REFINITIV STREETEVENTS

EDITED TRANSCRIPT

HUM.N - Q1 2022 Humana Inc Earnings Call

EVENT DATE/TIME: APRIL 27, 2022 / 1:00PM GMT

CORPORATE PARTICIPANTS

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

Lisa M. Stoner *Humana Inc. - VP of IR*

Susan Marie Diamond *Humana Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

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

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

Gary Paul Taylor *Cowen and Company, LLC, Research Division - MD of Health Care Facilities and Managed Care*

Joshua Richard Raskin *Nephron Research LLC - Research Analyst*

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

Kevin Caliendo *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

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

Lisa Christine Gill *JPMorgan Chase & Co, Research Division - MD, Head of U.S. Healthcare Technology & Distribution Equity Research and Senior Research Analyst*

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

Nathan Allen Rich *Goldman Sachs Group, Inc., Research Division - Research Analyst*

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

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

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

PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Humana Incorporated First Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. (Operator Instructions) At this time, I would like to turn the conference over to Ms. Lisa Stoner, Vice President of Investor Relations. Ma'am, please begin.

Lisa M. Stoner - *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 first quarter 2022 results and our updated financial outlook for 2022.

Following these prepared remarks, we will open up the line 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 first quarter 2022 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 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 earnings call refer to diluted earnings per common share.

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

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

Thank you, Lisa, and good morning, and thank you for joining us.

Today, Humana reported financial results for the first quarter of 2022, reflecting a solid start to the year. I'll speak briefly about our first quarter results and outlook for the rest of the year before providing an update on our strategy and the steps we're taking to position Humana for continued long-term success.

Adjusted earnings per share for the first quarter were $8.04, which was above our initial expectations. This outperformance was primarily driven by favorable pharmacy results combined with lower-than-planned administrative expenses, some of which is due to timing. All other lines of business are performing as expected or slightly positive, further contributing to our strong quarter.

We raised our full year 2022 adjusted EPS guidance by $0.50 to approximately $24.50, representing 19% growth over our 2021 results. Importantly, our updated financial guidance continues to include an explicit $1 COVID headwind. Our updated guide also includes the dilutive impact related to the pending divestiture of the company's 60% ownership of Kindred at Home's Hospice and Personal Care division. Susan will provide additional detail on our first quarter performance and our full year outlook in a moment.

Turning to our previously announced $1 billion value creation initiative. You recall, we committed to delivering this value for the enterprise through cost, productivity initiatives and value acceleration from our previous investments. This will create capacity to fund growth and investment in our Medicare Advantage business, driving more robust benefits and lower cost for our members, which we believe will lead to improved membership growth. In addition to -- it enables further investment in our health care service capabilities, including expansion of our value-based home health model and transformation of the consumer experience and home delivery service model in Humana Pharmacy.

I'm pleased to report with the work completed to date, we remain confident in our ability to realize this value for investment in 2023. As shared in February, we are focused on 4 key areas that will drive the value creation, strategic initiatives, organizational efficiencies, third-party spend and automation and digital advancement.

We indicated the value would be largely split evenly across the 4 categories. Through work completed in recent months, we've established goals throughout the business within the 4 key areas. We now expect strategic initiatives to account for about 1/4 of our goal by organizational efficiencies and third-party spend will each come about 1/3. The remaining 10% of value realized in 2023 will come from automation, which, given the nature of the work, will drive some incremental impact in 2024. Susan will provide additional details on the progress made to date.

We are pleased with the quick pivot of our teams to support the value creation initiative. It is important to maintain our focus on one of Humana's core differentiators, our strong culture. Currently, we are seeing a slight decrease in engagement but remain in the top 20% of industry leaders.

Engagement scores are impacted in part by the internal uncertainty around our value creation initiative as well as the strong external market pull, economic disruption and the inflationary environment. Importantly, we are seeing strong engagement with our nursing population, which is currently at 89%, and we are proud that 86% of our physicians would advocate for Humana as a Great Place to Work.

While challenging choices remain to fully realize our goal, I'm confident our team is equal to the task and understands the purposeful approach we are taking to make Humana an even stronger company. In addition to creating capacity to invest in our Medicare Advantage product for 2023, we are also focused on working closely with our distribution partners to improve the retention of our members. We continue to work with our call center partners to more closely replicate the experience delivered by our employed agents through enhanced training.

We are also focused on service-level agreements aimed at improving the quality of the sales experience, and ultimately, the customer satisfaction and retention. As part of this work, we have developed a new computer-based training modules for our call center agents that focus on behaviors linked to customer complaints.

While still early, we are pleased to see -- have seen a decrease in complaints to CMS year-over-year. With respect to compensation for external brokers, we have introduced new compensation structures designed to improve overall quality by more closely tying administrative service fees to specific quality assurance activities and service levels as well as addressing agent level compensation to promote individual quality performance.

Within our proprietary sales channel, we are looking at opportunities to advance our payer-agnostic capabilities to improve our ability to support consumers who desire more choice. In addition, we are making investments to better link digital-first shoppers to our internal sales agents. Digital shoppers are now able to not only complete an application online but also request that one of our internal sales agents visit their home to discuss Medicare Advantage plan options.

The digital shopper is also able to directly connect to one of our internal sales call center agents from humana.com to assist them in their shopping experience. Finally, we are working with brokers across our distribution channels, both internal and external, to engage the customers and activities that are positively correlated to retention. This includes onboarding activities designed to promote engagement prior to plan effective date as well as efforts to help members understand and fully utilize their plans, benefits, such as assisting in the activation of their healthy food card.

With respect to 2022 Medicare Advantage membership trends, results of the open enrollment period trended slightly better than our initial expectations, driven by higher sales and improved voluntary termination rates, both of which we view favorably. The outperformance was partially offset by higher deaths related to the pandemic in the first couple of months of the year.

Turning to our Healthcare Service businesses. As you know, we introduced CenterWell as the new brand to describe and connect our payer-agnostic health care service offerings. We have significantly expanded our health care service capabilities, including our senior-focused primary care, pharmacy and home care offerings, to better serve our medical members while also increasing our total addressable market.

We've been developing our Healthcare Services capabilities in 3 phases. The first is building the capabilities. We are accomplishing this through a combination of organic build as we've done with our Pharmacy business. Inorganic growth as a result of our acquisition of Kindred at Home as well as through partnerships, such as those we have with Heal and Dispatch, which are site of care innovators in the home.

The second phase includes enhancements to align with value-based principles to improve health outcomes as well as expanding the capabilities to achieve the desired scale. Our primary care business is in this phase today as we are expanding our geographic presence through a mix of building de novo centers as well as tuck-in acquisitions.

