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# Humana Inc. (HUM)

Q2 2024 Earnings Call

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**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, and thank you for standing by. Welcome to the Humana Second Quarter 2024 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to Lisa Stoner, Vice President, Investor Relations. Please go ahead.

### **Lisa M. Stoner**

*Vice President, Investor Relations, Humana Inc.*

Thank you, and good morning. I hope everyone had a chance to review our press release and prepared remarks as well as the letter from the CEO, all of which are available on our website. We will begin this morning with brief remarks from Jim Rehtin, Humana's President and Chief Executive Officer; followed by a Q&A session with Jim and Susan Diamond, Humana's Chief Financial Officer.

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 risk and uncertainties. Actual results could differ materially. Investors are advised to read the detailed risk factors discussed in our latest Form 10-K or other filings with the Securities and Exchange Commission and our first quarter 2024 earnings press release as they relate to forward-looking statements, along with other risks discussed in our SEC filings.

We undertake no obligation to publicly address or update any forward-looking statements in 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 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. Any references to earnings per share or EPS made during this conference call refer to diluted earnings per common share.

Finally, this call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, [humana.com](http://humana.com), later today.

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

### **James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

Thanks, Lisa, and good morning, everyone. Thank you for joining us. Let me start by just saying that it's a privilege to be able to serve as Humana's President and Chief Executive Officer. And I want to say thanks to the Humana board of directors for providing me this opportunity.

I also just want to say thanks to Bruce for the last six months of his mentorship and partnership. It's been really, really great. And I actually look forward to continue to work with him over the next year. So, Bruce and our 65,000 teammates have built a great company here, and it's pretty exciting to be a part of it.

I shared some thoughts on Humana and the industry and the opportunity ahead in the letter that I posted on our Investor Relations website this morning. I encourage everyone to take a moment to read the letter. That goes along with our second quarter prepared remarks and the earnings release. I'm not going to repeat what is in the letter, but I do want to hit a couple of themes.

So let me start by just reinforcing what I think is basic truth about the business. It's a good business. It's good for our members, and it's good for our patients. This is well documented in my opinion. CMS and the federal government, state government and by extension, even taxpayers are also our customers.

I think we need to constantly remind ourselves of that. What we do create is value for those customers as well. We need a regulatory environment that allows that value to be fully realized, and that requires constant collaboration and adjustment.

We need to be a proactive partner with CMS in that process and we need to do this to make sure that we've got a long-term stable Medicare and Medicaid program. This is also good for investors, for all of you. And I think you guys know that the sector fundamentals have not meaningfully changed.

They're still attractive and we still have differentiated capabilities to compete in that space. We understand that there is frustration with the volatility that we've been experiencing. I want you to know that we also acknowledge that right now, we are not achieving our full potential.

The external environment has certainly been difficult. However, the message I want to keep driving home is that we need to see the external environment for what it is, it's context. We need to shape it to the degree that we can, and we otherwise need to be focused on the things that we control within that context.

That's our product, it's our pricing, it's our clinical capabilities, it's admin costs and it's growing our business. To execute well against the things that we do control, we need to be incredibly focused on operating discipline. We're good at operating discipline, but we need to be reminding ourselves of that day-in and day-out as the external environment changes.

We also can do a better job with multi-year planning in order to deliver consistency and performance over time. We've got great teams. We know how to do this. It's simply about maintaining focus on the things that we control, even when the environment around us has shifted.

Now, let me turn to second quarter performance. I'm going to give a quick headline. I'm going to give some examples to support that headline, and then I'm going to come back with some implications on our outlook.

The headline today is that our second quarter results exceeded expectations. We feel good about where we are at midyear, but we did experience some medical cost pressure in the quarter. So let me expand on that a little bit.

Much of the good news comes from our Medicare business, which is outperforming the expectations that we had at the beginning of the year. Our member growth is better than we expected. We raised our forecast by 75,000 members. That means that we should grow at just over 4% for the year.

Our benefit ratio for the quarter was lower than we anticipated. That was driven by claims development and higher than expected revenue, and that was also offset by the higher inpatient costs that I referenced earlier.

More specifically, inpatient admissions were higher than we expected in the back half of the second quarter. That pressure has continued into July. For now, we believe that planning for continued pressure within our guidance is the right approach.

But we also feel good that this pressure ultimately can be mitigated. We've taken several measures to mitigate that pressure. So for example, we're continuing to ensure clinical appropriateness of admissions, especially in light of the two-midnight rule. We are enhancing claims audits, and we are negotiating with provider partners to achieve better clinical and contractual alignment.

In Medicaid, we're excited about our continued growth through both contract wins and member growth. And we continue to wait for additional RFPs. We have some modest claims pressure in Medicaid, but we do not expect it to impact our full year results. In CenterWell, primary care is delivering strong clinic and patient growth, and we're confident that we're on track to mitigate v28 as it phases in.

Overall, our pharmacy volumes are in line with plan, and we continue to drive lower cost to fill, particularly in our less mature specialty pharmacy business. The home business has generated high single-digit admission growth, and the team continues to improve their cost structure, anticipating continued rate pressure in that space.

