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PRESENTATION

Operator

Good morning. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Humana Third Quarter 2017 Earnings Call. (Operator Instructions) Thank you. Ms. Amy Smith, you may begin your conference.

Amy Smith

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer, and Brian Kane, Senior Vice President and Chief Financial Officer, will discuss our third quarter 2017 results and our financial outlook. Following these prepared remarks, we will open up the line for a question-and-answer session with industry analysts. Christopher Todoroff, Senior Vice President and General Counsel, will be joining Bruce and Brian 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 third quarter 2017 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 D. Broussard - *Humana Inc. - CEO, President and Director*

Thank you, Amy. Good morning, and thank you for joining us. Today, we reported strong third quarter results and raised our full year adjusted 2017 earnings guidance. Our third quarter 2017 GAAP EPS of $3.44 or $3.39 on an adjusted basis once again exceeded our previous expectations. Our individual Medicare Advantage business continued its strong performance, in line with our most recent guidance, and our Group and Specialty segment performed well ahead of our previous expectations. We raised our adjusted EPS guidance by $0.10 to approximately $11.60, reflecting the improved Group and Specialty segment performance. This was partially offset by lower than previously expected Healthcare Service segment pretax. Our full year 2017 GAAP EPS guidance is now approximately $17.62 per share.

Over the last several years and particularly throughout 2017, we've committed to productivity initiatives designed to promote operational excellence, accelerate our strategy, fund critical initiatives and advance our growth objectives. Following my remarks, Brian will comment on our third quarter results and some of the specific multifaceted productivity initiatives.

In addition, in October, CMS published its updated Star quality rating bonus year 2019 showing that we have 12 contracts rated 4 Stars or above and 2.4 million members in 4-Star or above rated contracts to be offered in 2018. This represents approximately 74% of our Medicare Advantage membership as of July 31, 2017.

We are pleased that Humana received a 4-Star rating for 5 Medicare Advantage contracts offered in 8 states, an increase from one such contract last year.

All Humana Medicare Advantage HMO contracts in Florida received a 4.5-Star rating, improving our position with our provider partners. These higher ratings are expected to result in higher rebates in 2019. As discussed in our second quarter earnings call, over the last year, we've renewed our focus on Stars and have made operational changes to reduce volatility in future years, the effectiveness of which we believe is shown in improved results in certain Star measures.

As our sharp focus on productivity continues to drive cost out of the system, one area we are making critical investments is around our providers. A key pillar of our strategy that we highlighted at our Investor Day in April is to partner with providers to support their transition to value-based care that fosters the management of health holistically. Medicare Advantage is one of the few reimbursement models that rewards holistic health management. The primary care physicians on their own, especially independent physicians, lack the capital, scale and expertise to make the investments in technology and analytics necessary to thrive in a value-based environment. To that end, we are making investments in payer-agnostic care coordination technology and analytics capability that enable providers to be successful in the value-based models, easing their administrative burden and enabling more time for clinical management of their patient population.

In a recent study we completed based on 2016 results for Humana Medicare Advantage members affiliated with providers in Humana value-based reimbursement models, we found that medical costs for Medicare Advantage members affiliated with providers in value-based models were 15% lower versus those affiliated with physicians under original fee-for-service Medicare. In addition, HEDIS scores were 26% higher for providers in value-based arrangements with Humana than providers in standard Medicare Advantage settings.

We will execute our provider strategy using a range of models that fit the unique characteristics of a local market. This includes owned senior-focused primary care clinics, many of which are payer-agnostic, as well as joint ventures, alliance clinics and our MSO model, where we will focus on supporting affiliated independent primary care providers.

We spoke to you previously about our 2016 launch of 4 wholly-owned clinics in Greenville, South Carolina. Membership growth in these markets have exceeded our initial expectations. And today, I want to share with you some early encouraging results that we saw between the second half of 2016 and the first half of 2017. These results include a 5% reduction in admissions per thousand, a 24% decrease in readmissions per thousand, positive trends in member satisfaction with an improved Net Promoter Score and improved Star scores associated with the patient experience. These results are a testament to the effectiveness of a value-based care model.

During 2017, we opened 5 additional clinics, including 4 in Kansas City and 1 in North Carolina.

In addition, we continue to develop sophisticated value-based alliance and joint venture partners in new markets. In 2017, we launched 15 new clinics in 7 markets. Among our alliance and joint venture relationships and our fully-owned clinics, we today operate 195 clinics across 27 markets.

We will continue to evaluate further investments in M&A opportunities in the provider space that improve our position in priority markets or accelerate the advancement and expansion of our MSO platform.

Interwoven with our provider strategy, we continue to be very focused on the home, as home is often a superior clinical environment to deliver care and reduce high cost hospital admissions. In its current state, care in the home is often disconnected from primary care physicians, challenged with issues on timeliness of care, lacking in robust data exchange, as well as based on a fee-for-service driven business model.

We've been utilizing our 6 existing Medicare certified home health agencies in Florida and Texas, along with enhanced relationships with high-performing agencies in select markets to pressure-test some of these paradigms. Through these early tests and learned efforts, we've seen that these barriers can be overcome and the member and provider experience can be improved.

