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HUM.N - Q2 2021 Humana Inc Earnings Call

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OVERVIEW:

Co. reported 2Q21 adjusted EPS of $6.89. Expects full-year 2021 adjusted EPS to be approx. $21.25-21.75.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Humana Second Quarter 2021 Earnings Call. (Operator Instructions) Thank you.

Now I would like to welcome Ms. Amy Smith, Vice President of Investor Relations. Ma'am, 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 Susan Diamond, Chief Financial Officer, will discuss our second quarter 2021 results and our updated financial outlook for 2021. Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. Joe Ventura, our Chief Legal Officer, will also be joining Bruce and Susan for the Q&A session.

We encourage the investing public and media to listen to both management's prepared remarks and the related Q&A with analysts.

This call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, humana.com, later today.

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

Investors are advised to read the detailed risk factors discussed in our latest Form 10-K, our other filings with the Securities and Exchange Commission and our second quarter 2021 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.

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*

Amy, thank you. Good morning, everyone, and thank you for joining us.

Today, we reported adjusted earnings per share of $6.89 for the second quarter of 2021, in line with our previous expectations. We continue to focus on delivering strong operating results, while navigating a dynamic environment due to the ongoing COVID-19 pandemic, all while staying true to our commitment to delivering the highest quality health care experience for members and patients.

We are maintaining our full year 2021 adjusted EPS guidance of approximately $21.25 to $21.75 at the midpoint, representing full year adjusted EPS growth of 16% above the 2020 baseline of $18.50, in excess of our long-term growth target, while acknowledging the continued uncertainty driven by COVID-19 hospitalization trends and the rate at which non-COVID costs normalized.

As Susan will describe in more detail, our full year adjusted EPS guidance now assumes a $600 million COVID-19-related headwind that is expected to be largely offset by favorable operating items. In addition, this guidance assumes no COVID costs will run -- non-COVID costs will run approximately 2.5% below baseline in the back half of the year, including an assumption of minimum COVID testing and treatment costs for the remaining of the year.

I'd like to reiterate that our core fundamentals are performing well, and 2021 is a year of COVID-19 transition, with various pandemic-related financial impacts, including reduced Medicare Advantage revenue resulting from the significant temporary deferral of utilization in 2020, as well as the lingering near-term uncertainties regarding the pace and level of the return of utilization for the balance of the year. We also acknowledge that we are seeing increase in COVID utilization in recent weeks, which we will continue to watch closely.

While we continue to navigate this pandemic-related uncertainties in 2021, as Susan will lay out in detail, we expect 2022 to be a more normal year. The health care system has been open for several months, and we have seen vaccination rates in the seniors reach approximately 80% nationally.

Accordingly, our members continue to engage in more routine interactions with their providers, which we anticipate will result in more normalized Medicare Advantage revenue next year, as providers are able to ensure that our members are receiving appropriate care and that their conditions are being fully documented.

I would reiterate our remarks from the last quarter regarding our Medicare Advantage bids for 2022, which reflected the continued uncertainty associated with COVID-19 in our premium and claims assumption, with a focus on maintaining benefit stability in 2023. While it is still too early to provide 2022 guidance, we believe our operating discipline in 2021, combined with the depth of our planning for 2022 Medicare Advantage AEP, puts us in a strong position for financial growth in 2022.

I will now turn to an operational and strategic update. Importantly, our underlying core businesses continue to deliver strong results on solid fundamentals, with individual Medicare Advantage membership growth outpacing the industry. As we highlighted at our recent Investor Day, this growth is balanced across various product lines, including HMO, PPO and dual special need plans, or D-SNPs.

Our Medicaid business continues to perform well in 2021, and our South Carolina plan is now operational. We are diligently preparing for the Ohio contract go-live date in early 2022 and are continuing to improve our operating model, building off of our core Medicare Advantage capabilities.

We've also experienced slightly better-than-expected results in our home and provider businesses and increased mail order rates in our pharmacy business.

Finally, as announced last quarter, we've entered into an agreement to acquire the remaining 60% interest in Kindred at Home, and we expect the transaction to close mid-August, which we've included in our revised estimates for the year.

Our strong operating performance this year is in part a tribute to our strong partnerships with providers who are delivering high-quality care to our members. We are currently seeing 87% of our provider partners and value-based arrangements in surplus.

Further, our relentless focus on consumer centricity has led to an all-time high Net Promoter Scores for our retail organization, contributing to Medicare Advantage membership growth and resulted in an external recognition of Humana as an industry leader in customer satisfaction, including the announcement this morning that we received the highest ranking in mail order pharmacy customer satisfaction for the fourth year in a row in the J.D. Power 2021 U.S. Pharmacy Study.

On the public policy front, as policymakers explore changes to Medicare, including adding dental, vision and hearing as part of the Medicare benefit, we stand ready to both innovate for the more than 12 million of our members who already have these benefits, including 7 million dental and vision policies in our MA group, as well as offer ideas, a public-private collaboration to leverage our deep capabilities in Medicare and specialty markets, so that beneficiaries could quickly see benefits go from a proposed law to a tangible benefit.