We continue to make progress managing our admin costs, and we're ahead of plan for these. Broadly, we are focused on automation. This is in reducing our cost to fill in our pharmacy business, and it's also in lowering member service costs within our insurance segment.

I'll give just a few examples of the type of work, actually, really good work that our teams are doing. We're seeing an increased Medicare claims auto adjudication rate by about 70 basis points. This does improve the provider experience and it does also reduce claim processing costs. We've optimized logistics across our specialty pharmacy facility in a way that reduces transit times and also lowers average delivery costs. We've improved our digital enrollment experience. This is leading to higher conversion rates. And again, it's lowering our distribution costs.

Finally, we're making good progress on multiyear initiatives. We recently announced a partnership with Google. This will help accelerate our AI efforts. That will, in turn, help reduce cost and improve the consumer experience. We're excited about a recent investment that we made in Healthpilot. Healthpilot uses AI to make the consumer purchasing experience better when shopping for Medicare Advantage. And we just entered into a lease agreement with Walmart that should help accelerate our primary care clinic.

The implication, as we look forward, is that we are reaffirming our full year 2024 adjusted EPS and benefit ratio guidance. This prudently assumes that the higher inpatient costs will continue even as we work to mitigate that pressure.

We're looking ahead to 2025, we continue expansion in adjusted EPS growth as a first step on what will be a multiyear path to a normalized margin. We continue to feel good about our bid assumptions and our product portfolio as we head into AEP. I'm excited about all of the momentum and the opportunity ahead.

And so with that, I'll just remind you that we posted the prepared remarks to our Investor Relations website so that we can spend most of our time on Q&A today, and we will now open up the lines for your questions.

Operator, please introduce the first caller.

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## QUESTION AND ANSWER SECTION

**Operator:** Our first question comes from the line of Ann Hynes with Mizuho.

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**Ann Hynes**

*Analyst, Mizuho Securities USA LLC*

Q

Hi. Can you hear me?

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**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yes. Good morning, Ann.

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**Ann Hynes**

*Analyst, Mizuho Securities USA LLC*

Q

Oh, hi, sorry about that. Cut out. So, maybe going to the inpatient trends, is it really only the two-midnight rule you're seeing pressure or are there other areas of pressure that you're seeing? Thanks.

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**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah. Hi, Ann. Happy to take that. So, yes, and as we described in our previous commentary, both in the first quarter and then at conferences in the second quarter, we have seen some variation in our month-to-month inpatient results for – and then also the avoidance rates as we implemented the two-midnight rule requirements, which, if you remember, that was a meaningful change and we need to make some assumptions around how it impact our historical patterns.

As we described in the first quarter, our avoidance rates initially were lower, but then ultimately did come in line with our expectations by the end of the first quarter. Those have remained stable and continue to be in line with what we would have expected.

The inpatient absolute level, however, has seen some more variation and was higher in the back half of the second quarter in particular. As Jim mentioned, that has continued into July at relatively similar levels.

Based on everything that we are seeing, including the fact that these continue to be lower acuity and lower average costs as well as the fact that we continue to see corresponding reductions in non-inpatient on observation side, it does all point to a belief that it is likely largely due to further impacts from the two-midnight rule implementation.

We would say this is also consistent with what we've seen reported from the hospital systems with their results in terms of volume and revenue per patient. So we do believe it's all consistent.

With respect to July, it is relatively consistent. We are seeing just a slight amount of COVID as well on top of that, but otherwise consistent. So, as far as everything we have visibility to right now, it does seem to have stabilized, but it is higher than we had anticipated entering the second quarter.

**Operator:** Our next question comes from the line of Sarah James with Cantor Fitzgerald.

**Sarah E. James**

*Analyst, Cantor Fitzgerald & Co.*

Q

Thank you. The guidance implies a good step-up in second half MLR. Can you speak to how much of that is seasonality versus assumed continuation of the July trend? And is there a way to break out the impact of the increased inpatient in July on the 2Q MLR?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Hey Sarah. Yeah, so in terms of the second half MLR, as we said, it does anticipate that the higher inpatient volumes, which are partially offset by lower average unit costs and then those lower observation days will continue into the third quarter and the back half of the year. So that is fully accounted for.

To your point, there is some workday seasonality that impacts the quarterly progression as well. For the third quarter specifically, it is contributing about 80 basis points to the expectation for the third quarter MLR. So that is accounted for as well.

The offset to that is largely in the fourth quarter, where we expect to see favorable workday seasonality relative to last year. I think your second question asked whether the higher July activity impacted second quarter results, which obviously it wouldn't. That would be considered in our third quarter results.

**Sarah E. James**

*Analyst, Cantor Fitzgerald & Co.*

Q

Right. Sorry. Is there a way to quantify the July impact on MLR?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

No. So I'd say, again, the core admission volumes is in line with what we had anticipated based on the second quarter performance. There is a slightly higher amount due to COVID, which, again, I wouldn't say that's overly concerning to us and given its clearly COVID related, we would expect it not to persist for the full balance of the year. But something we'll certainly continue to watch.