The third phase is integrating these capabilities in select local markets. We believe the integration of CenterWell Primary Care, home health and pharmacy in a local market will lead to improved health outcomes, increased customer satisfaction and decrease in the total cost of care, while also building additional profit pools for the enterprise. Recall that a health plan member who utilizes the full suite of our health care service assets can drive 2 to 4x the direct margin contribution for the enterprise as compared to the health plan margin alone. This is what we refer to as the flywheel effect.

Let me highlight some of the progress we've made moving our various capabilities through these 3 phases, starting with home. We started our journey with Kindred at Home in 2018, acquiring 40% minority interest with the belief that a key component of the next generation of integrated care delivery model was the ability to provide care to consumers in their home, meeting them where they want to be and a preferred lower cost setting, also recognizing that the traditional volume-based fee-for-service model, limits innovation and home health.

We then completed the full acquisition of Kindred at Home in August 2021, reflecting our continued commitment to investing in home-based clinical solutions that drive improved patient outcomes, increased satisfaction for patients and providers, and value for health plan partners.

We took another step on this journey last week with the announcement of the divestiture of our majority interest in Kindred at Home's hospice and personal care divisions to Clayton, Dubilier & Rice or CD&R. We explored a broad range of alternatives for the hospice and personal care businesses and believe this transaction best allows us to accomplish our previously stated intent, divesting majority ownership of these noncore businesses while maintaining a strategic minority interest through our remaining stake.

With CD&R's established physician relationships, value-based care expertise and record of supporting providers to deliver high-quality care for patients. We are certain these divisions are well positioned for success under the joint ownership of Humana and CD&R. Importantly, we are pleased that when viewing this transaction in conjunction with our purchase of the broader Kindred at Home platform, we have been able to achieve our objective of substantially increasing our footprint in home care by acquiring one of the leading home health platforms in the country and an attractive valuation for our shareholders.

Our home capabilities were further expanded with the acquisition of onehome last year. Onehome's management service organization capabilities and experience providing home health, infusion and durable medical equipment services establishes the platform for our value-based home care model. We remain on track to begin the launch of the value-based model in North Carolina and Virginia in June with the expansion in additional geographies planned for late this year and early 2023.

Beyond shifting to value and integrating DME and infusion, onehome will also have the ability to help members navigate the broader care ecosystem. For example, if a member lacks a primary care provider, onehome could connect the member with a high-value local option, including Humana's primary care organization.

In addition, if a member would benefit from home delivery of chronic medications, onehome can help the member set up a home delivery through our Humana pharmacy. We believe these efforts can lead to both improved member experience and better health outcome, demonstrating the power of integrating our health service capabilities in the local market.

Turning to primary care. We are actively scaling our platform through a combination of de novo expansion and inorganic growth. We are the largest senior-focused, value-based primary care provider in the nation with 214 centers today. This includes 37 centers in the Welsh Carson joint venture, which began in 2020. We expect to have approximately 250 centers by year-end and intend to add 30 to 50 centers per year going forward. As shared in February, we are committed to funding the organic growth of our primary care organization in 2023 and beyond through a combination of on- and off-balance sheet financing, such that we expect no dilution to earnings growth from the organic expansion.

As of March 31, the 2020 cohort of 20 centers opened within Welsh Carson joint venture had an average of 520 Medicare risk patients per center, approximately 60 patients per center higher than planned. In addition, our cumulative EBITDA results were in line with the plan. We are pleased with the results to date, which have demonstrated the performance consistent with the expected J curve. We continue work to establish off-balance sheet structure that will be leveraged beginning in 2023. We are applying the proof points in learnings from our joint venture with Welsh Carson to optimize the go-forward financing structure, considering enhancements, such as limiting the financing to only the operating expenses. We look forward to sharing additional details when finalized in the coming weeks.

Our pharmacy business is the most mature of our health care service businesses, driving significant value to the enterprise with industry-leading mail order penetration, resulting in improved medication adherence and better health outcomes for our health plan members. 38% of our individual Medicare Advantage members utilize our mail order services in the first quarter, a 100 basis point increase year-over-year. This increase is due in part to the fact that Medicare Advantage members retained in 2022, used Humana Pharmacy home delivery services, nearly 9% more frequently the members who disenrolled.

This is another demonstration that members who engage with our Healthcare Service businesses not only create incremental enterprise profit but are more loyal to our health plans. This result demonstrates the impact of investments we're making to transform the consumer experience and home delivery service model through improved e-commerce and logistic capabilities and additional distribution sites allowing us to deliver prescriptions to our members within 1 to 2 days. As you know, we committed to providing additional transparency into our Healthcare Service businesses in 2022, which began with the new disclosures we provided on the home and primary care in our first quarter earnings release. Susan will also provide further 2022 performance details during her commentary.

In addition, we look forward to hosting a virtual investor update on September 15, 2022, where we will discuss the operational model and the long-term growth and earnings potential for the primary care and home businesses. The benefits of integrating our health care service capabilities in local markets and driving penetration by our health plan members as well; a progress update on our $1 billion value creation initiative and current thoughts on improving our Medicare Advantage membership growth for 2023; and the long-term outlook for the company considering future earnings growth opportunities, balanced against the ongoing investments necessary to advance our strategy.

In closing today, I want to reiterate that we are pleased with our strong start to the year with all our business lines performing well. In addition, we remain confident in our ability to deliver on our $1 billion value creation plan. This will allow us to create the needed capacity to fund growth and investments in our Medicare Advantage business, which we believe will further drive significant improvement in our membership growth as well as further expansion of our health care service capabilities, while still delivering on our long-term earnings growth target in 2023.

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

Susan Marie Diamond - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone. I will provide an update on our first quarter results, including line of business performance details, our outlook for the full year and progress made to date on our $1 billion value creation plan. Finally, I will provide an update on capital deployment, including the planned use of proceeds from the pending divestiture of our majority interest in Kindred's, hospice and personal care businesses.

Today, we reported first quarter 2022 adjusted earnings per share of $8.04, driven primarily by lower-than-anticipated administrative costs, some of which is timing in nature and outperformance in our pharmacy business. All other lines of business are performing as expected or slightly positive, further contributing to our strong quarter. Inpatient utilization was favorable across our Medicare and commercial businesses due to a faster decline in COVID admissions and slower rebound in non-COVID admissions than we've seen during previous surges and we will need to continue to monitor how utilization further rebounds in the coming weeks.

