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HUM.N - Q3 2020 Humana Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 03, 2020 / 2:00PM GMT

OVERVIEW:

Co. reported 3Q20 adjusted common diluted EPS of $3.08. Expects full-year 2020 adjusted common diluted EPS to be $18.50-18.75 and 4Q20 adjusted common diluted loss per share to be approx. $2.40.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Humana Third Quarter 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to Amy Smith, Vice President of Investor Relations. Thank you. Please go ahead.

Amy K. Smith - *Humana Inc. - VP of IR*

Thank you and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Brian Kane, Chief Financial Officer, will discuss our third quarter 2020 results and our updated financial outlook for 2020. Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. Our Chief Legal Officer, Joe Ventura, will also 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 latest Form 10-K, our other filings with the Securities and Exchange Commission and our third quarter 2020 earnings press release as they relate to forward-looking statements and to note in particular that these forward-looking statements could be impacted by risks related to the spread of and response to the COVID-19 pandemic, including the potential impact to us of: one, actions taken by federal state and local governments to mitigate the spread of COVID-19 and in turn, relax those restrictions; two, actions taken by us to expand benefits for our members and provide relief for the health care provider community in connection with COVID-19; and three, disruptions in our ability to operate our business effectively; four, negative pressure and economic employment and financial markets, among others, all of which creates additional uncertainties and risks for our business. Our forward-looking statements should therefore be considered in light of these additional uncertainties and risks, along with other risks discussed in our SEC filings. We undertake no obligation to publicly address or update any forward-looking statements and future filings or communications regarding our business or results.

Today's press release, our historical financial news releases and our filings with the SEC are all also available on our Investor Relations site. Call participants should note that today's discussion includes financial measures that are not in accordance with generally accepted accounting principles or GAAP. Management's explanation for the use of these non-GAAP measures and reconciliations of GAAP to non-GAAP financial measures are included in today's press release. Finally, any references to earnings per share or EPS made during this conference call refer to diluted earnings per common share.

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

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

Thank you, Amy, and good morning and thank you for joining us. I want to begin by thanking our associates from proactively reaching out to check on our members, making sure they have access to care and medications to showing up on members' doorsteps for delivery of much needed food. Our associates continue to go above and beyond to meet the needs of our members and providers.

Our team's discipline and continued focus on quality is evident in Humana's recently announced Star ratings, again, putting us in a leadership position among our peers. A key tenet of the MA program, the Star's rating system incentivizes plans to focus on quality in both care and the consumer experience, driving improved clinical outcomes. Plans then invest the Stars bonus dollars and additional benefits, improved care and better member experiences.

We are proud that approximately 4.1 million or 92% of our MA members are currently enrolled in plans rated 4 stars or higher. For 3 straight years, our CarePlus MA plan in Florida, which covers more than 164,000 members, received a 5-star rating. In addition, more than 99% of our retirees and our group MA plans remain in contracts rated 4 stars and above. These outstanding results are a testament to our associates' commitment to building trust with our customers through simple, personalized and empathetic experiences. It is what we call human care.

You have probably seen our new human care ads. Human Care is more than an ad campaign. It is a strategy for how we run the company, centering on holistic care that addresses our members' most important health care needs. Our newest ad stresses the importance of continuing to take care of your health during the pandemic and how Humana is making it easier for members to seek care safely. This is one of several messages to our members, encouraging them to continue to engage with their doctors for managing their ongoing health conditions.

As you know, Humana, in partnership with CMS, was among the first in the industry to quickly implement benefit changes for Medicare Advantage members that removed financial barriers, improved access to care and addressed social determinants of health needs during the pandemic. I've described over the past few earnings calls many of our initiatives to support our members, providers and associates. So I won't repeat them. However, as the pandemic progresses, our actions will continue to evolve to meet the changing needs of our constituents.

For example, the pandemic has highlighted the importance of social needs, such as social interaction. In response to this need, Humana extended the Papa program, a program that matches college students with members identified as lonely or severely lonely, into several South Florida communities.

I'd like to share a story about [Otis,] a Humana member. While registering [Otis] for the Papa program, the case manager noticed that it was [Otis'] birthday and began singing happy birthday to him over the phone. Otis was overcome with emotion, noting it had been years since someone had even wished him a happy birthday. His reaction impacted his case managers so much that she reached out to Papa's corporate team and Humana, who immediately took action and had a birthday cake delivered to Otis' home. Sometimes the smallest action can make a big difference in someone's life. Programs like Papa are an important element in addressing the holistic needs of our members.

As we look forward to 2021, we are able to provide stable or enhanced benefit for most of our members with plans that continue to reflect our commitment to their holistic health. Our strong clinical and quality programs drive improved clinical outcomes and cost savings that allow Humana MA plans to invest and expand member benefits beyond those covered by original Medicare Parts A and B, including: supplemental benefits like dental, vision, hearing coverage; prescription drug benefits; and gym membership as well as programs that address social determinant of health needs like the Papa platform.

For 2021, all Humana MAPD members will enjoy a number of benefits, including: $0 telehealth co-pays for primary care physician visits, urgent care and outpatient behavioral health; $0 co-pays for COVID-19 testing and treatment and 14 days of home-delivered meals for members with COVID diagnosis; and a health essential kit with useful items for preventing the spread of COVID-19 and other viruses like the flu. Other 2021 plans highlights include: nearly 60% of our members will be in plans that offer care coordination services and enhanced benefits not offered under Original Medicare for $0 member paid premium; primary care co-pays of $20 or less for approximately 93% of our members, including nearly 60% with $0 co-pay; an insulin savings program included on approximately half of our Humana's MAPD plans and 1/3 of our PDP plans. Members will pay no more than $35 for a 30-day supply of select insulins. In addition, eligible Humana Medicare Advantage members who need help remaining independent at home have access to their own personal care manager through Humana At Home.

We are pleased that for 2021, Humana MA -- and MAPD plans are all recommended by USAA, a company known for its customer satisfaction and commitment to the financial security of current and former members of the U.S. military. Our ability to offer enhanced benefits relative to Original Medicare is due in large part to our chronic condition management programs and our focus on value-based care. The Medicare Advantage program incentivizes a holistic focus on health and, because of this, offers opportunity for private organizations like Humana to partner with providers on value-based care models, customized to meet both the unique dynamics of the local market and the risk tolerance of a given provider.

This ability to customize is key to driving deeper and faster adoption of health-based care models and together with our industry peers, we are structurally changing the health care system. Approximately 2/3 of Humana's individual Medicare Advantage members are cared for by providers in value-based arrangements, with just under 1/3 in full-risk arrangements where the provider is responsible for the entirety of the members care for a capitated payment.

We are pleased that approximately 86% of our value-based care partners are in surplus, demonstrating the success of driving improved clinical outcomes in these models. Our annual value-based care report for 2020 included several key findings based on 2019 experience. Humana Medicare Advantage members under the current care of physicians in value-based arrangements would have incurred an additional $4 billion in plan-covered medical expenses had they been under Medicare fee-for-service. Prevention screenings, improved medication adherence and effective management of patient treatment plans all contributed to creating these reductions. Humana Medicare Advantage members served by physicians in value-based arrangements had a 29.2% lower rate of hospital admissions and a 10.3% less emergency room visits when compared with Original Medicare.