As we look to advance our integrated care delivery strategy and expand our access and reach in the home, we are taking a multifaceted approach, including, but not limited to, care coordination, remote monitoring, telemedicine and the provision of care in the home through nurses and doctors. The insights we've gained from owning home health agencies demonstrates the value of having a home health platform to evolve capabilities and services, including integration of data, advancing moments of influence and transforming home health to value-based reimbursement.

This model produces improved outcomes such as lower admissions, readmissions and emergency room visits in common high cost conditions, including congestive heart failure, diabetes and COPD. This is a change from today's fee-for-service home health reimbursement model, which does not encourage the holistic management of health. It also provides us with an additional touch point with our members to enhance engagement, trust and close additional care gaps, such as missing HEDIS measures.

Many aspects of care coordination are already in place, and we continue to look for ways to expand and optimize these capabilities. For example, our entry into the long-term support service business via our acquisition of American Eldercare in 2013 and the beginning of what is today our Humana At Home business with the acquisition of SeniorBridge in 2012 are becoming even more important as we continue to seek greater linkage of the Medicare D-SNP population and Medicaid long-term support services.

However, other aspects of this strategy, particularly the provision of care in the home, will require M&A and other partnerships or collaborations to effectively bring them to life, as we've discussed previously.

In order to advance our strategy, we need to continue to evolve the capabilities of our Healthcare Service segment. Accordingly, over the last several months, we have been working on a newly refined operating model to better align the Healthcare Services segment strategy, business and processes. The new organization will afford us a greater opportunity to engage our members, patients, physicians and associates to drive the best possible financial and clinical outcomes.

With this new organization, we recently named new leaders of both our Home and Pharmacy operations, who will work under the leadership of William Fleming, President of Healthcare Services. We welcome Kirk Allen to Humana to lead our Home operations as President of Home Care. Kirk brings more than 20 years experience in health care and was most recently the President of Ascension At Home and Executive Vice President of Home Care Services at Evolution Health.

We also welcome Labeed Diab to lead our Pharmacy operations as President of Humana Pharmacy Solutions. Labeed is a registered pharmacist who brings extensive operations, management and business development experience in both the retail and health care industries, most recently servicing -- serving as Chief Operating Officer and Executive Vice President at Brookdale Senior Living. Prior to joining Brookdale in 2015, Labeed served in executive leadership roles for Walmart stores since 2009, most recently serving as President of Health and Wellness, which included managing retail pharmacies.

Now to touch on 2018. We are confident in our Medicare Advantage competitive positioning despite the return of the health insurance industry fee in 2018. As a result of our overperformance in 2017 and various cost-saving measures, we've made targeted investments in our product design, clinical programs and operating processes, which enable us to maintain stable benefits, simplify the member experience and improve clinical outcomes. We've been proactive in our broker outreach this year, demonstrating for them our confidence in our stand-alone strategy and commitment to helping seniors achieve their best health. Additionally, we worked to simplify the broker experience by investing in technologies that enables them to have 24/7 access to our information, with further plans to roll out simplified enrollment tools in 2018. As a result, we expect to return to meaningful individual Medicare Advantage membership growth in 2018.

Brian will provide additional commentary on our 2018 in his remarks. With that, I'll turn the call over to Brian.

Brian A. Kane - *Humana Inc. - CFO and SVP*

Thank you, Bruce, and good morning, everyone. As Bruce mentioned, today we reported adjusted EPS of $3.39 for the third quarter, which is ahead of our previous expectations. We raised our full year 2017 adjusted EPS guidance to approximately $11.60 from our previous adjusted EPS guidance of approximately $11.50, and we increased our operating cash flow guidance by approximately $250 million at the midpoint to a range of $3.3 billion to $3.6 billion, primarily due to continued better-than-expected financial performance.

Our Retail results are in line with our most recent forecasts and continue to exceed -- significantly exceed our initial expectations for 2017, led by our Medicare Advantage business. Consistent with the first half of the year, third quarter MA medical utilization trends, including hospital admissions and pharmacy spend, are running favorably relative to our pricing assumptions. In addition to our Retail segment producing strong results, our Group and Specialty segment significantly outperformed our previous expectations, primarily due to favorable prior period development and better-than-anticipated utilization trends. Trend is now running at the low end of our initial expectations of 6% plus or minus 50 basis points.

Accordingly, we raised our pretax target for this segment for the second consecutive quarter from a range of $320 million to $340 million to a range of $350 million to $400 million. We also decreased our benefit ratio expectation to a range of 79.0% to 79.25% compared to our previous range of 79.75% to 80.25%.

The Group and Specialty segment continues to consistently deliver solid results due to the team's strong focus on productivity and on offering innovative products that resonate in the marketplace. We are pleased with the return on investment we generate from this segment.

As we discussed last quarter, while the Healthcare Services segment continues to generate profits and steady cash flow to the parent, and importantly, reflects the integration of our business model by delivering clinical excellence and trend benders for our insurance lines, we continue to see lower-than-expected mail order utilization, particularly for new members in our Humana-Walmart stand-alone PDP offering. Today, we slightly lowered our pretax target range for this segment to $900 million to $950 million from our previous target of $925 million to $975 million.

Turning to our Individual Commercial segment results, which are excluded from our adjusted EPS, we now expect Individual Commercial segment pretax income of approximately $150 million, up from our previous estimate of approximately $85 million. Consistent with last quarter, these results reflect significant positive prior period development as well as lower-than-expected utilization in our ACA-compliant business.