**Operator:** Our next question comes from the line of Andrew Mok with Barclays.

**Andrew Mok**

*Analyst, Barclays Capital, Inc.*

Q

Hi. Good morning. Hoping you can give a little bit more color on the MLR progression this year. You're guiding 3Q insurance MLR up about 100 basis points sequentially, but it sounds like you're leaving that assumption relatively flat, is that right? Because I would think 4Q MLR would be even higher than 3Q MLR just based on normal seasonality. Just want to understand those two points. Thanks.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah. When you think about the back half of the year, we do anticipate higher MLRs for the third quarter relative to last year, relatively consistent, which again includes that workday impact I just mentioned.

For fourth quarter, we obviously saw that very high utilization in the fourth quarter last year. Obviously, we've jumped off of that in terms of our expectations for this year. So you'd see some slightly higher incremental pressure just because of the expectation of a normal trend on top of last year's jumping off point. But because of that favorable workday seasonality that I just mentioned, it will positively impact the fourth quarter MLR, which is going to offset some of that.

**Operator:** Our next question will come from the line of Justin Lake with Wolfe Research.

**Justin Lake**

*Analyst, Wolfe Research LLC*

Q

Thanks. Good morning. First, the higher inpatient cost, if I just run some simple math, your typical seasonality first half to second half on MLR, typically pretty flat to up slightly, let's call it, zero to 50 basis points. So looks like you're up closer to 125.

So am I right in thinking that this inpatient pressure is about 100 basis points to MLR in general. If not, can you quantify it somehow for us in terms of the level of pressure that this is specifically putting on MLR? And then what's embedded in the second half relative to what you expected previously?

And then you talked in the prepared remarks about being comfortable with your 2025 bids. You said this came in the back half of the quarter, so that's second half of May. Those bids are due in the beginning of June. How do you get investors comfortable with the fact that your bids would be able to absorb this type of pressure given that you didn't see it until rival bids were being submitted?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah. Hi, Justin. So in terms of the MLR seasonality, there are some impacts year-over-year just because we continue to see increasing pressure last year. So it impacted the progression we saw last year.

With respect to this year, when you think about first half and second half, there is some favorability in the first half of the year that offset some of the higher costs that we did see beneficially impacting the benefit ratio.

And those are – some of which are onetime in nature where [ph] they (00:17:08) run rate. Some are unique to the first quarter or the first half of year. Typically, things you can think of like prior year claims development, which you've acknowledged has been favorable versus our expectations. We've also mentioned that we saw favorability in our 2023 final MRA payment, which is more one-time in nature, still positive, but won't run rate into the back half of the year.

So some of those things are disproportionately impacting our first half MLR this year relative to some prior years. And so obviously, won't repeat in the back half, which can create some differences in what we're expecting first half and second half. So within our second half assumptions as we've said, we have assumed that the higher absolute level of inpatient volumes plus the naturally offsetting unit cost and observation stays that we've experienced, those are all assumed to continue for the balance of the back half of the year. And then as we've



said, there are some workday seasonality impacts that are a little bit different this year that are also embedded in that as well.

As far as 2025 bids, while, to your point, we submitted these bids prior to some of the development of this inpatient pressure. So that is not explicitly contemplated in the bid. But we would say some of the offsetting positive news, the higher risk scores and the final MRA payment as well as the lower inpatient unit cost, the lower observation phase and some of our other favorable prior year development coming from things like claim cost management and audit were also not contemplated in the bids and some were durable.

And so all told and considering all of those factors, we continue to feel good about the bid assumptions in the aggregate and the ability to deliver the margin and earnings expansion that we had always contemplated.

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**Operator:** Our next question comes from the line of David Windley with Jefferies.

**David Windley**  
*Analyst, Jefferies LLC*

Q

Hi. Thanks for taking my question. I wanted to ask a clarification and then a broader question. The clarification being, Susan, I think you had previously said the two-midnight rule was worth about 50 basis points to 75 basis points in the MLR. I wondered if you could give us an updated number on that.

And then the broader question I have is, over multiple years of value creation plan activity the company has endeavored to drive efficiency and take cost out. I'm wondering if essentially you've cut the muscle, if you've cut so much cost that your kind of anticipatory mechanisms and ability to react and act quickly on elevated cost activity has been hampered by the depth to which you've cut costs. Thanks.

**Susan M. Diamond**  
*Chief Financial Officer, Humana Inc.*

A

Yeah. David, I'll take the first question on the two-midnight rule, and then hand it off to Jim for your second question. So yes, I think the impact that you referenced was what we anticipated going into the year relative to the two-midnight rule. Obviously, as what we've seen, if the higher inpatient costs are in fact attributable to two-midnight rule, which, again, the information we have would seem to suggest that it generally is, then that would obviously have a higher impact than we had expected.

All told, when you consider the positive prior year development, as it respects claims and the unit cost and the observation stage. When you take all of that in total, we were able to mitigate a significant portion of that, but not all of it. And so intra-year, the remaining offset is coming from that favorable MRA, which again, we expect to continue, which is why we continue to feel good about the \$16 for this year and \$25 for next year. But we haven't sized the incremental impact for the two-midnight rule, and I don't have that information sitting here today that I'd be prepared to do that on this call.

