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PRESENTATION

Operator

Ladies and gentlemen, my name is Lance, and I will be your operator for today's conference. At this time, I would like to welcome everyone to the Humana Inc. 3Q 2018 Earnings Call. (Operator Instructions)

I would like to turn the call over to Amy Smith, Vice President of Investor Relations. You may begin your conference.

Amy K. Smith *Humana Inc. - Vice President, Investor Relations*

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Brian Kane, Chief Financial Officer, will discuss our third quarter 2018 results and our financial outlook for the year.

Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. 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 third quarter 2018 earnings press release as well as in our filings with the Securities and Exchange Commission.

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*

Thanks, Amy. Good morning, and thank you for joining us. Today, we reported adjusted earnings per share of \$4.58 for the third quarter of 2018 and raised our full year 2018 adjusted EPS guidance to approximately \$14.40, primarily reflecting favorable Medicare Advantage



results.

Our continued strong performance reflects the advancement of our strategy, which centers on the consumer with quality, convenience and local presence top of mind throughout the organization. Our success is due to the exemplary efforts of our associates and their focus on quality every step of the way.

We're fortunate to have a highly engaged team and are encouraged by a recently completed survey indicating that engagement levels of our associates rank as world-class, above the 90 percentile. This engagement reflects a culture of commitment to our values and strategy, diversity of thought and pride in the services we provide our customers.

You see it's not only in our recently released Star scores, including 2 5-Star contracts in key markets, but also in higher Net Promoter Scores and improved productivity. It was also recently announced that Humana Pharmacy was ranked #1 in customer satisfaction for U.S. mail order pharmacies in the J.D. Power 2018 U.S. Pharmacy Study. Ultimately, all of these efforts result in deeper member engagement and improved clinical outcomes.

While we are proud of our Star scores, we recognize that there is an inherent volatility in their measurements and health care is a dynamic environment. Measures may change, and as the industry as a whole improves performance, measure thresholds also rise substantially. Therefore, this requires a relentless focus on quality on both the member experience and clinical outcomes throughout the organization.

To that end, we continue to invest in people, processes and technology to create a more local, personalized and simplified experience while proactively managing health conditions.

Let me give you a few examples. We continue to make progress with Kindred at Home and our effort is already being felt by our members. There are numerous examples of Kindred at Home nurses in our 4 pilot programs identifying and addressing gaps in care, including addressing nonmedical patient concerns that may cause them to forgo the recommended pre- or post-acute treatment plan and jeopardize their health. Kindred at Home's direct engagement and information sharing with the health plan further enables our members to make decisions that are best for their personal health and well-being.

Similarly, our medication reconciliation program is leading to better clinical outcomes for our members. We implemented and then performed our first medication reconciliation nearly 3 years ago. In the beginning, it took 3 months to complete 500 medication reconciliations. We now can do it in 3 days with the use of technology. We've heard countless stories from our care managers and pharmacists around the impact we are having on members' lives through this program.

Together, our clinicians have caught drug interactions, duplicate therapies, missing therapies, incorrect therapies and side effects. Our analytics team have spent considerable time working through the data, catching important discrepancies and ensuring accurate results. We've prevented hospital readmissions and adverse drug events, and are generating significant trend savings through this program annually. And our members experience the value of this work through more healthy days in their home.

We've seen similar success in our value-based care model with primary care physicians. In our wholly owned Partners in Primary Care clinics, one story in particular stands out. A member at one of our clinics, Mr. Smith, a high-risk patient with elevated A1C frequently missed his appointments. By proactively reaching out to him, the clinic staff determined that while he understood that he was at high risk of heart attack, stroke, kidney failure and losing his vision, he could not afford the \$15 copay for the office visit, medication copays or healthy foods. He was fully aware of the consequences and felt hopeless.

The clinical staff worked with him to address financial concerns that were a barrier to his ability to manage his disease progression. He was already receiving 100% low-income subsidy for his prescriptions and still couldn't afford the \$8 copays or the \$15 copay for the office visit. So the clinic staff found other ways to help him financially.

This includes: referring Mr. Smith to a food pantry, even entering the address in his GPS phone for him; assisting him with Supplemental

Nutrition Assistance Programs, or SNAP, application under which he was preapproved for \$135 to \$165 in benefits; informing him that if he used those SNAP benefits at the local farmers market, for every \$5 he spent on produce, he would be given an additional \$10 in fresh produce; helping him apply for low-income housing supplement that would pay at least 50% of his rent; and assisting him in calling the power company to obtain a low-income reduction in his power bill. Mr. Smith was appreciative of the assistance and indicated the savings to his budget were life-changing for him.

There are stories like this across the organization. At the root of all of them is the success of our integrated care delivery model, breaking down silos, empowering Humana associates and encouraging partnering across the health care ecosystem.

We recognize that in order to slow disease progression, improve the health of those we serve and ultimately reduce medical costs, we have to solve the barriers to achieving better health outcomes for our members. Those barriers often occur outside the medical realm, including social determinants of health, like food insecurity and social isolation as well as financial constraints. In addition, consumer convenience and local presence are top of mind as they lead to increased member engagement.