With regard to cost share reduction payments, we do not expect the impact of the recent executive order to be material for us.

As these collective results demonstrate, we've had a great year so far, with significant outperformance that has enabled us to take the opportunity to invest in our future, including higher AEP marketing spend. This outperformance also results in higher compensation as our performance-based compensation arrangements reward our associates for their excellent work.

In addition, as Bruce discussed, we have taken significant actions to reduce administrative costs in a sustainable way for 2018 and beyond. Some of these measures have resulted in incremental spend in 2017, including investments in analytics and enabling technologies that have significantly advanced our integrated care delivery model, such as investments in our big data and our customer relationship management, or CRM, system, among others. Our big data environment now enables us to integrate and routinely mine data sources such as clinician notes, home health assessments and social determinants of health data. Through our CRM, we now have a comprehensive longitudinal data view of our members, which helps us know our members deeply and engage them effectively. We have also made investments in the provider space to advance care coordination capabilities, focusing on interoperability and analytics to improve the provider experience.

And lastly, we invested in a number of productivity and expense management initiatives related to internal management systems as well as vendor contracting and rationalizing our real estate footprint across the country.

More fundamentally, we have completed the build-out of the Process Transformation Office, or PTO, and we recently named process champions and owners for 3 critical processes that together comprise over $1 billion in administrative spend. These include processing claims, resolving inquiries and issues and designing and delivering member communications. The PTO is working diligently with leaders throughout the organization to optimize these processes horizontally across silos and has already identified meaningful savings by connecting upstream and downstream workflows and eliminating inefficiencies while ultimately increasing automation. We believe that by focusing on these core areas and then extending the PTO to additional processes over time throughout the organization, we can continue to reduce administrative costs and increase the reliability of our processes while improving the member and provider experience that together will set us up for sustainable growth over the long term.

Lastly, as a result of our efforts to continue to evolve and streamline the organization to align with our integrated care delivery strategy that Bruce has articulated, we've had to make some difficult decisions, including closing certain open roles and initiating both a voluntary early retirement program and an involuntary workforce reduction program that are expected to impact approximately 2,700 employees or just under 6% of our workforce.

In the third quarter of 2017, we recorded charges of $0.54 per diluted common share associated with these programs, which has been excluded from our adjusted EPS. This has resulted in a higher operating cost ratio than initially expected for 2017, and we now expect to end the year at or slightly above the higher end of our previous forecast range. We believe the culmination of these investments and our associates' hard work during 2017 has positioned us for a solid 2018 in the face of significant headwinds, in particular the return of the health insurance fee, or HIF.

While we do not intend to provide specific 2018 guidance until our fourth quarter call, I will now offer some higher level commentary and direction about next year. I'll begin with membership. We are only 1 month into the annual election period for our individual Medicare Advantage, but we are encouraged, albeit very cautious, with early sales results and our competitive positioning. Our philosophy heading into this enrollment season was to maintain stable benefits for our members and in some markets improve benefits where we believe we were well positioned relative to the competition. We did this recognizing that the return of the HIF presented significant challenges given its magnitude, and therefore, as discussed previously, we invested our 2017 outperformance and made significant strides in administrative spend productivity to fund this benefit design for our customers.

We believe that balancing growth and margin are paramount, and it was essential after 2 years of stagnant membership growth, in no small part attributable to the Aetna transaction, to drive our top line in a disciplined fashion that would enable us to achieve our EPS growth targets of 11% to 15% over the medium and longer term. In this process, we have also strengthened our relationships and enhanced our partnership with the external brokerage community, who, along with our outstanding MarketPoint career sales organization, allows us to achieve this objective.

Based on what we know today, achieving individual MA membership growth in the neighborhood of 150,000 to 180,000 lives is a reasonable estimate. And while there are scenarios that could certainly reduce that number, including a sales slowdown for the remainder of AEP, there are also factors that could increase it, including greater-than-expected retention of existing members and higher post-AEP sales figures than are currently forecasted. It is important to note that data on member retention is very limited at this point.

I would also like to comment briefly on our forecast for group MA membership. Based on what we know today, which is significantly more certain than individual MA given the timing of the pricing cycle, we estimate membership growth to be comfortably in the low double digits on a percentage basis for 2018. This achievement will be the second consecutive year of double-digit percentage increases in a highly competitive business, particularly for jumbo accounts, where we have committed to remaining disciplined with our pricing.

While we are pleased with our estimated growth in MA, there is some pressure in the competitive stand-alone PDP space for 2018. As you are likely aware, Humana offers 3 PDP plans, including a basic plan that serves, among others, our low-income members; an enhanced plan; and a low-price Walmart plan, whose extraordinary growth has made us the leading individual PDP carrier in the country.

With regard to the basic plan, we price to break-even contribution margin at a regional level. In Florida and South Carolina, our bid proved to be priced over the benchmark, which we anticipated, resulting in the loss of our auto-signed, low-income members in those states. Additionally, our enhanced plan continues to lose members each year, but historically, this has been more than offset by the significant growth in our Walmart plan. This year, however, the Walmart plan is no longer the low-price plan in a number of markets as other carriers have priced more aggressively. And as a consequence, while we will still grow that plan, it will likely be at a materially lower rate. Collectively, therefore, we expect that our overall PDP business will decline by a few hundred thousand members. While the impact on PDP insurance profitability will not be meaningful, we expect the lower Walmart plan growth will impact the growth of our pharmacy business given the industry-leading mail order rates in this plan.