**James Rehtin**  
*President, Chief Executive Officer & Director, Humana Inc.*

A

Yeah. Hey. I can jump in on the cost management question. First of all, it's a good question. One of the questions that I was asking and staring at when I first came in here seven months ago. The short answer is I don't see any evidence that we've done anything that has cut into muscle today. And I think that's the most important thing.

Anytime you go through a cost transformation like this, you've got some low-hanging fruit upfront and then you have a lot of harder work that is tied to the things that we talked about earlier, automation, using technology to do process redesign, et cetera. The quick hits, you get quickly and the rest of it takes real planning investment over multiple years.

The company has done a nice job of planting the seeds for that multiyear cost management and there's more to do. When you think about the nature of this business and what technology can do to take cost out over time, there is still more opportunity. That opportunity is just going to be phased in over multiple years. It's not going to be the big jump that we saw a year, year and a half ago.

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**Operator:** Our next question comes from A.J. Rice with UBS.

**A.J. Rice**

*Analyst, UBS Securities LLC*

Q

Hi, everybody. Maybe just stepping back, I know Jim, in your letter, you talk about multiyear opportunities for margin recovery and some of the discussions we've had with the company earlier in the year. The thinking was, given the market competitive environment, given some of the restrictions on tweaking benefits that we should think of it in terms of 100 basis points to 150 basis points of margin recovery, MLR and then margin maybe each year for the next few years.

I wonder if you have any updated thoughts on how fast we can see that margin recovery. I know you reiterated long-term, you think it could be 3% target. I think that's before investment income. Can you give us any updated thoughts on how the progression looks over the next two or three years?

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Yes. Let me hit a couple of things in there. So first of all, I want to separate two concepts. We have talked about the multiyear margin recovery that is really driven by the regulatory environment, what you can do in any one year with TBC, et cetera. And we really don't have any change to the commentary that we have made on that previously.

The second thing that I referenced is multiyear planning. And when you think about multi-year planning, I'm going to go back actually in a way to the comment that I just made. If there's a place that we're going to have to be more disciplined over the coming years, it's really in how we're measuring and evaluating the return on the expenses, whether it's capital or whether it's operating expense that that we have in any given year.

So that we're optimizing those decisions and then making sure that we've got the processes in place that we're not just operating with discipline in a one-year period of time, but we're driving the accountability over years two, three, four and five that go back to that investment you made in year one. That's the place where I think that there's more opportunity. And the benefit of that is just getting to more consistent performance year-over-year-over-year-over-year that is kind of really grounded in how do you optimize shareholder value over multiple years. So that's a different concept or a different thing that I am commenting on in the letter from the margin recovery that we need to make sure that we're building into our benefits and our pricing. [ph] Sam? (00:24:36)

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**Operator:** Our next question comes from the line of Kevin Fischbeck with Bank of America.

**Kevin Fischbeck**

*Analyst, BofA Securities, Inc.*



Great. Thanks. Maybe two quick questions. Maybe just to wrap-up that last point, Jim. Would you say that this is a change for Humana that you're bringing to this that maybe this was a shortfall relative to multiyear planning with a shortfall relative to historical? Or are you just saying this is something you always have to do, and you're just going to continue to do it?

And then I guess, second, on the provider business, can you comment a little bit more about the MLR trends there? Are you seeing the same inpatient pressures there? Or is there anything else that you would spike out on that side of the business? Thanks.

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*



Yes. I'll hit the first one, and then I'll hand this over to Susan to comment on the second. It's not so much that it's a change as it is something that we can get more disciplined about and we can get better at. The nature of this business, Medicare Advantage, in particular, is that it's an annual cycle business. You guys know that. We talk about it all the time, annual repricing, annual rate notice, annual AEP and member growth. And in that environment, it can be challenging to really be disciplined about how you think about three, four, five-year investments. And again, that's not just capital investments, that's operating investments that you're making in any given year. And so it is something that the company thinks about. It's also something that the company can get better at.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*



Yes. And Kevin, on your second question with our provider business, I would say at the highest level similar results to the health plan, although on the claims side, I would say not quite as much inpatient pressure as we've seen. And that's consistent, I think, with what we talked about early in the year where we weren't seeing as pressure in the risk book from some of that inpatient activity when it started to emerge.

They've also, as I've said before, consistently demonstrated a better impact to work with the hospital systems on those authorization requests and determining the appropriate level of care, which oftentimes results in not needing an inpatient stay, and again, just better than what we see on average is within the health plan. They've also seen some favorable MRA in their 2023 final payment.

But then we also acknowledge that CenterWell, because they do have an agnostic platform, they don't get the same level of real-time information as we do. And so we are taking a little bit of a cautious approach, as we think about their performance. It's harder to estimate the impact of change that's still running through the system. So I would say, generally, not inconsistent with the health plan, but not quite at the same level.

**Operator:** Our next question comes from the line of Joshua Raskin with Nephron Research.

**Joshua Raskin**

*Analyst, Nephron Research LLC*



Hi. Maybe just shifting gears, can you speak about your expectations for the PDP segment in 2025, including expectations for membership and then profit and margin? And then maybe based on that benchmark data that we

saw this week, what should we take away from the industry bids? And maybe lastly, any commentary on expectations or participation in that demonstration project?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

So hey Josh, so yeah, there is a lot going on, obviously, in the Part D side, particularly PDP. As we said, it is hard to really understand what – how everyone might have approached their bids for 2025, particularly in the stand-alone Part D spaces.