Physicians in value-based arrangements with Humana with 2016 through 2018 had an average of 4.44 HEDIS Star score at the end of 2018 compared to 3.10 for physicians in nonvalue-based arrangements. Our deep value-based contracting experience positions us well to participate in other value-based care models, including the new direct contracting program. Initially, we intend for both our health plan and primary care assets to participate as Direct Contracting Entities on a limited basis. We are working very closely with CMS as there are still a number of points of clarification needed before the programs begin in 2021. While we believe this is -- could be an interesting opportunity to take on Original Medicare fee-for-service members, we do not expect our participation to have a material impact on our results or operations for 2021 as we will employ a test-and-learn approach to implementing and evaluating the direct contracting program.

Before turning the call over to Brian, I want to touch on our stand-alone Medicare Part D or PDP offerings for 2021. As we've discussed the last couple of years, PDP plans have become a commodity, with low price leader essentially capturing all of the growth. As a result, after our meaningful PDP membership losses in 2019, we made significant changes to our portfolio for 2020, combining 2 plans to create space to offer a new low-premium plan co-branded with Walmart. This low-premium plan was the most competitively priced plan in the majority of our regions and grew substantially by adding almost 1 million members.

For 2021, the PDP industry remains extremely competitive, with multiple carriers offering low-premium plans. We've taken a disciplined approach to pricing, balancing membership growth and the overall impact to the enterprise. As a result, the Walmart Value plan will not be the lowest cost leader in 2021 but is priced in a similar range to other low-premium plans with competitive benefits. However, one plan sponsor is an outlier with an offering priced well below the rest of the market. While we once again anticipate the overall PDP market will shrink in 2021 as seniors increasingly choose Medicare Advantage plans with prescription drug coverage, we expect PDP to continue making meaningful contributions to the overall enterprise with high mail order pharmacy utilization and more PDP members converting to MAPD over time.

Our Premium plan will include the new Senior Savings Model demonstration where members can get certain insulins at a maximum monthly cost of $35. In addition, all 3 PDP plans have expanded preferred network pharmacies to improve member access, convenience and options to reduce their out-of-pocket costs. Despite our enhanced offerings, the very competitive price marketplace will be a headwind for the PDP membership again in 2021, as Brian will discuss in his remarks.

Turning to the importance of the day. I would be remiss if I didn't encourage everyone, if they had not already done so, to get out and exercise their civic duty to vote on this election day. Regardless of the outcome of the election, Humana is committed to public-private partnerships that are solution-oriented and drive results that will meaningfully benefit the health care system in the coming years.

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

Brian Andrew Kane - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone. I would first like to begin by also thanking our associates. Several years ago, we made the Medicare Stars program an enterprise-wide priority, and everyone across the organization rose to the challenge. As a result of these efforts, for the third year in a row, we led our peers, with 92% of our Medicare Advantage members in 4-star or higher plans. This great accomplishment gives us the ability to invest in enhanced benefits for our members and offer compelling Medicare Advantage products to drive continued membership growth.

Turning to our financial results. Today, we reported third quarter adjusted EPS of $3.08. These results were impacted by increasing utilization compared to last quarter, COVID-19 testing and treatment costs and the financial impact of the company's ongoing crisis relief efforts. As I will discuss in a moment, we continue to expect our results for the second half of 2020, including an anticipated loss in the fourth quarter, to entirely offset the significant outperformance experienced in the first half of the year that resulted from historically low medical utilization levels. We continue to see non-COVID medical utilization trending slightly below normal, all in, though well above the trough levels experienced at the end of March and early April. In September and October, medical utilization was running at approximately 95% of pre-COVID expectations, with inpatient running a bit higher and outpatient and physician running a bit lower. With the number of COVID cases again increasing throughout the country, we continue to expect non-COVID Medicare medical utilization to remain modestly below pre-COVID expectations through the end of 2020.

From a business line perspective, we have seen non-COVID utilization recover a bit more quickly in our Group and Specialty segment as compared to a slower rebound for our senior and Medicaid members. Regarding COVID utilization, we have seen an increase relative to our previous expectations, with per member treatment costs also higher than anticipated for both our Medicare and commercial products. As a result, we now expect COVID testing and treatment costs to approach $1 billion in 2020.

From a pharmacy standpoint, scripts volume has largely leveled out, and we continue to expect pharmacy utilization to net out close to normal levels for the full year, with early refills seen in the first and second quarters, representing more of a pull forward within the year rather than a run rate change. However, we are seeing more new starts and, as I said last quarter, the increased number of members utilizing Humana's mail order pharmacy is expected to persist as those members continue to use the service, which benefits not only health care services through higher EBITDA but also the health plan as mail order generally results in better medication adherence.

As we have indicated since the beginning of the pandemic, we fully expect that any impact we experience from lower medical utilization will be entirely offset by the support we provide for our members, providers, employer groups and the communities that we serve. Given that the lower the previously expected utilization we are experiencing is largely offset by higher COVID testing and treatment costs, we expect our levels of support of approximately $2 billion to remain largely the same as previously communicated for the full year.

Accordingly, in the fourth quarter, we expect to record a loss of approximately $2.40 on an adjusted EPS basis and are tightening our full year 2020 EPS guidance to a range of $18.50 to $18.75, still within our initial guidance expectations prior to COVID. As I reminded investors last quarter, historically, our fourth quarter EPS contribution is always the lowest. And in 2020, as expected, the fourth quarter will be impacted by the continued support for our constituents, which is more heavily weighted to the fourth quarter, along with the impact of increasing COVID-19 testing and treatment costs and rebounding utilization levels.

As a result, we expect our fourth quarter consolidated medical expense ratio to be at least 300 basis points higher than our third quarter 2020 ratio, with the Retail segment sequential increase modestly lower and the Group and Specialty segment sequential increase meaningfully higher than the consolidated increase. The sequential increase in the Group and Specialty segment benefit ratio reflects both a seasonally adjusted higher MER as well as a disproportionate investment in this segment in the fourth quarter relative to non-COVID utilization levels.

Moving to operating costs. As I described last quarter, we are making significant investments in our Medicare distribution channels, including equipping and training brokers so that they can interact with consumers telephonically and digitally as well as increasing the marketing dollars we provide to our distribution partners for the AEP. As you know, these marketing costs are heavily weighted to the back half of the year, primarily the fourth quarter. These costs, along with our previously announced contribution to the Humana Foundation and other COVID-related costs to support our associates to enable them to work virtually in response to the pandemic, are now estimated to be higher than the estimate we provided last quarter.

Consequently, we now expect the full year consolidated operating ratio to be approximately 120 basis points higher than our pre-COVID expectations. The modest increase over last quarter is primarily due to an increase in the investments in our Medicare distribution channel.

Turning to membership. We are increasing our full year expected individual Medicare Advantage membership growth to approximately 375,000 members from the previous range of 330,000 to 360,000 members, representing expected year-over-year growth of approximately 10%, in part reflecting continued compelling D-SNP sales. As of September 30, our D-SNP membership had grown to approximately 391,000 members, a net increase of approximately 103,000 lives or 36% from December 31, 2019. Additionally, MA new sales and terms more broadly have returned to more normal levels as the year has progressed after being reduced by the pandemic.