I will now turn to making a few high-level comments regarding our projected 2018 financial performance. As we've discussed previously, Medicare Advantage membership growth drives top line revenue growth that is a critical component of our long-term EPS trajectory. Recall that MA membership growth not only benefits the health plans but also feeds our Healthcare Services segment as our members engage with us in our Pharmacy, Home Care and Provider businesses. Moreover, we are able to achieve increased scale with our administrative spend as the top line increases, which helps drive the bottom line over time.

From a profitability perspective, I have already highlighted the return of the HIF, which, for overall Humana, is a nondeductible fee in the neighborhood of $1 billion, as well as the impact of lower PDP growth on our Pharmacy business as meaningful headwinds to our 2018 performance. It is also important to note that we will not assume that our mail order rate in the Walmart plan, while still very high, will recover from the lower levels of mail order usage that we have seen this year, particularly among the new members who joined us in 2017 and any members who select this plan for 2018.

Our Provider business also continues to face significant rate pressures in South Florida. Additionally, the Group and Specialty segment will have a timing headwind associated with the HIF due to the timing differences that result from group renewals that are not on a calendar year basis.

And finally, there are certain stranded costs that resulted from our exit of the Individual Commercial business on January 1, 2018. Together, the HIF timing issue and Individual Business stranded costs represent a headwind of approximately $0.30. We expect to offset these headwinds through the productivity initiatives described above and capital deployment, both through share repurchase and M&A. It is important to recall that the impact of new Medicare Advantage members on profitability is relatively muted in the initial year before they are documented appropriately for the risk we are taking and are engaged in our clinical programs.

Turning now to EPS. Recall that on last quarter's call, we discussed the need to begin with a baseline-adjusted EPS of approximately $11, which is largely unchanged. It is also important to note that we have achieved EPS growth well in excess of our long-term range over the last several years. Additionally, we would anticipate guiding to a slightly wider range than we did in 2017, which will be more in line with historical practice given our anticipated greater MA growth in 2018 versus 2017, which can create slightly more uncertainty in our earnings forecasts.

Finally, we would expect that the high end of our initial guidance range will be a bit below our long-term target of 11% to 15% growth, with our individual MA margin guide slightly below our 4.5% to 5% range. This reflects the significant headwinds that I've articulated and the importance of offering a compelling value proposition to our customers while continuing to invest in the build-out of our integrated care delivery model that will create long-term sustainability.

Consistent with our historical practice, our 2018 initial guidance will assume a normalized rate of favorable prior period development for our Retail segment, which exceeded expectations in 2017, while assuming no favorable prior period development for our Group and Specialty segment.

Finally, I would like to briefly discuss the recently announced deal to sell our nonstrategic closed block of long-term care insurance business. Upon consummation, we will have no remaining exposure to this business, where we have seen significant reserve strengthening over the last number of years. Based on the terms of the agreement, the transaction is expected to result in an estimated GAAP loss on sale of approximately $400 million or $2.75 EPS, which includes some noncash charges.

That said, we do anticipate a net positive economic benefit for Humana as the $203 million of parent company cash contributed into the subsidiary, together with the transfer of approximately $150 million of statutory capital with the sale, should be more than offset by the estimated $500 million of cash savings associated with the expected tax treatment of the sale. We anticipate the transaction will close by the third quarter of 2018 subject to customary closing conditions, including regulatory approvals. Excluding the loss on sale, the company does not anticipate a material impact to earnings in 2017 or 2018 from the sale of the business.

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

Operator

And your first question comes from the line of Pete Costa with Wells Fargo Securities.

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

I'd like to understand a little bit more about why the change in the way you're giving 2018 guidance this time as opposed to giving more detail on a straight-up EPS number, and also your expectations for Medicare Advantage growth next year given the increased competition we're seeing from others in the marketplace. Why is it you believe you're going to see better growth there?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Sure. Peter, on the guidance side, we didn't actually give guidance on the third quarter last year either. We're trying to give investors a broad direction of what we see 2018 to be. But there are still a lot of things that are going to happen in the next few months, and we think it's appropriate and prudent to give guidance on the fourth quarter call. And that will be our practice going forward.

With regard to individual MA growth, really, the reasons that I discussed in my opening remarks relating to the stability of benefits that we provided for our members and investing in certain markets where we believed we had a high right to win, and as we think about our value proposition as we see the competitive data, we feel good about the range that we provided this morning.

Operator

Your next question is from Kevin Fischbeck with Bank of America Merrill Lynch.

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

I guess I wanted to go back and make sure I understood what the commentary was around the EPS guidance for next year. Did you say that you were going to guide below the range of 11% to 15% or below the midpoint of that range? And I guess, when we think about the rationale for doing below that this year, would we think that there's anything unusual into 2019 that should stop you from getting to that long-term target?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Sure. So with regard to the range, what we said was our initial guide at the high point will be a bit below our 11% to 15% range. So a bit below 11%. So it's not below the midpoint. It's really -- it would be way too early to comment on '19 since we haven't given 2018 guidance. The only thing I would say is that, given the HIF return in 2018, that is a particularly large headwind that we've had to deal with. I mean, a $1 billion nondeductible fee is a very big number. And so that's been a major issue that we've had to grapple with. And it's really -- it affects our customers and affects our earnings performance.

