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# EDITED TRANSCRIPT

HUM.N - Q3 2021 Humana Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 03, 2021 / 1:00PM GMT

**OVERVIEW:**

Co. reported 3Q21 adjusted common diluted EPS of $4.83. Expects 2021 adjusted common diluted EPS to be approx. $20.50.

## CORPORATE PARTICIPANTS

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

**Lisa Stoner** *Humana Inc. - Vice President, Investor Relations*

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

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

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

## PRESENTATION

**Operator**

Good day, and thank you for standing by. Welcome to the Humana Inc. quarterly earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your speaker today, Ms. Lisa Stoner, Vice President of Investor Relations. Please go ahead.

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**Lisa Stoner** - *Humana Inc. - Vice President, Investor Relations*

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 third quarter 2021 results and our updated financial outlook for 2021. 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 and other filings with the Securities and Exchange Commission and our third quarter 2021 earnings press release as they relate to forward-looking statements and to note, in particular, that these forward-looking statements could be impacted by risks related to the spread of in 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 in future filings or communications regarding our business or results. Today's press release, our historical financial news releases and our filings with the SEC are also available on our Investor Relations website. 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.

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

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

Today, we reported adjusted earnings per share of $4.83 for the third quarter of 2021, slightly above consensus estimates. Our year-to-date results reflect the strength of our core operations as we continue to see strong underlying fundamentals across all lines of business and have remained focused on ensuring our members receive the right care at the right time despite the continued disruption caused by the pandemic.

While our underlying fundamentals are strong, 2021 financial results have been impacted by the ongoing pandemic, which has resulted in an adjustment to our full year adjusted EPS guidance. As detailed in our earnings press release, we have updated our guidance to approximately $20.50 from our previous guidance of $21.25 to $21.75. As Susan will share in more detail, this reduction of approximately $1 in adjusted EPS, as a direct result of COVID and corresponds to our current expectation of the total Medicare Advantage utilization inclusive of COVID costs, will run 1% below baseline in the fourth quarter, which is 150 basis points less than our previous assumption of 2.5% below baseline.

This update reflects a more conservative posture going into the final months of the year. And notably, $21.50 remains the baseline of which to grow for 2022.

As a reminder, prior to this guidance update, we had not recognized a COVID headwind in our '21 guidance as many of our peers did. Our adjusted EPS guidance has been above our long-term growth target at the midpoint throughout the year at 16% growth. This update results in an expected adjusted EPS growth at the lower end of our long-term range and, importantly, is not reflective of any concerns with our core operations.

I will now turn to our operational and strategic update. Our Medicare Advantage individual above-market growth in 2021 of 11% can be in part attributed to our industry-leading quality and consumer satisfaction scores. We are pleased to be recognized by CMS for having 97% of our members in 4-Star or higher-rated contracts for 2022. We also increased the number of contracts that received a 5-Star rating from one contract in 2021 to 4 contracts in 2022, the most in our history. And while CMS did make adjustments to the...

(technical difficulty)

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**Operator**

This is the operator. Your conference will begin momentarily. Please stay on hold until the conference begin.

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

Well, welcome back, and we're sorry for the technical glitch here. Let me just maybe just go back to our guidance update here and ensure that the investors understand the guidance and in addition, how it reflects in the -- as we look at the future here.

First, the guidance reflects a much more conservative posture going into the final months of the year. And notably, $21.50 remains the baseline of which to grow for 2022. As a reminder, prior to the guidance update, we had not recognized a COVID headwind in our 2021 guidance as many of our peers did. Our adjusted EPS guidance has been above our long-term growth target, at the midpoint throughout the year at 16% growth. This update results and expected adjusted EPS growth at the lower end of our long-term range and is importantly does not reflect any concern with our core operations.

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And while CMS did make adjustments to the 2022 Star ratings due to the possible impact of the COVID-19 pandemic, these adjustments had minimal impact on our ratings. This further demonstrates our enterprise-wide focus on quality, clinical outcomes and best-in-class customer service, which has been recognized from notable organizations such as Forrester, J.D. Power and USAA. Importantly, the Stars bonus allows us to maintain a strong value proposition for our members and provided valuable supplemental benefits that address social determinants of health and other barriers not addressed by fee-for-service Medicare.

Looking ahead to 2022, we are pleased to be able to provide stable or enhanced benefits for the majority of our Medicare Advantage members, offering plans that support members' whole health needs while continuing to deliver the human care our members have come to expect from us. Our strong clinical and quality programs drive improved clinical outcomes and cost savings that allow our Medicare Advantage plans to continue to expand member benefits beyond those covered by fee-for-service Medicare.

Our plans include highly valuable extra benefits, including dental, vision, hearing and over-the-counter medication allowance, transportation support, business program memberships and home-delivered meals following an inpatient hospital stay.

Over the last few years, we've made great progress in addressing social determinants of health and health equity by expanding our Medicare Advantage benefits. Examples of those impactful areas include respite care, distributing 1.5 million meals during COVID, sending fans to seniors with COPD during a heat wave and providing support for financial need impacting a senior's health and well-being. Given the increase in demand for health equity across America, we have aggressively expanded our efforts to address it.

We continue to advance our consumer segmentation efforts, developing plans that are tailored to the unique needs of specific member populations. This has allowed us to provide benefits that enhance and complement an individual's existing coverage through programs like Medicaid or entities such as Veterans Affairs.

This approach leads to disproportionate growth. As you've seen in our D-SNP plans designed for dual-eligible members, where we have grown our membership approximately 40% in both [2020] (corrected by company after the call) and 2021, we've expanded our D-SNP offerings for 2022 to cover nearly 65% of the dual-eligible population nationally.

To reduce food and security, 97% of our members enrolled in our D-SNP plans and will have a healthy food card, which provides a monthly allowance to purchase approved food and beverages at various national chains. New for 2022, many of our D-SNP members will have reduced Part D drug co-pays as a result of the D-SNP prescription drug savings benefit, which will help address the financial barriers some members face when assessing needed prescriptions, leading to better medication adherence, an important driver of members health -- overall health outcomes.

As previously shared, we took a more conservative approach to our 2022 bids, recognizing the continued uncertainty associated with COVID-19 and potential impacts to premium and claims assumption, allowing us to prioritize long-term benefit stability for our members. While it is early in the selling season, we believe we've struck the right balance and are competitively positioned for our continued growth in Medicare Advantage. Our brand promise to deliver human care resonates with seniors given our comprehensive set of offerings and focus on providing a patient-centric experience based on their specific needs. Susan will provide more detailed 2022 commentary in our remarks, including high-level EPS and membership guidance.

I now would like to highlight the continued progress of our strategy through the build-out of our health care service platforms, starting with primary care business and then moving to our growing home solutions offerings. We have the largest senior-focused, value-based primary care organization in the country, which by year-end, will include approximately 200 clinics, serving 300,000 patients across 24 markets in 9 states.