Before turning the call over to our new Chief Financial Officer, Susan Diamond, I'd like to take a moment to speak about Susan's experience at Humana over the last 15 years. She has served in various leadership roles across the company during her tenure, spending 8 years as part of the Medicare leadership team with various financial and operational and line of business responsibilities. She also spent 2 years on the finance team, leading enterprise planning and forecasting and overseeing the company's line of business, CFOs and controllers.

Most recently, she led our home business, growing it to the largest offering of its kind. Her strong financial background and extensive knowledge of our business made her uniquely positioned to step into the CFO role.

The Board and I have great confidence in her abilities and the contribution she will make in the next chapter for Humana as we execute on our strategic plan and deliver shareholder value. In addition, given the strategic nature of the CFO role, Susan will continue to contribute in a meaningful way to our home health business.

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

Susan M. Diamond - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone.

Today, we reported adjusted EPS of $6.89 for the second quarter, in line with our previous expectations. Our underlying core business fundamentals remain strong, and we experienced a positive start to the year across our segments, with the first quarter coming in modestly ahead of our previous expectations.

Our results moderated back to expected levels in the second quarter, albeit with variation in the way specific underlying assumptions emerged, with COVID treatment cost coming in lower than expected, offset by non-inpatient utilization continuing to bounce back faster than originally anticipated.

As I will describe in further detail in a moment, uncertainty remains for the balance of the year due to the pandemic, specifically as it respects to COVID hospitalizations and the rate at which non-COVID costs normalize, inclusive of both volume and unit costs.

Recognizing the majority of today's call will focus on our emerging experience and our 2021 guidance, I want to quickly touch on operating performance across our segments before diving into that detail. Our Medicare Advantage growth remains on track and consistent with our previous expectations, with individual MA growing solidly above the market and an expected 11.4% at the midpoint.

Our Medicaid business results are exceeding our initial expectations given membership increases largely attributable to the extension of the public health emergency as well as higher-than-expected favorable prior period development.

In our Group and Specialty segment, consistent with our commentary on our last earnings call, medical membership declines are lower than we expected coming into the year. Our specialty business results are exceeding expectations as utilization, particularly for dental services, has been slower to bounce back than initially expected.

Finally, within our Healthcare Services operations, pharmacy continues to see increased mail order penetration as a result of customer experience improvements and additional marketing initiatives.

The home business, CenterWell Senior Primary Care and Conviva, are performing slightly ahead of expectations, and we remain on track to open 20 new clinics this year with Welsh, Carson.

In addition, as Bruce indicated in his remarks, we now expect the Kindred at Home acquisition to close in mid-August, subject to customary state and federal regulatory approvals.

Before I go into more detail on our 2021 guide, I want to reiterate that the uncertainty we are seeing in 2021 relates solely to the difficulty estimating the impact of the pandemic and is not expected to carry forward into 2022. We remain comfortable with how we approach 2022 pricing, which I will expand on later in my remarks.

Turning to full year 2021 guidance. I would remind you, our adjusted EPS guidance represents growth at or above the top end of our long-term target of 11% to 15%. Our philosophy regarding 2021 guidance has been to provide transparency into the uncertainty caused by COVID-19 and the ability to deliver our targeted earnings growth, with solid underlying core business performance and largely offsetting COVID-19-related headwinds and tailwinds. We have been consistent in and remain committed to this philosophy.

There is a reasonable path to achieving adjusted EPS within our initial guidance range. And accordingly, today, we are maintaining our full year adjusted EPS guidance of $21.25 to $21.75, while acknowledging the continued uncertainty as it respects to COVID hospitalization trends as well as the pace at which non-COVID costs bounce back and at what level they ultimately normalize. Additionally, we expect our third quarter adjusted EPS to reflect a low 20s percentage of our full year adjusted EPS.

As Bruce indicated, given our experience to date, together with our current estimates for the back half of 2021, we have effectively recognized a $600 million COVID-related headwind for Medicare Advantage in our full year guide, offset by favorable operating items.

These favorable items include, among others, higher than initially expected prior period development, the previously discussed better-than-expected specialty and Medicaid results and the expected contribution from Kindred at Home given the transaction is expected to close in the coming weeks.

Now let me provide an update on the underlying changes since our initial detailed guide in February, articulate key assumptions regarding utilization in the back half of 2021 and expand on the continued pandemic-related uncertainties I described.

I will begin with Medicare Advantage revenue. As discussed last quarter, given our significant exposure to Medicare Advantage, we are disproportionately affected by COVID's impact on Medicare Risk Adjustment, or MRA. Recall, our risk-adjusted revenue for 2021 is determined by 2020 dates of service, medical utilization and resulting documentation, which, as previously discussed, was materially depressed in 2020.