Furthermore, today, we are modestly improving our Medicare stand-alone PDP membership outlook for full year 2020 primarily due to the extension of the grace period for nonpayment of premium. We now expect to lose approximately 500,000 members as opposed to our previous estimate of 550,000 members. Accordingly, previously expected membership losses in 2020 due to nonpayment will likely occur in 2021.

With respect to Medicaid, September 30 membership of approximately 730,000 increased over 261,000 members or 56% from December 31, 2019, primarily reflecting the transition of the risk for the Kentucky contract from CareSource as of January 1 as well as additional enrollment, particularly in Florida, resulting from the current economic downturn driven by the COVID-19 pandemic.

In our Group and Specialty segment, we are tracking the challenging economic environment, especially for small business, although medical membership declines on account of COVID have been less severe to date than we anticipated. Lastly, in our Healthcare Services segment, adjusted EBITDA increased 27% year-to-date, primarily fueled by operational improvements in our Conviva assets and overall lower utilization in our provider businesses as a result of COVID-19, along with higher pharmacy earnings as a result of Medicare Advantage membership growth, partially offset by the anticipated PDP membership declines. These improvements were partially offset by administrative costs related to COVID, including expenses associated with additional safety measures taken for our provider and clinical teams who have continued to provide services throughout the pandemic, along with additional costs in the company's pharmacy operations to ensure the timely delivery of prescriptions during the crisis.

Regarding Kindred at Home, you'll recall we mentioned on our first quarter earnings call that new home health admissions have been adversely impacted by COVID. As the year has progressed, volumes have stabilized, and early signs of a rebound in demand are beginning to materialize. Further, the company has been able to offset these initial challenges with strong clinical and overhead cost controls across the organization.

In our provider business, our clinic expansion continues, and we are on pace to double our Partners in Primary Care footprint through our partnership with Welsh, Carson over the next few years. Despite the challenges of COVID, in the last 45 days, we have opened 5 of 8 planned clinics in Las Vegas, with the remainder to be opened later this year and early first quarter, and further deepened our footprint in Houston, opening 5 additional centers, with 2 more expected to open by the end of 2020. Including Conviva, by the end of the first quarter next year, we will operate approximately 160 clinics under these 2 brands.

Turning to 2021. As Bruce described in his remarks, we are pleased to be able to offer stable or increasing benefits for most of our individual Medicare Advantage members due in large part to the permanent removal of the health insurance industry fee. Based on what we're seeing early in the ongoing annual election period, we expect to grow our individual MA membership by 350,000 to 400,000 members in 2021. This represents growth of approximately 9% to 10%, which is at or a bit above our view of 2021 individual MA membership growth for the industry. However, the number we are providing today could change materially depending on how sales develop and where voluntary terminations ultimately come in. As is typical, we have very little membership termination data at this point in the AEP cycle.

With respect to group Medicare Advantage, as we have previously stated, growth can vary widely from year-to-year based on the pipeline of opportunities, particularly large accounts going out to bid. We have experienced compelling group MA growth the last couple of years, with particularly robust growth in 2020, including winning a large account from a competitor.

As we look ahead to 2021, large group accounts, particularly jumbo accounts, continue to be competitive. While we expect nice membership growth in the small and mid-market group segments, we are seeing some membership pressure in the large group MA space for 2021, where we have both won and lost contracts. Accordingly, net-net, we expect our group MA membership to decline by approximately 45,000 members in 2021.

Regarding PDP, as Bruce described in his remarks, the Walmart Value plan will not be the low-cost leader in 2021, but is priced in a similar range to other low-premium plans with competitive benefits. However, 1 plan sponsor is an outlier, with an offering priced well below the rest of the market. Based on what we've experienced in the annual election period to date, we expect a net decline in PDP membership of approximately 350,000 members in 2021, which includes membership losses that were originally anticipated in 2020 that have been deferred to 2021, as I previously described. However, we will caution that we are still early in the AEP.

I will now briefly turn to our expected 2021 financial performance. From an earnings perspective, we believe we have struck the appropriate balance between membership and earnings growth while continuing to invest in our integrated model to create long-term sustainability. Given our balanced approach and taking into account the permanent removal of the health insurance industry fee, which was not deductible for tax purposes, we expect the midpoint of our initial guide for 2021 adjusted EPS to be modestly above our long-term EPS growth rate of 11% to 15% off of a baseline of $18.50, the midpoint of our initial adjusted EPS guide for 2020.

Given the pandemic, we are mindful of the uncertainty it has created and acknowledge there are multiple moving pieces that will impact our estimates, including our per member per month revenue, which is determined by our final 2020 risk scores as well as the impact from COVID treatment cost and non-COVID utilization levels as we enter 2021. Accordingly, our adjusted EPS estimate will evolve as visibility increases around the expected duration and severity of the pandemic. We look forward to providing more specifics on our fourth quarter earnings call in early February.

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

Amy K. Smith - *Humana Inc. - VP of IR*

Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Robert Jones with Goldman Sachs.

Robert Patrick Jones - *Goldman Sachs Group, Inc., Research Division - VP*

Great. I guess, Brian, maybe just to go back to the initial view on 2021, very helpful to have the starting point. You mentioned the HIF. Could you maybe share a little bit more on how you're thinking about reinvesting versus letting some of the HIF drop through?

And then just any other major moving pieces that you would highlight as far as headwinds and tailwinds. I know it's a tricky year with COVID. But any other major moving swing factors that we should be considering as we think about that initial look at 2021?

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. With respect to the HIF, as I said in my remarks, we really tried to take a balanced approach. And just to frame it, the HIF, were it to be in place for 2021, would be about $2.50. When you actually roll forward from 2020 to 2021, it's about $2, just the way the math works. And I would say of the $2, as you guys think about your roll forward from '20 to '21, we have given back a portion of that to shareholders and a portion to our members. I'd rather not parse out exactly how much, but I would just say of the $2 roll forward from '20 to '21, we've taken a balanced approach in that respect. And that's why, as we said, we would be modestly above -- at the midpoint, modestly above the 11% to 15% range.

With respect to other headwinds and tailwinds, I think the material ones really relate to COVID. We're still working through the impact on our revenue for Medicare risk adjustment. As I think investors know, our 2021 revenue is dependent on the risk in place we have for 2020. And so it's predicated, at least in part, on our members seeing the doctor and entering the medical system. To the extent that's below normal, that could have an impact on revenue. As we've mentioned multiple times, we're doing a number of things to get to our members and ensure they have the right clinical needs taken care of as well as in that process, ensure that we're collecting the appropriate documentation code. So we're working through that.

Obviously, COVID treatment cost is a wildcard as our COVID nonutilization. As we said in our remarks, utilization, non-COVID related, on the Medicare side remains a bit below normal, and we'll see how that how that tracks forward. But I would say those are really the major headwinds and tailwinds that we're focused on.

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Operator

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

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

All right. Great. When I was looking at the growth this year, really surprised by the D-SNP growth. Just wanted to see if you felt like that was coming in -- well, obviously, it's hard to tell with COVID, but just where I see outsized growth, always wonder about how you feel about the underwriting of that business. And then also, whether you expect to see similar type growth into 2021.

