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HUM - Q2 2019 Humana Inc Earnings Call

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OVERVIEW:

Co. reported 2Q19 adjusted common diluted EPS of $6.05. Expects FY19 revenue to be $64.2-64.8b and adjusted common diluted EPS to be approx. $17.60.

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PRESENTATION

Operator

Good day. My name is Myra, and I'll be your conference operator today. At this time, I would like to welcome everyone to today's Humana's Second Quarter 2019 Earnings Conference Call. (Operator Instructions) Thank you.

With that, it is now my pleasure to turn today's program over to Amy Smith, Vice President of Investor Relations. Ma'am, the floor is yours.

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

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Brian Kane, Chief Financial Officer, will discuss our second quarter 2019 results and our updated financial outlook for the full year. Following these prepared remarks, we will open up the line for a question-and-answer session with industry analysts.

We encourage the investing public and media to listen to both management's prepared remarks and the related Q&A with analysts. This call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, humana.com, later today.

Before we begin our discussion, I need to advise call participants of our cautionary statement. Certain of the matters discussed in this conference call are forward-looking and involve a number of risks and uncertainties. Actual results could differ materially. Investors are advised to read the detailed risk factors discussed in our second quarter 2019 earnings press release as well as in our filings with the Securities and Exchange Commission.

Today's press release, our historical financial news releases and our filings with the SEC are all also available on our Investor Relations site.

Call participants should note that today's discussion includes financial measures that are not in accordance with generally accepted accounting principles or GAAP. Management's explanation for the use of these non-GAAP measures and reconciliations of GAAP to non-GAAP financial measures are included in today's press release.

Finally, any references to earnings per share, or EPS, made during this conference call refer to diluted earnings per common share.

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

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

Well, good morning, and thank you for joining us. Today, we reported adjusted earnings per share of $6.05 for the second quarter of 2019 and raised our full year 2019 adjusted EPS guidance to approximately $17.60 primarily reflecting improved results in our Retail segment. We are pleased to deliver these strong results while experiencing the highest individual Medicare Advantage membership growth we have seen in the last decade, which is reflective of our operating discipline and execution, investments in our integrated care delivery strategy and our relentless focus on creating a simple and personalized health care experience for our members.

Today, we are raising our full year 2019 individual MA membership growth guidance to a range of 480,000 to 500,000 members primarily reflecting improved rest-of-the-year growth projections for age-ins and our Dual Special Needs Plans. Through the end of the second quarter, our D-SNP membership grew approximately 21% or 46,000 members from the prior year, demonstrating our ability to serve the unique needs of these population through our benefit offerings and the deep clinical programs and services we've built over the years.

Seniors are increasingly choosing Medicare Advantage because the program rewards high quality of care; fosters deep relationships; aligns incentives under a consumer-based model designed to manage the sickest, most vulnerable beneficiaries; encourages a holistic view of member health; and creates competitive market forces that encourage innovation.

The aging population and the ongoing increased penetration of Medicare Advantage as a percentage of total Medicare eligibles, combined with our strong brand and value proposition, gives us confidence in our long-term membership growth prospects. And it is important to note that our growth trajectory is balanced across product lines, including HMO, PPO and D-SNP, individual Medicare Advantage offerings, group Medicare and Medicaid.

To drive this broad and balanced long-term growth, we are investing in capabilities that create sustainable member value with a focus on 5 key areas of influence: primary care, home, pharmacy, behavioral health and social determinants of health, which we outlined at our March Investor Day.

We also spoke to our consumer-centric health outcomes-focused operating model enabled by technology. As we invest further in these capabilities, our investment approach encompasses both the type of investment as well as the return horizon, balancing both short-term growth and long-term sustainability.

We consider the implications of our investment in terms of their ability to advance our strategy and create sustainable competitive advantage. Important, too, is the risk profile of the investment in the context of structural changes in our industry and the speed at which those changes are occurring.

Following this philosophy enables us to vary our approach based on both enterprise and local market considerations via wholly owned investments, both organic and through purchases, partnerships or direct contracting. Some examples of our success in deploying capital with risk-based return criteria include our primary care partnerships, minority investment in Kindred at Home and minority investments in start-up organizations to encourage and learn from innovation.

Today, I'd like to highlight a few ways we are delivering on our commitments from our Investor Day. In primary care, our investment strategy comes to life through our multiple-pronged approach to expanding access to value-based care. We may own, partner or contract with providers based on the local market dynamics and appetite for value-based contracts. Over the years, we've fostered deep relationships with providers, meeting them where they are as they evolve to value-based care. This oftentimes includes our supporting them through reporting and analytics, complemented by dedicated human resources.

As a result of these long-standing relationships, approximately 1/3 of our individual MA members are cared for by providers in full-risk arrangements and another 1/3 are cared for by providers under value-based arrangements along the path of full risk.

Included in our full-risk arrangements are wholly owned and JV alliance clinics, which allow us the agility to stand up high-quality, senior-focused primary care in underserved markets. By the end of 2019, we expect to open 40 new clinics, 9 of which have already opened, expanding our footprint to 272 primary clinics. This includes 12 new partners in primary care clinics, including 5 new clinics in Houston as well as 3 additional pilot clinics with Walgreens in Kansas City and Anderson, South Carolina.

In the home, through our minority investment in Kindred at Home, we are piloting value-based care models in multiple markets and continue to see encouraging results from a stand-alone financial perspective for Kindred at Home and from the standpoint of delivering improved clinical outcomes for our members. To usher in the next wave of integration, Humana and Kindred at Home have invested in a interdisciplinary team of clinicians responsible for taking the best practices gleaned from pilot markets and applying those learnings across Kindred's broad geographic footprint.

