THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

HUM - Q2 2017 Humana Inc Earnings Call

EVENT DATE/TIME: AUGUST 02, 2017 / 1:00PM GMT

## CORPORATE PARTICIPANTS

**Amy Smith**

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

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

## CONFERENCE CALL PARTICIPANTS

**Albert J. Rice** *UBS Investment Bank, Research Division - MD and Equity Research Analyst, Healthcare Facilities*

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

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

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

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

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

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

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

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

**Ralph Giacobbe** *Citigroup Inc, Research Division - Director*

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

**Scott J. Fidel** *Crédit Suisse AG, Research Division - Director and Senior Analyst*

**Zack Sopcak** *Morgan Stanley - Analyst*

## 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 Second Quarter 2017 Earnings Call. (Operator Instructions) Thank you.

I would now like to turn the call over to Ms. Amy Smith, Director of Investor Relations. 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 second quarter 2017 results and our financial outlook for the full year. 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 second 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*

Good morning, and thank you for joining us. Today, we reported second quarter results and raised our full year 2017 earnings guidance. Our second quarter 2017 GAAP EPS of $4.46 or $3.49 on an adjusted basis significantly exceeded our previous expectations, led by our individual Medicare Advantage business and our Retail segment. Given these results, we have raised our full year 2017 GAAP EPS guidance to approximately $17.83 per share or approximately $11.50 per share on an adjusted basis. Brian will discuss these results in more detail following my remarks.

The quarter results demonstrate the strength of our focused strategy: improving the health of seniors living with chronic conditions through an integrated care delivery model that brings simplicity and connectivity to the health care experience. Members in our small to mid-sized group and military businesses also benefit from this integrated model through an improved experience.

Key to our strategy and woven into all aspects of our business is a philosophy of fewer, bigger and better. We are focused on identifying key improvement areas that drive the greatest benefit for our members, provider partners, associates and our company, overall.

As we've outlined in our Investor Day presentation, we are doing this by focusing on integration in 3 major areas: integrating with providers to evolve economic incentives from treatment to health; integrating lifestyle and health care by expanding our offerings in the home, pharmacy and behavioral health programs; and integrating technology, both internally and externally, with provider partners to reduce friction points.

We are actively advancing expanding our primary care and home care platforms as part of this strategy. We believe we can accomplish some of this through continued organic development, while some areas will require M&A. Our efforts are focused on expanding our platforms with geographic coverage to serve our members while enhancing clinical capabilities to improve their health. These platforms will be locally oriented, integrated across the provider community and enabled by technology and analytics.

In addition to expanding our clinical platforms, our associates are working toward solutions that reduce other friction points for both our members and our providers. For example, navigating the health care system can be complex and challenging. If a member calls with a question and is immediately transferred, sometimes multiple times, it becomes a very frustrating friction point.

In 2016, we addressed this friction by our members -- by reducing unnecessary call transfers through identifying the root causes and by creating more consumer- and provider-friendly processes. That work continues in 2017, and we expect to see further positive results. By removing these friction points for the member, a few things happen. The member is more satisfied and our response is more timely, which improves Net Promoter Score, a measure of members who recommend us to friends and family. Our associates handling the calls are more engaged because they feel they're making a difference for the member. And finally, our organization becomes more efficient, which results in savings that we can reinvest to benefit members and providers.

This is just one example of the strides our associates are making to improve the consumer and provider experience. Our service centers are focused on improving our ability to meet our members' needs, particularly in important areas such as benefits, in-network providers and claims payment.

In addition to reducing call transfers, we've improved our digital capabilities, which enable members to access needed information 24/7. We are leveraging our customer relationship management platform to better meet the needs of our members based on their history and preferences. And we've significantly improved our communication practices by simplifying and personalizing our messages and refining the quality of how messages are delivered.

As we continue to evolve our integrated care delivery strategy, we have seen increased activity in our members' completion of health risk and in-home assessments, participation in our Go365 wellness platform and more effective engagement in our Humana At Home chronic care management program, which focuses on members most in need of health support.

While there is still work to do, we are pleased with our progress to date. Over the course of this year, we've seen significant improvement in our Net Promoter Score relative to last year. For Medicare Advantage, through June 30, we have improved our relationship Net Promoter Score by more than 500 basis points and our transactional Net Promoter Score by more than 700 basis points. We believe our focus on eliminating friction points and providing enhanced value through health engagement positions us well for the future as we continue to improve the experience and health of our members.