Typically, we would not raise guidance at this stage, as it is too early to fully evaluate results and medical cost trends in particular. However, given the main drivers of our first quarter outperformance, we are raising our full year guidance by $0.50 to approximately $24.50, representing nearly 19% growth over our actual 2021 results. Importantly, this revised guide continues to anticipate $1 of conservatism to cover a net COVID headwind, should it emerge, and also anticipates the estimated impact to earnings of divesting 60% of our interest in the Kindred hospice and personal care businesses later this year. With respect to quarterly earnings seasonality, at this time, we expect the percentage of second quarter earnings to be in the low 30s. We want to reiterate, however, that investors should continue to focus on the full year estimates as quarterly development will continue to be impacted by ongoing COVID-related timing dynamics.

With that, I will now provide additional details on our first quarter performance by segment, beginning with our Retail segment. As Bruce discussed, results of our open enrollment period trended slightly better than previous estimates. If these trends continue for the remainder of the year, we expect our individual Medicare Advantage growth to be slightly above the midpoint of our current guidance range of 150,000 to 200,000 members.

Revenue for the quarter was in line with expectations with individual Medicare Advantage PMPMs up 8% year-over-year. We continue to expect our PMPM yield to be in the high single-digit range for the full year.

Turning to claims trend. Total medical costs in our Medicare Advantage business ran largely in line with expectations in the first quarter. We experienced lower-than-anticipated inpatient utilization offset by higher inpatient unit costs and lower-than-projected favorable prior period development. As it respects prior period development, we saw inpatient unit cost for the fourth quarter of 2021 restate higher than anticipated.

As claims were received, the average cost of non-COVID hospitalizations restated higher and hospitalizations occurring in December of 2021 restated as a COVID admission, whereas the initial authorization request reflected a non-COVID admitting condition. Recall that we incur an additional 20% payment on any Medicare admission with a COVID diagnosis under the public health emergency even when it is not the reason for the admission.

These incidental COVID admissions represented 10% to 15% of total COVID admissions during the Delta wave, increasing to 25% to 30% with the Omicron wave resulting in a meaningful increase in average unit costs. We will need to continue to monitor inpatient unit cost trends and COVID positivity rates throughout the year.

With respect to current year utilization, COVID admissions peaked in January at 65 admissions per thousand, and then began reducing more quickly than we've seen historically, ending the quarter at approximately 2.5 admissions per thousand the lowest level we have seen since June of 2021 just before the rise of the Delta variant. Non-COVID admissions did not rebound as quickly as COVID declined resulting in net inpatient utilization favorability for the first quarter, although it continues to rebound towards expected levels. We considered the higher fourth quarter 2021 inpatient unit costs in our first quarter estimates, resulting in overall inpatient costs running generally consistent with expectations.

As previously shared, we have limited visibility into non-inpatient trends until claims are received. And so as is customary, our first quarter results assume non-inpatient utilization is in line with previous expectations. All in, we are pleased with the early performance of our Medicare Advantage business and continue to expect a 50 basis point improvement in our individual MA pretax margin in 2022. However, as previously shared, much remains to be learned about the long-term impacts of COVID, including the impact of higher mortality on the morbidity of our Medicare members. Provided COVID levels remain low, we will have an opportunity to further evaluate baseline trends relative to our estimates.

Moving to PDP. Membership trends are tracking favorable due to higher sales in the Walmart Value plan and lower voluntary terminations in the premier plan. As a result, we have updated our full year guidance to down 100,000 members versus our previous projection of down 125,000 members. In addition, we continue to expect approximately 80,000 PDP members to move to a Humana Medicare Advantage product this year.

Our Medicaid business performed well in the first quarter, experiencing lower-than-expected COVID costs. The Medicaid team is actively preparing for the Ohio contract implementation, which we expect to occur later this year. We updated our full year Medicaid membership guidance from a range of down 50,000 to 100,000 to a range of down 25,000 to 50,000 to reflect the extension of the public health emergency to mid-July. In addition, we were pleased to receive notification in the first quarter that the Louisiana Health Department announced its intent to award Humana a contract to serve Medicaid beneficiaries. We now expect the state to re-score the previously submitted RFPs with a decision anticipated in late May, and we are optimistic that we will once again score well given the strength of our offering. We continue to be very proud of our Medicaid program and success growing our footprint organically.

Group and Specialty segment results were slightly favorable with both our group medical and specialty businesses contributing to the positive results. The fully insured group medical business experienced favorable inpatient utilization due to fewer COVID admissions, similar to what we experienced in the Medicare business, partially offset by slightly higher-than-expected membership losses. The rating actions taken in the back half of 2021 to incorporate expected ongoing COVID costs resulted in slightly higher attrition than originally anticipated. Our specialty business also outperformed as utilization, particularly for dental services continues to run lower than expected. To the extent this lower dental utilization continues, we plan to reduce pricing to our Medicare Advantage business in 2023 accordingly.

Our Healthcare Services segment had a strong start to the year. As previously mentioned, our pharmacy business meaningfully outperformed expectations, driven by higher-than-expected increases in mail order penetration, lower unit costs due to favorable underlying drug mix and lower cost to fill. We currently expect the favorability to persist throughout the year, although with some moderation as our previous estimates contemplated increasing mail order penetration rates over the course of the year. Our efforts to drive increased mail order penetration are demonstrating success with 38% of our individual Medicare Advantage members utilizing our home delivery services in the first quarter, a 100 basis point increase year-over-year.

As Bruce mentioned, Medicare Advantage members retained in 2022 used Humana Pharmacy's home delivery services, nearly 9% more frequently than members who disenrolled, also contributing to the strong start to the year. As a result of the outperformance seen in the pharmacy business, we have increased our full year health care services adjusted EBITDA guidance by $50 million to $1.725 billion to $1.875 billion from the previous range of $1.675 billion to $1.825 billion. This adjustment also contemplates the estimated impact to EBITDA of divesting 60% of our interest in the Kindred hospice and personal care businesses later this year. At this time, we have not updated revenue or operating expense guidance points as the impact could vary depending on the timing of the transaction close.

Turning to the home. Beginning with our first quarter release issued this morning, we disclosed episodic and total admissions for our home health business. Episodic admissions are up 3.5% year-over-year, while total admissions are up 4.9% year-over-year, largely consistent with expectations. For the full year, we continue to expect home health admissions to be up mid-single digits.