In our pilot markets, we have seen 1,800 home health episode authorizations year-to-date under the new value-based model compared to 600 in all of 2018. The expanded coverage include -- area includes 6 states, Georgia, Kentucky, North Carolina, South Carolina, Virginia and West Virginia, representing over 90 Kindred at Home branches. For the full year, we expect a total of nearly 20,000 home health episode authorizations under the new value-based model for both pilot markets and expanded coverage areas.

In addition, we are preparing for the upcoming changes in 2021, when individuals with in-stage renal disease will be eligible to enroll in MA. We are contemplating how we can expand options for these members and incorporate the home as an alternative site of care. We are also working with CMS on ways to enhance care, address structural barriers that exist in the dialysis market today and ensure appropriate funding. The methods and systems in place today do not incentivize dialysis providers to focus on slowing disease progression and result in provider payment rates in excess of original Medicare. Accordingly, we are working with dialysis providers and potential alternative contracting models, including risk contracts and value-based models, to make care more affordable while driving desired clinical outcomes.

Turning to our technology strategy investment. Let me first highlight the key elements of our approach. We are focused on building an enterprise technology platform that can be leveraged across all our business channels, bringing together disparate systems and data both inside and outside the company, with the end goal of being the creation of a single, intuitive, longitudinal health record for each of our members. It is through an interoperable platform like this that we are able to deliver a seamless, simple and personalized health care experience. Creating this platform requires developing several layers, specifically data, analytics and experience layers centered on focused -- customer-focused use cases.

The data layer includes the governance and structure that allows for ease of integration and the consumption of multiple data types, including, for example, free text, images and voice. This layer then facilitates deep analytics in the next layer.

The analytics layer includes a set of contemporary tools for the use by our data scientists to develop advanced models while creating user-friendly intuitive tools for data analysts and others in the company to access in the experience layer, to improve insights, capabilities and ultimately allow for more proactive care.

The experience layer enables a user experience that is simplified and personalized in the context of member circumstances and preferences. By integrating the insights from the analytics layer through a convenient and contemporary mobile app, we increase consumer engagement and ease for providers, which in turn, enables the capturing of additional contextual information that informs our interaction and enhances our data and analytics to determine the next best action.

Most importantly, we are building an integrated platform utilizing the most contemporary technology and partnerships. Our deployment is modular and based on specific customer use cases with clear business needs.

Let me share a few examples. Last year, we announced the creation of Studio H in Boston. While it's early, Studio H is beginning to launch innovative products. Humana is the first health insurer to make member ID cards available in Apple Wallet. Also in Greenville, South Carolina, we are piloting a care management application for care coaches in our clinics, which integrates the electronic medical records and provides a view of the members with the most critical and immediate needs. As a result of the success of this pilot, we plan to roll out the application to all Partners in Primary Care clinics by the end of the summer.

In addition, we have organically built OneMedList, a medication therapy management tool that enables the provider and caregiver to have a real-time view of member adherence, improving clinical outcomes.

We also recently announced a collaboration with Epic, the most widely used comprehensive health record system that will integrate technologies to enhance patient, provider and payer access to health information. We are the first national health care insurer to collaborate with Epic to power value-based care. We believe interoperability is a core consumer principle and are fully behind CMS' and HHS' push to free data for the benefit of health care consumers.

Together with Epic, we are advancing interoperability to promote open communications and information transparency that will give patients and their clinicians integrated and real-time access to the patient's medical history, health insight and treatment options, which in turn enables cost reduction, improves quality and increases patient satisfaction.

To enhance the prescribers' experience, we are integrating our real-time benefits check tool, IntelligentRx, directly into Epic's e-prescribing workflow, delivering real-time pharmacy data throughout its network. Physicians will be powered to weigh evidence-based outcomes with patient's individual medication, cost and coverage.

All these advancements in technology and our integrated care delivery model, along with many other initiatives designed to personalize and simplify the consumer experience, have resulted in continued recognition of our leading position in customer satisfaction. In June, we were ranked the #1 health insurer among all for-profit and non-for-profit health insurers in Forrester's 2019 US Customer Experience Index, which measures how brands build loyalty with the quality of their experience.

This achievement reflects the dedication of our employees to helping our members achieve their best health. And we are pleased that we expect eligible employees across all levels of the organization to receive higher-than-targeted compensation from our annual incentive program. The expected higher payout is due not only to above-target individual membership growth and earnings per share, but also as a result of improved customer satisfaction as measured by our Net Promoter Score.

Before turning the call over to Brian, I'll touch briefly on 2020. Consistent with our comments last quarter, we continue to expect reasonable growth in adjusted earnings per share in 2020 and believe we struck the appropriate balance between membership growth and margin for our individual Medicare Advantage business.

As Brian will discuss further in his remarks, we are making significant investments in 2019 to create sustainable customer value and lessen the impact of significant 2020 headwinds on member benefits and premiums in 2020. That being said, millions of seniors across the industry will likely see a reduction in benefits and/or increased premiums next year from the expiration of the health insurance fee moratorium. As we've mentioned before, there is a bipartisan support to eliminate the HIF. Given the significant positive benefit the removal of the fee would have on members, we continue to urge Congress to repeal the HIF.

In addition, we are committed to our stand-alone Part D or PDP product as it is an important product for seniors and Humana. We acknowledge that in the last 2 years, our PDP portfolio hasn't achieved our growth expectations. Our PDP design focus for 2020 was to evolve our portfolio to ensure we can offer competitive products to consumers to achieve our long-term membership growth targets.