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. I think we feel pretty good about the D-SNP growth. I mean I think the Retail team has done a tremendous job really identifying this opportunity, developing a product design that really appeals to these members and then our sales team, marketing team going out and really finding these members and getting them to buy Humana. So we're very excited about the growth we've achieved.

And I would say our footprint relative to a few of our competitors is actually smaller. And so we've been seeing really great growth in our markets, particularly when you adjust for the fact that we're in fewer markets. And so we're excited to continue to grow that product and expand the footprint, which we'll do. We feel good about how we're positioned for D-SNP growth in 2021, and we're going to continue to go after that product.

I would say from a financial perspective, as we've always said, this is -- yes, these members are right in our strike zone because they allow us to manage their clinical conditions, and we get paid because of those clinical conditions and higher per member per month revenue number. And so it's a very attractive segment, and it's one that we're going to continue to pursue.

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

Just Kevin, on that, I think what we're experiencing, a lot of the plan itself is an important part of that, the basic medical plan. But we're also finding the additional benefits we offer around that really supports some of the social determinants and lifestyle issues are where we're finding really, really strong demand for. And as Brian indicated, this is sort of our strike zone and a lot of the work that we've done, both on social determinant side, our pharmacy medication adherence and some of the over-the-counter benefits we offer.

Operator

Your next question comes from Charles Rhyee with Cowen.

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

Maybe if I could follow up about D-SNP. Brian, am I right to think that the -- if you get a member that migrates maybe from one of your Medicaid plans into a D-SNP plan that is also a Humana plan, that member comes into a higher-margin because you're already managing that patient across both programs? And so then -- and if that's correct, I mean, is there a -- are you having success in getting members who might have been in one of your Medicaid programs to go, go into one of your D-SNP plan?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. No, it's a fair question, Charles. Our biggest opportunity is obviously Florida on that side, and the team has done a really nice job identifying the D-SNP members where we have some of the Medicaid plans in place and trying to convert them to a D-SNP plan. And I would say yes -- yes, I would say it's more on the margin at this point in terms of sort of the incremental benefit that we get because of the fact that they're already in our Medicaid -- a Medicaid member.

But the opportunity, as we continue to expand our Medicaid footprint, which we are committed to doing, identifying those D-SNP members or D-SNP opportunities from our Medicaid population and then trying to get them to have a more -- much more coordinated experience through a D-SNP opportunity is something we're very focused on. And so we do consider that an opportunity. And I think over time, you'll see us talk about that more.

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

And if I could just follow up real quick then. If we think about the margin profile then for these new D-SNP members, if they're coming kind of de novo, do they come in at a higher cost initially? And maybe are they more profitable down the road at sort of a run rate maybe just compared to maybe your typical MA retail member?

Brian Andrew Kane - *Humana Inc. - CFO*

I would say that they are more profitable when they come in initially than a traditional Medicare member. As you know, in our non-D-SNP boat typically, members, when they initially come in, they're more breakeven. You have a high selling cost. They're not in our clinical programs. Depending where they come from, they're not documented in the same way. And so it takes several years to get them up to our margin.

I would say D-SNP is on a steeper path there where they come in a little bit more profitable but then really take off as they get into our programs and do the things that we do to drive performance and outcomes. So like I said, it's a very attractive opportunity for us.

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

And Charles, the other thing that we experienced on the D-SNP side is that their revenue or cost of medical side is much -- is usually higher than a typical individual MA member. And so as we think about the profitability, it's as much about the margin as it is about the contribution dollars.

Operator

Your next question comes from Justin Lake with Wolfe Research.

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

If I remember correctly, you indicated, coming into 2020, that your individual Medicare Advantage margin target coming into the year was about 4%. And given you're reinvesting the HIF tax benefit into the business here for 2021, by my math, your margin target might be closer to 3.5% for next year in individual and Medicare Advantage.

So first, just wanted to understand, am I in the right ballpark without getting too specific? And if so, can you talk about the potential path investors should think about sort of getting back to your 4.5% to 5% target going forward?

Brian Andrew Kane - *Humana Inc. - CFO*

So on the margin side, look, without giving specifics, I think broadly, the way you're thinking about it is right, which is to say where the dollars show up, whether it's sort of pretax or after tax because of the impact of the HIF, can change the geography a bit. And so we are below our target. We recognize that. It's something that -- we intend to march back towards our target of the 4.5% to 5%. It's something that as an organization we're committed to.

Every year, we try to balance growth and margin and really EPS growth. I would say, as you've heard me say multiple times, a margin is an input, not an output, though it's an important input. But ultimately, we want to achieve that 11% to 15% bottom line EPS growth while also having a very attractive top line by growing membership.

And so we're going to continue to strike that balance. Margin is a really important input. And I would imagine, over time, we'll continue to bounce back to our targets, which we have in the past. I mean we've had a couple of years where we've been above our target. So we just had a lot of variability over the last number of years with tax reform and the HIF coming in and out. It's created a lot of distortions on that margin line as you know.

Operator

Your next question comes from Scott Fidel with Stephens.

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

Interested if you can give us any early sense on how the mix of your individual MA sales by distribution channel will evolve in 2021 versus 2020 when thinking about traditional sort of physical agent sales versus digital versus telephonic. Obviously, COVID having a lot of impact on that, but I know that you've also been implementing a variety of strategies to the digital and telephonic side so interested in how that mix will look to shift for 2021.

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

For a number of reasons, all the way from COVID and the impact of being able to get into individuals' homes and to community programs, combined with just the growing use, we're seeing the telephonic continue to be a channel that is growing and being an active part of that, both inside our organization and the dedicated telephonic program that we have with our agents, combined with the external partners that we've created over the last number of years. And we find that to be actually a great response to the COVID side where if we didn't have those channels, I think we would be in a much more difficult circumstance. So to answer your question, we're seeing continued growth there. It is at the expense of the face-to-face and the internal career channel. But it's -- I think it's both timely and much more convenient for ours.

We are also seeing, although a small part of our channel, an increasing use in the digital side. And I think this year, in preparation for COVID, the company invested significantly in making it easier from a member, not only in the experience, to sign up but in addition, to be able to analyze and understand what plans they want. And it's really the opportunity for us to use both the digital and the phone as a complementary mechanism to combat any kind of face-to-face that we can't do today.

Operator

Your next question comes from Stephen Tanal with SVB Leerink.

Stephen Vartan Tanal - *SVB Leerink LLC, Research Division - MD & Senior Research Analyst*

I just wanted to ask how you guys are thinking about the puts and takes inside of the 4Q outlook. So specifically wondering, if you start to sort of parse out the impact of the support you're providing for members, sort of the direct or discretionary elements of the plan and on the OCR side, I guess, more on a full year basis, the 120 basis point increase versus starting point for the guide, I think that's worth about $900 million. Wondering if you could give us a sense for how much of that reflects as reinvestment in the business and how much of that maybe is the increase in marketing dollars for the distribution partners that you guys called out.