We are accelerating organic and inorganic growth nationally and plan to open a total of 30 de novo senior-focused centers in 2022, up from 24 in 2021. This will include launching in 2 new major metropolitan areas, Dallas and Phoenix, next year. This faster-paced expansion comes as we continue to gain conviction in our de novo center model with panel growth in centers launched in '20 and 2021 exceeding plan, and clinical performance in our more mature markets continuing to improve.

In our more mature centers, hospitalizations and ER visits are down 12% year-to-date versus 2019 pre-COVID levels, with Stars performance tracking to 4.5 Stars and NPS score of 90. We will also continue to expand through inorganic growth, completing 7 acquisitions through the third quarter of this year, bringing 21 newly wholly-owned centers to our portfolio. We plan to continue this pace of acquisitions, focused on the markets where we have established presence to provide more access and high-quality care to our patients.

Turning to the home. We completed the acquisition of Kindred at Home in the third quarter and now the largest home health and hospice organization in the nation. As previously shared, we will be migrating Kindred at Home to Humana's payer-agnostic health care service brand, CenterWell.

Our efforts to transform home health to a value-based model come at a pivotal time for the industry. As seniors increasingly choose Medicare Advantage, there is a meaningful opportunity for home health organizations to engage differently with patients and Medicare Advantage payers to more holistically address patient needs and improve health outcomes, reduce the total cost of care for health plans and share appropriately in this value creation. We've made substantial progress towards our goal of scaling and maturing a risk-bearing value-based model that manages the provision of home health, durable medical equipment and home infusion services.

With the acquisition of onehome earlier in 2021, a delegated post-acute management services organization for the home, we have the capabilities to be a value-based convener, providing risk-based contracting and referral management and continue to develop technology, enabling us to coordinate other adjacent services.

These services include gap in care, closure, primary or emergent care in the home as well as coordination of meals, transportation and other services to positively support social determinants of health.

We currently care for approximately 270,000 Humana members under value-based home care models in South Florida and Southeast Texas, where we have seen improved outcomes, including emergency room usage being 100 basis points better than Humana's national average. We now are focused on expanding to select markets in North Carolina and Virginia, which we chose based on multiple criteria, including market density, opportunity to significantly reduce home care expense and a robust Kindred at Home footprint. We expect to begin the rollout in the second quarter of 2022 with the goal of covering nearly 50% of Humana Medicare Advantage members under this value-based home health model within the next 5 years.

We are excited about the continued progress of our strategy in the home. But consistent with our home health peers, we recognize that the national nursing labor shortage poses a significant risk to the industry, and we are taking proactive steps to address it as part of our well-developed integration process with Kindred at Home.

In some markets, the nursing shortage is resulting inadequate capacity to meet demand, negatively impacting our ability to grow the top line. We believe the Humana CenterWell brand, supported by our patient-centric culture, will bolster recruiting and retention efforts for nurses.

We've seen increased nurse satisfaction and engagement in pilot markets where we have deployed value-based concepts, with voluntary nursing turnover improving nearly 10% among home health nurses in 2021. In addition, to unlock sufficient capacity to meet our growth goals, we are implementing broader operational improvements and benefit enhancements while also making targeted investments in capacity-constrained areas to enhance nurse recruiting and retention.

With respect to hospice, our intent remains to ultimately divest the majority interest in this portion of the asset. As our experience has demonstrated, we can deliver desired experiences and outcomes for patients transitioning from restorative care to hospice through partnership models.

Since we closed the transaction in August, we have continued to explore alternatives for the long-term ownership structure for the business and have initiated steps to reorganize the hospice business for stand-alone operations while also ensuring business continuity and monitoring underlying trends. We do not have any further update on the specific transaction structure or expected transaction timing, but we will provide additional updates as appropriate moving forward.

Given the continued expansion of interest in our health care service platform, we are committed to providing additional disclosure to give further transparency into the performance of these businesses, beginning with our first quarter 2022 reporting.

Before closing, I want to touch on the current regulatory and legislative landscape. As you know, last week, the White House and Congressional leaders released their plan known as Build Back Better, which includes several proposed changes to the Medicare program, including establishing a hearing benefit starting in calendar year 2024, which will be included in the Medicare Advantage benchmark.

Given that today, more than 40% of Medicare beneficiaries, over 27 million seniors and those with disabilities are enrolled in Medicare Advantage, we were encouraged to see that the package did not include any payment reductions to the program. As this legislation continues to advance and likely be modified and as we look ahead to the annual CMS call letter and rate notice period, we will continue to work with policymakers and the Biden administration to further improve Medicare Advantage, building on the program's innovation and significant progress in areas like value-based care, social determinants of health, affordability and financial protection for beneficiaries as well as reducing the total cost of care.

These attributes, along with the deep consumer popularity of Medicare Advantage, are what have enabled it to have a strong bipartisan support with hundreds of members of Congress on the record supporting the program. With Medicare Advantage serving as a leading example of a successful private-public partnership, I am optimistic we can continue to lead on important health care issues facing both individuals and society, including addressing health and equities, improving health outcomes and expanding value-based care.

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

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

Thank you, Bruce, and good morning, everyone.

Today, we reported adjusted EPS of $4.83 for the third quarter and updated full year 2021 adjusted EPS guidance to approximately $20.50 to reflect a net unmitigated COVID headwind resulting from our current view of utilization levels for the balance of the year. Before beginning, I would point you to Page 4 of our earnings press release for detail of our previous assumptions for Medicare Advantage utilization in the second half of the year, actual third quarter utilization results as well as current projections for the fourth quarter.

I will now walk you through this detail, starting with a reminder of our previous commentary. As of our second quarter call, full year guidance assumed non-COVID Medicare Advantage utilization would run 2.5% below baseline in the second half of the year, with a further assumption of minimal COVID testing and treatment costs for the same period. In September 2021, as a result of the surge in COVID cases due to the Delta variant, we updated our commentary on full year guidance to indicate we expected non-COVID Medicare Advantage utilization to be 5.5% below baseline in the back half of the year, while being partially (inaudible) by 3% of COVID costs. Therefore, again, assuming total utilization would be 2.5% below baseline in the back half of 2021.

What we've seen developed for the third quarter is that total utilization is running 1% below baseline versus the previously anticipated 2.5%. COVID costs have been higher than initially anticipated as the Delta variant resulted in hospitalization levels on par with what we experienced in January of 2021 and were overwhelmingly driven by the 20% of our Medicare Advantage members believed to be unvaccinated.

These higher-than-expected COVID costs were fully offset by depressed non-COVID utilization in the quarter. As COVID hospitalizations increase or decrease, we continue to see an approximate 1:1 offset in non-COVID hospitalization levels. We also continue to see significantly reduced non-inpatient utilization when surges occur, offsetting the higher average cost of a COVID admission.