As we look beyond 2020, we are proactively pursuing initiatives designed to advance personalization and simplification, investing in technology and clinical programs to move more proactive, holistic health interventions while also continuously pursuing productivity initiatives. In addition, we're working to shift the broader health care conversation and focus to include health care policies that address not only coverage, but also the cost and affordability of care.

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

Brian Andrew Kane - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone. Today, we reported adjusted EPS of $6.05 for the second quarter. This exceeds our previous expectations primarily due to higher revenue and better-than-expected medical costs in our Retail segment. The favorable utilization that we experienced earlier in the year in our Retail segment relative to our initial expectations has persisted, and we are also seeing better-than-expected results in our Healthcare Services segment. This favorability was partially offset by lower-than-expected results in our Group and Specialty segment.

The strong year-to-date 2019 performance has positioned us to make additional strategic investments in the back half of 2019 to support our members' health, enhance customer experience and lessen the member impact of the headwinds we face in 2020, all while increasing our full year 2019 revenue and adjusted EPS outlook.

Today, we raise our full year revenue guidance by approximately $900 million to $64.2 billion to $64.8 billion and increase our adjusted EPS to approximately $17.60 from our previous range of $17.25 to $17.50. This represents year-over-year consolidated revenue growth of approximately 13% to 14% and adjusted EPS growth of approximately 21% in 2019. We expect third quarter adjusted EPS to approach 26% of the full year number, which factors in the expected negative impact of weekday seasonality in the third quarter and higher investment spending in the back half of the year.

As Bruce stated in his remarks, we are excited about our ability to execute our strategy and deliver strong results well in excess of our long-term growth target of 11% to 15% while also achieving 16% individual Medicare Advantage membership growth in 2019, which not only significantly exceeds the market growth rate but also is the highest net membership addition Humana has experienced in any year in the last decade.

As a result of our expectation of achieving adjusted EPS and individual MA membership growth in excess of our initial targets and because of the increase in customer satisfaction as measured by our Net Promoter Score, we intend to reward our associates with higher performance-based compensation under our annual incentive plan. The increased compensation is for eligible employees across all segments and all levels of the organization.

Importantly, we were able to identify these positive trends soon enough to be able to invest this outperformance into the bids for our 2020 Medicare offerings to help reduce the impact of the 2020 headwinds on our customers. Additionally, we have been working diligently to identify and invest in initiatives in 2019 to further lessen the negative impact of these significant 2020 headwinds. Specifically, we are executing productivity initiatives and accelerating investments in our integrated care delivery model across all segments. These investments include, among others, automation within the clinical and pharmacy spaces to drive better and more efficient outcomes; customer support services to simplify and streamline the customer experience; artificial intelligence for commercial small group risk assessment and coding; an enhanced dental platform to set up our specialty business for the future; technology innovation and integration to drive interoperability, including our partnership with Epic that Bruce highlighted in his remarks; and marketing investments in partnership with the external broker community.

As a result of the increased investment spending, coupled with higher employee compensation driven by our strong performance, we increased our full year consolidated operating cost ratio by 20 basis points at the midpoint to a range of 11.1% to 11.5%.

I will now turn to our segment results. While I will not repeat the impact within each segment, keep in mind that the increased annual incentive compensation and investment spending affect all segments. In our Retail segment, all lines of business are performing well, particularly our Medicare Advantage business. We continue to see favorable utilization relative to our initial expectations and higher-than-expected growth in our individual MA membership. We raised our full year individual MA membership guidance range to an increase of 480,000 to 500,000 members from our previous range of 415,000 to 440,000 members as our products continue to resonate in the marketplace. We are also seeing higher per member revenues and have increased our Retail segment revenue guidance by $700 million to a range of $55.8 billion to $56.4 billion. We have also lowered our benefit ratio guidance for the segment by 30 basis points at the midpoint to a range of 86.4% to 86.8%.

As it relates to our Medicare Advantage offerings for 2020, I remind you that contracts are not final until September, and we have not seen competitor plans so we do not intend to comment specifically on our 2020 offerings at this time. However, we have worked hard to create a competitive product and lessen the impact to members from the significant headwinds we are facing, which I'll discuss further in a moment.

For our stand-alone prescription drug plan business, we now expect a decline of approximately 700,000 members in 2019 as compared to our previous expectation of a loss of 700,000 to 750,000 due to slightly less disenrollment. As Bruce stated in his remarks, we believe we have taken meaningful ground in evolving our stand-alone PDP portfolio for 2020 but recognize that it may be a multiyear path to return to PDP membership growth.

Lastly for this segment, our Medicaid business is running slightly ahead of expectations, an important marker of success, given the amount of new members we took on this year after our statewide win in Florida.

Turning to our Group and Specialty segment. As I said last quarter, our level-funded ASO product for small groups continues to gain traction in the marketplace as groups migrate out of the community-rated segment. Small group membership comprised 37% of Group ASO medical membership at June 30, 2019, up from 18% at June 30, 2018 and 26% at December 31, 2018. This migration to ASO has resulted in a modest deterioration of our community-rated block, which resulted in additional negative prior period development this quarter.

Furthermore, the increase in small Group ASO membership with stop-loss, which generally carries a higher benefit ratio relative to our other fully insured products, is also impacting the benefit ratio. As a result, we increased our segment benefit ratio guidance by approximately 100 basis points at the midpoint to a range of 82.4% to 82.8%. We continue to forecast core trend of 6% plus or minus 50 basis points. And we now expect full year 2019 pretax earnings of $225 million to $275 million for the segment, a decline of $75 million from our previous expectations. Keep in mind, as previously discussed, this range contemplates higher employee performance-based compensation and increased investment spending to position the business for a strong future.