We also provided detail regarding members covered by our proprietary value-based home health model. We continue to expect approximately 15% of our Medicare Advantage members to be supported by this model as of year-end 2022 as we expand to additional markets, including Virginia and North Carolina beginning at the end of June. Within 5 years, we expect to support 50% of our Medicare Advantage membership with our value-based home health model and believe it will deliver mid-single-digit reductions in overall home health DME and infusion spend within 12 to 18 months of implementation and mid-double-digit reductions at maturity while improving patient outcomes.

The nursing labor shortage continues to be a concern for the home health industry broadly, and we continue to closely monitor clinical staffing levels, capacity and admission trends, making targeted investments to sustainably improve the recruitment and retention of nurses to position the business for further growth. We are particularly focused on markets where growth has been negatively impacted by insufficient nursing capacity.

We are seeing positive results from our efforts, including a 5% reduction in full-time nurse voluntary turnover in the first quarter as well as improved recruiting in March attributed to the return to face-to-face recruiting. We are encouraged by the improvement we are seeing in recruiting and voluntary nursing turnover, but acknowledge there is much more work to be done. The hospice business performed well in the quarter with total admissions up 9% year-over-year, fueled by a general improvement in referrals led by increased access to facility-based sources, investments in the business to expand clinical capacity, mainly in the form of dedicated on-call nursing staff and winter storms that negatively impacted admissions in the prior year.

Turning to our primary care organization. Results remain in line with expectations for the quarter. We enhanced our primary care disclosures to include a breakout of clinics by de novo, which includes all new centers opened since 2020 under our Welsh Carson joint venture, wholly owned, representing all centers, not in the Welsh Carson joint venture and IPA, which reflects patients served by our Conviva MSO.

We also updated our patient served metrics to only include Medicare patients covered by a value-based payment model as this is our focus and represents the primary growth driver for the business. As of March 31, we operate a total of 214 centers, serving 180,000 patients in Medicare value-based arrangements while also supporting 58,000 patients under IPA arrangements. We operate 37 de novo centers, which are focused on driving panel growth and patient engagement to ensure our patients' needs are identified and we can begin our care planning.

This early engagement supports our ability to identify and slow these disease progression. We opened 5 new de novo centers in the first quarter and 14 since March 2021, representing a 61% increase year-over-year. These centers grew paneled membership by 4,500 in the first quarter and 9,100 year-over-year, a 163% increase inpatients served.

We operate an additional 177 wholly owned centers, serving 166,000 patients in Medicare value-based arrangements, primarily in Florida and Texas. We are focused on continuing to grow these centers organically and inorganically while also focusing on improving clinical and financial outcomes by leveraging our senior-focused, multidisciplined care model supported by proprietary workflow technology and analytics. Since March

2021, we have increased our wholly owned center count by 30 and Medicare patients served by 37,000 or 29%, with approximately 2/3 of this patient growth attributed to acquisitions of Florida and Texas-based primary care practices and approximately 1/3 due to organic growth, including patients served under DCE contracts. As we monitor the continued performance improvement of our wholly owned centers, we are pleased to report that 15 are producing our targeted EBITDA contribution of $2 million or greater and have an average panel size of 1,500 Medicare Advantage risk patients. Additionally, 69 of our wholly owned centers are EBITDA positive compared to 51 at this time last year.

Finally, I would like to add to Bruce's commentary on our $1 billion value creation plan, highlighting some of our recent progress. We are tracking various initiatives across discrete stages of development starting with ideation, followed by sizing, design and execution; and finally, realization of savings.

We gained confidence as each initiative moves through the stages, and we're pleased that initiatives valued at approximately $575 million are now in the design and execute phase. We continue to believe that the majority of initiatives will be implemented in the back half of 2022, which was contemplated in our initial guidance. Our lower-than-expected administrative expenses in the first quarter in part reflect management actions that accelerated savings we otherwise expected later this year as well as some timing-related variances. We remain confident in our ability to achieve our goal, creating capacity to fund additional investment in 2023, and we'll continue to share updates on our progress throughout the year. From a capital deployment perspective, we expect to receive approximately $2.8 billion in cash proceeds upon closing of the pending Kindred hospice transaction.

As shared last week, the enterprise value of Kindred hospice is $3.4 billion. The $2.8 billion in proceeds is made up of approximately $2 billion related to the repayment of debt from Kindred hospice to Humana and $800 million, reflective of 60% of the $1.4 billion equity value. We intend to use the majority of the proceeds for debt repayment as we look to deleverage back towards our target of approximately 35%. In addition, as previously disclosed, we continue to plan for a customary level of share repurchase in 2022. We expect our debt to capitalization ratio to be approximately 40% at the end of the year.

Before closing, I would again reiterate that we had a strong quarter with all businesses demonstrating positive fundamentals supporting our full year guidance raise. There are a number of items we will need to continue to monitor to fully assess '22 performance, including non-COVID utilization trends, the rate of COVID positivity and inpatient unit cost trends which is why we believe it is prudent to continue to allow for COVID conservatism in our guidance.

Finally, we are pleased with the progress made to date on the value creation plan and remain confident in our ability to achieve our goal creating capacity for further investment in our Medicare Advantage business and expansion of our Healthcare Services capabilities, while still delivering on our long-term earnings growth target in 2023.

With that, we will open the lines up for your questions. In fairness to those waiting in the queue, we ask that you limit yourself to 1 question. Operator, please introduce the first caller.

QUESTIONS AND ANSWERS

Operator

My first question or comment comes from the line of Kevin Fischbeck from Bank of America.

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

Okay. Great. I guess I just wanted to dig in a little bit more to the guidance raise, if I understood it correctly. It seems like a little over half of it is from the services business being higher and the rest is G&A. So you didn't -- should we read that into that you feel a bit at the lower end of your G&A guidance that definitely changed the range there? And I just want to make sure that I understand the MLR guidance is unchanged. There seems to be -- we're getting some questions about how MLR looks given the decline in DCP.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure. Happy to take that. To your first point, yes, as you think about the raise relative to our performance for the first quarter, First, I would mention that consensus was lower than our internal estimates for the first quarter.

So as we think about it internally, we think about $1 of the outperformance is what we were looking at from an internal perspective. And you are correct, you can think about that as roughly half attributed to lower administrative expenses and half attributed to the pharmacy outperformance. So as we thought about the year, as you said and as I said, we do expect that the pharmacy outperformance will continue, although with some moderation. And so that will allow us to support the $0.50 raise as well as the dilution that we're currently estimating from a hospice divestiture later this year.