However, for the third quarter, in total, we saw 1% incremental reduction in utilization beyond the level needed to offset COVID costs versus a 2.5% contemplated in our previous guide. As a result, we have adjusted our full year guide to now reflect the fourth quarter running similarly with total Medicare Advantage utilization running 1% below baseline, inclusive of estimated COVID costs, consistent with what we experienced in the third quarter.

We realized higher-than-expected positive current period claims development in Medicare Advantage in the third quarter as well as other operating outperformance largely mitigating the lower-than-anticipated depressed Medicare Advantage utilization, allowing us to report results that were slightly favorable to the Street estimates. Our revised guidance does not assume that the higher levels of favorable current period development seen in the third quarter will continue. Taken together, our updated full year 2021 adjusted EPS guidance takes a more conservative posture going into the final months of 2021.

And it's important to note, as we've consistently shared throughout the year, the midpoint of our original guidance range of $21.50 remains the correct baseline for 2022, given our approach to pricing.

I will now briefly touch on operating results across our segments before sharing early thoughts on 2022 performance. Our Medicare Advantage growth remains on track and consistent with previous expectations. We have refined our full year individual Medicare Advantage membership guidance to up approximately 450,000 members, consistent with the midpoint of our previous guidance of up 425,000 to 475,000 members. This outlook represents above-market growth with an increase of 11.4% year-over-year.

Our Medicaid results continue to exceed initial expectations due to higher-than-anticipated membership increases largely attributable to the extension of the public health emergency. We now expect to add 125,000 to 150,000 Medicaid members in 2021, up from our previous expectation of up 100,000 to 125,000 members.

Utilization trends continue to be favorable to initial expectations, and the Medicaid team is working diligently toward a successful implementation in Ohio with go-live anticipated in July.

In our Group and Specialty segment, fully insured medical results were impacted by higher-than-expected COVID costs in the quarter, while our specialty business results continued to exceed expectations as utilization, particularly for dental services remained lower than previously anticipated. Recall that our guidance as of the second quarter did not contemplate significant COVID costs in the back half of the year, and the commercial business is not seeing the same level of utilization offset experienced in Medicare Advantage.

From a membership perspective, we have increased our expected group medical membership losses from 100,000 to 125,000, reflecting the expectation of additional losses in the fourth quarter as the result of rating actions taken to account for the expected impact of COVID in 2022.

Finally, within our Healthcare Services operations, the pharmacy and provider businesses continue to perform slightly better than expected, with pharmacy benefiting from increased mail order penetration as a result of customer experience improvements and marketing campaigns. And the provider business seeing continued operating improvements in our more mature centers, which are now aligned under the same leadership as our de novo centers.

As Bruce mentioned in his remarks, we are actively integrating the Kindred at Home operations, and results post integration have largely been in line with expectations. Similar to home health and hospice peers, the business is being impacted by COVID and labor shortages. For the third quarter, home health admissions grew low single digits year-over-year while hospice experienced a low single-digit decline year-over-year. We will continue to closely monitor trends as we make targeted investments to sustainably improve the recruitment and retention of nurses.

Now let me take a few moments to share an early outlook for 2022, starting with membership. As you're aware, the overall PDP market continues to decline as more and more beneficiaries, including dual eligibles, choose Medicare Advantage. In addition, as we have discussed previously, PDP plans should become a commodity with a low-price leader capturing disproportionate growth.

Consistent with 2021, the Walmart Value Plan will offer competitive benefits but will not be the low-premium leader in 2022. As a result, we expect a net decline in PDP membership of a few hundred thousand members in 2022. We continue to focus on creating enterprise value for our PDP plans by driving increased mail order penetration and conversions to Medicare Advantage.

With respect to group advanced -- group Medicare Advantage, we expect membership to be generally flat for 2022 as we do not anticipate any large accounts will be gained or lost as we continue to maintain pricing discipline in a highly competitive market.

Moving to individual Medicare Advantage. As previously shared, we took a more conservative approach to our 2022 bids, reflecting the continued uncertainty associated with the pandemic. We expect to grow our individual Medicare Advantage membership in a range of 325,000 to 375,000 members in 2022 or approximately 8% year-over-year, reflective of our prudent approach we took to pricing for 2022 and the competitive nature of the market.

It is early in our AEP selling season and the outlook we are providing today could change depending on how sales and voluntary disenrollments ultimately come in. And consistent with prior years, we have very little member disenrollment data at this point in the AEP cycle.

I will now turn to our expected 2022 financial performance. As previously mentioned, I want to reiterate that the $21.50 midpoint of our original 2021 guide continues to be the appropriate jumping-off point for 2022 adjusted EPS growth given our approach to pricing. In addition, we feel comfortable that the risk adjustment assumptions in our 2022 pricing are appropriate, as providers have been actively engaging with our members to ensure their conditions are fully documented and that care plans are established to address gaps in care.

Provider interactions and documentation of clinical diagnoses that we anticipate will impact 2022 revenue are approximately 92% complete to date, in line with both our expectations for 2021 as well as the estimated completion rate for the same time period in 2019. We also assumed medical costs would return to baseline levels, reflective of pre-COVID historical trending.

From an earnings perspective, we believe the conservative approach we took to 2022 pricing struck the appropriate balance between membership and earnings growth. Given the ongoing uncertainty surrounding the COVID-19 pandemic, we expect to enter the year with an appropriately conservative view of our initial 2022 financial outlook. Accordingly, we anticipate that our initial EPS guidance will target the low end of our long-term growth range of 11% to 15%.

We expect that COVID will be net neutral to the Medicare business in 2022 as we do not anticipate a risk adjustment headwind and expect COVID utilization to be offset by a reduction in non-COVID utilization. However, our initial guide will allow for an explicit COVID-related headwind that we can tolerate, should it emerge, similar to the approach some of our peers took in 2021. We believe entering the year with this more conservative approach is prudent in the current environment and sets the company up for success in 2022. We look forward to providing more specific guidance on our fourth quarter earnings call in early February.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Your first question comes from the line of Kevin Fischbeck from Bank of America.

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

All right. Great. I appreciate all the color on the 2022 guidance. I guess I think a lot of people are just wondering, the company has had a hard time forecasting where costs are going to be in the upcoming quarter for the last few quarters, obviously, to some degree, understandable during a pandemic. But just wanted to see how you felt about your visibility into costs and how good of a handle you feel like that, that cost trend as you develop your pricing for next year has come in? I guess how do you think about that visibility into the cost as you thought about next year?

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

Sure, Kevin. Happy to take that one. So to your point, estimating the impact of COVID has proven to be more challenging particularly given the environment that we were in, in 2020 is quite different than what we're experiencing, obviously, in 2021. In 2020, no one was vaccinated, various states have lockdown throughout the year. And as we acknowledged in our Q2 call, anticipating how behavior might emerge in an environment where largely people were back to normal and a large percentage of our Medicare population were vaccinated, we just recognized that it was difficult to anticipate whether we see the same level of offset through the surge.