To that end, we've invested in home health, an expansion of our senior-focused primary care clinic footprint, including opening 2 clinics inside Walgreens stores in Kansas City as previously discussed.

In addition, we recognize that we need an omnichannel approach to consumer convenience in health care with a seamless experience for members and providers, whether interacting with us over the phone or online through a desktop or mobile device. In August, we announced that we named Heather Cox to the newly created position of Chief Digital Health and Analytics Officer. And we'll soon launch a center for digital health and analytics in Boston called Humana Studio H.

We are developing a critical capability that can help Humana leap forward and overcome friction points to create a simplified, connected and personalized health care experience for our members, physicians and other medical professional who provide care. Studio H will focus on pioneering new products and services that will then be developed for use across the organization and with external parties.

Turning to 2019. Our commitment to helping our members achieve their best health remains stronger than ever. There were meaningful tailwinds going into 2019 Medicare Advantage bids, including, among others, tax reform and the health industry -- insurance industry fee moratorium, enabling us to make investment in our products to benefit our members and drive improved health outcomes.

We are pleased with the early positive response to our compelling Medicare Advantage offerings, with nearly all of our members experiencing stable or enhanced benefits. Based on our 2018 membership base, I would like to highlight ways our members will benefit from our plans in 2019.

93% of our members will have no premium change or will see a reduction in premium. Over 50% of our members will have \$0 premium plan. 1.6 million members will have \$0 primary care physician copay, an increase of 400,000 members for 2018. And nearly all members will have a PCP copay of \$20 or less. Nearly 40% of our members will see specialist copay reductions. Over 430,000 members are in plans from which prescription drug deductibles have been removed in 2019, bringing the number of total members with no Rx deductible to 1.3 million. And finally, 1 million members or 36% will see reductions in their maximum out-of-pocket expenses.

When designing these benefits, we knew it was important to offer a compelling value proposition to our customers to drive growth while also balancing the need to improve our margins at the same time. We have robust operational processes and controls in place, both at corporate and local market level to ensure we achieve both of these objectives.

As Brian will discuss in his remarks, early indicators from the annual election period are positive, reflecting member and broker excitement around these changes. Consequently, we are expecting strong individual Medicare Advantage growth while also delivering an increase in earnings per share above our long-term target. We look forward to helping both our current and new members achieve their best health.

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



Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Thank you, Bruce, and good morning, everyone. Today, we reported adjusted EPS of \$4.58 for the third quarter, ahead of our previous expectations. We continue to see favorable results, particularly in our Retail segment. And as a consequence, for the third time this year, we are raising our full year adjusted EPS guidance to approximately \$14.40 from our previous guidance of approximately \$14.15.

These strong financial results, coupled with solid nonfinancial metrics that are also a component of our compensation programs, are driving an increase in estimated incentive-based compensation for our associates across all segments, thereby increasing our consolidated operating cost ratio guidance for the full year.

Recall that earlier this year, due to tax reform, we were able to significantly expand our annual incentive-based compensation program to include all of our associates. This added approximately 28,000 associates to the annual program, tying a portion of their pay to the company's performance. As a result of their tireless efforts and commitment to our strategy, we are continuing to outperform our expectations. And we are therefore pleased to have the opportunity to further reward all of our associates for their exemplary work.

As I mentioned, our Retail segment continues to outperform, led by our individual Medicare Advantage business. We have increased our individual MA membership guidance for 2018 to a range of 200,000 to 210,000, an increase of 15,000 members at the midpoint, partially offset by slightly lower-than-expected Group MA membership. This greater Medicare membership, coupled with higher per member per month premiums, have enabled us to increase our revenue guidance to a range of \$47.8 billion to \$48.1 billion from our previous range of \$47.5 billion to \$48 billion.

In addition, the trends seen in the first half of the year continued in the third quarter, with inpatient utilization running favorably, partially offset by higher outpatient costs. As a result, we have again lowered our benefit ratio guidance to a range of 85.0% to 85.4% as compared to our previous guidance range of 85.1% to 86.0%.

While the lower utilization is good for the health plans in the Retail segment and Humana overall, it does put some pressure on Healthcare Services segment adjusted EBITDA. In fact, we are seeing the benefits of the investments we have made in our integrated business model and strong clinical programs over the last several years reflected in clinical excellence and trend benders for our insurance lines.

Accordingly, our associates in the Healthcare Services segment will also benefit proportionally from the consolidated company outperformance with higher-than-expected incentive-based compensation, which is an important factor driving the lower adjusted EBITDA guidance for the segment we have provided today.

Additionally, MAPD pharmacy network volume is down slightly for the year versus expectations, primarily with generics. And we have also experienced shifting market dynamics in our Specialty pharmacy business, primarily around members' initial engagement in new therapies which have tended to be filled by third-party providers rather than Humana Pharmacy. The pharmacy team is intently focused on improving these dynamics.

These factors, coupled with investments made in Conviva, which include accelerated rebranding to position this business for a strong annual election period to bolster 2019, resulted in a decline in our adjusted EBITDA guidance to a range of \$990 million to \$1.01 billion from our previous range of \$1.025 billion to \$1.075 billion.