Brian Andrew Kane - *Humana Inc. - CFO*

Without getting too specific and too granular, overall, we're committed to the, call it, $2 billion of support that we've provided to our various constituents. Included in some of those numbers is some of the investment we -- we're providing to our distribution partners, which is important there. And so I would say we've been largely weighted towards our customers and towards our providers and -- but also focused on investing in our business to make sure that we're set up for a strong future. And that would include, given the challenges of the environment of the migration from face-to-face sales to telephonic sales, we wanted to ensure that our partners are fully equipped to face that. And so we have invested in that channel.

We have seen an increase in COVID treatment costs, as I mentioned in my remarks, but we've also really seen that the -- sort of non-COVID utilization persist below par, particularly for Medicare, longer than expectations. And so I would say, broadly, that's just -- that's really an offset to one another.

Some of the tranche spending is really more of a migration between MER and operating cost ratios. There's not a lot of switch in the overall tranche spending in sort of the allocations that we've done and what we've seen as some of our programs have developed. So hopefully, that gives you some color of the puts and takes.

Stephen Vartan Tanal - *SVB Leerink LLC, Research Division - MD & Senior Research Analyst*

Yes. That's helpful. And maybe if I could just sneak one more in on the reinvestment of the HIF. Obviously, a big number of $7 pretax, $2 nontax deductibility going away. It sounds like you've reinvested north of [7]. So wondering, in the Part D senior savings model part of that, just the funding for the $35 cap on insulin, we did notice premiums went up there, but I wonder how that gets funded.

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. All the dollars goes into the mix. So implicitly, yes. I mean anytime -- any product that has HIF payment on it, there's a benefit for the HIF going away. So implicitly, yes, it just goes into the pot of our various expenditures. And so we obviously have to figure out a way to pay for the insulin benefit. We thought it's the right thing to do and so we rolled that out, a number of our Medicare Advantage programs as well as our enhanced -- second enhanced plan on the PDP side. And so that's part of the mix.

Operator

Your next question comes from Matthew Borsch with BMO Capital Markets.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Research Analyst*

So I'd try to pick up on the last question with Steve. So are you saying that the magnitude of the change in out-of-pocket costs that we may have calculated when the MA products were first unveiled ahead of open enrollment, it is about right -- I've had some communication, I know, with Amy on that, trying to figure out what's driving that. All right, let me be -- it looks quite a bit more than we've seen and quite a bit more than the HIF would suggest. And we've been -- yes, still a little bit puzzled there.

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. No, it's a fair question. Some of the way that -- on the website that some of these benefits were portrayed, I think, was a little confusing for folks.

I would just say that we've been -- we try to be very thoughtful in this crisis and recognize that our members are going through a lot, and the HIF has certainly helped finance a really nice increase in benefits for a number of folks. But -- and as Bruce said in his remarks, almost all of our members are either stable or up. And so as is always the case, there are some markets where we invest more, some markets where we invest less. But I would say that HIF was an important part of the financing of those benefits. But not as extreme as what might have been portrayed on the website there so -- but still, I think, a compelling benefit package.

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

And Matt, I would just [really] emphasize, as we look at our calculations of total actuarial value, we are -- I think our changes are fairly similar to our competitors. I don't -- I know -- I think there's -- every year, there's some that are more aggressive and others that are less aggressive. I would say that we're sort of in the mid-tier there and not out there.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Research Analyst*

Yes. No, actually, we didn't see any -- we didn't see you as an outlier. So -- but that's very helpful.

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

Yes. Okay. Thanks.

Amy K. Smith - *Humana Inc. - VP of IR*

Yes. I would just add that I believe Plan Finder is intended to be for members to use to compare plans, and so they make changes some years in the way they value benefits and do calculations, and so it's not really intended to be year-over-year. And I think that's where some of the complexity comes in.

Operator

Your next question comes from Josh Raskin with Nephron Research.

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

Can you speak more specifically to the benefits broadly of having these capitated physician groups and sort of what works best for Humana and how you're trying to grow that in the context of your path to risk strategy?

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

Sure. I'll start, and Brian can add to it. I think first, just in general, we find really, really great outcomes with relationships and value-based relationships. And I would sort of say, but we also see each local market different. And one of the reasons we see, I think, programs that come out of Medicare that are sort of standard that don't get the adoption is they're not being customized to the risk tolerance and to the needs of the provider in the local markets. So first, I would say that our program is really oriented to the risk tolerance and the local dynamics there.

And so that gives us this path to risk concept where you see this -- that we'll have some upside participation with little downside, all the way to some downside and some upside to full risk there and the provider can take the journey along with us. We do find that it's unlike the '90s and the -- at a time where risk became sort of popular that you just sort of hand in a contract and you walk away. It's much different now where there's a lot of support provided. And our support is technology-wise, it's also providing from a human resource perspective. And then in addition, the ability to help manage, including putting social workers and coordinators in their offices.

Our hope, that we continue to move more and more of our members to risk providers. You've seen it stayed in the mid-60s, but that's not because more members are going. It is because every year we grow, and we got to get more in there. So as we're stable, we're basically putting all the members that were growing into the program, which is considerable success.

What you do see in this year that we're quite proud of is that people that are -- providers that are in the program are actually -- now it's profitable for them. 87% are in surplus. So that means that they're making more money than they would in the fee-for-service side. And that's a great opportunity for them. And so we see the program continuing to demonstrate value. We continue to see the program being able to, from a member point of view, demonstrate value from the provider point of view and especially through the support.

We do continue to also want to grow the value-based from us, building our clinics and our home health side. So you see the primary care -- the Partners in Primary Care product and the Conviva product, along with some of our home solutions, moving more and more to value-based payment models that are really oriented to the ability to do it, whether we do it internally with our providers or externally through our partnerships there.

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

And just to follow up on that, the financial implications for Humana, is it fair to say that you're seeing now a differentiated financial result for the health plan side of things as well?

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

Yes. I would -- yes, very much so. And I would say that when we think about the value-based side, the -- it's not only the value from a financial point of view, but it's the Stars outcomes that you see happening. It's the retention that you see with the member there that has the longer-term lifetime value. So yes, the plan is seeing significant benefit from this, and we feel it's the best health care to be provided in the system today.

Operator

Your next question comes from Ralph Giacobbe with Citi.

Ralph Giacobbe - *Citigroup Inc., Research Division - Director and Co-Head of Americas Healthcare Research*

Just a quick clarification on the initial '21 commentary. I think you said modestly above the high end of the 11% to 15%, not modestly above the midpoint of the range. Just want to clarify that.

And then in the press release, you noted the commercial segment utilization kind of returned faster. Any reasons why MA wouldn't just be a lag?

And then what about acuity? We've certainly seen the providers cite it. And then given your population base, how concerning is that acuity factor going into next year? And how can you sort of factor that in or manage it?

Brian Andrew Kane - *Humana Inc. - CFO*

All right. I will try to take these in order here. As it relates to the guidance, we expect the midpoint of our guide to be modestly above the 15%. So modestly above the 11% to 15%, so above -- modestly above the high end.

On the sort of commercial versus Medicare, I think that's right. I think we would expect that seniors will be slower to return to the medical system than the commercial members, just for obvious reasons. And so that -- it doesn't surprise us that we see a little bit of a disparity there. And we expect that to continue. Obviously, once a vaccine happens, we'll see where that goes. Our expectation at that point is that seniors will be more comfortable reentering the medical system. And I would just say that we are very much encouraging our seniors to get the care that they need, which is why we're doing all the reach out programs that we've talked about.