Operator

Your next question is from Justin Lake with Wolfe Research.

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

Just questions on Medicare Advantage and the outlook there. First, can you talk to the rationale between not being able to guide to a target margin at 4.5% to 5%, given how strong the business was this year? And specifically you said, Brian, I think during the prepared remarks that cost trends were running better than what you built into the bid. Does this guidance at lower than 4.5% assume the bid margin? Or does it assume inclusive of a lower trend?

And lastly, can you just tell us what kind of attrition rate you're assuming for this year and how that compares -- or for 2018 and how that compares to previous years in individual MA?

Brian A. Kane - *Humana Inc. - CFO and SVP*

That was 3 questions. I'll try to -- okay. So below -- again, we've invested our outperformance in 2017 into the product design, which gets us to below that 4.5% to 5%, and that's really what's driving it. Again, we're facing very significant headwinds, as I've mentioned a few times, with the HIF. We've, I think, done a good job of offsetting a lot of the headwind with very significant productivity savings that we've been very focused on in driving in 2017. I think you'll see that ultimately in our 2018 guidance. But that's really the rationale for driving below the initial -- or our targeted range of 4.5% to 5%.

I'm trying to remember now the second question. Just remind me of the second question.

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

You said there was better trend...

Brian A. Kane - *Humana Inc. - CFO and SVP*

Sorry, right. So on the trend side, so to be clear, so on the trend -- sorry about that. On the trend side, what I was really referring to was the commercial business trend. Trends continue to run favorable to pricing but consistent with where we were really last quarter when we gave the updated guidance. Nothing has really materially changed from what we saw last quarter. So -- but on the commercial side, we have seen continued lower trends, and that's why we were able to improve our pretax guidance.

And again, I really wouldn't want to comment too much on attrition embedded in our numbers. I would say that we feel very good about our attrition levels. I'm just not going to comment at this point. It's way too early to give a sense of where attrition will be.

Operator

Your next question is from Matt Borsch with BMO Capital.

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

Not to belabor the point again, but on your 2018 guidance, can you just talk to your -- how maybe your view evolved over the last few months relative to how you described the outlook on the second quarter call?

Brian A. Kane - *Humana Inc. - CFO and SVP*

I would say, Matt, it's really consistent. I think the business continues to perform quite well. We feel good about all the initiatives that we're pursuing. We made the decision at bid time to invest the outperformance into our 2018 product design. We believe that was the right decision to create long-term sustainability. We also believe it's important to continue to invest in the business, which is what Bruce and I have talked about in our remarks, and so we're going to continue to do that. But I would say that nothing has really materially changed in our business outlook from this quarter from last quarter.

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

Okay. And if I could, just one more, which is on the Medicare Advantage growth. How does your very preliminary view of the open enrollment process compare with what I understand to be CMS's prediction for 9% overall growth in program-wide enrollment, which I guess would include both individual and group?

Brian A. Kane - *Humana Inc. - CFO and SVP*

It's really hard to comment on how CMS calculates the numbers. I would tell you that what we've seen the last 2 years on the individual side is a little bit less than 6% growth. For us, that's not an unreasonable way to think about market growth this year. But obviously, we'll see where the data shakes out. But there's nothing that's meaningfully changed this year that would change that growth rate.

Operator

Your next question is from Josh Raskin with Nephron Research.

Joshua Raskin

The question is around the reductions in force and the voluntary retirement. I'm just curious what the catalyst was there. Was there some sort of strategic review process? Was this sort of just a, "Hey, post the Aetna transaction we've got to start thinking about the business in a longer-term fashion"? I'm just curious what created that and was any of that tied to the MA bidding and the inability to get into that 4.5% to 5% range?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

Really, throughout 2017, we have been oriented to improving the productivity of the organization. And it's really to create capacity both to be competitive in the marketplace from a benefit design point of view for our customers and, as everyone knows, there's a continued need to invest in the business for long-term competitive positioning, whether it's in technology or it's in areas that are building capabilities like in our Provider area or even in our Home area, which helps us with clinical outcomes.

So I wouldn't say it was really a planned process that we went through over the year. It came together at the end, and in the last month or so, but I would say that we've been working on these productivity initiatives really even before the Aetna transactional termination. And so I wouldn't call it anything but just continuously trying to improve the productivity of the organization and reinvesting those dollars in our customer and reinvesting those dollars in the infrastructure of the company.

Joshua Raskin

All right. That makes sense. And just, Brian, real quick follow-up, I just want to make sure I understood, the starting point is $11 in terms of a run rate for this year, and that's the number from which you'll grow the high end slightly less than or a bit less than 11%? Is that the right math?

Brian A. Kane - *Humana Inc. - CFO and SVP*

That's correct.

Operator

Your next question is from Ana Gupte with Leerink Partners.

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

On the first question on the workforce reduction, what is the timing of realizing the run rate savings? Or is all of that termination happening at the end -- by the end of this year?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

We have notified the majority of the individuals. First, let me back up, Ana, a little bit. As I mentioned, we've been doing this throughout the year. So we've had reductions that have begun to show up in our financial numbers probably starting in the second quarter or so. But this particular reduction will show up in the first quarter of 2018 as we transition the individuals out. The full transition would be done by the middle of January.