As we have indicated since the beginning of the year, the MRA headwind that we are facing in 2021 is significant, and we have closely monitored it over the course of the year. Our April guide recognized we had $300 million of additional pressure from MRA relative to our initial expectations for the full year, which was offset by the net benefit of the extension of sequester relief.

In July, we received the mid-year MRA payment, and it came in modestly lower than expected. We are, however, taking operational steps now to be able to recover some of the MRA revenue and the final payment for 2021. Accordingly, our MA premium estimates, net of capitation, remain largely in line with our initial expectations when factoring in the net sequestration benefit.

Now turning to benefit expense. At the beginning of the year, we indicated that we expected non-COVID costs for our Medicare business to run 3.6% to 5.5% below baseline. We define baseline as 2019 experience trended forward based on a normalized trending factor, excluding the effects of COVID.

In the first quarter, we acknowledged that non-inpatient costs were bouncing back faster than initially expected. However, that was offset by COVID utilization decelerating faster than expected. We also recognize, however, visibility into non-inpatient claims was significantly less than inpatient and, therefore, we acknowledge that there was more uncertainty around non-inpatient service categories in terms of exactly where we stood.

However, at that time, we could still tolerate overall utilization returning to baseline late in the year if the non-inpatient acceleration we were seeing was due to pent-up demand and leveled off in the second and third quarters.

In the first and second quarters, non-COVID costs ran approximately 7% and 3% below baseline, respectively, with the bounce back outpacing expectations in the second quarter. Non-inpatient utilization did not level off and instead continue to increase in the second quarter and was offset by lower-than-expected COVID costs and other business outperformance.

As the health care system has been open for several months, and a high rate of the senior population has been vaccinated, our current guidance now assumes that non-COVID cost level off and run approximately 2.5% below baseline levels in the back half of the year.

Consistent with our original forecast, our current guidance assumes minimal COVID testing and treatment cost in the back half of the year. That said, we do acknowledge that we are seeing increases in COVID admissions in recent weeks, although it's too early to determine if there will be offsetting declines in non-COVID utilization, and we will continue to monitor this recent development.

Finally, as it respects to our 2021 guide for our commercial business, we expect all-in utilization for COVID and non-COVID to continue to run above baseline as anticipated.

In summary, I want to emphasize that 2021 is a COVID transition year. There is a reasonable path to deliver against our guidance expectations. However, as non-COVID utilization or COVID treatment cost increase beyond our expectations in the back half of the year, it will present a headwind to our guide, absent offsetting tailwinds.

I also want to reiterate that the $21.50 midpoint of our original guide continues to be the right jumping off point for 2022 adjusted EPS growth. Our members continue to engage in routine interactions with their providers, which we anticipate will result in more normalized Medicare Advantage revenue next year, as providers are able to ensure that our members are receiving appropriate care and that their conditions are fully documented.

During the first half of 2021, provider interactions and documentation of clinical diagnosis that will impact 2022 revenue outpaced those experienced in the first half of 2020 and are approximately 80% complete, in line with the estimated completion rate for the same time period in 2019.

Lastly, I would remind you that our Medicare Advantage bid for 2022 reflected the continued uncertainty associated with COVID-19 as it relates to our premium and baseline non-COVID claims trend assumptions, with a focus on maintaining benefit stability into 2023.

Before we open up the line for questions, I'm excited to announce 2 finance leadership changes that will promote the growth and versatility of our finance leadership team. First, with the expected integration of Kindred at Home, our Home business is growing significantly, and Amy has accepted the role of Vice President and CFO of Home Solutions. She will be a key member of the Home Solutions leadership team, responsible for the financial oversight and planning and forecasting for the segment.

Lisa Stoner will succeed Amy, accepting the role of Vice President, Investor Relations. Lisa has worked with Amy over the last 4 years and is well-known and respected by our investors. We are excited about the opportunity this affords both Amy and Lisa, and Lisa's continuity in Investor Relations will allow for a seamless transition.

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

QUESTIONS AND ANSWERS

Operator

Your first question is from the line of Justin Lake from Wolfe Research.

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

Obviously, a lot to cover. I'll try to keep it to one question here. But I see -- I'm hoping you could give us a few numbers. One is the MRA. Can you tell us what the full year impact is of the negative MRA?

And I think there's a lot of confusion around 2 things. One, it sounds like the first half -- or the second quarter, I should say, was worse than expected. And yet, you still kind of came in line with -- from an MLR perspective. So you're telling us the back half has -- is -- needs to be more optimistic.

So what happened in the second quarter beyond that allowed you to make the MLR, but still have higher medical costs beneath the back half? And then I guess the -- around that, the $600 million specifically, can you flesh that out in as much detail as you can because is that comparable to the old COVID estimate? Or is that a new COVID headwind that you've kind of thrown in there for the back half of the year for us to think about?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So I'll take these one at a time. I'll start with your last question around the $600 million. So just to clarify, the $600 million represents our full year estimate of the Medicare Advantage-only net headwinds and tailwinds related to the COVID pandemic. And if you recall, back to our initial guidance earlier this year, we provided a schedule that laid out the specific line items that were considered in that and a range of estimates at the time.