The good news is, as we saw the surge emerge in the third quarter, despite it being just as high as what we experienced the last time, we did continue to see a full offset. The hospitalization offsets have been pretty consistent throughout 2020 and 2021. It's on the non-inpatient side where we tend to see more variation. And as we explained in the second quarter, that claims service category is one where we don't have the same level of near-term visibility.

Having said that, we've studied all of the historical patterns based on what we saw in the third quarter, and our estimates of the continued decline in the COVID curve in the fourth quarter, we feel very comfortable with the assumptions that are underlying our revised guide and feel like we have sufficient visibility to feel confident we can deliver against that.

Your question about 2022 was a good one. As we've explained in all of our calls, given this late surge in 2021, getting visibility to where baseline trend is actually running, obviously, will be more challenging. However, given how we approach the pricing for 2022, meaning that we started with pre-COVID historical levels and assumed historical trending factors not anticipating any ongoing depressed utilization into 2022, we feel confident that, that's an appropriate baseline expectation. So we'll continue to watch it. And certainly, if we see something different emerge, if any of the depression continues, that would be positive for us, but we are not contemplating it, which is what gives us confidence about our approach to 2022.

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**Operator**

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

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

Yes. So I was just hoping that you could maybe comment on the competition in Medicare Advantage. I know you said it's competitive, but just relatively speaking, we've seen geographic expansions by really almost all of the major public companies over the last few years and a number of new entrants. And yet it doesn't seem like it's had a noticeable impact on profit margins. I guess I'm just wondering how you see the dynamic. Is the greater availability of products actually, in essence, expanding the Medicare Advantage market more than it's necessarily lead into competition that would push down margins?

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

Yes. Matt, maybe I'll take that. What we see is a few things. I mean first, we do see more and more intensity in the local markets. And similar to in the past, we see some players being more aggressive to try to gain market share while others are a little more aligned with the pricing that -- and a little more stability in the marketplace. So we do see a bell curve in just how people are approaching it as their strategic plan is pushing them to make those decisions.

We are seeing more awareness in the marketplace as a result of the amount of education that's going on through marketing and through the telesales efforts that are going on. And I think that is a positive for the industry because it really brings alive all the benefits that members receive. It creates more competitive nature for that, for those members, but it does create, I think, more growth industry-wide.

For us as an organization, we were one of the early adopters of the tele market -- the telesales area, and we have benefited from that, I think, in multiple different ways, benefited from it in the way of both our market growth and in addition, our ability to reach a population that we haven't been able to reach in the past. So I do think it's a benefit for us. But to answer your question, more competitive in the local market, more awareness as in the industry. That is a good thing in the industry, and I feel that we have been a beneficiary of that.

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

And Matthew, one thing I would add to that as well as I think our focus on, as Bruce mentioned in his comments, the consumer segmentation efforts by designing products that more specifically address unique consumer needs, you've seen in our dual offerings as well as our veteran offerings that we can drive disproportionate growth. And so we do think that's a differentiator and something you'll see us continue to focus on.

**Operator**

Your next question comes from the line of Steve Baxter of Wells Fargo.

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

I was hoping to come back to the commentary on assuming baseline utilization in 2022. Just to clarify, it seems pretty clear that there will be some level of ongoing COVID costs into 2022. So does that mean you're continuing to assume non-COVID costs to be below baseline in 2022? And then just any color or context you can provide on the magnitude of this EPS hedge that you're talking about in relation to baseline would be appreciated.

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

Sure. Great question. So just to be clear, so what we -- right now, based on all of our experience, we would expect that to the degree we experienced additional COVID costs in 2022, that we would see an offsetting depression in non-COVID utilization, but the net of that would be neutral, right? We're not expecting net favorability that we've seen this year, that 1% we're projecting for the fourth quarter, consistent to what we saw in the third quarter.

So what we would say is we are expecting that if we have COVID cost, they'll be offset, but that we would still be at baseline. But as I mentioned in my comments, what we intend to do with our initial guide though is despite the belief that, that's a reasonable assumption, we will allow for an explicit net COVID headwind, should it emerge, such that and then we would run actually above baseline levels, should that emerge and our guide will contemplate and allow for some of that if it should emerge.

And while not giving a specific amount, obviously, today, when we do give specific guidance on our fourth quarter call, we will be explicit about how much of a COVID headwind we can tolerate within the guide. So we will be explicit about that at that time.

**Operator**

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

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

So one for us and then a long-term question. Just to understand, Susan, if you think about 80% of your MA members are vaccinated based on your estimate. So just kind of trying to reconcile what you're saying versus what some of your peers are saying. What do you think happened that drove COVID hospitalization to levels experienced back in January? Was that sort of a specific geography or anything else that can explain it? And then the longer-term question is really around sort of virtual. Many of your peers launched a virtual-first offering on the commercial side for 2022. Do you see room for some sort of virtual-first-type offering in the Medicare population, especially when you consider sort of the Kindred capabilities?

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

That'd be great. So to take your question, so with respect to the high COVID levels and you're right, and honestly, this was something that was a bit surprising to us as well that we did see levels on par with what we experienced in the last surge despite the high vaccination rate. And what we learned is to your point, some of that was a reflection of our geographic mix. Say like Florida and Texas and Louisiana did see higher levels than even the previous surge. It represents a new all-time high, and we have disproportionate share there. So that was part of it.

But the main driver is that as we looked at the hospitalization rate between vaccinated and unvaccinated, the unvaccinated fairly consistently saw hospitalization rate that was 10 or more times the vaccinated population. And so that, again, as I mentioned in my comments, was the overwhelming driver. And because of the spread of the Delta variant through that unvaccinated population and at much higher hospitalization rate, that is what drove the level on par with what we saw historically.

To your second question about virtual first in Medicare, we were pleased with the COVID pandemic to see that primary care providers and specialists really did adopt telemedicine at a higher rate to ensure that they could continue to support their patients and their permitted needs. I think as a result of that, frankly, providers gained a better appreciation of the range of care and the quality of care that they can provide through virtual, which frankly, pre pandemic, they really didn't appreciate and weren't adopting.

So I think we will see some continued use of virtual technology to enhance the operating model and allow for more touch points with their patients than we did pre pandemic. Your question about home health is definitely a good one. It's something we're looking at, particularly with the challenges we have in terms of nursing labor shortages. Virtual is one strategy we're looking at to see how it can be leveraged to, again, create more touch points with the patient and improve the efficiency of the operating model to just create more overall capacity. And so we'll be testing with Kindred appropriate uses of that and where we can implement it and still see the high-quality outcomes that we would expect. So we'll be testing that, and the hope would be that you'll see expansion of that in the future.