To support our strategy, we've developed a strong internal framework to advance our enterprise-wide commitment to quality, risk management, compliance and productivity. While these have always been top priority for us, we have renewed our focus on them, beginning with the recent announcement of Sam Deshpande to fill the newly created position of Senior Vice President and Chief Risk Officer. Sam and his team will help to drive integration throughout the enterprise, ensuring timely, proactive discovery and faster mitigation of risks and their causes.

In addition, last year, we created the Process Transformation Office to drive productivity throughout the organization, with a focus on improving our operating structure while also improving member experience and compliance. This renewed focus is evident on how we look at CMS Medicare Star ratings.

As a background, it is important to note that the Stars program is complex not just for Humana, but the entire industry. A Star score is an aggregate of multiple measures, some having to do with quality; others with process, policies and procedures.

There's a lagging indicator with scores for particular bonus years dependent on assessments that took place years previously. Many health plans, including Humana, implement remedial measures as a result of these assessments that are not reflected in the Star scores for the bonus year to which it is assigned. In addition, small movements in individual measurements can have significant impacts, positive or negative, on the overall score.

With this in mind, we've disclosed in today's earnings release that for the bonus year 2018, we now expect approximately 74% of our Medicare members to be in 4-Star or higher plans, which compares favorably to our previous forecast of 37%. We are pleased with the final outcome for bonus year 2018 and have implemented operational changes that we expect will reduce volatility in future years.

Aside from our Star results, we're also proud of our strong HEDIS measures, demonstrating the achievement of clinical outcomes, which are at a record-high level for us.

In closing, I'd like to thank Humana's associates for their outstanding efforts on behalf of our members, providers and our company. It is through their hard work and commitment that our company continues to deliver strong performance.

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, the strong performance of our individual Medicare Advantage franchise resulted in adjusted EPS of $3.49 for the second quarter, well ahead of our previous expectations. We also raised our full year 2017 adjusted EPS guidance to approximately $11.50 from our previous adjusted EPS guidance of at least $11.10, and we increased our operating cash flow guidance by approximately $200 million due primarily to our better financial performance.

As a percentage of adjusted full year earnings, we expect our third quarter to reflect adjusted EPS in the high-20% range, with the fourth quarter, therefore, comprising a percentage in the high teens as it incorporates the usual cost increases associated with the open enrollment season.

I will now highlight the drivers of each segment's operating performance. Led by individual Medicare Advantage, our Retail segment continues to significantly exceed our expectations. And today, we raised our full year 2017 Retail segment pretax income target by approximately $300 million at the midpoint of the guidance range. Consistent with the early indicators we saw in the first quarter, individual MA medical utilization trends, including hospital admissions and pharmacy spend, are running favorably relative to our pricing assumptions, and we are seeing better-than-anticipated prior period medical claims development. We are also experiencing higher-than-expected revenue on a per member, per month basis. Accordingly, we reduced our projected full year benefit ratio for the Retail segment by a full 100 basis points from our previous guidance.

Turning to our other businesses. Our Group and Specialty segment is continuing to have a solid year, and as a result, we raised our pretax target by approximately $20 million, at the midpoint of the guidance range. The increase was driven primarily by positive prior period claims development and specialty results that exceeded our previous expectations as well as current year medical cost trends that are slightly favorable to our expectations. We continue to believe that a key element of our strategy is a focus on small to mid-sized employers as well as our specialty dental and TRICARE businesses, as each delivers steady cash flow and good returns on capital.

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. Consistent with the first quarter, we are continuing to see lower-than-expected pharmacy volumes, which reflect less health plan drug utilization than we had previously anticipated.

In addition, while to date, mail order rates are higher than last year, we are experiencing slightly lower penetration than we previously expected as some of our new stand-alone PDP members appear to be lower utilizers of mail order relative to historical experience.

Finally, the optimization of our chronic care management programs, whereby we are ensuring that our members are receiving the right level of intervention at the right time, is proceeding at a faster pace than initially expected, also contributing to lower Healthcare Services segment pretax than anticipated. As a result of these items, we've reduced our pretax guidance for the segment by approximately $130 million, at the midpoint of our guidance range.

To reiterate my comments from the first quarter call, this dynamic is positive for overall Humana, and we expect that the increase in health plan pretax income will more than offset the reductions in Healthcare Services segment profits, even considering that a meaningful portion of lower pharmacy utilization does not benefit the insurance segments due to the corresponding lower CMS reinsurance and member cost share. These dynamics reinforce our integrated approach to running the business, taking a holistic, enterprise-wide view to drive business decisions that result in the best outcomes for our members, providers and the company.