So the $600 million represents our current view and what is contemplated in our guide related to those items on a net basis, so the net of all the various headwinds and tailwinds based on our current expectations.

As it respects to the first half and second half, as we described in the call, what we continue to see throughout the first half of the year was COVID cost coming down faster than initially expected, but non-COVID outpatient, in particular, rebounding faster than expected, and that continued through the second quarter. And we anticipate that, that will extend some into the third quarter before it levels off.

In the first half of the year, the benefits we saw from COVID-related cost as well as some lower inpatient -- non-COVID inpatient cost, we do not expect to continue at the same rate because our expectation has -- had always been that those costs on the COVID side would come down as a result of the rollout of vaccinations and that utilization would rebound to more normal levels, such that there is less positive upside that can offset those costs in the second half of the year, which is why we are now estimating a net 2.5% decline in non-COVID utilization in the back half of the year to meet our guide.

As it respects to MRA, I think we provided the net detail in terms of what our current estimates really are. I know we provided the line item in the initial guide in terms of the beginning of the year. And what we're saying is on a net basis, net of capitation, there's about a $300 million additional headwind. And in the context of the overall guide, that is largely offset -- or fully offset by the net impact of the positive sequestration benefit.

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

Okay. And then just quick follow-up on the $600 million, that was all really helpful. The $600 million, can you just tell us what that compares to specifically? Because you had like a $400 million to $700 million COVID number thrown into the original schedule. Is that the comparable now?

And then have you said that, that's all eaten away in the first half of the year? So effectively, that updated $600 million is comparable to the $400 to $700, and it's completely gone effectively, so you don't have any -- none of that's assumed in the back half. Is that the way to read it?

Susan M. Diamond - *Humana Inc. - CFO*

Yes. So just to be clear. The $600 million is a full year estimate, so inclusive of first half and back half. But I also want to clarify, it is not meant to be specific to the line item that's labeled COVID testing and treatment on that initial schedule. That was one line item. When we refer to the $600 million, it is the net impact of all of the line items that were represented on the schedule.

And the other thing I would add as well in terms of your question about how did you offset that, there was a lower COVID and other inpatient costs. But also recall, we had other business outperformance that we mentioned in the discussion around prior period development, commercial, Medicaid that also offset some of that headwind we experienced in the first half of the year as well.

Operator

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

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

I wanted to, I guess, follow up on the assumption for trends in the back half of the year. I guess, you're saying core utilization, 2.5% below. I guess, if you could maybe provide a little more color on that. I mean, how do you get there? Are some things above average, some things below average?

If I understood what you were saying, I think you said that when you include COVID cost, total trend is above average. Just want to make sure I heard that, but just color on how you get to the minus 2.5% for the back half of the year and why there isn't more of an assumption of "core back to normal" by the end of the year.

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So just to provide a little more detail. So as we mentioned, the second quarter ran about 3% below baseline for that non-COVID utilization. Our third and fourth quarter now, on average, are estimated to run 2.5% below baseline. And recall that, that's inclusive of both utilization as well as unit cost.

So as I mentioned, we do expect, given that the country has been largely open, our population is largely vaccinated, that we will see those non-COVID utilization start to normalize, and so we've allowed for some additional return to baseline relative to what we've experienced in the second quarter.

I would also say that as we see that utilization come back, we also see that the average cost per hospitalization will come down because lower severity cases are reintroduced. And so the combination of leveling off of utilization and continued reductions in the unit cost contribute to that 2.5% below baseline.

I think you've suggested that overall utilization might be above baseline. I think you might be referring to my comments about commercial, where we had planned to see in total COVID, non-COVID to run slightly above baseline as we were beginning to see that at the end of 2020. But for our Medicare business, because we're including limited COVID cost in our forecast in the back half of the year, it's not contributing significantly, so that would not take it over baseline.

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

Okay. But when you say it's the low baseline, inpatient, outpatient physician, drugs, I guess, those 4 categories, are they all kind of there or some above, some below?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. We are seeing variations in some of the service categories as you can imagine. One of the reasons we believe that some of the pent-up demand has been worked through the system is things like surgical procedures, colonoscopies and things like that. We did for a period of time see it go slightly above baseline. But other traditional -- normal course ER and observations and other activities continue below baseline. Thank you.

Operator

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

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

Maybe I could just continue on this theme of trying to understand with the Medicare baseline through the end of the year. Do you think that -- what is sort of thought of this deferred care or the health care that didn't happen, but would have happened, I guess, really over the last 5 quarters?

Is a lot of that just not going to -- that isn't something that is going to flow through as pent-up demand? It's sort of embedded in there is that assumption that -- and the seniors, I guess, are going to still have some avoidance of the health care system even in the back half of this year. Just trying to understand that.