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

Okay. And then if I could just do a quick follow-up. On the physician services where you're seeing pressure, is there some level of -- how do you not double count that pressure on your Medicare MLR outlook? And will that persist into 2018? Or is that kind of done at this point? Because that's related to the rates in MA, correct?

Brian A. Kane - *Humana Inc. - CFO and SVP*

When you say physicians here, do you mean our provider business in South Florida? Is that what you're referring to?

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

Yes, yes.

Brian A. Kane - *Humana Inc. - CFO and SVP*

Yes, I mean, look, it's an interesting dynamic in South Florida. Those rates have continued to be ratcheted down over the last few years. We've seen that multiple years in a row. I would tell you to date that the competition really hasn't changed fundamentally the benefit design there. And so as a consequence, I think people have just had to get better and better to continue to drive profitability. But there's no doubt that profitability has been reduced in the Provider segment because of that -- because of those actions.

We've also adjusted some of our contractual terms with our providers to help ease that transition and been very thoughtful about our benefit design and working with our provider partners. But net-net, it has had an impact on our overall profitability in that region in the Provider business.

As it relates to growth, as I said, I think the carriers, us included, I think have tried to be very prudent about how we deal with these rate declines and still offer compelling value proposition to members, and that's allowed us to continue to grow. I would tell you that, were it not for those provider -- those rate reductions, we would grow more. There's no doubt about it. But we've done everything we can to try to minimize the impact on the customer.

Operator

Your next question is from A.J. Rice with Credit Suisse.

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

Just a point of clarification to Josh's question, and then I want to ask you about Pharmacy. On the $11 base earnings, you commented, Brian, that you would guide differently than what your actual PYD was this year. Is that reflected in the $11 baseline start? And then more broadly, on your Pharmacy comments, have you been able to drill down as to what's happening in mail order? And I know you guys did a strategic review of Pharmacy a few years ago, but there seems to be a whole lot of changes in the PBM landscape. Does that cause you to look at anything differently? Partnerships? Opportunities?

And in your push for integrated models, I know guys are talking about engaging with the pharmacists more and at the retail pharmacy outlet. You have your relationship with Walmart. Is there any evolution in how you're deploying that in terms of maybe provision of care or dealing with gaps in care?

Brian A. Kane - *Humana Inc. - CFO and SVP*

So on the $11, what the $11 reflects is the '17 outperformance. So effectively, what that does is it takes into account the PPD for '17 as we start our baseline. But as you think about '18, when we grow off that $11 base, we're not going to assume the same level of PPD that's occurred. So that's the distinction we make between the '17 PPD that's effectively reflected -- that outperformance is reflected in taking the baseline back to $11, but the '18 guide will not assume the same level of PPD that we've seen in '17. So hopefully that makes sense.

On the mail order side, I would separate the mail order reduction we've seen and some of the broader questions that you're asking. It's hard to know exactly what's driving the mail order reduction, particularly for the new members. We think it might have something to do with benefit design. It could have something to do with just the nature of the risk that we're attracting versus our -- versus the competition and where perhaps the higher utilizers are going. I think overall we're benefiting, from a health plan perspective, in terms of the risk dynamic we're seeing, but it has had an impact on the pharmacy profitability.

More broadly, to your question on strategic reviews and cost, we constantly are looking for opportunities to drive cost out of the system. We continually review our cost of goods. We continue to look at our cost to fill. And I will tell you that the Pharmacy team really does a fantastic job of being best-in-class in both those areas as we look at the opportunities that are out there. But as we've said multiple times, we are not wedded to any particular philosophy with regard to -- if we can find opportunities to drive out costs in the system, we will do that. But what's critical for us is that the Pharmacy is a critical -- clinical engagement opportunity mechanism with our members. And so that can't change. But as it relates to cost, we are always open-minded. And I will tell you, these guys do a great job of driving best-in-class cost of goods for our plan and for the Pharmacy.

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

A.J., you did further ask the question around leveraging pharmacists and the ability to close gaps. We do think that pharmacists serve an important role in the clinical interaction with our members. And today, in fact, we have quality contracts with a number of retail chains that allow that benefit to both encourage pharmacists at the counter to do it and, in addition, to get rewarded for any kind of improvement in quality and clinical outcomes.

In addition, we are continuously adding pharmacy locations to our provider areas where we will have a pharmacy inside our pharmacy -- inside our primary care clinics. And again, it's leveraging that moment of influence that the pharmacist has. We are finding mixed results in our relationships with the retail pharmacies and clinical outcomes. We find where it's convenient and it's more in a clinical setting it's more effective than it is in the retail setting. But I think that's also just the time that the pharmacist has at the counter to be able to have that engagement.

Operator

Your next question is from Chris Rigg with Deutsche Bank.

Christian Douglas Rigg - *Deutsche Bank AG, Research Division - Research Analyst*

Just wanted ask a big-picture question about the competitive environment in the Medicare Advantage business. Seems like you guys are working really hard to get to sort of market growth, albeit at a target margin slightly below where you want to be long term. Do you think other participants are being a little bit more aggressive or slightly irrational in their attempts to grow membership at this point?

Brian A. Kane - *Humana Inc. - CFO and SVP*

I don't know if I'd use the word irrational, but I think it's fair to say that our competitors view Medicare Advantage as an exciting growth area. I think they've invested a lot to grow their platforms and to expand their positions across the board. And it's just something that we're going to have to deal with. I think we feel good that we are really in the strike zone of where the growth of managed care is happening. We believe that we have superior clinical programs and the right operating model to capitalize on that growth. But there's no doubt that we're facing a much stronger competitive environment.