On the administrative expenses, as I mentioned, some of that is timing. Some of that is a pull forward of savings we would have otherwise expected later in the year, so not necessarily incrementally positive. We want to see how that continues to develop. And then we'll also look to see if we continue to see some favorability that may allow for some additional investment in the distribution and marketing strategy that we've talked to you about and may allow us to accelerate some of those investments, again, if we continue to see favorability, but we are not taking any of that into the full year guide currently.

On the MLR then, I would say, looking at the retail MLR in particular, analyst ranges were quite wide as we looked at the models. And so the comparison to what's reported this morning is heavily influenced by the few that actually responded to the survey. So I think that's part of it. As I mentioned in my comments, from an individual Medicare perspective, I can tell you that the MLR came in as we expected. Per my commentary, we did see positive utilization on the inpatient side due to COVID. With COVID, what we saw higher absolute levels in January, it declined more quickly than we've seen historically than we would have expected. And non-COVID was not able to rebound as quickly as COVID declined. So that was certainly positive.

Given the high level of COVID, however, and the higher rate of what we refer to is that incidental COVID, where it wasn't the admitting condition, but there is a COVID positivity diagnosis, that translates to additional unit cost. So we did see higher unit costs as a result. As I mentioned, we also considered the higher unit costs that we saw restated for fourth quarter and our first quarter estimates.

And so as you think about that all-in, the first quarter results reflect inpatient pretty much in line with expectations. And then for non-inpatient just given how early in the year it is and the limited visibility, we have those in the first quarter at expectations as well. So we'll continue to watch those things over the course of the year, but feel good about the early indicators we're seeing and no source for concern about what we're anticipating for individual MA or retail MLRs.

Operator

Our next question or comment comes from the line of Nathan Rich from Goldman Sachs.

Nathan Allen Rich - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I wanted to ask on your bid strategy for 2023. And in the release, you talked about the final rate notice and you expect rates to be up for Humana, 4.6%. A little bit below the sector average, and I think more of a gap than you faced in recent years. I guess how does that impact the strategy for '23?

And then I appreciate the details that you gave, Bruce, upfront about kind of the plan design and distribution strategy. Do you have an updated view on how you might allocate that $1 billion of savings across plan, design and distribution that will ultimately provide the best ROI on those investments?

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

Relative to the rate notice and our investment, I would say, we feel very confident that we are going to have the ability to be competitive in 2023. So even though we might have a little bit some -- because of our STARS scores, we see higher STAR scores in absolute, but on a relative change, it's lower than the industry there. So we still have the same amount of dollars going into the program.

The second part of your question, just about the allocation among the various different components, the bucket, so to speak--between plan, design and the distribution and marketing--we just don't feel comfortable today to give you that disclosure, as we enter the latter part of the year and we're in the AEP cycle. We'll probably give you more details there. But I think today, it would be best that we don't do that.

Operator

Next question or comment comes from the line of Justin Lake from Wolfe Research.

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

Bruce, I wanted to follow up on your commentary around the Investor Day. Specifically, you talked about doing something in June, you pushed it until September, just curious on the driver of that. And then, what have you been hearing from investors in terms of what they -- what they will be looking for at that Investor Day, specifically any thoughts around margin targets in the Medicare Advantage business?

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

Yes. As I mentioned, we are shaping for September. And the reason for the move between June to September is we just felt that the information will be more relevant as we entered the latter part of the year for a few reasons. First, we'll be closer to AEP and provide more thoughts around our go-to-market strategy since we're getting close to that. Second, we'll have more progress on the $1 billion program, and I know that's important in the short run.

So those are really why we just felt that getting later in the year would be important to allow more timely information for the investors. Relative to the subject matters, I mean, we do look as an important part of our strategy of the Healthcare Service business being important, I think giving more disclosure around what that looks like and the strength of that over a longer period of time will be an important discussion.

In addition, we will discuss just our earnings potential and the growth in our earnings potential, including how that affects margin and our view on the margin side. So we will discuss that as you articulated. It is an area of particular interest by our investors, and we will be prepared to discuss both the individual MA margin and then also just how Healthcare Services impacts the enterprise side.

And then lastly, we'll also just be able to give the investors much more update just on how we see the Healthcare Service business growing and the impact it has in the integration within the market itself because as I articulated, we're building the capabilities, we're leveraging and scaling the capabilities. And then in addition, an important part of that value is the integration in the local market as referred to in the commentary around the flywheel effect, and so that will be an important discussion that we'll have.

Operator

Our next question or comment comes from the line of Matthew Borsch from BMO Capital Markets.

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

As I'm looking back, I know there have been other years where it seems like you have weighted your MA product design towards earnings improvement. And whether it was deliberately or somewhat unintentional that was seem to be the case for this year.

I'm just wondering if I can ask why that isn't more apparent in the Medicare Advantage profit margin that you've seen so far this year? I would have expected that to be a bigger driver maybe on the medical cost ratio side of the upside this quarter.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure, Matthew. I can take that. And you're right. As you look at the first quarter, and again, you're looking at retail MERs versus individual MA. And so there are some differences in terms of the underlying product mix year-over-year, particularly around Medicaid and some growth in DCE membership, which has a higher MER than individual MA. Again, I do want to reiterate that from an internal perspective, as we look at the underlying businesses, each are performing as we would expect. So no concerns there.

In terms of one other difference I would highlight in terms of just the first quarter specifically is the change in prior period development year-over-year. With COVID, there were a lot of changes in claim processing, payment policy changes as a result of some of the stress that hospital systems were under. And so that significantly impacted prior period development. We anticipated a significant decline in prior year development year-over-year, and that will disproportionately impact the first quarter results. Which is why in our earnings release, we gave you the detail on what that would look like if you just stripped out PPD and the noise that, that creates.

It's hard to tell whether some of the analysts fully understood or anticipated the magnitude of that change year-over-year. So those are really some of the main drivers. And again, I just want to stress that we continue to feel comfortable with our expectation of a 50 basis point improvement in the individual MA margin, as we said, and believe we're on track to do that and know early concerns.

The other thing to keep in mind is the dollar of COVID contingency, you can assume that's largely in the retail MER expectation. As we said in our commentary, we continue to hold that conservatism within our guide. So if it proves unnecessary over the course of the year, then that would benefit the retail MERs as well.

Operator

Our next question or comment comes from the line of Kevin Caliendo from UBS.

Kevin Caliendo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare IT and Distribution*

I just want to get a little bit of better understanding, maybe a better way to ask this is, what do you expect the MLR trend to look like over the course of the year? Meaning, given what we saw in the first quarter with the prior period development, would we kind of just take where we started this year and where you expect to end?