Lastly, I would note that Kindred at Home is performing in line with our expectations, and the value-based pilots we have launched have begun to gain traction, as Bruce indicated in his remarks.

Shifting to Group and Specialty. The segment is still expected to perform within the range of our prior expectations from a pretax perspective, though this quarter we slightly lowered the high end of the pretax range on account of extraordinary items.

During the third quarter, several developments, including the resolution of provider matters in Texas and Florida, which were not

previously contemplated in our guidance, resulted in an increase in our benefit ratio guidance to a range of 79.1% to 79.5% from our previous guidance range of 78.3% to 78.8%. The resolution of these issues sets the segment up for success in the future. We continue to expect trend of 6%, plus or minus 50 basis points, but trending towards the lower half of the range. Additionally, our TRICARE business continues to perform very well and exceed expectations.

Turning now to 2019. While we do not intend to provide specific detailed guidance until our fourth quarter call, I will now offer some high-level commentary and direction for the upcoming year. Let me first reiterate that we have significant tailwinds going into 2019 with minimal headwinds. Tailwinds include the positive Medicare rate notice, the HIF moratorium, the continued beneficial effects of tax reform, our incremental membership from the statewide Florida Medicaid contract award and our general Medicare business momentum.

In addition, we now have 2 5-Star contracts in the critical markets of Florida and Tennessee that give us the ability to market year-round. More broadly, we have endeavored to be very thoughtful with how we balance our 2019 goals of achieving a greater-than-market individual MA membership increase, while at the same time improving our pretax margin to drive EPS growth above our long-term target.

Let's begin with membership. As Bruce indicated in his remarks, we believe that our solid membership and earnings growth in 2018 is paving the way for significant growth in 2019, and we are pleased with the positive early response to our individual MA offerings for 2019 during the first month of the annual election period. The significant tailwinds just discussed allows us to invest in benefits for our members and offer compelling Medicare Advantage products.

In addition, in 2018, we continued the extensive broker outreach that we began in 2017, revitalizing and deepening these critical relationships as we geared up for the 2019 annual election period. Based on what we know today, we expect 29 -- 2019 individual MA membership growth in the range of 250,000 to 300,000 members.

There are scenarios that could certainly impact this estimate, including a sales slowdown or speedup for the remainder of AEP, a change in the expected retention of existing members for which we have limited data to date, higher or lower post-AEP sales figures that are currently forecasted and the return of the open enrollment period for 2019 for the first time since 2011. The OEP runs from January to March, allowing members to make a single switch of their MA plan or return to original Medicare.

With regard to group Medicare Advantage, as we've indicated previously, growth can vary significantly from one year to the next, depending on the large account RFP pipeline, which for 2019, was less robust than in prior years. That said, we still expect to grow our membership by approximately 30,000 members year-over-year.

Moving to Medicaid. We expect 2019 membership growth of 120,000 to 140,000 members, primarily reflecting the expansion into new regions with the Florida contract award. Regarding our stand-alone Medicare PDP membership, as previously discussed, we expect this business will face meaningful headwinds for 2019. Given the competitive nature of the industry and the price discipline we are employing, we are no longer the low-cost plan in any market. We expect 2019 PDP membership losses to be at least 500,000 members.

Finally, we anticipate that our Group and Specialty segment will see an overall medical membership decline though not at the level of decline experienced in 2018. That being said, we do expect to grow modestly in our sweet spot of 2 to 1,000 members with a big focus on expanding our level-funded premium products that are very attractive to small employers.

I will now turn to our expectations around 2019 financial performance. We expect the membership changes discussed above will drive sizable top line and pretax growth as well as margin improvement in our Retail segment. As we indicated previously, while we expect our individual MA pretax margins to improve nicely from 2018, we anticipate they will remain below our long-term target of 4.5% to 5% on account of the continued impact of investments made in 2018 due to tax reform. We remain fully committed to achieving our long-term target over time.

With regard to the Healthcare Services segment, we expect adjusted EBITDA percentage growth in the low teens, given our individual

MA membership growth expectations, the annualization of the Kindred results and operational improvements in our other businesses in the segment, particularly our Conviva provider clinics. However, a decline in PDP membership has the impact of constraining the growth of our pharmacy business, which will therefore rely on Medicare Advantage growth and improved operations to fuel its results.

Lastly, in our Group and Specialty segment, while we expect our insurance businesses to have nice pretax growth in 2019, this will be more than offset by the previously discussed lower TRICARE profits, given that the positive final settlements received in 2018 associated with the previous TRICARE contract will not recur in 2019. Therefore, we anticipate that pretax results will be modestly down year-over-year in this segment.

All in, we are pleased to reiterate our expectation of meaningful EPS growth in 2019 of a new baseline of \$14.40 in excess of our long-term target of 11% to 15%. More specifically, we would expect the midpoint of our initial guidance range to be slightly above the current consensus estimate of \$17.18.

Before I open up the line for questions, I also wanted to announce that we plan to host an Investor Day on March 19, 2019, in New York City. Please save the date.