And I would say that's been compounded by the fact that we have this massive health insurance fee that's returning in 2018. That impacts the customer, and it impacts the industry. And so I think those 2 factors have required us to take significant action, which we've done this year, and invest some of the outperformance that we've done -- that we've had this year into our 2018 benefit design. But long term, I'll tell you, we feel very good about how we're positioned.

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

I would just add to that, I think as you look at the trajectory of the industry, it has a very strong demand trajectory. But I would also say that I think, even on our investments we're making today, that the competitive nature is going to evolve. And we think the competitive nature is going to continue to evolve to be much more oriented to a clinical approach as opposed to just a -- just from an insurance and pricing point of view. And as you look at our investments, it's really focused on how we continuously proactively help people with, especially chronic members, in managing their conditions.

And I think long term, all organizations to be in this business are going to have to have some really clinical strength. And we believe in the short run we have to meet the competitive natures of pricing relative to the number of players being in the marketplace. But long term, we have to invest and build those clinical outcomes. And it's the combination of those 2 things you see the organization doing.

Operator

Your next question is from Gary Taylor.

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

I just had one clarification and then my question. And to be awfully redundant on the clarification, I just want to make sure I have this perfectly correct, so if we start 2017 base of 11%, we're going to grow a little below 11% to 15%. 11% growth would be [12 21] -- I'm sorry -- yes, 12 21 . So something a bit below that. And you're going to give a wider range than the initial $0.30 range? Is that fair?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Yes, without opining on the [12 21], yes, that is correct.

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

Okay. And then just going back to the early retirement and the layoffs announced, I wanted to make sure I had Bruce's comment correct that you expect most of that to be effective in January, so you get a full year earnings benefit from that? Did I understand that correctly?

Brian A. Kane - *Humana Inc. - CFO and SVP*

You did, yes.

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

And can you give us a dollar amount that you're targeting? And then does most of that just come out of G&A?

Brian A. Kane - *Humana Inc. - CFO and SVP*

I would say -- so, I mean, these are big numbers. I mean, ultimately, at the end of the day, our savings initiatives will run into the hundreds of millions of dollars for '18. And I would say some of that's in G&A. Some of that will show up actually in our MER because of the nature of the associate base that's being impacted. That actually gets classified as an MER expense. I think it's fair to say that when you look at our adjusted operating cost ratio next year, when you pull out the HIF and other things, that you will see a reduction for sure. And we'll obviously give more color on that on the fourth quarter call.

Operator

Your next question is from Dave Windley with Jefferies.

David Anthony Styblo - *Jefferies LLC, Research Division - Equity Analyst*

It's Dave Styblo in for Windley. I wanted to just come back to the RIF and understand a little bit more, specifically what parts of the business does this affect? I'd imagine maybe some of it is for exchange support. But can you give us a better sense of what departments these are coming in and to what extent the savings are going to be used to offset the HIF? Or is this going to be used to invest in initiatives you outlined in the prepared remarks about care in home or with the providers?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

Yes, I'll take that. I think it really is across the organization. There wasn't one area that was impacted, both geographically or from a department point of view. The organization really, as Brian has mentioned, is we're looking for productivity improvements throughout the company. So I wouldn't say it's one specific area related to any one initiative we have.

In regards to the investment side, is it investing -- is it going to the shareholders or is it going to benefits, I would say it's fairly -- it's fungible and it sort of goes through all that. I think we've continued to manage in how do we invest in the business for long-term sustainability and compete in the local marketplace, how do we continue to have a competitive market offering. And if you look at our market offering, you'll see that we're not the cheapest in the market, so we're constantly trying to ensure that we're not giving the product away and our brand and all the things we do from a customer experience point of view wins the customer over. And then at the same time, we also look at the ability to invest in the advancement of our initiatives. And I would say it's sort of all those items. I wouldn't say we did it just to fund a particular initiative. We really worked through saying how can we be competitive, how can we meet the long-term goals of our shareholders and, at the same time, how do we ensure that we are productive and being able to also invest.

David Anthony Styblo - *Jefferies LLC, Research Division - Equity Analyst*

Okay. And then as you're looking to reduce some of these costs, how do we get a little bit more comfortable from the outside that these don't impact your ability to move forward on trend benders?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

Yes, I would tell you that we cherish the trend bender area. And I would tell you, a lot of what we've done is to look at where are those areas that are less -- where it's not as impactful. But the trend bender area is a very important part. And as you can tell from the script that I outlined, we are investing in the areas that we feel will affect the chronic conditions and really bring alive longer term trend benders. So investors should not worry about that. That is a passion of ours, is continuing to ensure that our clinical programs are advanced.

Operator

Your next question is from Zack Sopcak with Morgan Stanley.

Zachary William Sopcak - *Morgan Stanley, Research Division - VP on the Healthcare Services and Distribution Team*

Can you just remind us, included in that preliminary 2018 guidance, what the contribution of capital deployment is? And then you talk about some potential opportunities for M&A, but your -- how you view M&A versus share buybacks as we head into next year?