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

Just a few other comments to that. We did launch a few years ago, a virtual first with doctors on-demand product, and that was a success for us on the commercial side. But on the Medicare side, what we do find is that there's a great opportunity to see the patient, both to understand the patient in a physical setting. And unlike more episodic of care versus a chronic care management, there's a good -- there is an importance of being able to have a physical and encouraging a physical interaction.

We see that telehealth as being an opportunity to have a complementary and more interaction. But I don't know if it would be a replacement or we would want to motivate highly chronic members to have a virtual-first interaction for a whole host of reasons, both from a care point of view and from the ability for us to establish the proper care plan.

**Operator**

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

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

I wanted to ask about sort of the shorter short term. So just the assumption that non-COVID utilization will be down in 4Q, I'm just curious, are you seeing script trends, pre-authorizations or anything that would indicate sort of that level of decline just in light of what seems to be an abatement in COVID cases currently? And then specifically, are you seeing any different trends with members that are in your centers or with other value-based providers? Or the underlying trends underneath that capitation any different?

(technical difficulty)

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

Hi, Josh. Are you there?

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

Yes. Can you guys hear me okay?

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

We can. Sorry about that.

**Lisa Stoner** - *Humana Inc. - Vice President, Investor Relations*

Yes, we can.

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

Your question must have been so insightful that it just dropped off the line.

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

I thought it was so scary that you ran for it. So I'll ask my question again, sorry. So just in the very, very short term, my question is, why are you assuming that non-COVID utilization will be down as much as 4% in the fourth quarter, especially in light of what we're seeing in terms of the big reduction in COVID costs -- in COVID -- direct COVID cases in the fourth quarter? And is there script trends? Is there pre-authorizations? Is there something that would indicate that level of decline that you're seeing today? And then long -- or sort of adjacent to that, are you seeing different trends with members that are in your centers or even with other value-based providers sort of the underlying trends underneath the capitation?

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

Sure. So to your question, so with respect to the fourth quarter, as we said before, we have really analyzed all of the prior surges to understand the patterns coming out of a surge. And you might recall from our previous commentary, what you typically see is a tail of depressed utilization anytime you come off a curve, which is what allows you to sort of fully recapture the cost of that COVID peak. And so we've -- with this surge in particular, what's kind of interesting is different states, as I mentioned before, are seeing different levels of utilization relative to previous surges. Texas, Florida, were examples where we saw a very high peak and a very rapid decline.

There are some other states like New York and Michigan, where we're actually seeing a much more moderate and sort of gradual increase without sort of seeing the same sharp peak in decline. So as we've seen that in total that on a national basis, what we're seeing is the slope of the downturn from -- coming off of the peak isn't quite as sharp as what we've seen historically.

We've drilled into each of those states and are consistently seeing irrespective of that difference in peak level, we are still seeing that 1:1 offset regardless. And so to some degree, we think there's just an overall capacity constraints, particularly on the inpatient side that comes into play. And the rest is just that behavior change in terms of providers and patients as they manage through it.

So based on what we've seen emerge and particularly in the third quarter with that 1% offset, everything we've seen suggests that assuming the same level of offset as we continue to come off that third quarter peak is reasonable. To your point about early indicators, we do, as we've said before, have really good real-time information on inpatient activity. That continues to hold, where as the COVID utilization comes down, we'll see a bounce back on a 1:1 offset in the non-COVID hospitalization. So that has been very consistent. And we'll continue to watch the non-inpatient, but again, based on everything we've seen, we believe that is a reasonable assumption.

In terms of your question about value-based providers, interestingly enough, most of our -- both our own centers and some of our high-performing partners, they have indicated that they are not seeing the same sort of neutrality or even benefit from a COVID event that we do. And the theory there is that in general, they manage sort of the unnecessary hospitalization events as lower value out of the system more routinely.

And so when you do see a surge, there's not as much utilization to manage to be depressed because they have already managed it out on a more run rate basis. And so we're still, frankly, trying to assess and use some analytics on that. I think they may take a little bit more time for their claims to fully develop and have a full view of that. But their belief is that they don't see the same level of net benefit that we do on the health plan side generally.

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

Got it. So they see the COVID cost, but not the offset you're saying?

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

Correct. Now on the flip side of that though, they tend to do better on a revenue basis than our non-risk payers, and they were much better about making sure they got their patients in, in 2020, got their conditions documented. So on the revenue side, I'd say they would make some of that up. But on the utilization side, they typically are saying they're not seeing a benefit.

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**Operator**

Your next question comes from the line of Kevin Caliendo of UBS.

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

In thinking about '22, I appreciate all the color, but I just wanted to know if there was any other sort of onetime things we should be thinking about, any other headwinds or tailwinds whether it comes to investments or benefits that you might be making that could impact the sort of EPS growth for the year?

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

So I would say, obviously, as we mentioned, COVID is the main one that we continue to evaluate. We've been clear that based on history, we think it would be an offset, but we will take a more conservative initial approach and allow for a headwind should it emerge. And that really is reflective of the fact that, again, the environment continues to shift, the level of vaccination, hopefully, will continue to increase. But now there's the introduction of the need for boosters. And so will people be as compliant with boosters as they were in the initial vaccine, the emergence of variants and all of those things we'll continue to monitor as well as the ability for people to have reinfection breakthrough cases.

So that's the main one. I would say, obviously, with what comes out of the administrative priorities, certainly, the taxes are one that we continue to watch. It's not obviously an investment, but something that we'll have to watch if there's any '22 impact. But otherwise, as we said before, and Bruce mentioned in his remarks, we continue to support our primary care business. We certainly will continue to look for capital-efficient way to support that business. I would say we aren't expecting anything in 2022 that would have -- that we couldn't withstand within our guide. So obviously, right now, there's nothing that I would point to that's a looming concern that we have that gives us any concern that we can't manage through in our -- whatever we go out with in terms of our initial guidance.

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

Can I just maybe follow up? Is the guidance inclusive or exclusive of the incremental headwind that you're discussing here? Meaning like is the sort of low end or 11% net of the headwinds or not? I just -- I'm a little confused on how I should think about that.

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

Yes. With what we do out in our initial guide, it will explicitly contemplate a net headwind should it emerge that we could -- would create no net impact than beyond our guide. So it is inclusive of that. So if it does not emerge, then you would see that conservatism release throughout the year. But it will contemplate a potential headwind within the guide.

**Operator**

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

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

Just wanted to ask another question just on the Medicare Advantage annual enrollment period. And I know you already talked about the competitive dynamics. Just interested in terms of what you're seeing on the consumer behavior side. And in particular, just whether you're seeing any types of shifts in distribution channels in terms of where more of the sales are occurring or not. Just thinking about, obviously, 2021 was an unusual year for the AEP as it was playing out a mixed COVID. So interesting whether -- interested whether you're seeing more of a continuation of that 2021-type dynamic in terms of consumer buying practices or whether we're seeing, I guess, more of a blended sort of post-pandemic and pre-pandemic dynamic more for 2022?