As we said before, selection in terms of your underlying membership is really important, and we each have a little bit of a different product strategy, which may have caused us to approach the bid differently.

I would say broadly, I think the industry was focused on mitigating some of the increased exposure and liability risk that we all have in the way that the program will be constructed for 2025. With the information that was released this week on the benchmark, as we've all seen, it does suggest that the direct subsidy maybe is going to be higher than what certainly analysts had expected.

It's impossible to know what each company might have anticipated, but what is nice to say that it is more reflective of some of those higher costs that we've been saying the industry is going to have to deal with in 2025.

As far as the demo, honestly, there's still a lot of questions about how the demo will work that we're all awaiting additional guidance from CMS on that. And so too early to say whether we're going to be able to participate or not.

And as far as the direct impact of the direct subsidies and the benchmarks, again, as always the case, we aren't going to comment on that specifically, recognizing bids are still open and people will be making changes in light of that. So certainly, we'll talk more as we get past the bid submission timeline. But right now, for competitive reasons, we won't be commenting specifically.

**Operator:** Our next question comes from the line of Ben Hendrix with RBC Capital Markets.

**Ben Hendrix**

*Analyst, RBC Capital Markets LLC*

Q

Thank you very much. Switching over to Medicaid, seems like a lot of your peers saw some utilization and acuity headwinds in those books, but you noted some favorability in Florida and seems like you might have been a little bit better forecasted there. Could you talk about kind of what you're seeing specifically in that key market and then maybe what you're noticing in some of your newer Medicaid markets in terms of utilization? Thank you.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah, Ben, so as you pointed out, we do think our results are probably a little bit different than some others have reported. And that is because I think we've always said we tried to take a conservative approach to how we thought about the impact of redetermination, assuming that ultimately, we would only retain 20% of the members who gained access through to PHE and made the assumption that the acuity of those members that were retained would look like more like the historical Medicaid performance versus the lower acuity we saw through the PHE. I would say that has all largely proven to be true.

So – and we called out Florida specifically because it's the best representation of that. We're obviously the largest membership and would be impacted most significantly from redeterminations. And Florida is performing slightly better than our expectations. So that is positive.

We did call out in our remarks, we are seeing in our newer states discrete pressure. It's a little bit different in each one. Oklahoma as an example is pharmacy-related. As we understand it, everybody is seeing that. There are risk corridors in place that mitigate the exposure on that, which is good. In Kentucky, it's behavioral related, which again, I think others have called out as well. The team is working hard and has mitigation opportunities across each of those states that they're working on.

And then ultimately, we do feel good about our discussions with our state partners and that ultimately that they will adjust the rates to be reflective of those trends. So all things being considered, we still feel good about the Medicaid performance in 2024 relative to our expectations and then also on a go-forward basis, given all the items I just mentioned.

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**Operator:** Our next question comes from the line of Stephen Baxter with Wells Fargo.

**Stephen Baxter**

*Analyst, Wells Fargo Securities LLC*

Q

Hi, thanks. Just a quick clarification first and then an actual question. Susan, I think in an earlier response, you said you feel good about the \$16 of EPS this year and then feel good about 2025. I think some misheard the comment on 2025 as a specific value you're offering as an EPS expectation. Can you just confirm first, if you were offering any kind of comment on 2025?

And then my actual question is, as we think about the MLRs and the incremental margins on the few hundred thousand members and plan and county exits, any sense you can give us on that? Just trying to wonder if it's actually an EPS driver for you year-on-year? Or is this something that incrementally could be – it's something you just have to manage through in context of everything else you're trying to achieve with bids and profitability next year? Thanks.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yes. So yes, definitely I want to clarify, here's what's interesting. So yes, we feel good about the \$16. And yes, we feel good about our 2025 assumptions. I did not mean to suggest that we're sharing an EPS target for 2025. Obviously, we've been clear. We haven't given any forward guidance for 2025 and would expect to do that on our normal time line. So I was just making the point based on everything we know, we continue to feel good about the 2024 results and what we're planning for, for 2025.

As far as exit specifically, so as we've been saying, given the TBC limitations and the trend in IRA and v28 that we're having to price for in 2025 that a lot of that would fully sort of be offset by the benefit changes you could make and not leave much incremental room for margin recovery in the aggregate. The planned exits though do provide an opportunity to actually get margin expansion in terms of percent and absolute earnings because we do have claims that are running at a loss.

And so as we said before, we studied the performance of our plans in each market very closely. And if they were performing at a loss and did not have a reasonable path to getting to at least breakeven performance in a reasonable period of time, we did consider an exit as a better solution there.

So there are cases where we'll do that, and that will be incrementally positive to our earnings progression. But ultimately, as we've said, the absolute level of earnings growth is very dependent on our ultimate membership change for next year. And in this environment, we've acknowledged there's a wider range of potential outcomes. And so we'll need to see the landscape before we can comment further on member growth and then certainly EPS expectations for next year.