Brian A. Kane - *Humana Inc. - CFO and SVP*

At this stage, we're not prepared to talk about the specifics around capital deployment. I think you've seen our willingness to deploy capital in buying back stock, and we will continue to do that. And similarly, on the M&A side, it's really not something that we're prepared to give any more color around today, other than just referring back to Bruce's opening remarks that we actively look for assets that advance our strategy. And we're going to continue to do that because it's important to do that.

I would tell you that if we found an M&A opportunity that advanced our strategy, that would take precedence over share repurchase if it made sense to do that. But we're very committed to share repurchase. You see that we have leverage capacity in our balance sheet. We're at 30%, 31% debt-to-cap. We have ample parent company cash to accomplish our objectives. And so we won't be shy about deploying our capital, obviously maintaining our investment-grade rating, which is also very important to us.

Zachary William Sopcak - *Morgan Stanley, Research Division - VP on the Healthcare Services and Distribution Team*

Okay. Just to clarify, when you give full guidance, I guess in the fourth quarter, will we get more color on how much of that is coming from capital deployment?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Yes, we typically, in our guidance waterfalls, will call out for you exactly what is capital -- what relates to capital deployment. So yes, we will do that.

Operator

Your next question is from Sarah James with Piper Jaffray.

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

I appreciate the detail on analytics and data sources. Can you tell us how you're using that data? Is it on the care management and clinical side? Or are you also rolling it into decisions on branding spend, marketing mix and product development?

Then do you feel that you have the technology and human assets that you need for your analytics? Or should we expect Humana to get more competitive in recruiting data scientists?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

We have multiple sources of information, both clinically, which are coming from a claims base, to electronic medical records information, which also includes coming from notes within the electronic medical records. So you see that one side. But on the other side, we also pull a significant amount of consumer information both from -- as much as we can get from public but also in the interactions that we have with our members. So we look at how they're using the digital, what kind of -- from the pharmacy point of view, what are they using in the pharmacy area, how they're using it, are they using mail-order, are they using retail. And that gives us a lot of information about how their preference is in engaging in their health care. And so I would say that there's a whole host of ways we go about bringing the analytics to the forefront.

In regards to the question on analytics from a human resource point of view, we have, over the last number of years, and we really haven't brought it out to our investors, have invested significantly both in the consumer analytics and also in our clinical analytics. And I think people would be very surprised at the depth of our analytics capability today. We're always adding and expanding our clinical capability as just part of our normal planning cycle in our HR recruitment area. And so I would say that yes, to answer your question, that we will continue to be investing in that area.

But I would say today we are, in this area of predictive analytics and in contextualization of the member, I would say we're fairly advanced, both from our competitive point of view but I think in the industry in general.

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

You said that we would be surprised at how much Humana has invested in consumer analytics. Is there any way for you to frame that up or size it for us?

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

I don't think I would do that. I think we will -- both from a competitive point of view and then, in addition, we don't disclose that kind of detail.

Operator

Your final question comes from Christine Arnold with Cowen.

Christine Mary Arnold - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

A couple things. Healthcare Services, I keep hearing that we still have some headwinds here. But also I'm hearing that the MA (inaudible) services. Is Healthcare Services a headwind or a tailwind next year with respect to earnings?

And then good growth in group MA, but we're hearing that it's a pretty competitive environment there. Do you expect the margins there to come in kind of below your target range of 4.5% to 5% as you do with Individual? Or do you expect margins to be maintained there?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Christine, so I'm not prepared to comment on giving individual segment guidance. I think there are pluses and minuses on the Healthcare Services side. Obviously, you mentioned MA growth. That's obviously a positive. I've talked about some of the headwinds on the Pharmacy side with regard to PDP growth, et cetera. So I'm not prepared really to give segment-level specific guidance at this time. But obviously, we'll comment extensively on that on the fourth quarter call.

With regard to Group MA, we've been very clear that we're going to maintain pricing discipline on that. As we've said before, our margins in Group MA are not 4.5% to 5% that we -- that is not a target margin of Group MA. It is below that. But I think we feel pretty good about our Group MA business. I think the team is doing a really nice job of finding opportunities where we can earn a good return on capital, and again, being very disciplined in some of these larger accounts where we can drive profitability as well as customer satisfaction. So I think we feel very good about the positioning of our Group business.

Christine Mary Arnold - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

So on the margin, is the margin a headwind or a tailwind, do you think, for Group MA next year?

Brian A. Kane - *Humana Inc. - CFO and SVP*

Again, I'd rather not just give -- I'm sorry.

Christine Mary Arnold - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Is it easier to pass the HIF along because you're dealing with a group and so...

Brian A. Kane - *Humana Inc. - CFO and SVP*

Typically in the larger accounts there's a specific adjustment for the HIF, particularly the jumbo accounts. So -- but that obviously impacts overall growth in the space but also potential willingness of a group account to actually choose Group MA. So there's some impact there. But it is a -- I would call it a very transparent market, particularly at the large end, and so the HIF is well known and it's discussed.

Operator

I will now turn the call back over to Bruce Broussard for closing remarks.

Bruce D. Broussard - *Humana Inc. - CEO, President and Director*

Well, thank you. And again, thanks to all our investors that support the organization over the years. You've been part of us. And lastly, and as importantly, I'd like to thank our talented Humana team members which really make these results possible. And so we appreciate it, and this will be the close of the call. Thank you.

Operator

This concludes today's conference call. You may now disconnect.