To close our segment discussion, I will comment briefly on our Individual Commercial segment results, which are excluded from our adjusted EPS guidance. Our Individual Commercial segment is now expected to generate full year 2017 pretax earnings of approximately $85 million versus our previous expectation of a full year loss of approximately $45 million. These results reflect significant prior period development -- positive prior period development, which includes the net favorable settlement of the 2016 to ours of reinsurance and risk adjustment as well as lower-than-expected utilization in our ACA on-exchange business.

The strong performance we are seeing across the organization reflects our focus on operational excellence and the solid execution of our strategy. This will enable us in the third quarter to provide the Humana Foundation with a charitable contribution, reflecting our continued commitment to the communities we serve following the deal break. In addition, these results will enable us to spend incremental dollars on the Medicare annual enrollment period.

Lastly, our compensation policies result in changes in compensation, both up and down, depending on our operating performance, with some years resulting in higher compensation levels relative to others. We are accruing compensation for 2017 based on the strong results we have seen across the company. As a result, we have increased the range of our full year consolidated operating cost ratio guidance by 25 basis points at the midpoint.

Pivoting now to CMS Star ratings and our Medicare bids for 2018. We reported this morning that we now expect approximately 74% of our members to be in 4-Star or higher plans for the 2018 bonus year. We are pleased that we were able to significantly reduce the impact that the lower Star ratings would have had in our members in 2018 and that our final Star ratings reflect our commitment to quality products and services for our members. In particular, these ratings reflect our strong clinical HEDIS measures, which are at record-high levels. It is nonetheless important to note that there were certain contracts that we chose not to consolidate and still others that we were not able to consolidate due to state regulatory limitations.

Taking this into account and considering rebate implications from reductions in Star ratings for certain of our contracts, we still expect to have some Stars-related financial headwinds for 2018.

With regard to our 2018 Medicare Advantage bids that were submitted in June, we continue to work very hard to offset the negative impact that the return of the nondeductible health insurance fee and the remaining Stars-related financial headwinds could have on our members and the attractiveness of our products more broadly. We are focused on continuing to drive cost out of the organization and expect to make progress in this regard in 2018. The Process Transformation Office that Bruce referenced in his partnership with our various businesses is working diligently across segments to achieve increased productivity while improving and simplifying our core processes.

Additionally, we have invested the 2017 outperformance I've discussed directly into our product designs for 2018. When combined with enhanced productivity, this has enabled us to keep benefits stable and competitive, and we believe will allow us to grow individual MA membership growth meaningfully in 2018 while maintaining our commitment to steady EPS growth.

It is important to note that as we think about our 2018 earnings profile, our 2017 baseline remains our initial 2017 adjusted EPS guidance of approximately $11 at the high end, given the investment of the strong 2017 performance that I mentioned.

Finally, I would like to reiterate our previously communicated capital deployment plans. As you're aware, we initiated a $1.5 billion accelerated stock repurchase, or ASR, in the first quarter of 2017, which we expect to settle in the third quarter. Upon completion of the ASR, we continue to expect to repurchase shares for the balance of the year and have the flexibility to spend up to $750 million under our existing authorization. Additionally, as Bruce indicated in his remarks, we continue to explore ways to accelerate our strategy in the home and with providers, including with M&A and other partnerships or collaborations. As discussed at our Investor Day, our capacity for cash M&A is approximately $3.5 billion while allowing us to maintain our investment-grade ratings.

With that, we will open the lines up 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 Scott Fidel with Credit Suisse.

---

**Scott J. Fidel** - *Crédit Suisse AG, Research Division - Director and Senior Analyst*

Just a question on Part D. We had some information out of CMS, giving us the 2018 initial bids and benchmark data for 2018. Just interested if you can give us an update on how you're expecting the competitive environment for Part D next year. And then also, just on the low-income subsidy auto allocations, how you're expecting that for 2018 versus 2017.

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

I would say that what we've seen is consistent with where -- what we expected on both fronts, on both the low-income benchmarks as well as our direct subsidy calculations. And as the fall goes on, obviously, we'll talk more about what that means for us and our membership growth.

**Scott J. Fidel** - *Crédit Suisse AG, Research Division - Director and Senior Analyst*

Okay. Then just had a follow-up question, just on thinking about sort of the comments that you made on investing for 2018 into the MA business on the upside and then given the improvements that you had on Stars in terms of the mitigation efforts. I know in the first quarter, you guys have talked about a view of MA industry growth running around the 6% range sort of over the next few years. How are you thinking about your ability to sort of return to that type of growth rate next year, given some of the recent developments?

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

Well, as I said in my remarks, we do expect to grow meaningfully in the individual MA business. We're not prepared to comment today on where that will be relative to the market. But again, I think we feel very good about the product we've put on The Street. We've really endeavored to maintain stable benefits, and we think it will be compelling products for our existing members and also future members looking to enter MA.