**Operator:** Our next question comes from the line of Scott Fidel with Stephens.

**Scott J. Fidel**

*Analyst, Stephens, Inc.*

Q

Hi. Thanks. Good morning. I was hoping you can maybe just sort of catalog or walk us through the different inputs into the \$3 billion raise to the revenue guidance. Obviously, you saw the updates to the MA and PDP membership changes. But in isolation, those won't sort of amount to anything really close to \$3 billion. So know there's probably some other drivers there, whether it's Medicaid or CenterWell. And just would be helpful, Susan, if you'd just walk us through those different pieces. Thanks.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yes. Hi, Scott. So yes, the change to the revenue guidance is – the largest driver is by far the membership when you consider the magnitude of the increase in expected membership for year, that will drive both revenue and claims, right? And we've said before, new members on average you can think of is having little contribution, particularly added membership in the back half of the year where the commission costs run higher for that first year.

So the main driver is membership. But as we said, we did see some favorable outperformance on our 2023 final year MRA and some intra-year positivity on our revenue risk or estimates as well that's included, but I would say the majority by far is membership related.

**Operator:** Our next question comes from the line of Lance Wilkes with Bernstein.

**Lance Wilkes**

*Analyst, Sanford C. Bernstein & Co. LLC*

Q

Yes. Jim, could you describe a little bit of how you're morphing the management process of the company? And any sort of org and talent changes you're making there? And any sort of timing related to a strategic review? And then maybe as part of that, what are your top priorities for taking operating expenses out, both in light of the member reductions and then just obviously, as part of trying to recover your margin? Thanks.

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Okay. So there's a lot in there. Let me see if I captured this. Management process, strategic review, cost management, did I miss anything in...?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Margin recovery.

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Oh, margin recovery. Yeah. So I'll try to hit each of those succinctly here. Management process, I think the biggest thing that we're doing around management process is actually what I referred to earlier. It is trying to take up to the next level, our discipline of looking out multiple years, how we're measuring performance over multiple years against the investments and the expenses and the things we're doing in any given year. And then how do we make sure that we're driving accountability over those multiple years.

I mean that is the single biggest change. That obviously then dovetails into strategic review. We're in the midst of that. We're going a little deeper than I think we would in normal year, largely because I'm new to the team. And we're really trying to use that process to implement those management processes that I just described. So we're in the middle of that process. We will have more to say about the exact timing and the exact outcomes of that sometime early to mid next year.

The cost management, there are two different things in there. One is how do we manage variable costs. And so the team actually has good processes around that. Of course, we're tightening them up, given the range of membership outcomes that we could have this year but that is a pretty standard process that you're simply honing, taking variable cost out with membership.

And then we are diving deeper and deeper into how do you actually drive real process redesign with automation technology. I'd point back to the partnership we've got with Google around AI, what we're thinking about even in things like distribution costs by being able to drive more efficient digital distribution. All of those things are about driving long-term cost management, which hits both fixed and improves variable over time. And then – did I hit everything?

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Margin recovery.

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Oh, margin recovery. I'm going to go back to the same place that we've been on margin recovery. It's going to take – we expect to be at least 3% in our Medicare Advantage business. It's going to take multiple years to get there. That is largely driven by the regulatory environment, TBC, et cetera, and that is based on some basic assumptions, kind of reasonable assumptions about how rate and trend is going to develop over that period of time. We think we'll be back to normal in 2027, back to a normalized margin, and that's what we've communicated in the past, been pretty deep into those numbers. And I feel good about the direction that the team has given.

**Operator:** Our next question comes from the line of Michael Ha with Baird.

**Michael Ha**

*Analyst, Robert W. Baird*

Q

Thank you. Just a quick clarification on OpEx first and my real question. I know your press release you mentioned some of your lower than planned admin expenses were considered timing in nature. But wasn't that also mentioned in 1Q? So are those timing items expected to flip back into the third quarter and fourth quarter?

And then my real question coming back to Justin's question on bids. Apologies, I may have missed part of the answer, but it sounds like this elevated inpatient utilization was not embedded in 2025 bids. So if it were to persist through to 2025 and presumably, if it is an industry-wide dynamic, then I imagine your relative competitive positioning would in theory be unchanged. But I imagine this would also then impact your own expected MA margin recovery for next year. So all in all, if it were to persist, wondering if you could discuss how this could incrementally impact your MA margin progression next year versus your prior expectations? Thank you.

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**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah. Michael, so on the OpEx, yes, we did mention both in the first quarter and then second, but some of the favorability we've seen in administrative cost is timing in nature. And that's just a difference in when we projected we would have certain spend, and when it's now expected to be incurred.

Some of the areas where it's natural you might say it is marketing and just the timing and the opportunity they see in the AEP versus OEP versus ROI and then going into next year. IT is also one that can be difficult to predict the exact progression of when projects will be completed. So there are a number of things where, while it's favorable in the quarter, we would expect that it's still going to be spent for the full year, and so then we'll flip out in the third or fourth quarter.