Lastly, from a segment perspective, Healthcare Services is performing above expectations, and we increased our adjusted EBITDA guidance for the full year by approximately $40 million at the midpoint to $1.05 billion to $1.075 billion.

Our home business, including Kindred at Home, is performing well, and we continue to see operational improvement in our Conviva care delivery assets as well as better-than-expected results in our new Partners in Primary Care clinics. Pharmacy is also performing well, fueled by higher-than-expected individual Medicare Advantage membership.

Turning to operating cash flow and capital deployment. We now expect full year cash flow from operations of $3.1 billion to $3.3 billion, an increase of $500 million at the midpoint from our previous guidance. This increase is primarily driven by the operating outperformance and the positive working capital impact from higher-than-expected individual Medicare Advantage membership. Years where we experienced significant increases in membership generally result in higher operating cash flows as premiums are collected in advance of claims.

With regard to parent cash, the subsidiaries paid dividends to the parent of approximately $1.2 billion in the second quarter of 2019. We continue to expect subsidiary dividends to the parent for the full year to be approximately $1.6 billion to $1.8 billion with the remaining balance expected in the fourth quarter of this year. As a reminder, the parent company also immediately receives cash from the nonregulated earnings of our Healthcare Services segment and our TRICARE business.

From a capital deployment perspective, as announced this morning in our press release, we intend to enter into a $1 billion accelerated share repurchase agreement after the market close today. After the completion of the ASR, we will still have ample capacity to execute on our strategic priorities given our parent cash position and current low financial leverage. These M&A priorities include assets that can enhance our integrated care delivery model as well as tactical health plan acquisitions.

Lastly, as we look to 2020, while the headwinds we face are significant, particularly with the return of the health insurance fee, we have worked diligently to position the company for a successful year on both the top and bottom line. Specifically, we are investing meaningful effort during 2019 to find ways to drive down 2020 administrative costs through end-to-end process redesign, leveraging automation and streamlining certain corporate and market functions all while enhancing longer-term sustainability. Additionally, as mentioned above, our strong performance this year is enabling us to accelerate important investments from 2020 into 2019. And we have also been able to incorporate the 2019 outperformance into our 2020 MA bid design.

Finally, the exceptionally strong membership growth in 2019 provides tailwinds into 2020 as members are documented appropriately and enter our clinical programs. Collectively, we believe these factors will position us effectively in the marketplace next year. We are also reiterating our expectation of reasonable EPS growth off the initial $17.25 guidance midpoint but below our long-term target of 11% to 15%.

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

QUESTIONS AND ANSWERS

Operator

Our first question comes from the line of Ricky Goldwasser from Morgan Stanley.

Ricky Goldwasser - *Morgan Stanley, Research Division - MD*

So building on the comments around kind of like the 2020 and positioning, obviously, last year, you mentioned that you expect 2020 growth to be below the long-term range of 11% to 15%. Given that now you submitted the bids and all the improvement that we've seen this quarter, any updates to that?

Brian Andrew Kane - *Humana Inc. - CFO*

Well, I would just reiterate what I just mentioned in my remarks that, obviously, we work very, very hard to mitigate the impact. The impact is significant. But we do have a number of tailwinds that we've incorporated into our bids, but nonetheless, it's still a material headwind that we have to deal with. But we believe we'll have a competitive product out there for 2020, and again, just reiterating our EPS guidance from -- high-level guidance from last quarter. So I would say that the -- certainly, the second quarter outperformance helps us from a bid design perspective, but we still face meaningful headwinds for 2020.

Ricky Goldwasser - *Morgan Stanley, Research Division - MD*

And then one follow-up, if I may. You talked about your technology strategy, and I think one of the debates in the marketplace is that seniors tend to be -- utilize less digital into their medical benefits or how they manage their medical. Based on the pilots that you've done, what are you seeing in the marketplace? And do you think that this is an opportunity that the market is underestimating?

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

I would say we continue to see growth in the use of seniors and technology, and we continue with the age-ins that, that will be the case. But more importantly, what we see as being the enabler of technology and what really comes into play is streamlining within the health care system to allow the ability to have more information to then allow us to have deeper analytics that then allows us to have more proactive interventions. And so I would say that the investments are around the consumer orientation to -- for self-service kind of activities, but it's much more around enabling providers to be much more proactive and being able to treat and prevent conditions to -- from progressing.

Operator

Our next question comes from the line of Kevin Fischbeck from Bank of America.

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

So I guess just trying to understand the commentary here because trying to put the 2020 outlook really hasn't changed, I guess, from the wording at least that you're using as far as reasonable growth off of 2019. But it does feel like the membership growth has gotten better, which I think in 2019 should help 2020. It sounds like you're making a lot of investments. Is there a reason why you're still using the same language? Or is there any, I mean, I don't know, directional color you might provide within what a reasonable range might be as we think about 2020?

Brian Andrew Kane - *Humana Inc. - CFO*

Kevin, we are not prepared to do that. We'll give more specificity on our third quarter calls. We typically do and detail guidance on our fourth quarter call. As I said to the prior question, the second quarter outperformance has helped our bid design, and it's important to invest those dollars for customers and to ensure that we have a competitive product. And we've worked very hard to do that. You can't underestimate the impact of the health insurance fee on our customers, and we've done everything we can to try to mitigate that.