How would you see -- is it more of a straight line? Or is there going to be a little bit more of a hockey stick to the back end of the year? And just the part of that question, I guess, is did you see any of the COVID headwinds in 1Q at all for dollar?

Susan Marie Diamond - *Humana Inc. - CFO*

Kevin, this is Susan. So in terms of your second question around the COVID headwinds, we would say that we did not see a COVID headwind emerge in the first quarter. As I mentioned, given the dynamics we saw with the utilization patterns, the way we've thought about it is not just the absolute gross COVID impact but rather net of any offsetting reductions in non-COVID. And so as I mentioned, while January saw higher COVID levels -- and in fact, we saw that was the highest level of COVID admissions in any given month since the start of the pandemic in February and March, given the rate of decline and how much faster that was versus previous surges. We just didn't see non-COVID have the ability to rebound at the same pace. So -- and that's true both across Medicare and commercial. So we would say that, that was net positive.

As we said in our fourth quarter commentary, we do not -- we'll be very cautious in releasing that dollar of contingency that we're holding, just recognizing the longer COVID goes on, we just don't want to assume that patterns will remain the same as we've seen historically. And then as I mentioned in my commentary, just the rate of sort of COVID positivity itself, while the public health emergency is in force, we'll drive additional unit cost for any admission that does happen to have a COVID positive diagnosis associated with it. So we'll need to continue to watch that.

In terms of MLRs, with the exception of the PPD that I mentioned that will disproportionately impact the first quarter, I think if you normalize for that, then I would say there's nothing sort of unique about this year that we would expect MERs to be -- to vary other than the fact that sequestration, if you recall, is still in play the way we refer the first quarter. It will reduce by half for the second quarter and then is assumed to be back in force for third and fourth quarter. So that will cause a little bit of seasonality differences year-over-year. But aside from that, I can't think of anything else specifically that we would expect unless, as I said, the COVID -- depending on what happens with COVID, which we've acknowledged could create some quarterly variations.

Operator

Our next question or comment comes from the line of A.J. Rice from Credit Suisse.

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

I thought I might just ask you about the home health, Kindred at Home business, and some of the things you're doing there. First of all, I think, Susan, you called out some labor challenges that you're trying to address. I wondered how widespread those are in the business, and have they gotten worse in the first quarter versus what you saw in the fourth? Or are they getting better?

And then on the virtual value-based work you're doing, I'm just trying to make sure I understand, is that Kindred at Home contracting with the Humana MA plans? Or is it subcontracting with your primary care docs? How does that work? And how do you manage the steerage of the patients to make sure they end up in your home health operations and not someone else's?

Susan Marie Diamond - *Humana Inc. - CFO*

Sure. Happy to take that. The first question on labor challenges. I would say they're fairly widespread. There are certainly some markets where we have sufficient capacity and we're certainly doing everything we can to take advantage of growth opportunities there. But generally speaking, some of the larger markets where there is more of an opportunity, we continue to see challenges.

I would say though they're -- I would say they're getting a little bit better, primarily due to the fact that COVID has subsided. So some of the labor challenges are due to nurses having to quarantine as a result of COVID. And so as we see that come down to, again, the lowest levels we have seen that certainly helps as we have more nurses available.

As I mentioned in my commentary, we are also pleased to see that we -- our initiatives are having some positive impact on recruiting nurses and retaining those nurses, again, creating some additional capacity. But I don't want to diminish the fact that it continues to be a challenge. We continue to watch sort of the wage environment and other sort of resources being used to recruit and retain nurses and we'll try to make sure we stay contemporary with that.

On the value-based model, the way that works is onehome, which is a company you might recall, we acquired last year, which currently provides home health DME and infusion services to our Florida- and Texas-based members under a value-based model, that is the model that we are looking to expand. So onehome actually contracts with the health plan under a capitated arrangement for all of the spend for those 3 service categories.

And then in markets where there are downstream risk providers, they will then downstream sub-cap with those providers. But onehome is the one taking the full risk on those services. What's unique about that model is the way that it is structured is they act as a convener and provide some relief and administrative burden from referring providers where the referring provider can refer a patient in for the home health DME and infusion services and onehome will take responsibility for placing all of those services. In the absence of that model, the referring provider has to discretely coordinate all of those services, which can lead to some fragmentation and dislocation in the way care is delivered.

So with the onehome model, they will take responsibility and where possible, then they can refer that patient directly into Kindred or other high-quality home health providers in the market based on capacity and other things. And so that -- typically, as we launch the market, we will go in with a more broad network to avoid any sort of provider and patient friction at start.

And as the providers get more comfortable and understand the model, then we will look to then begin referring those patients into our high-quality providers in the market and certainly with Kindred top of mind. So that's how it works. Happy to answer any other questions when we talk later today, if you like.

Operator

Our next question or comment comes from the line of Stephen Baxter from Wells Fargo.

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

I appreciate all the color on utilization and PYD. Certainly, you gave us a lot to digest. Just wanted to ask a clarifying question on the lower-than-expected PYD. So on the inpatient unit cost side, can you just clarify whether or not the higher unit cost you experienced was purely the result of these incidental COVID dynamics?

If you were to look at the remaining inpatient non-COVID utilization, I guess, how does that compare to your expectations on the unit cost side? I guess big picture, just an update on acuity trends and how they're running on the non-COVID population.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure, Stephen. So yes, so on the PYD, we did see lower -- prior period were most favorable. It was just lower than we had previously expected and really attributable to higher inpatient unit costs in the fourth quarter. There were 2 main drivers of that. One was higher non-COVID unit cost. They were quite high in the fourth quarter.

Frankly, there's still some work we're doing to understand why that is. And then also on the COVID admissions, as we set reserves at year-end, we have the benefit of authorization data. And so we have really good data on the absolute level of admissions. From a utilization perspective, claims of restated just as we would have expected. So the absolute level of admissions is consistent with what we thought.

What we saw, however, is of those admissions we anticipated more restated as a COVID admission when on the initial authorization, they did not reflect COVID as the reason for the admission. And so we would have contemplated those as non-COVID admissions Given the significant difference in unit cost for COVID admission versus non-COVID, that caused our December unit cost to restate higher.

So I'd say it's a little bit of a mixture with December, specifically related to COVID and the previous months more reflective of increases in the non-COVID unit costs, which we're still studying. Those are things, again, we want to see how those continue to play out. But for the first quarter estimates, we have contemplated those higher unit costs.