With that, we will open up the lines for your questions. (Operator Instructions) Operator, please introduce the first caller.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of A.J. Rice from Crédit Suisse.

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

Maybe following up on those comments just made about Medicare Advantage growth. A quick back of the envelope would suggest that you're thinking your individual business will grow 8% to 10% next year. I'm wondering if you could put that in perspective with do you think that's sort of in line with the market growth, better than the market growth, if I calculated that right. And then secondarily, on the MA comment, I think a lot of your outperformance this year has been in the MA margin area. And I guess if you're saying you won't quite get to the 4.5% to 5% target next year, is that -- are you sort of close to that now given the outperformance you've seen and expect -- whatever you expect for fourth quarter? Or what does the year-to-year trend look like on margin?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Sure. A.J., as it relates to market growth, let me just provide a little context of how we view the market. This year being 2018, we expect the market to grow in the, call it, the 7-plus percent range, maybe 7.5%. We'll see where it ends up. Again, I'm talking on the individual MA side. For 2018, it's conceivable that goes up modestly. We'll see where that ends. The reality is we don't have a lot of market data just yet. We have anecdotal data that suggest that we are taking market share from our competitors.

And so the, call it, 8-plus percent to 10% growth that you cited, we do believe that, that is a performance above market. We'll see where that goes. And obviously, we'll also see where we end up on our AEP results and our rest-of-year results. It's still very early. We feel very good about the 250,000 to 300,000 member target that we put out, and obviously we're working hard to drive growth above that range.

I would say on the margin side, again without providing specifics on our margin, we remain, notwithstanding the significant outperformance this year, significantly below our 4.5% to 5% margin target in 2018. I mean, it's important to remember the context of that initial margin guide that we gave. We had a number of headwinds, including the HIF coming back, a difficult flu season, the fact that we actually grew faster than we initially anticipated and, as I said, the significant tax reform investments which we reinvested in our associates and in our communities and in the integrated care delivery model. So we do expect to make nice margin improvement in 2019 off that 2018 base, which as you indicated is coming in above our initial guidance, but we still do expect to be below that target for 2019.

Operator

Your next question comes from the line of Ana Gupte from Leerink Partners.

Anagha A. Gupte *Leerink Partners LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Following up on the MA margin question. Where would you see the medical loss ratio on a normalized basis? I guess from the revenue side next year, you're getting -- your Star ratings are solid for '19, and the risk coding of the rate looks great. Why is it that the loss ratio couldn't go down? Are you coming up against some MLR floor barriers? Or is it something else that's holding it back?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Look, there's obviously always opportunity to continue to push the MER better. We're -- but as we think about the world, we really think about it in pretax margin terms because there's a lot of levers that we pull between the medical costs and then the operating costs. And as you know, from -- coming into 2018, we spent a significant amount of effort across the company trying to drive down that admin spend. And we took out many hundreds of millions of dollars this year to fund that benefit design. And so I'd rather not comment specifically on the components between MER and AER. I would just reiterate our long-term margin target, which we're focusing and ultimately getting back to.

Anagha A. Gupte *Leerink Partners LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

And again, related to this long-term target, where do you see your operating cost ratio? The consolidated basis is still in the low teens, and there should be at least leverage there as you're doing your business. And then on the -- technically, on the value-based care, when you report your employed physicians and just partial risk and full risk, they look like they're not changing much. So what are the trend benders that you're driving for lower -- or improved medical cost structure at this point?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

So I'll point you back to the comments I just made on the various ratios. The only thing I would say on the operating cost ratio is that we continue to work on productivity initiatives, on process transformation across the enterprise to drive cost out of the system. It's, I think, really become part of the DNA of this organization that every year, we're going to get better and better and drive productivity. If you look at our administrative costs on an apples-to-apples basis, if you adjust for mix, adjust for the health insurance fee, you'll see a pretty dramatic reduction year-over-year, again, taking into account also tax reform. You want to take -- yes.

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

Ana, on the value-based question you had, what you're seeing is as much about the amount of physicians that are in value-based payments versus the quality. And what we've seen over the last few years is really our focus on improving where providers are being in the surplus, and they're actually making more money off of the value-based payments. And that has been our orientation versus the volume. And I would -- we don't report the surplus, but you would see if we did a significant improvement in the number of providers that are in surplus payments.

Operator

Your next question comes from the line of Matthew Borsch from BMO Capital.

Matthew Richard Borsch *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

Could you just talk about -- I know you stressed stronger broker outreach as a factor driving the results that's you're seeing in open enrollment. How much of that has to do with maybe catching up to, if that's the right way to put it, the compensation that maybe some of your competitors have been offering? And where do you see that broker compensation going as a competitive factor?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Matt, it's less about compensation. I think most of our competitors really pay the CMS max levels. That's typical across the industry. It's really about the support that you provide them. And really, we think about support in 2 buckets. One is the tools they have to interact with us, how easy is it to engage with us digitally as well as in other forms. So that when they try to understand the nature of their book, how they're doing, enrolling members who might have started an online application and how easy is it to finish, how easy is it to track, how they're doing from a results perspective, how quickly do we respond to request that they need and support that they need. And then there's also marketing dollars and putting muscle behind that. So that when they're out trying to drum up sales and leads, we're there supporting them.