With respect to acuity, we are seeing higher per member costs, particularly on the COVID side. Obviously, there's the 20% premium that gets paid on the Medicare side. So any time there's a COVID flag and a COVID code, there's a 20% premium on the entire DRG. And so that does result in higher acuity. And so we're very mindful of that, and that's something that we've obviously baked into our expectations.

What we haven't seen, which is something that we've been clearly very focused on, is the health of our members deteriorating. That's something that our teams monitor very closely. We haven't seen a meaningful impact there as yet. Obviously, we're hopeful that we can get back to normal to make sure that our members get the care that they need but -- that's why we've been so proactive in that outreach.

Operator

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

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

I'd say I appreciate the comments about the competitive landscape around the PDP and also your comments about the landscape files. I guess I'm just thinking about, as you're -- now that the plans are all out there, and you can assess them, and it's hard sometimes to assess competitively 1 MA claim from another because there's a lot of subtlety to it. You've got a lot of incremental variables for next year that I don't know whether you think these are huge or they're more modest, the potential of a vaccine, the therapeutics, the ongoing testing, the potential for further deferrals, the potential for pent-up demand. Can you give us a little flavor for how you approach those issues in setting your plan structures for next year? And are you seeing any, when you look at the competitive environment, any outliers that you would highlight as you did on the PDP side that would make the market more disruptive?

And then maybe another twist on that is your HIF comments about the tax benefit, some of that being "reinvested". Is some of that just holding that in your back pocket because you've got more variability about how these things might shake out, so that if you -- if that ends up getting eaten up in some of these factors, you're still delivering what you set out to deliver?

Brian Andrew Kane - *Humana Inc. - CFO*

As we always try to do, we try to be prudent and thoughtful and balanced about how we set our financial targets. I would say with respect to the benefits, as Bruce said, we feel good about how we're positioned relative to our competitors. People clearly invested largely. Some pulled back, but most people did invest, which was our expectation. So from that perspective, I think as reflected in our membership guidance, we feel good about how we're positioned there.

The financial side is clearly more tricky. I mean there's no doubt about it. There always are a lot of variables as we try to predict various claims, trends and revenue trends. But with COVID on top of that, that adds additional complexity.

I would just say, again, we try to incorporate all the potential variables that exist on account of COVID and non-COVID and try to blend that into our -- both our initial pricing in the bids back in June. And then now as we roll it forward, as we gave a high-level financial guidance today, it reflects what we know.

We did point out, and I would want to reemphasize the fact that there is still a lot of uncertainty and variability as we go into next year. And clearly, we would update you with any thoughts we have on the fourth quarter call with respect to 2021 financial guidance.

Operator

Your next question comes from Ricky Goldwasser with Morgan Stanley.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

So first of all, just following up on -- clearly, there's a lot of variability into next year. But just to clarify, with your early guidance, as you think about utilization, are you assuming that utilization is going to be back to baseline or above?

And my second question is around PDP. You mentioned a couple of times on the call the structural shift of PDP lives to the MA product. So as you think about this shift longer term, is there a point where you think that you reach sort of a balance? Or do you expect ultimately that entire benefit to be integrated?

Brian Andrew Kane - *Humana Inc. - CFO*

On the utilization side, I'd rather not give specifics. Clearly, there are countervailing forces, so to speak. So as a vaccine comes into play, and our expectation around the vaccine, for Medicare, it will be covered by CMS. So that's not an expense that we're worried about. But clearly, to the extent the vaccine gets implemented, that would impact non-COVID utilization, meaning that people will be more comfortable reentering the system, but treatment costs would go down. And so there's a natural push and pull there that we're focused on. And without giving any specifics, I would just tell you that we've -- and we always do run various scenarios and sort of various things can happen with respect to the vaccine and otherwise, how people reenter the medical system, and I would just say we've incorporated those various scenarios into our financial plan. And again, I would just reemphasize, there's also the question around Medicare Advantage revenue coming into 2021, where do we end the year in 2020 with respect to the documentation that's so important.

On the PDP side to MA, I think, as Bruce said in his remarks, I do think -- we do think that there is a shift moving to MA. We believe it provides a more comprehensive product, not only on the benefit side. So you get your -- generally, most plans are MAPD. You have PD as part of MA. So you get your drug benefit many, many times for free because it's 0 premium, but you also get a host of other benefits that Bruce walked through in his remarks. But importantly, we also, as an organization, provide significant care coordination and other support in the member's journey beyond just the financial benefit that MA provides relative to PDP. If you're a stand-alone PDP member, even if you have a Med Supp product to cover some of the financial cost sharing, you're still not -- you're not getting called. You're not getting meals sent to your home. You're not getting the clinical support that Humana provides to our members. And we think that's also a differentiating element of the product. And consequently, we think more and more people are going to migrate to Medicare Advantage as we've seen.

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

With the Medicare Advantage penetration just continuing to increase, and the growth is greater than the demographic growth, I mean, it's just a natural aspect that you have a declining part of the business. And as Brian articulated, the value proposition in MA as a result of companies like Humana is really increasing, whether you look at the value proposition in the 0 premium plans and where we are today to care coordination to the social determinants of health, and it's a great example of how we're taking the inefficiencies of the health care system and reinvesting them into programs that are continuing to improve the outcome -- the health outcomes of the individual and also the system.

Operator

Your next question comes from Steven Valiquette with Barclays.

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

So the initial outlook for individual MA membership gains for '21 obviously looks pretty positive. Just regarding that, from the data we've analyzed, it looks like the company has made a fairly balanced push forward on the number of plans with 0 premium offerings on both the HMO and PPO side. But it seems that some of your competitors have made an even bigger push on the PPO side for next year. So just curious if you can just give us a little more color on how you're thinking about the competitive landscape in the individual MA, like considering HMO versus PPO offerings, and then how you're expecting membership gains skewed more heavily around that one way or the other for 2021.

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

I'll start and then just ask Brian -- Brian can add on. We have been -- out of all the plans, I think our growth has been the most balanced between HMO and PPO. You've seen the organization, whether it's geographic concentration to product concentration, continue to be able to have that balance. And we don't see next year being any

(technical difficulty)

We continue to really find the opportunity to have our members attributed to a physician and be able to be in the HMO that allows them to get that dedicated care that we've highlighted in the value-based side. And at the same time, we have the care coordination capabilities that allow people to be in a broader platform, well, like Humana at Home and our chronic care and all the technology that we are able to help find those interventions that are important and help people navigate through the health care system. So out of all the companies, and obviously, we're biased, but we feel very, very prepared in being able to serve the need of our member, whether they want to be in an HMO and get much more effective benefits or they want the freedom and variety of a care model within a PPO side. And so we're able to do that -- offer that.

I would say that we are much, as Brian has articulated, much more balanced in the way we offer that in the marketplace. We know some of our competitors have grown based on that product much more than we have. We, over the last few years, have added, but I would say that we'll continue to -- that will be one product, but it's not going to be the primary product that we grow in. You will see that it is one of many products. And I would just continue to say that we look at opportunity to serve the market base in a much more broader fashion than relying on one product to grow. Brian, I don't know if you have any...