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

And Kevin, I would just add to Brian's comments. I think out of all the industry players and we as a result of having high PMPM revenue, the industry fee disproportionately affects us more versus others in the industry. And so our headwinds starting out in the gate was greater. So we have worked with this balance of ensuring that we continue to deliver appropriate margin improvement and -- to our shareholders, at the same time, continuing to have a competitive product in the marketplace, and at the same time, have availability to invest and where we see the industry going with technology and clinical programs. And it's that balance that the management team has faced across, and we see the overachievements in 2019 helping achieve that balance. We also see -- and if you were to sit in our day-to-day meetings, you'll see that we're very focused on continuing to improve the productivity of the organization, both in the capital deployment area, which was evident by our ASR today and the ability for us to have -- reinvest our organic growth into returning into the shareholders, but then secondarily also in continuing to invest in the productivity aspects of our business. So it's a high order to try to achieve all of these headwinds, but we are working hard on behalf of our shareholders and customers to overcome it.

Operator

Our next question comes from the line of Peter Costa from Wells Fargo.

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

My question's on Part D. Given all the changes that have been talked about in Washington on Part D, in particular, the Senate Finance Committee bill to restructuring the Part D program. You've talked about revitalizing your Part D program. And then yesterday, you just saw the bids that came out, the national average bid. What's your expectation for growth in Part D for next year and then for the years beyond that?

Brian Andrew Kane - *Humana Inc. - CFO*

Well, there is, as you mention, a number of proposals out there on Part D that we're obviously sorting through. As Bruce mentioned in his remarks, we are committed to growing the PDP product over time. It's an important part of our portfolio. Our customers like the product. It's important for our Pharmacy business. And so you'll see some meaningful product repositioning in 2020, which we'll talk more about when everything's finalized on the next quarter call. But we have to see where things shake out versus our competitors. But as we mention, over time, we are committed to growing this business again.

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

So by repositioning, do you mean you're going to retrench back next year a little bit?

Brian Andrew Kane - *Humana Inc. - CFO*

No. Not necessarily. Again, I think we have to see where our competitors ultimately shake out with their benefit design. I would say that we have made some meaningful changes in our plans, and we'll see how those resonate. But it's important to understand where the marketplace is before we can comment.

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

I think right now, just to add to that -- Brian's comments, Peter, we are working hard to reposition, as you said, to a product that we feel would be competitive in the marketplace. Due to some constraints in structure within PDP and other things, it's not an easy task to navigate through. But I think when plans are published publicly, you'll see that we're thoughtful about how we approach that. .

A second thing, similar to what we're doing in the MA space, we are also focused on how do we continue to make it easier for the brokers and, in addition, for the customers and oriented to segmentation within that area. So it's really a 2-part approach. But we are hesitant to give any kind of estimates because we don't know the comparator to how we would fit in the marketplace. So it's not about being timid about next year. It's just really we are committed to the product, we are committed to making change to make it competitive, but it's just how do we look to others in the marketplace.

Operator

Our next question comes from the line of Josh Raskin from Nephron Research.

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

First, just a clarification. I want to make sure, Brian, I heard that you were talking about the -- not coming in with your long-term growth rate in 2020. Was that off the $17.25 base that you'd referenced last quarter? Or is that off of the higher base this year? And then my real question is just around the accelerated share repurchase that you've announced for this evening. Is that sort of just a simple confidence in the core, feeling a little bit better about 2020? Or should we read into that around short-term M&A and maybe lack of opportunity there?

Brian Andrew Kane - *Humana Inc. - CFO*

Josh, I was referring to off the $17.25 on the first part of your question as the baseline. And again, that's really a function of the fact that we've taken this outperformance, as I mentioned in my remarks, and invested that into the bids. So as we think about the adjusted baseline, we think about our initial guidance and that's why it's off the $17.25. .

As it relates to the ASR, we do feel that our stock is a very good investment, first and foremost. Secondly, we have ample capacity and doing $1 billion ASR today really doesn't meaningfully impact that capacity to execute our strategy. As I mentioned, we are looking at a number of what I'd described as tactical M&A opportunities, and we have ample capacity for that. So I wouldn't read anything into it. We recently received our dividends from -- up to the parent company, and we deleveraged pretty meaningfully from the last ASR that we did. So we felt it appropriate and a good investment to buy back stock.

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

Josh, just to add to that a little bit. One of the unique aspects of Humana has been the strength of our organic growth and the ability for us to generate cash without having to buy earnings and that has allowed, I think, us to be more opportunistic in returning cash to shareholders, and specifically more in stock buybacks. We do, and as you've seen in the past, we do deals, but the deals had been more oriented to adding capabilities as opposed to just expansion of our existing customer base because we feel that our value proposition and our existing customer base is strong and enhancing that value proposition through adding capabilities has been sort of the strategy longer term.

Operator

Our next question comes from the line of Matt Borsch from BMO Capital.

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

Congratulations on the great results. I have the question about what you're seeing in terms of the overall growth in the MA program. I mean obviously, we can track that, but I'm curious of your perspective. Do you think that there's a pickup in the MA penetration with age-ins? I know before you've talked about you see it more in kind of the, if I got this right, 67-, 68-year-old population where the MA product is more typically taken up. I'm wondering if you're seeing that changing at all.