And then there's the intangible element of a relationship, where our Medicare leadership has done a wonderful job of driving that -- those relationships. I think there's a personal bond there, which is very important in that business. And so I think when you look across the range of levers we can pull to drive those relationships, they've improved meaningfully. Part of it's a catch-up, I would say, because we were damaged, as we've said, by the Aetna transaction with the brokers, but I think we've more than made up for it.

Matthew Richard Borsch *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

That's great. If I could just ask one more. I think you alluded to some negative skew in the commercial fully insured group risk pool that's resulting from healthier groups migrating to self-funding or quasi-self-funding options. There's a potential for that to spiral, particularly if there's traction on the association health plans on the low end of the group side. What's your outlook there?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Well, I think what you're saying is right. I mean, if you're a particularly healthy group and you're in a community-rated pool, you may not be getting the best rate. And so we have seen a material uptick in our sales of what we call our ASO-level-funded products, which is effectively self-funding with stop-loss wrap to give them out-of-the-money protection in the event that the health care costs spike. We've seen that be particularly compelling. It's still too early to comment on the association health plans. We'll see where those go, but we're actually quite bullish on this level-funded product and we've seen significant growth there. And it also, we think, plays to our strengths, which is our ability to understand risk and price it accordingly. So we're actually pretty bullish on that move.

Amy K. Smith *Humana Inc. - Vice President, Investor Relations*

(Operator Instructions)

Operator

Your next question comes from the line of Justin Lake from Wolfe Research.

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

I'll do my one question in a couple of parts here, I apologize. Let's see. First, do you -- on your membership guidance, do you expect the 80% to 90% of that individual growth to come during open enrollment similar to what we've seen over the last few years? Or those 5-Star plans skew this a bit? And then how does your retention rate assumption look for 2019 versus what you saw in '18? And then just lastly, can you tell us what the HIF benefit is to the earnings number implied in guidance?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

That was impressive, 3 questions.

Amy K. Smith *Humana Inc. - Vice President, Investor Relations*

Way to get in 3.

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

All right. In order. On the AEP/rest-of-year mix, we've generally assumed a similar mix in our budgets here in the forecast we gave. To the extent that the 5-Star plan really takes off and with our value prop being pretty strong, hopefully we can exceed that. But I think it's prudent to assume a similar AEP, what we call ROY, AEP/ROY mix. And we'll see where that ultimately goes. I wouldn't underestimate the importance of the 5-Star contract, particularly being in Florida and Tennessee. These are markets where we have important risk relationships with our providers. They're very high-performing markets for us, and there's obviously a lot of opportunity in those markets. So we're particularly excited about achieving 5 Stars there. We'll see how that manifests itself into higher growth.

On the retention rate, broadly, we've assumed a similar retention rate as we did in 2018. There are some tweaks here and there, but I'd say in the ballpark of similar. So as I said in my remarks, it's still pretty early on the retention side because typically, terms lag sales and you don't really learn about a term until you hear from the other carrier that someone signed up there. So it takes a little longer to process. So we think we've done the appropriate thing and assume a consistent -- a largely consistent retention rate. With regard to the HIF, I'd rather not break out the HIF versus the other components. As we've said in multiple contexts, we really think about all the financial levers as one pool of dollars that we look to allocate out between growing benefits and helping our members in achieving growth as well as driving margin. So I'd rather not piece that out separately.



Operator

Your next question comes from the line of Peter Costa from Wells Fargo Securities.

Peter Heinz Costa Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

I applaud your goals of spreading the tailwinds between stronger earnings and better member benefits and maybe employee incentive compensation. Is there perhaps a fourth bucket of higher spending that's perhaps something you can only do next year that you can get away from in 2020 without some adverse consequence if the HIF comes back in 2020? What is your plan for if the HIF comes back in 2020?

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

I would say, Peter, that it would be consistent with what we did this year and continue to focus on the improved productivity. I would probably disagree a little bit. We look at our spending in a pretty cautious fashion every year, and I wouldn't say next year just because we have headwind -- I mean, a tailwind that we would be overinvesting. I think we continue to look at how we can improve margin and improve productivity in the company, and at the same time drive a customer value proposition that is competitive in the marketplace. So I recognize that the HIF is always a challenge to predict, but we as an organization look at that as -- a way to approach that would be continue to drive our productivity up.

Peter Heinz Costa Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

So if the HIF comes back in 2020, which of the other buckets then would you squeeze back? Would it be earnings? Would it be member benefits? What exactly would you squeeze?

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

Yes, I mean, we continue to maintain committed to improving our margin, growing at a market rate that is between 11% and 15% level, our earnings per share growth rate, and at the same time continuing to be committed to our value proposition in the marketplace. And every year, we are constantly trying to find that ability to meet all 3 of those. And I would consider 2020 no different than any other year that we have.

Operator

The next question is from the line of Kevin Fischbeck from Bank of America.