Brian Andrew Kane - *Humana Inc. - CFO*

I think it's a perfect answer. I agree.

Operator

Your next question comes from Gary Taylor with JPMorgan.

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

My question is around capital deployment. You have not been very active on share repurchase this year. I can't recall if it was ever officially suspended or just sort of held in check sort of pending the uncertainties related to the pandemic. But cash at the parent is building. You haven't repurchased much stock. You're in the low 30s on debt to cap. So maybe just a little bit of your outlook on capital deployment in the next 2 years. And does the '21 guide rely upon share repurchase in any disproportionate way?

Brian Andrew Kane - *Humana Inc. - CFO*

We do have ample capital and flexibility, which we believe is important. I would say that over the next few years, we expect to have a balanced capital deployment strategy. We're always on the hunt for M&A opportunities in the strategic priority areas that we've identified, whether it's around home, primary care, pharmacy. We always look for opportunities in the plan -- health plan space. So to the extent there's a Medicaid plan in a particular state that's of interest, we look at it closely. There are fewer opportunities for us. But even if there were a Medicare plan in a state where we were able to complete a deal there, we would look at that.

So I would just say that our capital deployment plans will be balanced on the M&A side. And clearly, share repurchase is an important part of our capital return strategy. We will continue to do that. Our '21 guidance does assume some capital deployment, and we're working through how we'll do that, but there is some capital deployment in that number.

Operator

Your next question comes from George Hill with Deutsche Bank.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

And I think most of my questions have been answered. I guess I'll just do one follow-up on the PDP space. It sounds like you guys wanted to have a highly competitive product there. But you saw an unusual competitive environment. And I guess given the growth in MA, how important is PDP to the company going forward? And have you guys historically seen it as a funnel for MA conversions? Or if people with a kind of a different setup in PDP have a different motivation, I guess, does it make sense to have more of a middling product there as opposed to a highly competitive product?

Brian Andrew Kane - *Humana Inc. - CFO*

Well, I think it's a product, I think, Bruce remarked on initially, which is to say, it does contribute, particularly to our pharmacy business. It's become much less of a contributor over the last few years. The pharmacy business has had an extraordinary growth in EBITDA as you see in the numbers. It's really -- our EBITDA has been driven by pharmacy and really Conviva driving its turnaround. And so pharmacy is an important part of our EBITDA growth element there. And PDP is part of that, although Medicare Advantage as well as, candidly, all the efforts that the pharmacy group has undertaken to increase the mail order penetration rate and have that continue to be an important part of the interaction with our members. You've seen a nice increase year-over-year, particularly on the MA side, on the mail order side, and you'll continue to see that. PDP is part of that.

As it relates to contribution to Medicare Advantage growth, over the last few years, we've really amped up our strategy to convert those members. We do think that over time, that will continue to be an important funnel strategy for us into MA. The last few years have seen nice growth. We'll expect nice sort of cross-sell this year as well. That's our expectation for 2021 as we saw in 2020 and 2019. I think we would all say we have even more opportunity than what we've tapped so far, and so it's definitely an important growth element of the company. And our PDP teams and our Medicare teams and particularly on the sales side, they're working closely together to figure out how we can make that cross-sell happen.

Operator

Your next question comes from Lance Wilkes with Bernstein.

Lance Arthur Wilkes - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Great. Can you talk a little bit about Medicaid? And if you could talk a little on the pipeline? And then a little on what's the capital deployment priority of Medicaid? Meaning, is it really tuck-ins? Are there particular types of capabilities you would also be looking for there?

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

Yes. I would say when we think about the next year or 2, I think it's going to be a fairly active response to RFPs. We see a number of states that are states that we want to participate in, and we feel that we can add significant value as a result of what we're seeing -- the desires of the state. So I would say first, just on an organic basis, I think you're going to see the organization go pretty active in a number of responses there.

On the capability side, we feel really good about where we are from an ability to serve the member, from a -- all the way from a lifestyle point of view to a need of the health side. So our programs have proven to be very successful, whether you look at satisfaction scores, to relationships with providers, to clinical outcomes. And so we feel really, really good about our programs.

I think the biggest challenge that we have right now is the procurement cycle and the procurement process. And so as we think about acquisitions, it's more around the states we want to enter and -- from a strategic point of view and then what is the procurement process there? And is there are a lot of barriers to the procurement process and therefore, does it make more sense from an acquisition point of view? So when I say all that, you're probably going to see more specific state orientation and capital deployment, and you're going to see more in one-off deployment -- I mean, purchases as opposed to large acquisitions.

Operator

Your next question comes from Dave Windley with Jefferies.

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

I know we're getting long here. I just wanted to ask a couple of clarifications. So one, on the 95% utilization, is that all inclusive, i.e., inclusive of COVID and across all books? Or is that core utilization?

Brian Andrew Kane - *Humana Inc. - CFO*

That is core utilization, exclusive of COVID, across all books.

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

Okay. And then, Brian, when -- I think you said per member costs are coming in a little higher than expectations. In one answer, you kind of referenced that some of that is COVID driven, maybe some not COVID driven. I'm wondering, I mean, in light of the kind of commenting above expectations, is it fair to assume that, that is above what you would have captured in bids? And is it possible -- I know there's a lot of moving parts you've already highlighted for next year. But is that a headwind specifically to how you're thinking about '21?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. It's something that we fully bake in. Obviously, part of that is the 20% premium on COVID treatment. Remember, it's really where there's a COVID code attached, then there now needs to be a positive identification of COVID to get that increased payment on that DRG related to a COVID positive test. And so the answer is yes. I mean we factor in all those things. We've got to see what happens to that -- whether that premium, et cetera, how it continues. But I would say on the scheme of things, that particular issue is relatively modest for 2021, but we are seeing it.

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

Okay. If I can come back to the first one, just real quickly for clarification on fourth quarter. If you layer the COVID in, does that -- I'm just wondering the magnitude of that. Does that get you above 100 as you exit the third quarter? And does that kind of help to shed light on why the fourth quarter will swing to the negative so dramatically?

Brian Andrew Kane - *Humana Inc. - CFO*

Well, what I would say is that on the Medicare side -- I'll just comment on today. The Medicare side, if you include COVID, we're still a bit below the baseline, whereas commercial is a bit above the baseline. And so we'll see what happens on -- for the fourth quarter. But largely, our expectation is that any increased COVID treatment cost will be offset by lower utilization as we sort of roll forward our guidance from third quarter to fourth quarter, which is why it's largely unchanged. It'll largely be offsetting impacts from what we expected 3 months ago.

Operator

Your next question comes from Steve Willoughby with Cleveland Research.

Stephen Barr Willoughby - *Cleveland Research Company - Senior Research Analyst*

Just one thing for you. It sounds like you're reinvesting more dollars into marketing payments for AEP this year. Just wondering when we roll forward a year, that the increased dollars you're spending this year and providing to partners, is that something that you'll probably need to keep at that similar level in the future? Because obviously, you're -- it sounds like you're benefiting here spending more money this year because of the HIF and from maybe utilization running lower than expected this year?