Susan M. Diamond - *Humana Inc. - CFO*

Yes. I would say that our view would be that given the pace at which the non-inpatient utilization, in particular, bounce back, which was faster than we anticipated, that we are seeing -- and a lot of that, you'll see they're reengaging with their physicians and specialists more than normal rate.

And so I think we do believe that some of the pent-up demand as a result of the deferred care in 2020 has been reflected in our first half of the year results. And that, again, because of the length of time the country has largely been open, that pent-up demand has worked through. And therefore, while we will -- we are expecting a little bit more return to baseline relative to our second quarter performance that, that will stabilize through the back half of the year. Thank you.

Operator

Your next question is from the line of A.J. Rice from Credit Suisse.

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

Just to put a fine point on some of the discussion and then 2 other data points. The 2.5% for the back half, I think, in the beginning guidance, you said that the underutilization for the full year will be 3.6% to 5.5% deferred relative to baseline. If you got an updated number, how much are you at the lower end of that? Or are you even the overall range when you think about that original number?

And then I would also ask you about the operating expense. Obviously, you've updated that. Is that mainly related to Kindred? Are you expecting more investments in the back half of the year in other areas?

And then if I could squeeze in one more. Your comment about the offset of sequestration versus the MRA headwind this year, does that, in your mind, reverse next year? So if we lose sequestration, you -- the MRA catch-up by having fully coded all of the people from last year and this year offsets that. Is that the way to think about it?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So I'll take these one at a time. So the first, to your question, based on our experience for first half of the year and our 2.5% expectation in the back half of the year, if you do all that math, it suggests that for the full year, our non-COVID utilization will end up at about 3.75% below baseline, so effectively at the low end of the range we had given you at the start of the year.

On OpEx, as you said, you're exactly right. The reason for the change in the guide and the increase that is directly attributable to incorporating the Kindred performance into our guidance points, and so that is largely the reason for that increase.

We do, however, I would say, in terms of our core business, and even within Kindred, anticipate some investment like we would in normal course. Kindred, as you can imagine, by integrating it, there are some investments we might want to make there as it respect to the value-based operating model that we've described at Investor Day. And so that is contemplated in there as well.

On your second question on sequestration, we do expect that to reverse in 2022. That would have been contemplated in our bids and pricing. And our MRA assumptions, as we think about 2022, would not be impacted by that explicitly. They are independently calculating. What we believe the risk adjustment will be based on the diagnosis submissions that we would expect in a more normal environment. Thank you.

Operator

Your next question is from the line of Ricky Goldwasser from Morgan Stanley.

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

So one clarification on utilization and then another question. So just to clarify, Susan, is basically what you're saying is that the 2.5% below baseline really encompasses the fact that care is happening outside the 4 walls of the hospital?

I think you mentioned lower ER visits. You're also mentioning that you don't expect 2022 risk adjusters to be impacted by this lower utilization. So is it that just you're seeing a shift in where care is being provided, i.e. the telehealth primary care, and that's what's impacting that below baseline, that's a dollar number?

And then my second question, if you can give us just some color and context around the announcement that we saw last week on the investment that you're making with Anthem on -- into a new PBM.

Susan M. Diamond - *Humana Inc. - CFO*

Okay. So to your first question on the 2.5%, so again, that is related to non-COVID utilization and all inclusive of inpatient and non-inpatient, again, both rate and volume. And so I wouldn't say that we're necessarily seeing shifts in the site of service or the site of care, but rather just, as utilization returns to normal, there is some level of utilization that hasn't -- just hasn't come back on an absolute basis.

But really, we are seeing, with the exception of some of those specific service categories I mentioned like surgical, other categories are largely still running below baseline across the board.

As far as MRA impact, as we said, what we are seeing in terms of the normal routine interactions with our providers, our in-home assessment activity and other annual wellness programs, those are all trending exactly as we would expect to see in order to deliver against our 2022 revenue estimates contemplated in pricing. And so we feel really good about our trajectory there.

Should we see somewhat depressed utilization in the back half of the year, given the way risk adjustment works, generally speaking, we feel good that so long as there's not sort of a full shutdown like we saw in 2020, which is not what we anticipate currently, we feel confident that we should be on pace to deliver against what we need for MRA, again, based on what we're currently seeing.

I don't know, Bruce. Would you like to address the Anthem partnership?

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

Sure. The -- similar to what we've done in the past and other more utility-oriented areas, I think Availity would be an example of that, where we've tried to find partners within the industry that can help build a longer-term utility.

And we look at the particular partnership with Anthem as the opportunity to update and really give more both increased productivity and, at the same time, increase the experience for members in the area of the PBM side. We, for a number of years, have been using SS&C as a vendor to help in the -- with the existing technology, but now have been able to take it and really enhance it through this partnership with Anthem and SS&C.

Susan M. Diamond - *Humana Inc. - CFO*

Thank you.

Operator

Your next question is from the line of Stephen Baxter from Wells Fargo.