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. I mean there's no doubt that over the last several years, there has been a pickup really across age ranges in MA penetration, Matt. You're right in that as people get to 67, 68, 69, that penetration tends to increase. I think what happens when people age in, they're deciding what makes sense, not quite ready to make a commitment. For those who want a Medicare Supplement plan, they were able to get it without getting underwritten, which has some benefits. And then they take their time and figure out what the right plan is. We're very bullish on the long-term prospects of the MA market. If you exclude the Minnesota cost plans this year, which distorted the growth rates, you're going to see individual MA growth well north of 8%, we think. And that's obviously quite a robust number. And we don't see any reason for that to stop. Now again, the HIF does provide headwinds for next year. And so I think that could, on the margin, impact the growth rate. Although we haven't seen that necessarily materially swing the appeal of the product just because of what we're able to do and all the things that Bruce articulated in his remarks. It is a richer product. There are more benefits. Importantly, there also are care coordination benefits that members don't get in traditional Medicare even with the Medicare Supplement policy. They're left to navigate the health care system on their own. And so that's where we think Medicare Advantage has great promise, and people are really voting with their feet.

Operator

Our next question comes from the line of Justin Lake from Wolfe Research.

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

My question's on the updated guidance for '19. Your MLR guidance in the Retail segment appears to be pretty conservatively biased relative to the first half performance and the typical seasonality we've seen the last couple of years. Should we read that to assume that you're not guiding to the better utilization you've seen continuing in the back half? And if so, should we assume that your bids only reflect the first half outperformance rather than assuming it continues for the full year?

Brian Andrew Kane - *Humana Inc. - CFO*

Justin, I would characterize the back half more a function of seasonality and things of that sort. I wouldn't read too much into it. Our bids do make an assumption about our full year estimate, so we do make a full year estimate. We don't assume that utilization is going to get better from where it is today, but I think it's fair to say that you assume it's going to trail forward largely as how you're seeing it. We'll see where the back half shakes out. We feel good about the guidance that we've given for the back half. But I think some of the differential there is some seasonality factors going on for the back half of this year.

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

Brian, is there something different about the seasonality? Obviously, what I'm looking at, and I could be wrong in my math, it's just that it looks like your retail guide for MLR has the -- is basically flat in the second half versus first half. In the last 2 years, it's been down 300 basis points first half to second half, but obviously you know about Part D seasonality. Is there something new?

Brian Andrew Kane - *Humana Inc. - CFO*

I wouldn't say there's something new other than there's -- yes, particularly the third quarter, like the workday pattern is different and it's just the higher utilization quarter than we've seen in recent years. And I think that's probably the main difference. I mean small changes in workday seasonality could have a pretty material impact on your MERs. So again, I wouldn't read too much into that. And like I said, we feel good about the guidance we have out there, and we'll see where it ends up.

Operator

Our next question comes from the line of Charles Rhyee from Cowen.

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

I had a question about the Epic partnership that you're talking about here. Is this -- does this also include basically you're going to be implementing Epic across all your clinics? And if that's the case, can you talk about sort of what the CapEx expectation you have as you roll that out over, let's say, this year and next year? And does this -- and also, does this include maybe now looking to partner with other EHR vendors to basic coordinate care with patients who might -- with numbers that might not be going to a place that uses Epic?

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

Yes. It doesn't contemplate rolling out Epic to our clinics. It is really more of an interoperability opportunity versus anything else, and it's not very material an investment for us as an organization. But it really highlights the power once the interoperability is operating of being able to have both easier workflow within the Epic system on behalf of certain administrative matters from us as an organization, but secondarily, also the ease of opportunity for us to be able to utilize that information to provide back to the providers on more proactive care management and coordination of care. So it's a great opportunity. We are excited that -- at the relationship with Epic. I know they're excited with their relationship with us and being able to take this and be the payer that's really helping lead them create a payer channel to facilitate a much better and simpler experience, both for the member and for the provider that are using their system.

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

Great. I'm sorry I missed this, but did you touch on sort of the Group segment here? I know it's relatively small, but obviously MLR was a little bit higher than expected. Is this -- is there something here about -- as you think about balancing sort of pricing versus growth and cost? Maybe if you could just touch on that a little bit more.

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. And I talked a little bit about it in my remarks. I wouldn't say it's really necessarily a pricing dynamic. It's really a sort of a mix dynamic as our book continues to evolve away from the community-rated small group space, which has some choppiness in it and just has experience -- just has different dynamics in terms of medical expense ratios, et cetera, in that. We continue to invest in this business more broadly. We believe there are a number of opportunities for us to play a role in this space and offer a compelling product. And so part of the guidance also reflects investing both in the shorter traditional group commercial space, but also in the Specialty space; meaning, largely dental, which runs very good margins, and it's as a business that we want to grow, particularly as we sell and cross-sell more of it both to our individual members on the Medicare side as well as our Group commercial members. And so we continue to invest in that segment, and we're bullish about its prospects.

Operator

Our next question comes from the line of Sarah James from Piper Jaffray.

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

You spoke about 2019 investments then being some pull-forward and some incremental spend, specifically I'm talking about the increased amount in the second half. Can you offer more color on what the step-down could be in spend in 2020 by sizing the 2019 nonrecurring investments then that was more strategic and also the pull-forward from 2020 into 2019?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. I think that's a very fair question, but really not prepared to give that level of granular detail. I would just say that, as I've said multiple times, we have worked hard to set up 2020 to be a good year, both on the top line as well as the bottom line. And in order to do that, we recognize that we still need to invest and make the business sustainable. And so to the extent we can bring investments forward and accelerate them into 2019, we're going to do that. And we're also, I would say, making incremental investments in 2019 that we don't necessarily have to make in 2020, so we can accelerate all of the things that Bruce articulated in his remarks. Because it's important that we think beyond just 2019 and 2020 and over the next number of years, and that's really what we're investing for. So I'm really not prepared to give you specifics. It's not immaterial, obviously. But again, I just would -- you should take the message that we're really trying to balance our short term, some of the pressures that we face with long-term sustainability.