Brian Andrew Kane - *Humana Inc. - CFO*

That's a fair question. I would say that we've got pretty transparent conversations with our partners about the dollars available this year and particularly as the -- some of our partners in the field who've had to convert to more of a telephonic way of selling. I think some of the dollars have helped them do that. But we have some very important call center partners that we wanted to support this year, and we'll be very thoughtful about how we do that next year.

But I would just say we've been very transparent about some of the dollars that we're investing in the channel this year that may or may not persist going forward. But we've been very committed to our partner channels. We'll continue to do that. And every year is a different circumstance, and we sort of judge where -- the wherewithal financially that we have as we go into AEP, the competitive landscape, where things stand, what we expect some of our competitors to be doing on the distribution channel. And so we try to calibrate our investment given those various variables.

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

I just would like to reemphasize that. I would say that this year is no different than previous years in how we approach it, and we approach it from a sort of what do we think is both needed, but what is also the proper investment considering our financial goals. And you see that combination happen every year. And this year, I would say it was no different so I would not look at this year as a statement for next year.

Operator

Your next question comes from Steve Halper with Cantor.

Steven Paul Halper - *Cantor Fitzgerald & Co., Research Division - Analyst*

Just a housekeeping question. So the fourth quarter loss, the EPS loss of $2.40, what's the tax rate assumption in that estimate, in that guidance?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. I would say our sort of -- well, I don't -- have we -- Amy, I'm not sure what we've disclosed, but it's sort of -- given the HIF, it's sort of in the, call it, low 30s range, probably.

Amy K. Smith - *Humana Inc. - VP of IR*

Yes. We haven't disclosed a tax rate guide. But...

Steven Paul Halper - *Cantor Fitzgerald & Co., Research Division - Analyst*

But presumably, you'll be -- for the quarter, right, you're going to report a tax benefit because of the pretax loss, correct?

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. But it's all -- on an annual basis, it's all going to net out. You get effectively a 30% benefit for the loss is the way to think about it.

Steven Paul Halper - *Cantor Fitzgerald & Co., Research Division - Analyst*

Yes. Got it. Understood that it's -- it nets out for the full year as -- but I'm just -- was just worried about the -- not worried, but just focused on the quarter and what's implied there in the $2.40. But I got it.

Operator

Your next question comes from Frank Morgan with RBC Capital Markets.

Frank George Morgan - *RBC Capital Markets, Research Division - MD of Healthcare Services Equity Research & Analyst*

Yes. Most of mine have been answered. But real quickly, what are your expectations around plan switching during this AEP? And how much of that will you see in OEP for the first quarter of next year?

And then you mentioned digital investments. I'm just curious, are you actually having -- have expectations around any online enrollment in MA this year?

Brian Andrew Kane - *Humana Inc. - CFO*

On the plan-switching side, we'll have to see it. As we mentioned, sort of during the height of the COVID crisis, we saw a decline in switchers and terms going down. Those have largely normalized. I think overall, we expect more of a normal switching season.

I would just say, though, that given the significant growth we've had in '19 and '20, on top of the fact that a lot of our new sales have come from the telephonic channel, both of those sources, sort of new members as well as the telephonic channel, tend to have higher term rates or more switching. So we would have baked that into our growth. But -- so we'll see where that comes out.

The amount of termination data we have at this point is very, very small. And so that's one of the biggest variables we have at this time of year. I mean we're -- we still got plenty of time left in AEP. And so it's always hard to forecast that. But broadly, that's how we're thinking about it.

We have invested in the digital channel. It's -- we think it's going to be more and more going forward. What we find is that members sort of start online. They can provide other information, they can shop. But ultimately, the sale is consummated through a live conversation with a broker. We expect that to continue, but we've actually invested in digital channels or proprietary digital capability that allows members to really understand their benefits. They can input their various conditions, the drugs they use and understand which plan is right for them. And so that's an important investment of ours, to make the digital experience more conducive to members really understanding their options. But again, it's -- the digital channel still -- the single-digit percentage in terms of overall sales.

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

Frank, what we are seeing is as we invest in the digital channel for the member, we do use that same technology for the brokers themselves. So it's a (inaudible), so to speak, that these tools are being able to find the best plan for our members based on their historical medical history. It's not only used by the member, but it also is used by the broker to help with that. So it's a way that we are able to really leverage the investments we make.

Operator

Your next question comes from Sarah James with Piper Sandler.

Sarah Elizabeth James - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Going back to the moving pieces on the '21 Medicare margins, how much of a headwind is the carve-in on ESRD? And I guess that question is both scale and margin profile implications for the ESRD book. And can you update us on the big pieces under your control for preparing to manage margins on that book, like hitting unit price goals and the network build-out or other big pieces needed to manage and hit margin targets?

Brian Andrew Kane - *Humana Inc. - CFO*

And I would say from a margin percentage perspective, it would be a headwind. I think broadly, we feel good about how we've mitigated the overall contribution margin on those members through all the efforts that we've gone through. We've announced important partnerships with Fresenius as that's been very public. And so we're excited about that. We've also announced a number of partnerships with other players to help us manage CKD, to slow the disease progression and make sure people aren't really crashing into ESRD and ending up in the ER, where a lot of the cost happen.

We're excited about the experimentation and innovation that CMS has introduced into the ESRD program that allows us to ultimately build out a more nontraditional networks use or use of dialysis machines at home and having -- dialyzing at home. Again, it really allows players to innovate clinically, which is something that we love to do. And over time, we think it will be really effective. And so we are being, I think, thoughtful about how we approach the market with ERSD in 2021 and obviously taking care -- very well the members we get, but also thinking longer-term about how we create partnerships and relationships with our providers, not only on the financial side so that we're sharing risk and sharing sort of the benefits many of our clinical programs would put into place, but also really encouraging innovation. And we think these regulations are going to encourage that. And so we're excited about that.

Operator

Your next question comes from Whit Mayo with UBS.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - MD of Equity Research and Equity Research Analyst of Healthcare Facilities & Managed Care*

I hope I'm the last one. Wasn't clear what you guys were thinking around cost sharing for members next year. Wasn't, I think, called out specifically. And I'm just wondering how long you guys can continue to waive co-pays and be responsive to your members. And what are the signposts that you're looking to perhaps revise your posture around this?

Brian Andrew Kane - *Humana Inc. - CFO*

Whit, that's a good question. It's something that we're going to have to see how the fourth quarter evolves and how the pandemic evolves and what we do around cost sharing. I mean currently, our cost-sharing savings or the lack of cost sharing of our members ends at the end of 2020. That's what's currently our perspective. And so we're just going to have to see how things evolve as we move into 2021. But that's something that's obviously top of mind as the pandemic continues here.

Operator

There are no further question at this time. I'll hand the call back over to Bruce Broussard for any closing remarks.

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

Yes. Well, thanks for everyone staying on the extended time that we've had, and this is probably a record for us. So we appreciate the interest in the company as a result of that. And obviously, we always are appreciative of our shareholder support but as importantly, our associate support for really allowing us to be able to deliver these results on a daily basis, both for our members but as importantly, for our shareholders. So thank you, and everyone, have a great election day.

Operator

Thank you. And that concludes Humana's Third Quarter 2020 Earnings Conference Call. You may now disconnect.