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

I was hoping that you could talk in a little bit greater detail about why the risk adjustment revenue ended up coming in below where you expected it for this year. I guess, you had a lot of visibility into certain inputs and not others. To the extent you could flesh those out, I think it would help give us a better sense of how comfortable we can be around next year's assumptions.

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So as it respects to the $300 million that we referenced that was contemplated in our April guide, so just for context, our January payment in 2021 would reflect claims that were submitted through the September submission deadline. And then that requires us to estimate the submissions that will come in organically as well as a result of our activities around chart review and prospective programs for the remainder of the year.

At that time, we were not anticipating the significant surge that we saw across the country in the fourth quarter due to COVID and the resulting reduction in non-COVID utilization. What that led to was lower, what we refer to as, organic diagnosis submissions. So those are not related to the campaigns that we initiated, but rather organic submissions across the provider community based on the utilization that's happening, and those ultimately prove to come in lower than we had anticipated.

And generally speaking, I think we've mentioned before that those organic submissions are more difficult to estimate, obviously, than the initiatives that we are executing. So that was reflected in our April guide at the time.

In terms of the midyear adjustment, as we've said on previous calls, the adjustment there was solely related to new members or members who were only enrolled for a partial year in 2020, where we don't have full visibility to their claims. And so while we made an estimate of what we thought the impact would be based on what we were seeing within our concurrent population, ultimately, that midyear payment came in. It reflected a lower level of contribution for those new members than our estimates had originally anticipated.

I would say that going into 2022, because those impacts were directly related to the COVID pandemic and impacts the utilization, I would not expect to see that continued uncertainty carry into 2022 based on what we're seeing so far this year. Thank you.

Operator

Your next question is from the line of Joshua Raskin from Nephron Research.

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

So I understand we're coming out of the second quarter with non-COVID utilization running 3% below baseline, but how do you see that continuing to run 2.5% baseline for the second half of the year if you're also assuming that you're not going to see any COVID -- direct COVID cost for testing and treatment? I sort of think of those as related.

And then would a rise in direct COVID costs, so if we did see this increase that you guys mentioned that you're seeing in the last couple of weeks, if that did continue, would that end up being a net negative now because you've got all the direct costs, but you're already assuming lower utilization?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So I would say that our view of non-COVID is not influenced by what the recent activity and uptick we've seen in COVID cases. That is not why we're assuming that it runs below baseline.

Our view is, again, just based on the trajectory we've seen that, given the level of utilization increase we've seen that we were at a point where it will be in the plateau and level off as sort of just a new baseline for the back half of the year.

As it respects to COVID, as we mentioned, it's just very early. In terms of the increase, what we've seen is literally just in the last couple of weeks. It is still a bit too early to determine whether or not we will see offsetting non-COVID utilization impacts like we have seen in all previous surges.

I will say, just this last week, we just began to see some level of reduction in inpatient -- non-COVID inpatient, as the COVID cases increase. It's simply just too early to really assess the duration that we might see in terms of an uptake and the offsetting utilization. But should we see offsetting utilization in the non-COVID space, in order for that not to present a headwind, it would be incremental to the 2.5% that we are currently forecasting.

Operator

Your next question is from the line of Lance Wilkes from Bernstein.

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

Yes. Let's see, my primary question is on the pricing environment. You called out a little bit of a pricing environment, I think, in group MA. Can you talk a little bit about that pricing environment impacts and magnitude in '21, outlook for '22?

And then in general for pricing, both individual and group, how does this work towards your return to kind of target margins here? And then on the utilization, the one extra thing I'd just ask on that 2.5% below baseline, just if you're getting any indications on impacts of Delta variant on utilization in any of your own clinics.

Susan M. Diamond - *Humana Inc. - CFO*

Sure. So I'll take these one at a time. The first is with respect to pricing, you asked specifically about the group MA, and I think as we've said before, the group MA space, particularly for larger group accounts, continues to be highly competitive, and we would expect that to continue, and so the margins that we would see on those accounts to continue to be competitive and pressured.

I think, though, as we think about group MA, there are a lot of other benefits to winning those large accounts in terms of the impact they can have in a local geography on the network and our ability to work with provider partnerships, et cetera. But we expect that to be -- continue to be competitive.

On the individual side, this is always a process we go through every year to understand sort of the rate environment, the competitive environment, other business performance. We always strive to maintain benefit stability, knowing how important that is to our members as well as our sales and distribution channels.

So that's always our goal, and there's always a number of puts and takes that we will consider, including the broader enterprise performance as it respects to, first and foremost, delivering against our overall growth target of 11% to 15%.

And after considering sort of strategic investments, other business performance and then understanding what's required of our Medicare business and what we're trying to achieve, balancing both growth and margin in the long term, all of those are taken into account.

We remain committed to achieving, long term, our targeted individual margin of 4.5% to 5%, and that will vary each year based on those things that I mentioned. But we would expect this to continue to progress towards that goal.

On utilization, I would say, really, it's too early, I think, for us to really see anything specific at the clinic level. That information is not as real time available to us as our health plan information. And so to date, I have not seen anything that would provide us any visibility.