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

And Scott, just a few things. I think -- this is Bruce. First, as Brian has articulated, we've really tried to keep the benefits stable this year. Second thing, we've been very proactive in reaching out to the broker community and building deeper relationships with them. Then the third thing is, as we articulated in our comments, we see our Net Promoter Score and some other things that can help out on the retention side. So we feel good about next year. We obviously aren't going to put estimates out, but I think we have a good feeling about going into 2018.

**Operator**

The next question comes from Gary Taylor with JPMorgan.

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

I kind of wanted to hit on the same point, maybe just in a little more detail. So if I'm understanding kind of how you're talking about 2018, there's roughly $0.50 of outperformance, the $11.50 versus the $11 you talked about, to invest in 2018. There's roughly $2.15 of excess HIF tax benefit that you'll be able to invest in benefits because you're not pulling that through operating earnings this year. So that's a little less than $3, and we think the HIF coming back at you is about a $4 headwind. So when we think about how that plays out in '18, either you have to absorb that differential in terms of lower earnings growth, you have to reduce benefits, you have to cut G&A or you have to raise premiums. Can you help us understand, when you say stable benefits, does that literally means stable, including premiums and the bulk of that differential has to get absorbed in earnings? Is that the message you're conveying today?

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

So there's a lot to unpack in that question. Let me try. It is fair to say that, number one, we are going to put products in the market that do have stable benefits, which means we've overcome the health insurance fee. Obviously, it's going to vary by market. But on a national basis, I think that's a fair way to think about it. It's also fair to say that the $0.50 you're talking about was reinvested into product design. But I think it's important to think about really the MER element of it, that 100 basis points that was reinvested into our product design. Some of the additional admin expenses that I mentioned around the foundation and compensation and other things are more onetime items. And so I think it's important to think about the investment as really the MER outperformance. And finally, as it relates to the HIF. Remember, the HIF is coming back next year. And so it's not as if we could take that $2.15 and invest it in benefits. It's just that we didn't have to claw it back that perhaps others may have had to if they put that into benefits for 2017.

---

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

Okay. So you're still going to have enrollment growth, you're still anticipating earnings growth even as you keep the benefits stable and reabsorb the HIF?

---

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

Yes. So again, I think it's' important, as we think about '18, and I don't want to comment too much more on '18, but to think about a baseline of $11 because we've invested this outperformance. We mentioned that in the first quarter, we would do that. We thought it was the appropriate thing to do to provide good benefits for our members and enable us to grow. And again, we feel good about where we stand. Our -- we do anticipate growing EPS. We've committed to our investors that we're going to have steady EPS growth, and that's certainly our intention next year as well as grow membership.

---

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

And one of the aspects, just to maybe pull it up a little bit, as we think about our strategy, one of the important parts of our strategy is to continue to grow our -- we refer to them as our trend benders, but our clinical outcomes, and that's an important part of our earnings per share and allows us to be able to both invest in benefits but also return dollars to shareholders. And then the second part, as we articulated today, also to focus on improved productivity and reduction of friction points into the system, and those are also included in the plan. So as we think about the growth of the organization, there's membership growth, there's clinical cost to offset growth, and then there's obviously productivity growth. And what Brian's talking about all of those are sort of included in there for us to have a growth year next year with the ability to also add stable benefits.

---

**Operator**

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

---

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

I just wanted to ask a question about the comment that you made around making changes to reduce volatility in Star ratings going forward. I think that the way I would interpret your mitigation strategy this year is that your consolidating plans might actually increase volatility of Stars, going forward. So I just wanted to get some color there.

---

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

Sure. I think it really relates to an environment we've been operating in for a number -- the last few years. And as everyone knows, we had a CMS audit in 2015, and we've concluded that audit and have really done a lot of great things in the infrastructure to ensure that we have very stable processing and the ability to operate in a much more complex environment. And I think that it's -- I think it's also evident in both our HEDIS measurements, as we look at those today, and also our customer satisfaction ratings. Both of those have increased over the last 18 months or so, and that's just an indication of how our, I think, our infrastructure is expressing itself in our results. But like everything, we have audits every year, and there are a lot of different inspections that go on in the organization like everybody operating in this regulatory environment. And so there will be fluctuations that come out. And as -- even as of today, we don't know what 2019 holds because we don't know what the relative measurement for others are in the comparison side. But really, the focus of what we are oriented to is just continuing to have solid processes, policies and procedures in the organization that ensures that our Stars performance isn't based on contract consolidations and other matters like that. It's really based on improved clinical outcomes, better satisfaction, and at the end of the day, also better compliance ratings. And I think that's when we talk about volatility. We talk about it in that context of how our infrastructure has really improved and our ability to manage the business in a highly regulatory environment.