Kevin Mark Fischbeck BofA Merrill Lynch, Research Division - MD in Equity Research

I just want to talk to the Part D losses that you're expecting for next year. I guess you've seen kind of an erosion of your market-leading position in the last couple of years. I mean, how important is it to have that position? I guess, a, is there anything you can do to move back into being a low-cost plan in those markets? And then b, does that have a secondary effect on your Medicare business? Because I guess, one of the benefits you give away in Medicare Advantage is a cheap Part D plan. So to the extent that you no longer have that advantage on Part D, does that hurt your (inaudible) outlook?

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

I would just -- I'll start and then I'll look to Brian to add commentary. I would say that, first, you just see the organization continuing to focus on pricing discipline here. And we've done this in other times when we see the market getting a little astray. We did it in group a few years ago. You see it now in PDP. You see it in group commercial, where we just don't want to follow the market down. And the consequence is, is that we're going to lose membership.

What we do see is both because of our brand and commitment to our service levels that we do see a higher conversion from Part D to Medicare Advantage and the success of that, and we continue to believe that. Now keep in mind, this is on a 5 million membership base. So as we talk about 500,000, it's large, but it's still in absolute, as a percentage, is not catastrophic by no means.

In meeting the future growth rate, we'll continue to be price disciplined in the marketplace. We'll continue to focus on our service levels.



And at times, we might add other components to the program. But I would say that you'll continue to see us wait this through because we don't think that the market can continue to offer the pricing that's in the marketplace and continue to have a sustainable product. And I think we're just going to wait this through and see what happens at the other end. Brian, do you have any other comment?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

No, I think that's good.

Operator

Your next question comes from the line of Sarah James from Piper Jaffray.

Sarah Elizabeth James *Piper Jaffray Companies, Research Division - Senior Research Analyst*

So LabCorp recently talked about their growth strategy being linked to locating the 600 labs and Walgreens expansions in the same locations that have clinical assets or primary care or urgent care. And I know it's early in the Kansas City rollout, but can you talk about any results in increased foot traffic or level of consumer interactions with the information booth that you've seen that could influence your decision to expand the JV? Realistically, how quickly could that happen? And do you have any data that helps you frame up what an incremental touch point with a potential MA customer could mean to influencing their future buying decisions to buy Humana's MA plan?

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

Yes. I think first thing that we've seen is that the convenience of the store is highly appreciative. We've seen that the traffic that goes into these particular clinics is more -- has increased as a result of the location and just the branding of it. And so we find that just in its initial opening. And keep in mind, it's been open only about 3 weeks now, so we're very early in it.

The second thing we do see is that as a result of that increased interest, we do see Humana being more discussed as both from a health plan point of view, but also just from a primary care clinic point of view. So we do -- we are very positive and excited about the exposure it provides. And in addition, we find that it does offer another opportunity for the retail side, where they've seen increased urgent care visits in their -- in the back of the store.

The last thing that we've seen in early part is the fact that we are influencing people's health. We've seen similar stories as what I articulated on the call of being able to help people with financial needs, and financing and getting support for their prescriptions. We've also seen the area in being able to help them and understand their benefits. And then in addition, in some of health areas, we've been able to influence their health decisions, along with prescription management. And so we've seen the other areas of supporting the individual as being very positive.

So to summarize it, great exposure. We see more foot traffic. We see engagement being greater as a result of our health coaches being there. And then in addition, I think the retail side is seeing some benefit as a result of that, both in the urgent care area but I think, in general, all part of the store.

Sarah Elizabeth James *Piper Jaffray Companies, Research Division - Senior Research Analyst*

So it sounds like all positives there in such a short period. How should we think about the framework for your evaluation of deciding to expand it and how long that process could take to make that decision?

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

Yes. I think we have a great relationship with both Walmart and Walgreens, and we'll continue to build on that relationship. My -- I suspect that we will do some other stores before we conclude on this particular offering as a result of the initial indication and the learnings from this. And I think being able to do a few more stores will also give us the confidence in being able to scale it.

Operator

Your next question comes from the line of Josh Raskin from Nephron Research.

Joshua Richard Raskin Nephron Research LLC - Research Analyst

Questions around Medicare Advantage and the outlook for next year. Strong growth. It sounds like you're expecting to be slightly above industry. And so I'm curious what you're seeing from the competition. You've gotten to look at sort of competitor plan design, et cetera. So is your expectation, it sounds like retention is the same, that you're taking share from competitors? Has there been a change in the competitive landscape? Or is this still really, no, we're just going to continue to take share as an industry from fee-for-service?

Brian Andrew Kane Humana Inc. - Senior VP & CFO

Well, I think what we've seen -- again, it's anecdotal and it's really hard to say because we don't have true industry data, but the broker chatter that we hear is that we are taking share from our competitors. So our sales being nicely above, in some cases meaningfully above, our existing market share. So again, it's way too early to make that this positive because we just don't know where the industry is, and -- but we obviously don't have visibility on all the sales that are occurring. But the early indicators are positive that we're taking share.

