical range to make sure that, that wasn't in question.

But there are a number of things that we'll have to evaluate as we think about '24. Detailed estimates, the level of membership growth certainly in 2024 is a big one. As we've said, we do think there is an opportunity for potential disproportionate growth, and so the composition of that between age-ins, switchers, as well as retention will be an important consideration. And then obviously, as we continue to evaluate these emerging trends and whether they sustain or further moderate will be an important input as well.

So certainly look forward to sharing more, but wanted to reinforce our confidence in our ability to deliver progression in '24 consistent with our historical targeted growth rate.

Operator

Our next question comes from Scott Fidel with Stephens.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

Would be interested if you could give us an update on how you're approaching coverage of the Alzheimer's drugs and the emerging therapies there for 2024? And then just some preliminary thoughts on sort of how you may be factoring that into your bids and into expected MA costs for 2024?

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Susan Marie Diamond - *Humana Inc. - CFO*

Sure. So we will certainly follow sort of CMS coverage determinations in terms of what and when and for what label use that we have to cover. As we went into our thinking for 2024, we did have a point of view that we would have some costs related to the continued launch of Alzheimer's treatment, so we do have pricing in our bids. I would say, based on the team's latest assessments, we feel comfortable with what we've priced for 2024.

There's been a lot of questions about whether the drugs would trip the significant cost policy. Based on our estimates, you have to hit about $1 PMPM of sort of expense discipline level to be able to trip that. And right now, we don't think we will get to that level across the industry in spend, but certainly something to continue to watch. So I'd say we have contemplated in '24 pricing, and based on what we're seeing so far, we feel comfortable that, that's not a material headwind.

Operator

Our next question comes from Steven Valiquette with Barclays.

Steven James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Great. So I guess just regarding the elevated Medicare cost trend for the second quarter and then thinking about some of the potential moderation in the back half of '23, can you just remind us whether or not there's any major levers you can and have proactively pulled midyear to just better contain the elevated Medicare cost for the back half of the year, either on prior authorization policies or just other coverage factors? Or are the '23 trend is really more just serendipitous at this stage? You just have to wait essentially until '24 to make any material changes to either better control costs or adjust pricing benefit design, et cetera?

Susan Marie Diamond - *Humana Inc. - CFO*

Sure. Steve. I would say at this point, in terms of what we're thinking in the second half trends, we are assuming that those trends continue and do not moderate. There's some seasonality differences in just workday seasonality year-over-year that we certainly take into account, but from a normalized basis, we were anticipating that those trends continue and are not mitigated by any actions or levers we might take.

I would say on the broader medical cost trend, I would say there's probably not a lot that, at least to date, that we would identify that we would be able to do in response that could mitigate that. On the dental side, which we have commented on, which is we think more Humana-specific, there are a few things we are looking at in terms of coverage to make sure that we've got the appropriate controls in place. But I would say that would not be a material factor, I'm thinking about how we're thinking about the trend for the year.

The main lever that I would say that we're relying on internally to offset some of the elevated trend in the back half of the year is more administrative expense savings. We have asked the organization to find additional opportunities, and that's largely informed by some of the ongoing productivity work that we've been viewing that highlights that there are some additional opportunities. And I would say relative to what we considered in our original plan for the year, those extra admin savings will be disproportionately benefiting the back half of the year. Whereas the first half of the year, the elevated trend had the benefit of things like prior year development that we would say is going to disproportionately benefit the first half versus the back half.

Operator

Our next question comes from Michael Ha with Morgan Stanley.

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Hua Ha - *Morgan Stanley, Research Division - Equity Analyst*

I appreciate all the commentary and confidence in '24 and '25.

Just quickly, first, did you mention you expect to maintain the same level of non-duals growth rate in 2024 as you saw in '23? And then quickly on '25, is it fair to say basically whatever happens in '24 in costs from -- even if it does run slightly high, that as long as you're able to capture that in next June's bids, then $37 still well on track for '25? And I'd imagine maybe even stronger if you're able to capture more growth, market share in '24 because you're carrying a larger base of MA lives that will see that year 1 to year 2 profitability ramp?