---

**Operator**

Your next question is from Ralph Giacobbe with Citi.

---

**Ralph Giacobbe** - *Citigroup Inc, Research Division - Director*

First, I just wanted to clarify, when you say growing EPS, just want to be clear, is there a context there off the $11.50-plus base or off the $11 base? And then the question I had was just if you can kind of discuss the crosswalk and maybe the process for a member. I'm assuming there's some sort of auto renewal if somebody stays on the same plan. But in the case of you rationalizing a contract, does that mean the member needs to go and sort of now select a new plan? Or if you could just help us understand the process and the differences for a member between sort of a legacy contract versus crosswalking to a new contract.

---

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

So I'll go there first. It will be seamless for the member as it relates to the contract consolidation, so that won't be an issue in terms of -- the member won't see that consolidation. With respect to the EPS, I think it's important to use $11 as the baseline. And we hope to -- obviously, our plan is to grow that number, and our expectation, it would be above the $11.50 as well. But $11 is the baseline. And so as we think about growth rates, I think that's the way you should be thinking about 2018.

---

**Ralph Giacobbe** - *Citigroup Inc, Research Division - Director*

And then the $11 to $15, I think, is what you've had as kind of your growth expectations. Is there anything that you'd consider kind of next year on, sort of puts and takes to that estimate?

---

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

Yes. So I'm not prepared to comment on where we'll be on EPS growth because that will be giving guidance for 2018. We're trying to help you and give you context about how we're thinking about the year, but really not prepared to give specifics. I think what we tried to communicate this morning is that we feel good about the product we're putting out for our members that will enable us to grow membership. And we also believe, when combined with trade benders and some of the productivity initiatives we're working through, will enable us to grow EPS in a steady way.

---

**Operator**

The next question is from Justin Lake from Wolfe Research.

---

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

I apologize. A couple of questions here. First, for 2018, so just to follow up here. I think there's some confusion in terms of how your Medicare Advantage bids shook out from a margin perspective. So Brian, your original 2017 guidance assumed a margin below the target of 4.5% to 5%. So can we expect that within your strong 2017 performance and the discussion of the stable benefits, you are able to get back to your target margins in 2018? Or is that a wrong conclusion?

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

So I appreciate the question, but obviously, you're -- we're not prepared to give 2018 guidance. What I will say is that it is true, as we articulated that we came into the year a little bit below our margin expectation, our long-term margin target. It's fair to say, with this outperformance, that we are above our margin target, and it's fair to say that our long-term target remains 4.5% to 5% on a pretax basis. But beyond that, I don't want to comment any further.

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

Okay. And then just on Medicare Advantage growth. I thought, and correct me if I'm wrong, but I thought you'd previously said, I think at the Investor Day, that you expected growth in line to above that industry target of 6% for next year. Is that now an incorrect assumption? And when you talk about stable benefits for Humana, given all the talk about competition, are you seeing your competitor plans also keep benefits stable in terms of what you're hearing from the market so far?

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

Well, first of all, we -- at the Investor Day, we talked about, long term, growing at or above the market. We didn't comment on '18, and I would just leave it at that. It's too early, really, to see what our competitors have done. We're -- the data still isn't out there broadly, and it's something we'll be analyzing in the coming months. But we're obviously, as an organization, gearing up for AEP, and we feel good about how we're positioned.

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

And Justin, let me just try to clarify a few things. Obviously, we're in a difficult position right now because we are not prepared to give detailed guidance on 2018. And so Brian is sort of shaking in his chair right now. So I just want to highlight that. But we are committed, I just want to make it clear. We are committed to managing the business to a 4.5% to 5% long-term margin business for us, which we committed at the Investor Day. We have not lost that commitment. Second thing we are committed to is being able to grow over a period of time annually in the double-digit growth level that we committed in the Investor Day. And so none of those have changed. I think what we're trying to communicate is we're having a great 2017. We think the 2017 allows us to -- the performance, operationally, allows us to reinvest dollars in 2018 that sets us up for a strong growth in 2018, and we feel good about that. And I'd just -- we had to leave it at that because we're not -- we can't give detailed guidance for 2018.

**Operator**

Your next question is from Peter Costa with Wells Fargo.