Joshua Richard Raskin Nephron Research LLC - Research Analyst

So I guess, the follow-up to that is, does it -- does that make it sound like you're not seeing a competitive response or a change in the market that you find troublesome? You're not seeing new competition or more aggressive change in benefits from competitors or anything like that. It sounds like it's more manageable in your mind.

Brian Andrew Kane Humana Inc. - Senior VP & CFO

Yes, I think so. I mean, I would say it's a local market phenomena. We see in certain markets that there are certain players who tend to be quite aggressive, and then there are other markets where it tends to be more rational. Frankly, you see that every year that there are some people who want to make a bet on a particular market for various reasons. And so I wouldn't say we've seen any difference in terms of rationality of pricing this year. Clearly, there's a lot of additional money coming from the health insurance fee, being on holiday and some of the rate notice and other things. And so I think, as an industry, the benefits have improved. And I think it goes to the importance of the health insurance fee for our beneficiaries. And so from that perspective, we have seen increased benefits. But I wouldn't say there's been anything irrational, with some exceptions in certain markets, but that's really par for the course.

Operator

Your next question comes from the line of Steve Tanal from Goldman Sachs.

Stephen Vartan Tanal Goldman Sachs Group Inc., Research Division - Equity Analyst

One question, I guess, on just cost trend. I guess it's probably fair to assume it's been decelerating, and maybe even more recently. Hoping to kind of get some color there, maybe confirm that. And the other part of that is really just understanding what was assumed for trend in your bids for next year and kind of baked into the initial earnings outlook.

Brian Andrew Kane Humana Inc. - Senior VP & CFO

Yes. I would say on the trend side, it's really consistent with what we've talked about the last few quarters in terms of this shift from inpatient to outpatient, that hasn't let up. We've continued to see that. I would just say on 2019 trend, we try to be very prudent about the numbers we put in our bids. And so -- but I'd rather not comment beyond that. We've obviously reflected what we've seen this year into the 2019 experience.

Operator

Your next question comes from the line of David Windley from Jefferies.

David Anthony Styblo Jefferies LLC, Research Division - Equity Analyst

It's Dave Styblo in for Dave Windley. I had a question about 2020 looking ahead. We estimate that the Stars there will increase your bonus of those -- in the bonus by about 10 points to 84%. Obviously, knowing rates is going to be an important part of your view on 2020, but curious if increased visibility on Stars there helps provide confidence that you could return to your target margin of 4.5% to 5% by that point.



Brian Andrew Kane Humana Inc. - Senior VP & CFO

Well, I think the Stars results obviously are very positive and I think indicative, as Bruce said in his remarks, of the quality focus that our organization has. And I think really the great effort of the Stars team and working again across businesses and across silos and departments to drive a great result for our members, which manifests itself in better Stars.

I think what you said is really important, obviously, in terms of where the rate notice ultimately shakes out and what happens with the health insurance fee. Those are really important factors as we think about what our 2020 ultimate bidding strategy will be and what that means for margin. So we're not prepared today to give 2020 guidance. We're just giving indicators of 2019, so you'll have to stay tuned for that. But I would just say, as Bruce said earlier on the call, that we're obviously very mindful of all the commitments that we have and goals that we have to drive both growth and margin.

Operator

Your next question comes from the line of Steven J. Valiquette from Barclays.

Steven J. James Valiquette Barclays Bank PLC, Research Division - Research Analyst

Bruce, the color on all of Humana's enhanced benefit design for individual MA for '19 was definitely helpful when you provided that earlier. This was kind of touched on a little bit, but I guess I had somewhat of a similar question around do you think you're unique among individual MA players in moving the needle as much as you did with the enhanced MA benefit for 2019. I guess what I'm really trying to get at is, maybe just to frame it slightly differently, would you characterize 2019 as more of a go for the gold type year for Humana regarding attempted individual MA membership growth? Or do you view 2019 as more business as usual with the levers that you're pulling to drive membership growth for next year?

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

Yes, I would categorize it as more business as usual. I think one of the reasons why you see such improvement in benefits is because we, I think as an industry, have invested back into the benefits both to be competitive on a number of things like HIF that should be included in the benefits. So I think you've just seen a continued belief that the areas that we can improve in, whether it's our medical costs trend or in addition our -- the rate increases or the -- or for that matter the tax benefits that we've received. We'll be mindful about margin, but at the same time be mindful of being competitive in the marketplace.

I think if you were to compare our benefits on MACVAT value, you'll see us be fairly competitive but not be the cheapest. We've always tried to maintain to be at a level in the industry where we are in the tier to be selected, but not to be the cheapest in the marketplace. We feel our brand, our service and our longevity of stable benefits has always served us well over time, and we continue to see that being the case.

The last thing, I think, is over the last 2 years, we've invested in the benefits to overcome some of the deterioration that was taking place in the '15, '16 time frame, especially during the Aetna transaction. And I think a little bit of last year was catch-up, this year put us in a competitive area. But I really would emphasize, it's competitiveness but not overzealous.

Operator

Your next question comes from the line of Michael Newshel from Evercore ISI.