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

Yes. And Scott, thanks for the question. We are continuing to see an increasing use of the telephonic channel, external, our external partners. And as Matt had asked about just on the competitive side, their marketing and their aggressiveness in the marketing, I think, is bringing more individuals to that channel. As I mentioned also, it's also how we feel it's a benefit for the industry because the industry is getting significant awareness and education from that. But what we're seeing is a continuation of that trend even pre-2021 AEP, it was also happening in the 2020 AEP.

**Operator**

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

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

Sorry to come back to this, but I guess what does the $21.50 baseline incorporate at this time? Is it what you would have earned with normal utilization and no COVID in it? Is it some level of COVID but lower than normal core? I guess I'm really just trying to understand what the $21.50 represents.

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

Yes. So the $21.50 is probably the midpoint of our original guide. And if you remember, the way we approached our initial guide was a bit different than many of our peers in the sense that we did not contemplate a net COVID headwind. And so that initial guide at the midpoint was actually above our more typical long-term growth range, recognizing some of the tailwinds that supported our pricing in -- for 2021.

So by reaffirming that, that is the appropriate baseline really just reinforces that the way we approached our 2022 pricing acknowledge that despite however the results emerge in 2021, that our revenue assumptions would assume that Medicare risk adjustment return to more normalized levels for 2022. And that claims also return to more normalized levels as if COVID did not occur. And so again, for claims, we started with pre-pandemic levels in 2019 and using historical trend factors trended that forward. And so that's why we continue to reinforce given that approach, $21.50 is the appropriate jumping-off point from which we would grow and expect to be in our long-term arrangement in 2022, recognizing, however, from an initial guide perspective, we do intend to take a more conservative approach to ensure we're set up for success and target the lower end of that range.

**Operator**

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

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

First, I had a quick numbers question. We're kind of putting to next year, Medicare Advantage yields probably being in the high single digits in the individual business. Just given the -- you have the strong rates and the bounce back in risk scores, offset, I guess, by a bit of sequestration. Is that a reasonable number? And then, Bruce, can you tell us how to think about where you think the growth opportunity is within your physician management kind of center business? I know you said you're adding 30. I know also that your Welsh, Carson deal is up in the end of 2022, and you have to think about how to finance those again going forward. So how many do you think you can add post 2022? And how do you think you finance these things going forward post that Welsh, Carson deal expiry?

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

Sure. So I'll take the first around premium yield and then Bruce can take the second. So we obviously haven't given specific detailed guidance points for 2022 yet. So I can't comment specifically, but certainly, as you think about the premium yield in '22, there are some tailwinds, as you mentioned, is the favorable rate notice as well as the -- as I said, the expectation that risk adjustment will return to more normal levels and then the typical sort of dynamics from just member growth. So to your point, all of those should produce tailwinds. But at this point, we haven't given specific guidance, obviously, on premium.

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

On the primary care, I'll answer the 2 questions on the growth side. I think, first, obviously, adding the number of organic units in the earlier years creates a drag as they mature, and we're seeing some great maturation in the cohorts that have been open a year or 2, both on a membership side from a point of view of revenue and in addition, on the cost side. So we feel very confident. And that's one of the reasons why we increased the number of cohorts this year as a result of our confidence and conviction in the business outcome.

What we see over a longer period of time is as we call it the J-curve, we'll start to become into profitability of the ones that we opened in the earlier years. And that will start to give us growth. So if you were to shut off the development, you actually see a pretty quick growth rate within the existing business. We are accenting that by 2 other opportunities for growth. One is the existing operations of the businesses that have been open for a while, the mature centers. And we're seeing some really great same-store growth in that area, and they have done a great turnaround over the last few years in being able to approve that.

And although it doesn't show up in the profitability because of the J-curve override it a lot, we are seeing some really great improvement there both operationally and then also from a quality and experience point of view. And then the third area of growth for us as an organization is really in the inorganic area. As many of you know, we do have a relationship with a number of providers, especially in our more mature markets that we have the right of first refusal. And that offers us an advantage in being able to continue to densify markets that we're in and add additional sites and we did that in 2021, we anticipate doing that in 2022. And those are very synergistic inorganic opportunities from the standpoint that we're able to evolve the management of it into our existing management team. We're able to, in addition, bring some of our operating capabilities to those centers.

So [going 3], the continuum advancement of our J-curve and what we see there, the more mature centers continuing to improve that. And then the third, the inorganic growth and being able to leverage in some of the markets we have. I think over a period of time, you're going to see a 5 to 7 period of time, I think you're going to see a fairly sizable business come out of this as a result of the investments we're making today and both in the organic and inorganic area, really today is the leading size clinic or clinics oriented to senior business. I think we'll continue to maintain that leadership long term.

And relative to financing, we don't have -- we haven't come to structure yet. And Justin, I think that will be an active conversation with the investors in probably the second quarter of 2022. We will come back to the investors and discuss how we will finance another cohort or number of clinics for the foreseeable future. We, today, have enough of the capital to invest from our off-balance sheet financing on Welsh, Carson to get us through to the 2022 openings. And so we -- this doesn't cause any slowdown into our openings. But we do and are looking at all the different alternatives for financing and the most cost effective for our shareholders as we think about the future.

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**Operator**

Your next question comes from the line of Steven Valiquette from Barclays.

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

Great. A lot of questions already on Medicare Advantage, just to maybe throw another one out there. Just curious to hear more about the pace of your county expansion. And obviously, you already have -- you're in more counties than anybody else already. Even some of your larger peers seem to be growing their county footprint by double digits for '22. I think you guys are somewhere around mid-single digits based on what we calculated. But just curious to hear more about your thoughts of pace of county expansion for next year, maybe just in general, kind of your strategy and thoughts around that.

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

Sure. I'll take that. So as you mentioned, Humana really was ahead of many of our peers in terms of the rate of expansion we had a number of years ago. And so you don't see from an accounting perspective, the same level of growth for us, as you might see for some others, particularly those who have focused on Medicare Advantage in the last couple of years.

What you'll typically instead see from us is product expansion within our existing geographies. That could be additional -- a couple of years ago, it was really focused on our $0 premium LPPO product, as an example. You see us continue to expand our dual-eligible SNP footprint, and you will see county expansion there in 2022 as well as our veteran offering. Both the duals and the veterans, as we said before, are great examples of where we focused on product and consumer segmentation and designing product that uniquely meets the needs of those consumers.

And when we do that well, you see an opportunity for disproportionate growth. So we'll continue to evaluate opportunities to do that. But again, I think you'll see more product expansion from Humana versus county expansion just because to your point, we've already got pretty broad coverage with some products.