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

Let me try it a little bit different way. You guys got nice improvement in your Star scores, moving up 37% of your membership. You put in bids in early June. Here we are in early August. Did you know that you had the improvement in Star scores when you put in your bids? Or should we be assuming that you didn't know that, and that you're going to have an incremental, call it, $600 million to $750 million of incremental earnings -- or incremental pretax earnings as a result of kind of -- either the benchmark caps or whatever, but the higher bonus amounts that you would get?

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

No. We did know our Star scores before we submitted our bids. So our bids incorporate the 74%.

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

So we should expect better member growth then?

---

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

Well, again, what we've said is we were able to keep benefits stable and competitive. And so we'll see where it shakes out, but we feel good about how we're positioned.

---

**Operator**

The next question is from Chris Rigg with Deutsche Bank.

---

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

Just wanted to, I guess, really come back to what others have been asking about the membership growth. When I think about your comments of stable in the context of what some of your other publicly traded peers, it all sounds about the same. So I guess, is it fair to think that maybe you has actually enhanced the benefits in some plans that make you confident? Or I guess, I still don't understand the logic that makes you confident you can "meaningfully grow the membership" when you don't see what others are offering at this point.

---

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

Well, again, I think that's why we're being cautious. We don't know where our competitors are. As I said, on a national basis, we're stable. I think there are clearly markets where we believe we can grow and we invested in. And there are markets where perhaps we're not as well positioned, and we didn't invest as much. So we were, I think, very strategic about where we put our investments and our dollars to be able to maximize growth and offer a compelling product for our members. But it is too early to assess where we are relative to our competition. But as Bruce said, we're working every angle and possibility we can to enhance growth, including distribution. So again, we feel good about where we are. We'll obviously know more in the coming months as we see how we're positioned relative to our peers.

---

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

Just to add a few things there. I think, first, we feel we're doing the right things for our customers as what we've talked about on the stable side. We've never been cheapest on the market. We've always been competitive, and we've always been able to compete there. So we don't -- we feel with the brand we have, the experience we provide the customer, our health offerings that we have, we can compete really, really well as an organization, especially if we are in the race with the benefit side. The second thing I really need to reemphasize with the investors is the organization has been under somewhat of a cloud for the last few years as a result of the transaction that has been -- I think it has caused a little bit of a challenge and headwinds in the sales process, whether it was in central parts of the state where we were having to market against where it was announced we were going to sell membership to some of the other markets where it was looked upon as that it wasn't going to be a Humana product at some point in time. So as you put it in context of where our performance is this year, our focus on growing and our ability to keep stable benefits, our improved orientation or relationship with our broker, we feel -- and that's where our confidence is coming from and the organization having clarity on its independence. And so I think that's what you hear from the management team and why we feel that next year, we'll have a good growth here.

---

**Operator**

The next question is from A.J. Rice with UBS.

**Albert J. Rice** - *UBS Investment Bank, Research Division - MD and Equity Research Analyst, Healthcare Facilities*

I figured I'd just maybe ask a couple of questions related to the specialty business, given the way questions have gone so far. I wanted to just flesh out a couple comments that I think Brian made. First, there was a comment about the uptake in the Chronic Care involvement being better than expected. I wonder if you could flesh out exactly what you're seeing there and the uptake. I know that's [happened] on your cost trend and [I don't know if you can quantify that]. As you mentioned the mail order rates not being as high and able to drill down to see why that's happening on the PBM side. And then lastly, on the specialty. I think you guys -- you're still looking at home health, and there was a proposal that just came out. I know you've put your emphasis on efforts to help your existing business. But the proposal change of Medicare, the way that they think about paying for home health, and I wonder if that affects your interest in doing something there (inaudible).