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

Yes. I mean you're thinking is consistent with what we're thinking on a few things.

I think first, as we look at how we've adjusted our benefits in 2024, we continue to orient the zero premium plan, and we've seen age-ins be oriented to that so that is an area where we continue to see that age-ins, that percentage, and we're anticipating probably a good level of growth. Now I won't get into the percentage between age-ins and non-age-ins there, but we do anticipate that. And as Susan articulated, we also see margin expansion happening in the book that's coming in 2023 to 2024 and continuing on to 2025. So we do have this ability to have a step improvement in each of those areas.

And then when you think about just the market in general and the growth of being able to do this, we're very optimistic about the growth, as I mentioned before, with Justin on the growth of it.

Susan, do you have anything that you would like to add to that?

Susan Marie Diamond - *Humana Inc. - CFO*

Yes. I would say on the -- the question about the non-dual growth, I do think the ground we made in '23 that we will continue into '24. And frankly, based on some of the preliminary information we're hearing from competitors and the focus on duals, maybe we'll be even a little bit better positioned if that wasn't as much of a focus for some others. So I do think that's positive.

On the pricing for 2025, as you said, we always -- if there's some residual trend where we are able to offset that in '24 with something that's nonrecurring, we would always have the pricing lever if we should need it. But our hope and plan would be to find durable offsets that would continue and prevent us from having to take further pricing action. But that is certainly always an option.

In terms of the progression, and to your point, the higher growth certainly is positive in supporting our trajectory to '25. I will say that one thing we'll have to continue to evaluate, though, is the impact of the risk model recalibration and then obviously, the rate book in '25. And we know that we'll have those cuts phased in over 3 years, and so our goal would be to try to offset as much of that as we can and minimize further beneficiary impacts, although there's likely to be some. So that's the one, I would say, caveat is we'll have to evaluate that as it comes out, and then the overall puts and takes that we always have to consider in '25 pricing and balancing, continued strong membership growth, but also delivering the EPS progression that's needed to hit the $37 and then continue to perform at a strong durable rate beyond that.

Operator

And our next question comes from Gary Taylor from Cowen.

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Gary Paul Taylor - *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

Most of my big-picture questions answered, so I'll just dive into a couple of the details. One, I wondered if you could just talk about the source of the stronger PYD, if that's been outpatient ambulatory or perhaps just kind of final inpatient acuity?

And then secondly, Susan, you mentioned the [sweep] revenue at 2Q being higher than it usually is. I just wondered if you could speak to the materiality of that? I don't think I've ever heard you talk about that much before.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure. Gary. On the PYD, I don't know that we've historically given a lot of detailed drivers. And I would say it's -- there's not a single sort of primary driver of that, that I would call out, so more broad-based. I would say one item is that we do -- we talked about last year that we took a more conservative posture to year-end reserving, and so that certainly would unwind over the course of the first half of the year as that proves -- as those claims ultimately mature. I would say, as we looked at the experience, we have acknowledged and seen that just internally, our seasonality models we think overstated our sort of expectation of claims trend in the fourth quarter, particularly in the month of December, and maybe then fully account for sort of workday differences or the impact of holiday differences in the day and the week they fall. So I would say we've seen somewhat consistently that December 2022 was more conservative than we would have thought at year-end, and we saw some of that emerge and release through the first half of the year.

In terms of Q2 revenue, as I said in my comments, part of the reason the MLR was a little bit more favorable relative to the commentary we gave intra-quarter was the fact that we did see some positive midyear risk adjustment payment, which would have been booked in the second quarter. I think from an overall perspective, from an annual basis, you wouldn't consider it material. And in the absence of some of this higher trend probably wouldn't be something we have even called out, but given the previous commentary on MLR, wanted to provide some transparency to the fact that there were some puts and takes that offset that higher pressure. And we were pleased to see some slightly higher midyear payment, which again, is probably to some degree reflected the higher trend too as those additional -- that was probably emerging partly last year in that book as well.