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**Operator**

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

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

Two more, one on perspective, and more and more on just clarifying what you're saying about 2022. I guess I'm trying to understand, so is it fair to say that the MA bids were due early in the summer? Obviously, from your perspective, at least the way it's coming across to us, there's been a lot of developments in the back half of 2021. There may be more difference than what you would have said when those bids would do. Is the right way to interpret what you're saying today is that you are so conservative when you constructed those bids that even though the second half has turned out worse, you're still comfortable with the outlook? Is that the way to interpret what you're saying?

And then give us something on the Kindred. I had assumed, I think that, that was going to be an incremental tailwind for next year. Obviously, home health business seems to have deteriorated a bit. Is that still a tailwind in your mind for next year? And any way to size how much that might help you?

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

Sure, A.J. I can take that. So for your first question on 2022, recall that in 2021, when we came out with our second quarter commentary, we acknowledged that we had a net COVID headwind that had emerged. And as I mentioned a few minutes ago, we did not contemplate that explicitly in our original guidance for 2021. So as we saw that emerge as we explained in the second quarter, we were able to mitigate a fair amount of that through other business outperformance, some favorable prior period development and other items.

But in order to achieve our guide, it did require that utilization continue to run below baseline throughout the year. That is not what we're considering in our 2022 pricing. We assume that it was bounce back. And so it's really just a reflection -- the challenges in 2021 are just acknowledging that while we are seeing net utilization below baseline levels, it's running less than we had previously anticipated or needed in order to achieve the guide and overcome that net COVID headwind that we discussed at the second quarter.

Again, given the way we approach '22 pricing, while our pricing didn't explicitly contemplate COVID costs beyond just sort of vaccination and testing, as we've consistently said, we did take a more overall conservative approach to pricing, recognizing there would be uncertainty that we would need to be able to navigate through and also recognizing that it was a favorable rate environment, we had the MRA headwinds. We wanted to make sure that we could maintain long-term benefit stability for our members and contemplated there may be a less favorable rate environment in 2023.

So again, those are all the reasons that we approach pricing the way we did and the reason we continue to have confidence, because we did not anticipate any ongoing net benefit in respect to price utilization into 2022. On Kindred, and we've had this question a couple of times. I think we've addressed it both in the second quarter call and again, maybe at Morgan Stanley, is that we -- that was one of the items that helped us address the net COVID headwind in 2021, the contribution from the full integration. We knew at the time of bid that we would be integrating Kindred. So that was something we were able to consider as we aligned around our targets and our good pricing for 2022.

We've always said the capital deployment is one of the levers we have available, and we'll use to sustainably deliver our long-term growth target of 11% to 15%, so that was something we specifically contemplated in pricing. So it wouldn't represent an incremental tailwind for 2022, but certainly expect the value that we expect to create from that value-based model and the continued growth of Kindred will certainly continue to contribute in the future to our sustainable ability to deliver against our long-term target.

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**Operator**

Your next question comes from the line of Lisa Gill from JPMorgan.

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

Susan, I just want to go back to your comment around PDP shift to MA. Can you talk about your ability to retain any of those members and bring them over to MA? I think you talked about losing a couple of hundred thousand lives. And then secondly, I know it's still fluid of what's going on down in D.C. around transparency and direct negotiation on the drug pricing side, but just curious if that will have any impact or you anticipate any impact around your PBM business.

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

Sure, Lisa. I'll take the first one. So PDP to MA, so that is something that we have been focused on for many years. And what we see is we actively work to educate our PDP members about the value proposition of Medicare Advantage. In recent years, as we've expanded our dual-eligible SNP offerings, that increased our ability to drive those conversions because a large percentage of our PDP members are low-income, dual-eligible members.

And so what we consistently see is that we will be able to generate a disproportionate share of our PDP members who ultimately choose Medicare Advantage. And so we will disproportionately capture share within a Humana plan relative to what you would see our share capture in just overall Medicare Advantage. So really pleased with that.

Having said that, some of our members do choose other competitor MA plans. And so we continue to focus on identifying if there are opportunities to enhance the product to attract more PDP members who ultimately are likely to migrate to MA, are there things we can do to enhance the marketing, product segmentation, all of those things we've talked about to continue to drive increased share capture for those PDP members who ultimately determine that MA provides a better value proposition for them.

On your second question around some of the recent tax has come out, we certainly are watching it closely. We'd say it really represents a framework at this point. We'll have to see some of the detailed tax that ultimately comes through and what the final proposals are and certainly are -- certainly supportive of anything that can be done to reduce the cost of prescription drugs for our members. And it's something we would certainly contemplate and take into consideration in our pricing each year. But I think at this point, it's too early, we'll need to see what comes out of the final tax.

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

Just on that -- from our vantage point, we continue to put rebates back into our pricing. So I guess back directly to the customer, we do not retain those rebates. So any kind of opportunity to lower the cost of the drugs will directly benefit our members and not have an impact on us as a result of just we pass it through.

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**Operator**

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

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

Great. Could you provide a little more color on the primary care centers? And what I was interested in is looking at the centers and the patients served, can you describe a little bit about the composition of patients, what percent are MA versus Medicare fee-for-service? And then how many of them are employer or other? What percent of those are in full-risk contracts versus maybe stages of that? And then how much of the membership -- or how much of the patient base is Humana membership as opposed to with other payers?

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

Okay. A few things there. There's a lot in that question. So let me try to provide as much as I can here. They are built really for full-risk Medicare Advantage members. That's what they're built for. That's how the staffing is constructed. That's how the recruiting of the physicians, that's how the business model is built. And so that sort of leads you to the conclusion the majority of them are going to be MA members.

Now we have some Medicare fee-for-service side members in there. They are really oriented to how, over time, that can evolve to be a longer-term member for us through a Medicare Advantage relationship. They are agnostic platforms, and so there's a good composition of Humana members as well as other payers in the clinic. That's why it's really called CenterWell. It's to reinforce that agnostic nature, and we are very oriented to that being agnostic. And a number of our sites, there's probably more non-Humana members than there are Humana members on there.

So you do see us oriented to a much broader opportunity for Medicare Advantage. In addition, in a few of the sites, we do have direct contracting members as a result of that. And so we are in the opportunity to take Medicare fee-for-service relationships that then -- that are more oriented to value based.

Your last part of your question just was the relationship. Over time, they will take full risk. Now there might be an earlier part of the opening that they will take a path to risk orientation where they'll have some upside and downside limits, but they will, over time, convert to a full risk model. And that's really just as the panel size gets bigger and bigger, the ability to manage the risk is much easier because of the diversification of the panel size.

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

Great. And what's the time to break even in those de novo sites for you guys?

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

Yes. Breakeven is between 3 to 5 years and fill up. I'd say the earlier year is probably 3 years is more around profitability and contribution margin. The fifth year is more around return on capital, obtaining the return on capital side.