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

So that's definitely more than one question, but we'll try to answer it, A.J. So when we refer to specialty, what we were talking out in that context was our Group and Specialty segment and, specifically, our dental business, which has been outperforming. It's not something that we're prepared to quantify, but it's a business that we don't talk a lot about, but has, I think, done very, very nicely. Membership, higher than we expected as well as better claims experience. Secondly, as it relates to the home care side or the Humana At Home optimization, as we called it, and the mail order side, those are both in our Healthcare Services segments. On the optimization side, as we've said for a number of months now, we are spending a lot of time making sure that our members are getting the right level of care at the right time and that the right interventions are happening. And so if someone, for example, improves or gets better and no longer needs our services, that's a member we won't touch as many times. And I think we're being a lot more disciplined and operationally rigorous in ensuring that the members who truly need the care are getting the care. And so we continue to see very good results where the member is getting the right level of care, and that's where we're focused. But that does have a pretax implication for Healthcare Services because as we reduce effectively the charges, the intercompany charges to Medicare, Medicare benefits from a lower charge, but Healthcare Services gets impacted because there's lower pretax associated with that because there's a margin there. And so again, I think that's important as we talk about the integration of our model that we're constantly looking at what is the best decision for overall Humana and, more importantly, for our members and their clinical health. On the specialty side, on the specialty -- sorry, the pharmacy side and the mail order side, what we're referring to there is our mail order rate. And as I mentioned in our low-price Walmart plan, which has been and continues to be a very successful plan and a very good partnership with Walmart, we are seeing a slightly lower mail order rate than we had anticipated. We think it's probably because we made some tweaks to the benefit design that may be causing some of those members to fulfill -- to fill their prescriptions at retail rather than at mail. But again, overall, it's a -- there's an impact on Healthcare Services, but there's only a small impact to overall Humana because of the way the co-pay structure works with -- when someone fills at Retail. And then finally, I'm sure Bruce will comment on this as well, as it relates to home health, we continue to look at opportunities. We're obviously mindful of the rate release that came out. We're analyzing that, and I'll just leave it at that. But it doesn't fundamentally change our strategy in the home and in being able to engage with our members in a much more significant way in the home.

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

I'll just add to that. The home side, we -- although, obviously, we haven't announced any acquisitions, we are working internally as we talk about organic. And when we think about at home long term, we think about it not only in coordinating care, delivery of care in the home, which is the traditional home health side, also being able to have a home-based clinical model that is, it can be -- nurses and doctors can help people at home through telemedicine or to go to their home. And we're working on all of those different ones, and so it doesn't necessarily mean that we just have to announce an acquisition, and that's our home health strategy. There're a lot of other things that are going on within the organization to advance the home side. But you're right, A.J., it is all wrapped around how do we advance our membership in the long term.

**Operator**

Your next question comes from Sarah James with Piper Jaffray.

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

You mentioned that MA individual was seeing lower hospital utilization and pharmacy spend. What's driving those 2 trends? And are those drivers sustainable beyond 2017?

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

Well, it's something, obviously, we do a lot of work around to try to understand what are the major drivers. What we're -- we're clearly seeing the success of our clinical programs and some of our operational initiatives, what we call trend benders. We are seeing an important advancement of our strategy there, and we think that is why we're beating our operational targets, particularly on the inpatient side. On the pharmacy side, it's something that we continue to look through, I think -- look at. I think we're seeing slightly lower trend than we had expected. I think that's really the major driver. There may be some mix issues there as well in the membership that we have, but it's something that we continue to analyze. And as we think about '18, obviously, as we mentioned, we've reinvested those -- that outperformance into our -- in our bid design. We're obviously cautious about certain trends and whether they will continue. And so we're very mindful of trends that might continue and trends that might not continue. And so we obviously do a lot of analytics, a lot of actuaries working in figuring that out. So I think that what we've put into our benefit design for '18, we feel good about.

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

I think on the sustainability side that you asked, I think that's really the core of our strategy when you think about advancing our relationships with our providers and moving them more and more to a value-based payment model, is all wrapped around how do we continue to think more holistically about the individual and move from a reactive type of health care system to more of a proactive side. In the conversation that we just had with A.J. on the home, it's really around how do we keep people out of institutions and be able to stay where they really desire, and that's at home, and how can we provide them the care that they're needing there, both on a reactive basis, where something would -- as their conditions are expressing themselves in some way or on a proactive business where we're preventing. And so we do feel that our ability to impact the hospital admissions and, specifically, pharmacy in some ways, is -- has sustainability, and it's really the core of what we're operating towards as an organization.

**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*

I wanted to follow up on Sarah's question, if I may. The South Florida market, by -- all of the hospital reports say as well as our channel checks suggest that you're having quite a bit of success on driving down inpatient with value-based care and all of that. So my question was a follow-up on, firstly, how much of the potential future outperformance do you get to keep relative to providers on lower utilization as well as you've learned more from your Star crosswalk on the revenue side? How much do you have to share with your provider partners? And might that change your strategy on just doing -- contracted to buying more docs at some point?

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

Well, it's fair to say that when we are in a full risk arrangement with a provider, they'll obviously get the financial benefits from that. About 1/3 of our members are in full risk arrangements, the other 2/3 are not. About 65%, including that 33%, are in some form of a value-based arrangement where we share in some of those savings. I think it's fair to say that everyone benefits when admissions go down. Obviously, most importantly, our members benefit, and so that's where we're focused. But also, from a financial perspective, we want our providers to do well and have strong financial performance because that enables us to demonstrate to other providers who are thinking about taking risk with us that there are opportunities to do very well there. And so really, everyone benefits from we're able to drive down medical costs and admissions. As it relates to the Stars impact, it really has a similar impact if -- depending on the arrangement that you're in, the provider will get a higher portion of dollars just because there's more premium going through the system. And if they get a percentage of premium, they're going to get more premiums. So they clearly share in the Stars recovery.