Michael Anthony Newshel Evercore ISI Institutional Equities, Research Division - Associate

I have a question on the recent proposal on MA policy changes for 2020. So if CMS finalizes its decision to extrapolate the RADV audits without a fee-for-service adjuster, would there be any impact on what you've already reserved for to settle past audits? And also, would there be any noticeable impact on booking the revenues on an ongoing basis?

Brian Andrew Kane Humana Inc. - Senior VP & CFO

Yes, I would just say that we're still reviewing the proposed rule, but we believe the proposal does not satisfy actuarial equivalence as required under the Medicare statute. And again, it's a proposed rule and we certainly plan to comment. But as we've said before, we feel very confident around our practices in this area. And I would just leave it at that.

Operator

Your next question comes from the line of Charles Rhyee from Cowen.

Charles Rhyee *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

You mentioned before that starting next year, a number of your members will have reduced payment -- reduced premiums or \$0 policies. And I think on one spot, you talked about a number of your members will have \$0 pharmacy deductible. Can you talk about when you go to that kind of a structure, what kind of changes do you make in formulary to control costs? And are any of those things able to help maybe stem the tide in your PDP book? And is there sort of a steady state in terms of membership that we should be thinking about as you model out to the future? Or should we continue to think about a slow -- maybe a slow gradual decline and think about it more as maybe some shift into your MA product with that?

Brian Andrew Kane *Humana Inc. - Senior VP & CFO*

Well, I'd sort of differentiate, there are 2 separate questions. One on formulary. I would say we're very thoughtful on formulary. And we -- obviously, there are a number of drugs that are protected, and therefore, they have to be covered. Others where we have the ability to incent one drug over the other, we use that as a way to what we call drive a trend bender and effectively get a better rate from the manufacturer, which we can pass back in the form of better benefits. And so I would say we're very thoughtful around our formulary approach, and we spend a lot of time on obviously ensuring that our members get the coverage that they need and us doing it in the most efficient and costly way possible.

As it relates to PDP, formulary is obviously a part of that. There's a whole host of things that go into PDP. As Bruce said, what we've seen is some aggressive pricing on the PDP side that we haven't been willing to chase. We think there is some cross-subsidization going on potentially, we think, with some of the retailers there to drive people into the store that perhaps gives them a different perspective than we might have. We do view PDP as a pipeline into MA that was a percentage of our MA sales. It's still relatively small, but it's still an opportunity that we see as potentially exciting.

And I would say going forward, we're not -- we're certainly not surrendering the PDP market by any means. We're going to have to be innovative and differentiated. I think if you look back several years, we basically pioneered the low-price product through the Walmart plan. That was really a revolutionary product in the industry that allowed us to get a #1 market share, and our relationship with Walmart has been very strong. And so we got to continue to innovate and provide perhaps different kinds of benefits to our members and think through what will appeal to them going forward. But we're just going to be thoughtful going forward. We're not going to chase price, but we also want to grow the PDP business ultimately.

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

And similar to all our plans or all our plans, we're very conscious about having a balanced customer base that is from a condition point of view. And so when we think about it, we also think about it just from the type of customers we would attract to ensure that it has its price -- proper pricing there. So in this particular case, we're not concerned about adverse selection.

Operator

Your next question comes from the line of Gary Taylor from JPMorgan.

Gary Paul Taylor *JP Morgan Chase & Co, Research Division - Analyst*

You guys had previously cited the 2018 budget act as a possible catalyst to potentially seek a Medicaid platform, basically, given your desire to participate in SNP growth and the requirement to have long term -- or capitated Medicare contracts in order to participate in SNP beyond 2021. Do you think the final rule still requires that? There was this sort of provision about if you didn't have state-capitated contracts on the Medicaid side, if you could do some notification around high-risk populations, basically sort of implying providing data to the state would satisfy the integration requirement, does that change your view on contemplating a deeper move into Medicaid?

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

I think, just in general, just to reconfirm our interest and continued growth in Medicaid continues to be high as we believe and have continued to believe over the years that the dual population, being highly chronic and in the senior population and disability, is a great



market for us to serve with our clinical programs. We continue to believe that our organic capabilities, as proven by Florida and some other states that we won, is very, very competitive, and we will continue to do that.

At the same time, we will continue to add our capabilities and specifically in the procurement process in areas and states that we feel is complementary to the existing membership we have and continue to be on the look out there. Specific to your question on the proposed rules that are being made, we do feel it provides more clarity around what the rules are. And specifically, that if the state does not dictate a lot of D-SNP plan is required that we would have more flexibility in offering a D-SNP or a related plan. And I think that clarity gives us more confidence that in certain states, that we'll continue to be offering a D-SNP plan without having the procurement of the Medicaid side. But that doesn't deter us from still focusing on the Medicaid and continuing to focus on winning contracts, both organically, and when necessary and in the appropriate time, be acquiring a Medicaid platform.

Operator

There are no further questions at the moment. Mr. Bruce Broussard, please continue for your closing remarks.

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

Well, like always, we thank everyone's support in investing and in the confidence in the company. So thank you very much. And on behalf of the management team, we want to thank our 60,000 people that every day go to work to help support our members and the great job that they do. So thank you very much. And everyone, have a wonderful day.

Operator

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

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