In terms of acuity, I would say broadly, we do not believe we're seeing an increase in acuity of the patients across any of our lines of business. There's no indicators of that so far. We think, again, when you're talking about the level of -- particularly in the fourth quarter of sort of COVID admissions to some degree, this is a reflection of as you see that higher incidental COVID positivity rate, as I mentioned, the admissions that are then sort of left in the non-COVID bucket tend to be higher average unit cost. And in this case, just happened to restate higher than we had initially expected.

Operator

Our next question or comment comes from the line of Ricky Goldwasser from Morgan Stanley.

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

Just wanted to focus on the Pharmacy outperformance. I think you said it was about half of the dollar upside from your initial targets. So what specifically kind of like drove the outperformance? I know, Susan, you mentioned that the existing members that are using your pharmacy services have a higher utilization of mail versus the wanted off-boarded. Is that sort of the entirety of it? Is it just kind of like that member mix? Or are there other more underlying trends that we can extrapolate for the rest of the year?

Susan Marie Diamond - *Humana Inc. - CFO*

Rick, yes, sure, happy to answer that. So there were a couple of contributors to the Pharmacy outperformance. One, as you said, was related to just some of the slightly favorable membership we saw across MAPD and PDP from an absolute perspective.

And then as you mentioned and Bruce and I highlighted, what we saw was that the members that were retained by the health plan through AEP had a higher use of Humana Pharmacy than members who disenrolled in AEP, and it was about a 9% difference. And that was a larger difference than we have seen historically. So it was not something we had specifically anticipated.

And so that higher membership and that dynamic of retaining more members who are more likely to use Humana Pharmacy contributed to some of the volume outperformance. I would say there was additional volume outperformance even above that, and we think that's a reflection of the continued investments we're making in the pharmacy business to improve the service delivery model and experience overall.

We implemented a number of initiatives over the course of 2021 designed to drive improved mail-order penetration and use of the pharmacy business and saw success there. And we've seen further success in the first part of 2022, just beyond what we had originally anticipated. And as I mentioned, we did anticipate higher mail order penetration in '22 versus 2021, and we're just seeing that come in slightly higher even than we had expected, which we view very positively. In addition, we did see lower unit costs, that is a function of just the underlying drug mix and the negotiated rates. And so that is contributing as well.

And then finally, we also saw a favorable cost to fill. And so as a result of some of the investments and enhancements they're making in the service delivery model, and Bruce referred to some of those investments. We're also seeing some positivity with reduced cost of fill than we expected. So all of those we view very favorably.

And generally, you can assume that those do continue, although as I mentioned, we do expect some moderation because our plan did contemplate continued increases in mail order penetration over the course of the year. And so as we described in the commentary, you can think about our thinking on pharmacy is raising $0.50 now that reflects the outperformance and then also that outperformance allowing us to cover the potential dilution from a hospice divestiture, assuming that we don't use the proceeds for share repurchase.

Operator

Our next question or comment comes from the line of Joshua Raskin from Nephron Research.

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

I wanted to clarify the 2022 sort of run rate or jumping off point for next year. Should we think about the $24.50 plus the dollar as sort of that starting point -- and maybe you could give us a little bit more color on the hospice dilution in 2023 or if buybacks or something else will offset that. And I apologize for the long question, but the real question is really, are there potential headwinds for 2023 that we should be thinking about that would preclude you from attaining your long-term EPS target, specifically thinking about investments in primary care, et cetera?

Susan Marie Diamond - *Humana Inc. - CFO*

Josh, so yes, so for your first question, we would say that you should think about the '22 baseline at the $24.50. Similar to how we talked about it in our initial guide, we would just encourage you not to get ahead of us on the dollar of COVID contingency. As I mentioned, there's still a lot to see in terms of how medical costs play out over the course of the year and utilization more broadly, morbidity, et cetera. So you can consider the baseline for now the $24.50, and we'll continue to be transparent about what we're seeing. But certainly pleased with the ability this early to raise and get towards the higher end of our range and certainly hope that we can see continued progress, but I would encourage you to consider the baseline for now the $24.50.

In terms of hospice solution, so as we said, for 2022, the Pharmacy outperformance will allow us to cover any potential dilution. We're internally anticipating that the transaction would likely close third quarter. And so that's what we're thinking about in terms of our current guide. As we've talked about, this has been something that we've been planning and looking at options for some time.

So from a 2023 perspective, we have always been anticipating that we would divest a majority stake in hospice. And so that is contemplated and will be contemplated in our earnings progression in 2023, where we would expect to, again, see a return to higher levels of Medicare growth while also delivering within our targeted long-term range of 11% to 15% off of that $24.50 baseline, despite the hospice divestiture.

For the proceeds, as I mentioned in my commentary. My preference would be to use as much as possible towards deleveraging, just so we can get that down and give us some additional flexibility. We mentioned in my commentary that we would expect to be at approximately 40% by year-end versus the 45% we reported for the first quarter. And so we do expect to use a majority for debt repayment.

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

Okay. So 11% to 15%, even including the dilution off of the $24.50, that's the right way to think about it?

Susan Marie Diamond - *Humana Inc. - CFO*

Yes, exactly. Perfect.

Operator

Our next question or comment comes from the line of Scott Fidel from Stephens.

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

Interested just to get your thoughts on Medicare provider contracting the environment for FY '23. Just as we're tracking all of the proposed Medicare FFS provider rate updates that are coming out from CMS. Most of them are tending to be notably lower than what the final MA rates actually came in at.

So just interested whether you see any type of positive arbitrage around that variance? Or do you think ultimately that providers will be pushing for higher MA rate increases than what they seem to be getting on a net basis in Medicare FFS, at least based on the proposed rates so far.

Susan Marie Diamond - *Humana Inc. - CFO*

Scott. So yes, so to your point, so right now, we'll have to see, obviously, what the final rates come in at. But currently, with what we've seen preliminarily, they are lower than the overall average sort of rate increase in terms of the rate book.

Most of our -- on the hospital contracting side, I would say most of our contracts are tied to fee-for-service reimbursement. And so typically, we would not see much -- whatever those rates come out with is what we would see. It's not to say that we might not see some providers come and sort of want to talk to us. I would say they may want to talk to us about some other components of our contracts in terms of how we handle claims processing and audits and some other things, but I would not anticipate that we would be opening contracts up to move off of them being tied to the Medicare reimbursement rate.

I think that there are some other service categories, home health is one example where we tend to pay lower than Medicare fee-for-service rates. So depending on where those rates come in, that could be an area where providers may come where they're being paid less than Medicare reimbursement, and they may want to have a conversation of that in this inflationary environment. So we'll continue to monitor it.