Operator

We have a question from Joshua Raskin with Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

I guess I'm just trying to understand that build up to the 2024 EPS growth in line with your 11% to 15% long-term targets. I understand you're growing 18% membership this year, and that will mature a little bit next year. But I'd assume if your pricing for benefit changes to take market share when competitors are vulnerable, and I totally get the strategy plus the impact of the risk model changes that it would be hard to expand margins on the rest of the book. So what am I missing? What are the positive drivers to EPS for next year?

Susan Marie Diamond - *Humana Inc. - CFO*

Well, certainly, Josh, as we thought about '24 intent all along, would have been to deliver against that needed progression to get to a reasonable trajectory to deliver on the $37 in '25. So that would have always been the intent. I think as we've seen some of the higher claims emerge this year, and we've further evaluated that as well as how the estimates are developing for next year, today, I thought it was important to convey confidence that we will -- we still continue to believe that we can deliver in that range.

So I would say that was the intent all along and as the enterprise book is performed and we thought about the membership growth opportunity. Because you were already advantaged coming into '24 in terms of obviously how well we were positioned in '23 and the lack of the STARS headwind

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for us going into next year, we always had a point of view that relative to others, we would have less benefit action to take and still be really well positioned and also still deliver on the needed earnings and EPS progression.

So that's always been the plan, and we felt really good about that going into our planning. The higher outpatient and overall trend is the new development that we've spent a lot of time working through the last number of weeks to make sure that we continue to be confident that we're still in a similar position and have the ability to navigate through that, which we do believe.

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

Josh, maybe a few other things. If you remember the Investor Day, we really broke down our earnings growth into a few areas where our core business was going to grow, and then in addition, where we were going to grow from productivity and from capital deployment there. And capital deployment and productivity were close to 4% of our growth with the growth of the core business, making up the 10% or so.

What we see this year is we're going to -- or next year, we anticipate growing probably a little more on the productivity side as a result of just some of the initiatives that we see that are really showing some good results, and us continuing to scrutinize where we feel that we're not spending that appropriately there.

And then on top of that, you mentioned a little bit about the rate notice. We price for the rate notice. I mean we incorporated that in the price, so as we look at the benefits, they will not be as rich as they've been in the past as a result of us having to reflect the impact of the rate notice. And that is the third. And we -- as Susan was articulating in the previous question, we have 2 more years that we'll have to incorporate it in there.

So I would say that, to answer your question specifically, we see the benefit of our growth this year showing up in 2024, and we anticipate that same benefit growing -- showing up in 2025 as a result of both '23 growth and '24. Our focus on productivity gaining greater than 2% and our capital deployment being there. And then our other businesses are showing good results, too.

Operator

We have a question from David Windley with Jefferies.

David Howard Windley - *Jefferies LLC, Research Division - MD & Equity Analyst*

I wanted to ask a question on trend on a couple of different axes.

One is kind of the geographic breadth of the higher trend that you've seen. Does it have any regionality to it? And then secondly, is it concentrated mostly in the non-dual population? Or is this also present or apparent in the duals population? I'm kind of thinking about as you're -- as you set up for growth in '24, do you have preferences about where that growth might come from either by type of member or by region of the country?

Lisa M. Stoner - *Humana Inc. - VP of IR*

David. To start with your first question on the medical cost trend, I would say it is not concentrated, it's pretty broad-based. The one thing we have commented on though, which again, we think is more Humana-specific, the dental -- higher dental trends, those are a bit more concentrated, and that's more reflective of just where some of the product offerings, we call it the allowance plans where there's just an overall dollar of funding that the beneficiaries can use towards those dental benefits. That tended to be more of an offering in state of Florida markets, and so you do see some concentration on just that one dental element. But the broader medical cost trend, I would say we haven't seen any real concentrations.