On the bids, what we want to try to convey is we did not anticipate this higher utilization in our bids given when it develops relative to the deadlines for filing those bids. So that will be incremental pressure relative to our discrete medical cost assumptions in the bids.

However, we also did not incorporate the lower unit cost, the lower observation stays nor the higher risk scores that we've seen develop in the first half of the year either. And because those have largely offset, and also expected to be durable into 2025, all considered, we still feel good about the MLR expectations that we have within the collective assumptions in our 2025 bid.

So we are, at this point, much like we're assuming it will continue in the back half of the year. We've looked at our 2025 assumptions. And if that continues through the big duration of 2025, with those other offsets, again, we should be back to a similar position as it respects the MLR that we had planned for within our 2025 bids.

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**Operator:** Our next question comes from the line of Jessica Tassan with Piper Sandler.

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**Jessica E. Tassan**

*Analyst, Piper Sandler & Co.*

Q

Hi. Thanks very much for taking my question. So I wanted to follow-up on that. How are the higher than anticipated risk scores that you referred to in the prepared remarks impacting your view of the v28 headwinds in 2024 and 2025. And is the favorability related to any kind of specific efforts like IHEs? And any reason why it wouldn't compound or effectively double year-over-year in 2025? Thanks.

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**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yeah. Jessica, so the favorability we saw on the 2023 file is primarily related to new members in 2023. And that's where, based on their data, we just don't have the full claims history in order to know specifically what their subsequent year risk score will be because we just don't have the benefit of the claim. So that typically, if we do



see favorability is the source of it and so that's what we've seen. It's largely within the membership growth was largely concentrated in the PPO plans. So that's where we've largely seen it.

It would have – I would say, the v28 impact is sort of unchanged in terms of our thinking. It's not now on higher membership, but I would say the outperformance on the 2023, final MRA doesn't have a literal impact in terms of our v28 thinking. But proportionately, because we have more members, it'll just be accounted for within that.

In terms of the outperformance, we did see, like I said, because it was related to the new members where we didn't have the full visibility and that was not contemplated in our 2025 bids. With the visibility we now have, we would expect to see that recur into 2025 and be another mitigant to offset higher inpatient utilization if it also happens to maintain throughout 2025.

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**Operator:** Our next question comes from the line of John Ransom with Raymond James.

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**John W. Ransom**

*Analyst, Raymond James & Associates, Inc.*

Q

Hey good morning. Two kind of super high-level questions. It looks to me like the industry is losing the argument in Washington. You've seen a couple of things that suggests taxpayers are spending 13-or-so percent more on Medicare Advantage than they would be on straight Medicare fee-for-service. So I wonder if you think your advocacy efforts are sufficient. And what is the kind of elevator pitch to a senator as to when he or she asks is MA a good deal for the taxpayers' apples-to-apples because it seems like there's a split question.

The second high-level question is, if you just look at your G&A long-term opportunity, incorporating all the tools of AI and everything you have today, what is the kind of floor on how low you think you could drive G&A over, say, the next 5 years? Thank you.

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**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

So DC policy efficacy, how do we make the elevator pitch and then comment on G&A. Let me just hit the G&A one real quick. That one's a little bit easier. We are working through that question, among others right now through the strategic review that we're doing, et cetera. We'll have more to say about that next year, early to mid next year. And so I'm going to defer on that question for the moment.

On the DC policy, so we've had a lot of conversation about that internally. And what I would keep going back to is, number one, we know that we deliver value to our members and our patients. That is very well documented. We get better outcomes. We deliver better health security by lowering the cost to members for the care that they receive and giving them access to more benefits.

We also know, and it's pretty well documented that we deliver like-for-like benefits at a lower cost than what original Medicare does. Those two things mean that there's a value proposition for members and for taxpayers. What we can do a better job of and part of what I think the entire industry needs to be focused on is building the case for the second of those two things even more tightly, and then better explaining and understanding what of that value does accrue back today to taxpayers, what doesn't? And how do we actually collaborate with CMS to make sure that the regulatory environment allows that value to accrue back or some of that value to accrue back. None of that should be harmful to the MA sector.

In fact, I would argue that it helps the MA sector, are getting tighter and better in understanding the impact on taxpayers, how the regulatory environment shapes that, what we can do to create a long-term value proposition for taxpayers that creates real stability for the Medicare and Medicaid program over time. That's good for everybody. It's good for the MA sector. It's good for the member. It's good to taxpayers. And that's what we've got to focus on getting back to.

**Operator:** Our next question comes from the line of George Hill with Deutsche Bank.

**George Hill**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Yes. Good morning, guys. Thanks for taking the question. I guess the question as it relates to the 2025 bid strategy, I guess, first of all, is there a way to characterize the approach to like how much – for how many beneficiaries did you guys kind of want to remove the plan or exit a plan as a way to preserve margin or pursue margin? And to what degree, I guess, on the other side, are you guys just looking to restructure plan benefits. And I think even at a higher level, the question I want to ask is like, are you guys willing to quantify like how many individual MA members you provide plans for now that will not have that plan offered in 2025?