I would say that at this point, based on what we've seen, we're not considering that a significant headwind that we're considering for 2023 and would view it as something that we can manage through.

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

So is it fair to say that you are seeing some favorability here between the final MA rates and the likely net provider FFS rates, right?

Susan Marie Diamond - *Humana Inc. - CFO*

I mean based on what's come out so far, then that's what it would suggest. And we'll have to see where the final rates come in.

Operator

Our next question or comment comes from the line of David Windley from Jefferies.

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

Just focusing on the home health build-out and expansion there. You mentioned, I think, onehome relative to Texas and Florida launching your value based in North Carolina and Virginia.

Can you talk about how rapidly you can continue to expand markets with that strategy? And then are there other -- is that mostly an organic strategy? Or are there some inorganic bolt-ons that you could add to that to accelerate it?

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

Yes. A few things. I think our goal is to get close to 50% over the next 5 years of our members to be in that. And that's the full relationship with onehome. And there's really a component of that relationship. One is around the actual ability to -- as Susan was describing -- the value-based payment area where you manage that and u go through onehome from a contractual point of view.

The second part of it is the build-out of DME and their pharmacy. And as you look at sort of the length of time it takes, it actually is the latter part, the DME and the pharmacy that takes more time than the actual contractual side. So what we're testing right now is actually sort of a light and a heavy model, so to speak. The heavy model has everything. And the light model is really more oriented to the contractual area of that. And we're hoping that, that will facilitate getting to the 50% quicker as a result of that and actually provide further improvement on the clinical cost, both in the clinical cost of the actual cost of providing the services but also downstream prevention of ER visits and hospital admissions there. So it's really two pronged. And again, we're trying to find how we can facilitate it quicker a lighter model that doesn't just have to require the build-out of the DME and the pharmacy side.

Susan Marie Diamond - *Humana Inc. - CFO*

Yes. And the one thing I would add to Bruce's comment is, today, the model is deployed in markets that are heavy risk-based primary care. So we're moving into markets where that's not the same dynamic. And so we're really interested to see how these first implementations go, and assuming those go well, then I do think we would look to go ahead and accelerate some of the further expansion. But I want to make sure we fully assess sort of how the model works and anything that we need to learn in the environment, recognizing it's a little bit different.

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

And then your second question was organic versus inorganic. This will be mostly organic. I think the ability to -- there's not a lot of assets out there to buy. And then in addition, I think the integration of it will probably not be as free flow as us just continuing to build the organic side.

Operator

Our next question or comment comes from the line of Lisa Gill from JPMorgan.

Lisa Christine Gill - *JPMorgan Chase & Co, Research Division - MD, Head of U.S. Healthcare Technology & Distribution Equity Research and Senior Research Analyst*

I just really wanted to ask about your risk-based primary care relationships. Can you talk about the percentage of premium that are under those types of relationships and the impact to MLR? And then as I think about primary care services more broadly, how do you think about virtual health care?

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

I'll take that. Today, about 2/3 of our revenue is within the Medicare Advantage business. It's really with practices that are under a risk model. Now that varies between a full risk to what we refer to as a path risk, which is up and down, but whether it's a bonus or up and down risk with some color around protection of it.

So we do see continued growth in that area and continued -- not only improvement in the number of members that are under that relationship but also more and more of our practices are in surplus, which we really consider as being the most important value because this means that they are earning more dollars than they would in a fee-for-service environment. So first, we do measure not only the total, but also the effectiveness and the impact it has on providers.

Relative to virtual health, I would say we look at that as virtual primary care. We look at that as not only being part of the primary care itself and being incorporated in our relationship, but in addition, we are testing through our Heal relationship, actually attribution of individuals to a virtual health provider and then the ability to not only use virtual health but also go into the home. So it's not office base, it's actually at traveling physician along with a virtual health component to it. And they are actually attributed the patient. And so we are testing that in a few markets as we speak today with a partnership that we have with one of our joint venture relationships we have, Heal.

Operator

Our next question or comment comes from the line of Gary Taylor from Cowen.

Gary Paul Taylor - *Cowen and Company, LLC, Research Division - MD of Health Care Facilities and Managed Care*

I just want to go back to reserves for a second, just a couple of parts to my question. I know days claims payable is only down 0.7 of a day sequentially. But the fee-for-service IBNR piece was down about 3 sequentially. So I just wanted some help if there was anything in particular driving that?

And then my second part of the question was you're sitting at 43 days claims payable. There's a comment that pre-pandemic you ran closer to 40. And just wondering, is that just sort of an FYI? Are you alluding to the fact that as we sort of move post-pandemic you anticipate moving back towards 40 and releasing some of those reserves into earnings over time?

Susan Marie Diamond - *Humana Inc. - CFO*

Yes. Gary. And so to your point, there is a lot of noise in just the last couple of years due to COVID and the impact to sort of claims submission time lines, capitated provider surplus amounts in payments. And I know we've talked about that in the last number of quarters and the magnitude of the impact of those dynamics. And so that's why we provided the reference to the pre-COVID levels, which we think is a better benchmark to assess this it's hard to otherwise normalize for all of those considerations. And so as you said, we are sitting 3 days above what our average ran pre-COVID, which we view is the more relevant comparator and feel good about the level of reserves that we're sitting on as of the end of the quarter.

Gary Paul Taylor - *Cowen and Company, LLC, Research Division - MD of Health Care Facilities and Managed Care*

Can I just follow up real quick. Is the dollar of COVID cushion, is that -- in your view, is that sort of already sitting in reserves that would be released? Or is part of that anticipated to be generated by '22 operating results?

Susan Marie Diamond - *Humana Inc. - CFO*

Yes. So I would say in terms of what's currently sitting in DCP, to the degree some of our reserve estimates for the first quarter or prior year proved to be conservative as that would unwind, then that would have been some of what is currently reflected in the reserve levels.

And the way we thought about in our plan anyway, we sort of layered in that conservatism ratably. And as we said in the earlier commentary, we certainly did not see a net COVID headwind in the first quarter, but we're being cautious about how we think about unit cost trend in particular.

Operator

Thank you. Ladies and gentlemen, this concludes the Q&A session. I would now like to turn the conference over to Mr. Bruce Broussard for any closing remarks.

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

Well, thank you, and thank you for all our investors in both participating in today and continuing to support the company. As we've communicated, we continue to believe that we started with a strong year and look forward to continuing that progression throughout the remaining part of the year. And then lastly, I'd like to thank our 90,000 employees that are every day going to work to help support both these results, but more importantly, our members and patients that we serve on a daily basis. Thank you, and everyone, have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.