I will say, there are some concentrations geographically. As you've seen probably in the press, Florida is a state that is seeing higher rates. Given we have a concentration of some of our clinics there, I imagine that they would see some, but we actually don't have detailed information on that just yet.

Operator

Your next question is from the line of Ralph Giacobbe from Citi.

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

I guess, going back to the 2.5%. If your assumption is that 2.5% below baseline, I think your original guidance was to run above baseline towards the end of the year.

So why wouldn't that represent upside? Or where is the offset there? And then can you give us how much COVID cost you've seen sort of through the first half against that $600 million full year estimate?

Susan M. Diamond - *Humana Inc. - CFO*

Okay. As it respects to 2.5%, as you mentioned, I think in earlier calls during the first quarter, we did mention that our original forecast did contemplate over the course of the second half of the year that we would begin to approach baseline and potentially for a short period of time see above baseline utilization related to pent-up demand. So we just projected that to occur later in the year.

Our view is that, given the rate at which we've seen it bounce back more quickly, that we have seen that in the first half of the year instead. And so at the time, I don't think we've given specifics on sort of the monthly trajectory. But in general, our original forecast going into the year did anticipate a slower return to baseline and could tolerate it getting to baseline by the end of the year.

But as I described in my remarks, because we saw the faster bounce-back in non-inpatient and in the first half, that was, again, largely offset by the reductions in COVID and inpatient, those trends will not continue at the same level. And therefore, we will need to see below baseline utilization on the non-COVID side in order to achieve that full year estimate of 3.75%.

And then could you repeat your second question, I'm sorry, about the COVID cost?

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

Yes. Just trying to get a sense of what it ran in the first half of the year relative to the updated sort of $600 million. Are you fully through the $600 million at this point? Is that what you're trying to imply, and there's nothing baked into the back half? Just trying to get a sense of magnitude there.

Susan M. Diamond - *Humana Inc. - CFO*

No. So again, that $600 million is a full year estimate. It does, just to be clear, include the assumption that the non-COVID utilization will run 2.5% in the back half of the year, so that's contemplated in that.

But I don't think we had intended to provide any quarterly detail of how that's emerging, but that is a full year number. It would not represent just the first half of the year.

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

Just to highlight on the $600 million. That is if you were to go to the first quarter or the February earnings release for the fourth quarter, we put together some lows and highs all the way from MRA, COVID testing, the depressed utilization and sequestration. And what the $600 million is if you were to take that and roll that forward now, all the ins and outs from that would be the net number of the $600 million.

The operational aspects of our business, as Susan has talked about, has offset all of that $600 million. But included in that $600 million net number is an assumption that 2.5% below baseline will be remaining for the remaining part of the year.

Operator

Your next question is from the line of Scott Fidel from Stephens.

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

First, I think you just clarified part of the question that I was going to have, which is just confirming that the net headwind and tailwind that had been 0 in that 4Q '20 slide deck, that's now $600 million, right? And then also just on the MRA piece in that same slide deck, you had called that out at $700 million to $1 billion of expected headwind.

I guess, given the update that you guys have given us around the $300 million incremental impact a couple of months ago and then how things came out in the midyear claims review, just interested if you have an updated estimate that we can compare now against that $700 million to $1 billion number.

And then sort of, I guess, just putting this all together, just how this sort of nets out to -- for 2021. Putting all the pieces together, what that sort of implies and what you're assuming for your MA pretax margin, so we can think about sort of the earnings run rate now relative to the long-term target margin?

Susan M. Diamond - *Humana Inc. - CFO*

So what I would say, we never -- at the time, as you mentioned, the schedule that we gave you, which provided a range of $700 million to $1 billion, I don't think at the time we ever said exactly where we were in that range in terms of our internal estimate.

I think what we just wanted to clarify was that we had seen $300 million of net pressure incremental to that, which is, again, in terms of the schedule offset then by the sequestration.

And then can you repeat your second question? I'm sorry, I think it was '21 -- oh, the '21 -- what was your '21 question? I'm sorry.

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

Yes. Susan, basically, it's just trying to take all these different pieces together, and what they net out to what sort of the underlying pretax MA margin assumption is for 2021, so we can think about that relative to the long-term target.

Susan M. Diamond - *Humana Inc. - CFO*

Yes. So what I would say is, as you see in our guidance points, our MER target -- or MER range and our -- hasn't really changed. So -- and because of the offsets and the nature of those offsets, there are many within the retail segment and Medicare, in particular.

So I would say, in general, there's not material movement in the individual MA margin because the headwind -- net headwind is largely offset by other positivity. And as we mentioned, the positive prior period development as an example as well as the sequestration would be attributable to the retail segment. Thank you.

Operator

Your next question is from the line of George Hill from Deutsche Bank.

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

I'm going to try to put in 2 very quick ones. I guess, Bruce, as I think about the JV investment with Anthem, that's much more of an infrastructure and back-end investment as opposed to more of a PBM JV, if I understand that right.