---

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

And just to bring that a little more in focus. We find, when we have a relationship with providers that are in a full risk or integrated model, as we refer to it, we have better health outcomes, we have higher satisfaction, we have higher retention, we have higher Star scores and we have lower costs. And to us, it is well worth sharing those benefits with our providers because we find that it is -- it's a win for everybody on both the member side and the provider side. And we are just advocates about how that should be the future of health care.

---

**Operator**

Your next question is from Christine Arnold with Cowen.

---

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

I know you're not giving '18 guidance, but I'd like to revisit history a little bit. My understanding coming into this year is that you didn't take the full benefit of the HIF and throw it into the benefits, you didn't take the tax benefit, whereas many of your competitors took the full benefit. And therefore, I'm thinking you probably are not going to have to impact benefits, instead, you said you kept them stable as much us your competitors. So I'm thinking your growth in MA should be better than your competitors. Yet I'm hearing you're above your target margins, so I'm thinking the margin probably has a little bit of a headwind next year. Am I thinking about this right? And also, is there anything to talk about in the group MA business in terms of your pipeline?

---

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

So again, it is the case that, without commenting on our competitors, that the tax deductibility of the HIF, we did not reflect in benefits for 2017. And so, therefore, with the HIF coming back in '18, we don't have to reduce benefits to effectively offset that or take an impact to margin, depending on what you want to do. That amount is something we don't have the address. And by the way, the reason why we did it in the first place was because we were concerned that we'd be in this situation and we wanted to try to keep benefits stable, which we've been successful doing. With respect to margin, as I mentioned with a previous question, we are above our margin target. We don't expect, by definition, to bid above our margin target, so there will be -- there should be an expectation that our margin target will be lower next year, and we're not prepared to give guidance around that as we've talked about. As it relates to group MA, we continue to be selective in picking our spots. Our team is out there really pounding the pavement for opportunities. We feel pretty good about where we stand in the group MA business and looking at a number of prospects. But I would tell you that as we said in multiple calls, we're going to be disciplined as we price that product. It's got to make sense from a return on capital perspective and from a risk perspective before we're willing to sign up, particularly for some of these large jumbo accounts.

---

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

Okay. So do you expect to grow group MA next year? I mean, the pipeline is probably pretty big, or is pretty stable?

---

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

Yes, I'm really not prepared to comment on group MA growth at this point. Again, there are a number of prospects we're looking at and the guys are doing a really good job, but I think it's just early to comment on group MA growth at this point.

**Operator**

The next question is from Dave Windley with Jefferies.

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

Are you complete with the streamlining or optimization of the Chronic Care Programs at this point? We saw a headline that maybe you reduced by about 500 people. And is the outcome of that optimization that you would kind of achieve the same impact with lower cost? Or do you actually think you can intensify focus on the important items to improve impact at lower cost?

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

We're going to continue to find the most optimal clinical model that's out there to take in both outcomes as you're asking about and, in addition, the cost of maintaining that. And frankly, I think as Brian articulated, we were probably spending some time with members that didn't want to spend time with us, so the experience is actually better. So we're finding that when we -- what we're doing is actually improving the program, overall, from both the effectiveness on the health side, the cost and the experience side. We do believe there are still some opportunities there. We're studying it. As Brian articulated, we wanted to walk before we run. We're seeing maybe some opportunities that we can be a little more efficient there. But that's the big [economy]. But I wouldn't emphasize in some of our clinical cost, it really is not only that we've reduced the administrative cost, but I can tell you that we're also still having a very large impact on the institutional costs that we're preventing.

**Operator**

Your final question is from Zack Sopcak with Morgan Stanley.

**Zack Sopcak** - *Morgan Stanley - Analyst*

I had a question with your provider relationships on CMS's proposal to move knee arthroplasty out of the inpatient-only list and onto the outpatient list. Is that something that could, if it passes and reaches steady state, impact your cost trend a few years out. And if so, how do you think about that opportunity?

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

I would just say that's a very specific opportunity, and there are probably 100 of those. And moving them from inpatient to outpatient is always effective. But we see these kind of particular trends in many different parts of different specialties.

**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, again, I thank everyone for supporting the organization, and most importantly, I thank our associates, our providers and our members as being advocates for our organization and really advancing our strategy going forward. So everyone, have a great day, and again, thank you for your support.

**Operator**

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