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On the more population-based, dual, non-dual, I would say again generally broad-based. Although I would say in general, the duals are performing better relative to non-duals. They're still seeing some pressure, but the risk adjustment and the revenue dynamics offset some of that. And so I'd say, the non-duals are performing a little bit worse than the duals.

I would say, consistent with what we've said before, we continue to see, though, is the broader medical cost pressure is more non-risk-based concentrated versus risk providers. The risk providers are not seeing as much of it, which -- in our minds makes a bit more sensitive sense in general, they do a better job managing some of that outpatient spend just by definition. And so we are seeing on the broader medical cost more in the non-risk space.

The dental, again, because of where it's located, that actually is disproportionately risk based, and so we do get some offset there because of the [geographies] that we're typically offering that coverage.

Operator

And our last question comes from Kevin Fischbeck with Bank of America.

Kevin Mark Fischbeck - *BofA Securities, Research Division - MD in Equity Research*

Just wanted to kind of clarify. I mean, I guess when you guys provided that initial $37 number for 2025, you were thinking you're going to grow below average this year. And given just how strong you're growing this year and I guess it looks like another year of above-average growth for next year, are you going to be at your membership -- your initial membership thoughts for 2025 next year so that you don't really need to grow membership in '25 at all to kind of puts you on track for that $37 number?

And then I guess, to think about there's been a lot of concern about trend and whether you need to reprice and what that could mean for growth in a given year. It sounds to me like what you're saying, and based upon I guess we've seen over 2/3 of the industry report and talk about higher trend too, it doesn't sound like you think anything you're seeing here is company specific. That if there is a need to reprice to elevated trend at the industry need, not a Humana-specific need that would impact your competitive positioning at all? I just want to make sure I understand that dynamic as you think about how you might need to reprice or think about repricing over the next couple of years to higher trend.

Susan Marie Diamond - *Humana Inc. - CFO*

Kevin, yes. So on the membership, we are certainly outpacing what we would have anticipated underlying the $37 target. As you said, we were anticipating lower than -- slightly lower than industry growth in '23, anticipating it would take us 2 years to get back to the industry growth rate. So that really strong growth this year is certainly positive, and our hope is that we can have a repeat performance in '24. So that would all be positive, and we should certainly outperform the membership growth that was contemplated.

Our goal though, as we said, is we're not going to take our foot off the gas, so we will continue to strive to position ourselves to sustain industry growth rate or better on a sustainable basis going forward, given the beneficial impact of that from a lifetime value perspective and importance in supporting a durable, strong continued EPS growth trajectory as well.

On the trend question, as you said, other than the dental, which we've talked about as being more Humana-specific and where you will see us having made some benefit adjustments in '24 and maybe potentially some additional in '25 as we continue to watch that emerge. The broader medical cost trend, we do believe, is consistent with what everyone else has been saying. I do think there's some maybe timing differences and when different companies thought and to what degree they reflected it in '24 pricing. And so I think, ultimately, though, if there is any residual price action that we feel we want to take in light of what we're seeing in 2025, to your point, we would not expect that to put us in an outlier position relative to others. Although it may be that some others have already taken more than we have, and it's just a matter of catching up. But we would say that it is an industry issue, and ultimately, to the degree it needs to be priced for would not create any competitive advantage or disadvantage because it seems fairly consistent across the competitor set.

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Operator

And there are no other questions. I'd like to turn the call back to Mr. Bruce Broussard for any closing comments.

Bruce Dale Broussard - *Humana Inc. - President, CEO & Director*

Right. Well, again, I would thank everyone for your support and your participation today. And like always, we want to thank our 70,000 teammates in being able to -- for us to be as successful as we are and being able to report the earnings we have. So thank you, and have a great day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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