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**Operator**

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

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

Susan, I was just wondering if you'd be willing to provide a little bit more color on how you're thinking about medical cost trend as it relates to 2022? And I guess to provide some granularity about how I'm thinking about the question is, is 2019 kind of the right baseline number from an MLR perspective, plus then adjustments for mix because we've seen so much growth in virtual and retail care clinics? And then if the -- if you've included some, what I'll call, some excess COVID headwind, but if we see a continued reversion of utilization, like could we see a number that looks like greater than 100% of that 2019 baseline from an MLR perspective? Are you thinking about utilization being higher offset by changing cost mix? I'm not asking for the hard number, but just would love how you're thinking about the moving pieces as it relates to the growth in medical costs.

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

That'd be great, sure. Yes, for lots of specificity. So I'll try to answer this as much as I can, maybe a little bit more generally. But as you said before, right now, in our '22 pricing, our approach to baseline trend was to go back to pre-COVID levels, use historical trend factors and roll that forward. Now we certainly -- our models have a lot of granularity to them. And so certainly, they would take into account any site of service shifts that we may be seeing and then our estimate of what those might be going forward.

They'd also look at what we've referred to as health care pipeline technologies to anything else that we expect that may be coming to market that would impact trends differently than what we've seen historically. And that's just part of our consistent process. So all of that work was done to support our '22 pricing.

We have not changed our view of that currently. Although as you can imagine, there is a lot of work being done across the enterprise to study as best we can what has emerged over the course of 2020 and 2021, how we can decipher COVID-impacted utilization, depression versus what might be just lower baseline trend. I think our view and as you've seen us consistently be able to meet and beat earnings historically, would imply that our core sort of trend forecasting models may have a little bit of conservatism in that. We've not assumed that going forward. Trending off '19 is certainly more years of trending than we would typically like. And so that's why we're going to do a lot more analysis between now and issuing our final guidance points for 2022 to see if there's any additional information that would inform our perspective on 2022 baselines.

But what we're considering now we think is an appropriately conservative view. To your point, is the COVID headwind that we will contemplate in that guide does not emerge -- does emerge, then we would be seeing utilization above baseline levels -- or I'm sorry, hit that backwards, is that what I heard? Yes. That we would be able to tolerate it running above baseline even though we don't expect that to occur. If it does not occur, then that would obviously represent an additional tailwind for us that you should see unwind over the course of the year. Does that answer...

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

Okay. And if I could go with a quick -- it does. And I guess my quick follow-up is just where do you feel like the flexibility is for your ability to pull levers on the cost side should costs on the medical side run ahead so that you guys can deliver your earnings targets?

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

I think in general, I would say we continue to work on our trend initiatives and various utilization management and other strategies not -- no different than any other year to continue to work to reduce total cost of care. Some of the work that we're doing with our value-based home health model as well as the use of our broader home set of capabilities or other examples of how we continue to work to see how we can use these capabilities to focus on patients who are disproportionately likely to see potentially avoidable hospitalization events and use those capabilities to redirect to an alternative site of service like the home or an outpatient setting. So we'll continue to do all of those things in support of not only 2022 trend mitigation, but then also longer term to support our value proposition in Medicare Advantage broadly.

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

And just -- you had asked a question about administrative management. We constantly are managing the investments we make and our cost trends within the administrative side to ensure that they provide the adequate cushion for us as we think about earnings being set.

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**Operator**

Your next question comes from the line of Whit Mayo from SVB Leerink.

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**Benjamin Whitman Mayo** - *SVB Leerink LLC, Research Division - MD of Equity Research & Senior Research Analyst*

I had just a quick clarification question, Susan. I think you said that you would expect that reserve development in the fourth quarter would come in less favorably than you experienced in the third quarter? I just wanted to make sure that I heard that right. And of the membership growth that you expect in 2022, I think 350 at the midpoint, how much of that is coming from special need plans, duals, et cetera?

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

Sure. To your first question on current period development, yes, you heard correctly that while we did see positive current period development in the third quarter, our guide does not assume that we continue to see those elevated levels. Our guide would always have seen some level of normal course CPD in any given quarter. You can see that [we typically decline] through the year. But we are not assuming currently that, that same excess favorability we saw emerge in third quarter will continue.

In terms of '22 growth, we obviously haven't given detailed guidance by product. What I can tell you though is while it's still early in the AEP, Bruce mentioned we saw 40% growth in 2020 and 2021. We do continue to see strong growth in 2022. So while we're not prepared to share any specific number so far, again, while it's early, D-SNP growth is actually coming in better than we had originally expected for '22 so far.

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**Operator**

Your next question comes from the line of Gary Taylor from Cowen.

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

Just two quick questions I have remaining. In April, you upped your MRA headwind to $1 billion to $1.3 billion for the full year. I just want to make sure, is that still the right '21 headwind and most of that comes back next year, and that's part of how you're offsetting the return to baseline utilization?

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

That's exactly right. Our estimate has not been changed since our previous update on the MRA headwind. As we said, we're tracking very closely the diagnosis code submissions in 2021. That will support our 2022 reimbursement, and those are in line with expectations and more similar to what we saw pre COVID. So to your exact point, that headwind, we do not expect to recur and does provide mitigation from trend bouncing back to more normal levels.

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

And just one more quick one. When you talked about -- as I was just mentioning less development in the 4Q. Your third quarter prior year development was very similar to last year. So I presume you were talking about intra-year development from the first half that you recognized in the 3Q that doesn't occur, you're not assuming occurs. Is that correct? And could you just give us a little color on where that came from inpatient, outpatient?

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

Yes, you are correct. When we refer to current period development that developed in the quarter, that would refer to (inaudible) for the first half of the year.

(technical difficulty)

Hi, Gary. I'm sorry. Can you hear us?

**Operator**

Speakers, you are now live.

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

Okay. Hi, Gary, I'm sorry, we dropped again, unfortunately. Can you hear me? All right. So just -- I'm not sure exactly where we dropped. But just to your last point, current period development does refer to how claims restated in the first half of the year. And as we said, we did see some favorable restatement. What I can say is, at a high level, relative to -- we gave you estimates as of Q2 and what we saw developed in the third quarter is that net of the COVID, any COVID costs that we saw positive restatement of about 50 basis points for both the first and second quarter of 2021 developed in the third quarter.

**Operator**

And speakers, we don't have any questions on the line. I would like to turn the call to Mr. Bruce Broussard for closing remarks.

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

Well, first, I want to apologize for the technical glitches here. I think we have a problem with our leader line, and we will definitely work on that to ensure that the service that we subscribe to is capable of keeping a consistent connection.

Second, I hope you take away from our conversation today that we have been very thoughtful and conservative as we look into the fourth quarter and as we enter into 2022. As you can see from all the commentary, we do reflect the uncertainty of COVID and all the aspects of going into 2022. I do want to say thank you for our 90,000 associates that make this such a successful organization and their dedication to not only our customers, but also providing our shareholders the adequate return. And I want to thank you for your long-term support for us as an organization. So thank you, and have a great day.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.