And then just kind of net-net of everything, am I hearing things right that the $21.25 to $21.75 is the right jumping off point as we think about fiscal '22 EPS, inclusive of all the moving pieces basically that they're all offsetting?

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

Yes. To answer your first question, you're exactly right. It is an infrastructural investment. And again, it's a utility for the industry. And actually, we would enjoy others to join that joint venture over a period of time.

In regards to your second question, you're exactly right. The midpoint is $21.50, and that is what we would base our '22 growth of off.

Operator

Your last question is -- I'm sorry, your next question is from the line of David Windley from Jefferies.

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

You touched on this a little bit, but I want to try to bring a finer point to it. The 2.5% baseline in the second half, would you expect that -- not withstanding time frame, but would you expect that to return to baseline? Or are you seeing some permanent shifts, like ER utilization that would cause you to stay below baseline beyond 2021?

And then what are you seeing in terms of member acuity as the bounce back utilization has come? Are you seeing higher acuity as patients represent for services?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. Great question. So as we said, the 2.5% represents an average for the back half of the year. I think it remains to be seen at what rate it ultimately settles in. It could come in more depressed in the third quarter and then get closer to baseline.

There's obviously a range of scenarios that could emerge, some of which could be that, by the end of the year, it gets closer to baseline. So I think that, until we get to the plateau and then see that sustained, I think it will be hard to assess the long term, whether that's a long-term new normal or not. So we'll continue to watch that.

As for acuity, I would say, so far, we are not seeing indicators that there is a higher acuity, that there's -- or there has been impact from the deferred care in 2020. We are continuing to watch it. But so far, we have not seen any sort of systemic indicators of that. And in fact, some of the things that we were able to initiate along with our provider partners to ensure members receive the needed preventative care through telemedicine were quite hopeful during the pandemic.

And one data point as an example was that we saw higher medication adherence through the pandemic than we actually did pre-pandemic. So a nice indication that members were receiving the needed preventative care, receiving their medications and hopefully staying on top of their conditions. But so far, we are watching it. We're not seeing any indications of higher acuity.

Operator

Your next question is from the line of Rob Cottrell from Cleveland Research.

Robert Sohngen Cottrell - *Cleveland Research Company - Research Associate*

Wanted to revisit the operating cost guidance and how should we think about that for future years, absorbing the full year cost of Kindred. And also any potential synergies that could offset that into 2022 and beyond?

Susan M. Diamond - *Humana Inc. - CFO*

Sure. As I said, the current year guidance revision was a direct -- is directly attributable to incorporating Kindred in the guide. To be quite honest, we're going to need to do some work post closing and integration to revisit our forward -- probably more in 2022, what our guidance points look like and whether they need to change.

Obviously, within Kindred, they have direct cost of care. Those are -- all of their costs are included in that OpEx ratio. There's -- it's not showing up anywhere else in the guide. So that's something we'll look at, so we'll need to see whether there's anything we should break out separately, specific to the Kindred business.

As it respect to synergies, the Kindred transaction was not really a traditional synergy play. We obviously don't have a Home Health business to integrate into, so the operations will be largely standalone. We are certainly looking at opportunities to see where we can create some synergies based on the capabilities we have and they have, but I would not expect those to be significant.

The real value is going to be on the new products and models that we intend to introduce, particularly the value-based model we shared during Investor Day, that will be the source of value creation as a result of that transaction.

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

And just to reemphasize, we don't see net our operating costs going up as a result of the transaction outside of some investments we're making in the short term as a result of the integration. We continue to maintain a long-term orientation to continuing to increase our productivity.

You've seen that over the last number of years, and that has not changed. And the investors shouldn't walk away from that. This is increasing costs. We continue to keep that as a discipline.

I think what you do see is it's just sort of taking one organization that has a different margin, a different operating structure and bringing it into our operating structure. And as we bring the 2 together, we'll have that same emphasis of continuing to improve productivity on the organization.

Susan M. Diamond - *Humana Inc. - CFO*

And I think that was our last question. So Bruce, if you have any closing comments?

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

Yes. And we really appreciate everyone's support. We recognize that this quarter as a result of the transition year of COVID is a difficult one. We are very oriented to continuing to have the transparency between what is COVID and what's operationally, and I hope you guys can discern between those 2 as we continue to have further questions on the operational performance.

That being said, I do want to leave the investors with the understanding that we continue to believe that the organization's operational performance in '21 has been very strong as a result of what you see and just some of the offsets -- operational offsets of some of the headwinds from COVID.

And then secondarily, as we see 2022, we did take a very conservative view into pricing in our planning for both AEP and as we start to enter the AEP season. I think you guys will see that thoughtfulness and reflect some of the uncertainties that maybe continue into 2022.

So as always, we appreciate your support, and we also appreciate our teammates' continue to drive to both improve our operating performance and serve our customers in the best we can. So thank you.

Operator

And with that, this concludes today's conference call. Thank you for attending. You may now disconnect.