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Yes. Let me jump in on this one. So the question – well, some of this is going to be a repeat of things that we've said in the past. So we've got a set of plans that are not profitable, that we don't see a path to making them profitable. We have exited those. That impacts a number of our members. In most cases, in the vast majority of cases, those members will have access to another Humana plan. So there's very few actual geographies we'll fully exit.

We have another set of plans that is either marginally profitable or marginally unprofitable, but we see a path to recovering the profitability of those plans. And we are working on that through reducing benefits and changing our pricing. And then we have a set of plans that are actually quite attractive, how they perform today and we are protecting those plans. That is how we have approached this. Today, for competitive reasons, we're not prepared to give specific numbers of members that fall into each of those categories.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Yes. And I think, George, just to add to what Jim said. We've given you the overall expectation that we'll reduce membership a few hundred thousand numbers primarily related to plan exit. So you can assume, right, it's not a small number. Within that, there is an assumption that obviously, we will retain some of those members because, as Jim said, in almost virtually all of the counties where we're having plan changes, there is another plan option available to our beneficiary. So there is an inherent assumption.

As Jim said, we don't want to give details right now because, again, there are still changes being made to bid submissions through the normal process. As we get later into the quarter, there may be an opportunity in another public forum once bids are filed, where we can provide some detail.

**Operator:** Our next question comes from the line of Erin Wright with Morgan Stanley.

**Erin Wilson Wright**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thanks for taking my question. In light of the disciplined approach that you're talking about in the ongoing strategic review, how are you thinking now about capital deployment from here, whether it's prioritizing the alignment with the Medicaid book and ability to service tools? Or is it more on the care delivery assets? And what is your level of focus or thinking even on the organic opportunities, I guess, generally speaking across, at this point? Thanks.

**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Yes. So let me start by characterizing where we believe growth opportunity is over and above what's in the Medicare book. And again, this is largely consistent with what the company has done in the past. We believe that there's growth opportunity in CenterWell. We believe there's growth opportunity in Medicaid. And to your point, there is significant kind of synergy or interrelated benefits between the Medicaid growth and the Medicare book because of duals and between CenterWell and the Medicare book because of the ability to impact quality and total cost of care. So we actually think that combination works and we continue to lean into it.

When we think about capital deployment, the simple rubric that we're kind of staring at is strategically, does it align with driving lower total cost of care and/or quality, does it offer an attractive return on capital. And when you look at the array of opportunities to invest what drives the best return over time, right? What drives shareholder value over time? Those are the things that we're looking at and we're looking at that in the same spaces that we've been looking at it in the past.

**Operator:** Our last question will come from the line of Ryan Langston with TD Cowen.

**Ryan Langston**

*Analyst, TD Cowen*

Q

Hi. Good morning. On the inpatient activity, just in the prepared remarks, you said performing higher levels of appropriateness checks and potential mitigation activities.

I guess is there a potential maybe down the road for maybe a larger than normal amount of revisions on these claims for medical necessity or the like? Or at disadvantage to those, kind of claims in mass look largely to be adjudicated as they are?

And then I think you said that you were negotiating with providers for closer alignment. Can you elaborate on exactly what that means? Thanks.

**Susan M. Diamond**

*Chief Financial Officer, Humana Inc.*

A

Hey Ryan, yeah, I'll take the first part of that and then hand it over to Jim for the second. On the inpatient, I think as you guys know, we do within our utilization management programs have a, what we call a front-end review process. So we are reviewing those authorizations in real time, as they come in for things like medical necessity and site of service effectively.

And as I said, we did have some changes to our expectations and how those programs would impact under the two-midnight rule. So that is operating as intended and as we said, largely having the results we expected. There

is also activity that we do after the claim comes in, which we call a post-pay review, where there are some incremental opportunities to just review again the more specificity on that claim to make sure it's appropriate.

And we get value from both sides of that. But I would say we have really good information and tracking of the impact those programs are having, and I would not expect a material change to happen relative to our current expectations as a result of some of those long-standing programs.

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**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

A

Yes. And then on the contracting, if you think about the way that contracting works at high level, you're essentially aligning on a rate and you're aligning on a set of initiatives or incentives around how to manage appropriate utilization.

And we have contracts that align those incentives very well, and we have contracts where there's an opportunity to improve that alignment around utilization and appropriate care. And so we are really looking at the contracts that perform best, and we're trying to figure out how you begin to move more of the network in that direction.

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**James Rehtin**

*President, Chief Executive Officer & Director, Humana Inc.*

Hey. So with that being our last question, let me just say a couple of quick things. I'm going to come back to we do feel good about where we're at midyear. We feel good about the performance that we've seen and where that's at relative to the beginning of the year. I am going to reinforce that we are seeing inpatient pressure. We have seen that in particular in the back half of the second quarter and now obviously, a little bit into July. We're taking a cautious approach in reaffirming our \$16 guidance. And we continue to feel good that we're going to have margin expansion, EPS growth heading into 2025. And so that is where we're at. We feel good. I do want to just thank our teams. They put a lot of work into getting us where we're at here at midyear, and I continue to look forward to working with all of you on this phone call and our teams here at Humana. So thank you.

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**Operator:** This concludes today's conference call. Thank you for participating. You may now disconnect. Goodbye.

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