Operator

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

David Anthony Styblo - *Jefferies LLC, Research Division - Equity Analyst*

It's Dave Styblo in for Dave Windley. Question about -- just recognizing that you don't have the individual MA competitive landscape for 2020 yet, do you think you can grow well above the industry average again next year given the accelerated investments you're making in the second half as well as incorporating some of this year's upside into the bids?

Brian Andrew Kane - *Humana Inc. - CFO*

It is too early to comment on our relative positioning. We just don't know the answer to that. I would just say that we have worked hard, as I said, to create a competitive product. And obviously we need to see what others do with their benefit design. We are more impacted, as Bruce said, from the HIF, and we've talked about. So we do have those incremental headwinds that we have to face. But again, for all the things we've said in the last hour here, we're very focused on trying to mitigate that. I would also say that we continue to invest in the broker channel. They've been great partners for us really across the board. We wouldn't be in the position we're in were it not for the external broker channel, frankly, as well as all the great work that our internal MarketPoint team does as well. And so we are very focused on cultivating those relationships and giving them the dollars they need to support our product. And so that's another element of our strategy. But we'll see where it goes. We'll know more in the next few months where the benefits are. And obviously, we'll have more to say in the third quarter call.

Operator

Our next question comes from line of Michael Newshel from Evercore.

Michael Anthony Newshel - *Evercore ISI Institutional Equities, Research Division - Associate*

I just wanted to clarify on the impact of mix shift in the Group business, the higher benefits expense ratio there. That's just the risk pool getting worse because employers switching to self-insured are relatively healthier? I know that's not a new trend, but it's just the magnitude there of risk deterioration has been worse than what you priced for?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. Again, I wouldn't -- I don't know if I would call it, say, risk deterioration, but it's more just a mix of our membership as they move from one segment to the other, and what's left is a worse risk pool. And so from that perspective, yes. And frankly, a lot of the sort of backup on the MER that isn't stop-loss-related -- remember, our stop-loss product is priced at a much higher MER than traditional commercial insurance. So as that mix shifts, remember, the ASO is paired with a stop-loss. As that mix shifts, you're going to get a higher MER. We're also impacted this year by some negative PPD, prior period development, from last year that has impacted the medical expense ratio this year. And so year-over-year, it's not immaterial change for the sector -- sorry, for the segment. And remember that this segment for us is very, very small. And so small changes and arguably immaterial changes for the company, nonetheless, have outsized effects on some of the ratios that you see. And so that -- I think that's important to take into account as well.

Operator

Our next question comes from the line of Steve Tanal from Goldman Sachs.

Stephen Vartan Tanal - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I guess I'll make this sort of a two-parter on 2020. The first sort of high-level question is when you guys talk about headwinds, it seems to be plural, but the only one that I think I'm very comfortable with is the return of the HIF. So wondering if you could maybe walk through headwinds and tailwinds at this stage, what else we should be thinking about, especially on the headwind side. And then kind of beyond that, but also on 2020, back in June, you kind of previewed expense reduction initiatives at our conference. And I just wanted to clarify if that's one and the same as the productivity initiatives you discussed this morning. And I'm wondering whether you might be willing to comment on the expected or targeted impact on next year; and if not, sort of in numbers terms, maybe provide some qualitative color on materiality in the context of year-on-year EPS growth.

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. With regard to the headwinds, it's -- we probably made it plural because the HIF is so big, so it is very material. I would also say, though, that while the rate notice was good and actually positive relative to not last year, but years before that, we still have trend we have to overcome on managed trend that is in excess of that. And so those are just the natural headwinds we typically face. But there's no doubt that the health insurance fee is far and away the biggest headwind, and it's a big one. And as you know, it's nondeductible as well. So it's a big number. But that's really the primary one.

With respect to expenses versus productivity, yes, that is the same set of activities that we're undertaking to reduce our admin spend for 2020 while also, I think, setting us up for a stronger company going forward because of the way we are streamlining processes and rationalizing our business. I would say it's material. I would say it's definitely meaningful for next year the amount of cost that we're taking out. We, as you said, we started talking about this many, many months ago. We started this last year knowing that the HIF was -- could very well come back. And so unlike the 2017 experience, where arguably we had lower-hanging fruit to go after, we had really go deeper here to figure out what areas could we be more productive. And I would say the teams across the board have done a tremendous job of identifying and now are in the process of executing of the initiatives that we're talking about here. But they are material, and we'll talk more about it in the coming quarters.

Operator

Our our next question comes from the line of Steven Valiquette from Barclays.

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

So there's clearly been a lot of questions on the outlook so far. But just back on the 2Q results, specifically the MLR coming in well below consensus estimates was obviously a bright spot in the quarter, especially with really minimal benefit from prior period development. So I'm just curious if there's any additional color you can provide just on what seems to be an enhanced ability to control medical costs. Obviously other managed care companies and maybe other books of business have had some more mixed results this year. So is the biggest factor this time is just better engagement of members into your clinical programs? Or what else would you call out as really the most critical factors?

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. No, it's a fair question. I'd say it's a combination of things. I mean Bruce went through a number of things in his remarks, and this integrated care model that we've created and all the various touch points that we've discussed do move the needle. They definitely do move the needle, and I think give us a good handle of what the costs are and what members are in need of our clinical intervention. And so I think that is a part of it. I think we also have a very good handle from our tight financial and operating linkages that we've created. I think finance and operations are very tightly aligned and that allows us to see trends early. And really when we see potential issues in trend or we're seeing a market or a particular product or whatever it maybe that's running a little bit hotter than we expected, we can immediately identify and go after it. And so we've been very focused and proactive about that. .

But look, this is -- it's a very -- it's not an easy business to manage. All of our costs are estimated. And so it's important to identify these early warning systems that can allow us to identify the issues and then create the clinical programs and the customer engagement platform and, frankly, the analytics to be able to identify who needs the intervention. And so we continue to invest in that. We're nowhere near where we need to be. This is going to get -- it's going to be more and more important over the coming years as the tools we invest in continue to develop. And you'll see us continue to talk about that and also have new distribution channels that we've created, whether it's Kindred or PiPC or other areas where we can engage our members in different ways. That's why we continue to invest in those channels and the technology that supports it so we can continue to manage our medical costs.

Operator

Our next question comes from the line of Gary Taylor from JPMorgan.

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

Just kind of a 2-part question. I guess, one, when we think about the MLR upside versus your original guidance in the first part of the year, are you able to ascertain if more of that is coming from this large bolus of new membership versus where that might typically be when you enroll a new member? Or is most of it coming from your retained members? And then second -- and if so, how does that inform your thinking about 2020 bids in margins?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. I would say our new members are running in line, maybe slightly better than expectations. I'd say a lot of the upside is in the existing block and on both the cost side and the revenue side. And so we're seeing both of that. The good news is that the membership is running -- the new membership because, well, obviously one of the things you're always focused on when you could grow 480,000 to 500,000 members, what are the members that you got? And we've been pleasantly, I guess, happy to see that the utilization that we've seen from those members are running in line or a bit better than expectations. And so I would say it's a lot of the existing block that's really driving the outperformance on the cost side.

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

And could we have just a little more color on the upside in the Healthcare Services EBITDA of 20-some-odd percent year-over-year? I mean are you seeing an acceleration of visits? Is there something on the PBM side in terms of margins? Just a little more color on that, please.

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. Well, I -- and this is a business that we've worked really hard in 2 regards. One is to try trend benders for our Retail and Group segments, and I think they do a really great job of doing that. The other is to drive stand-alone EBITDA in the business, notwithstanding the fact that we're seeing really lower utilization than forecast, and sometimes there are trade-offs there. I would say that the outperformance is pretty balanced across the board. Our Pharmacy business is our largest driver of the segment, and it's running particularly, I would say, on certain areas running better, some areas running sort of in line. But again, small changes there can have a meaningful impact just on the EBITDA. .

Where we're seeing, I'd say, greater percentage outperformance is on the Kindred side and on the Conviva side where we've spent a lot of time working to turn around that Conviva business, and the numbers are better than what we had in our forecast. And the Kindred team is really executing on the business plan. I also mentioned that our care delivery organization outside Conviva, sort of our new clinics, are running less of a loss, I would say, than we expected. And so that's been positive, too. So I would really say it's balanced contribution across the EBITDA raise, which we're happy to see.

Operator

The next question comes from the line of A.J. Rice of Crédit Suisse.

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

Maybe just following up first on that Pharmacy question. Your MA growth has more than offset, you point out in the release, the PDP decline. I guess I'm just curious, I don't think I've ever asked you this, is an MA life in the Pharmacy side equivalent to a PDP in terms of overall scripts utilization or utilization of mail order or anything else? Or are they sort of equivalent? Or is an MA life better or worse than a PDP life?

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Brian Andrew Kane - *Humana Inc. - CFO*

Yes, it's a fair question. It really depends on where that MA life is coming from. Is it HMO? Is it PPO? What geography is it in? Because certain geographies use mail order less than others just given some of our risk partners and the like. So I would say, unfortunately, to your question, it really depends. So it's probably not a satisfactory answer. And also, it frankly depends on which -- where the PDP growth comes from. So some of our plans have much lower mail order penetration than other PDP plans. So I would say it depends. But obviously the extra MA growth relative to our expectations is helping our Pharmacy business.

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

Okay. And then I know it makes sense that you wouldn't want to comment on the individual MA yet, not knowing where other bids are, but I'm assuming the group MA season is well along. Can you just comment on what you're seeing there, what you're thinking and heading into 2020 on that business line?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes. We've commented on this before. I would say we feel good about our Group MA growth prospects. There aren't a host of accounts out there, but there are some -- a few guys that we're chasing. And we feel good about some of the close ratios that we've seen. And so I feel good about where our Group MA growth is going to come in next year.

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

Okay. Do you think you will see growth?

Brian Andrew Kane - *Humana Inc. - CFO*

Yes, we definitely expect Group MA growth next year. And I would tell you I feel good about that Group MA growth. Not prepared to give you a number, but we feel good about what we're seeing in the space in the accounts that we've already won. So we feel good about that.

Operator

There are no questions at this time. Mr. Bruce Broussard, you may continue.

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

Well, like every quarter, we really thank everyone's support and having confidence in the company and continuing to be a supporter. And -- but these results that we reported today cannot be obtained without the strong support by our associates of 50,000 people that come to work every day, so thanking them for their dedication to improving the health of individuals and making it much easier for them to engage in their health. Everyone, have a great day. Thank you.

Operator

Thank you again for joining us today. This concludes today's conference call, and you may now disconnect. Have a good day, everyone.