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EDITED TRANSCRIPT

HUM.N - Q3 2022 Humana Inc Earnings Call

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OVERVIEW:

HUM reported 3Q22 adjusted diluted common EPS of $6.88. Expects full year 2022 adjusted diluted common EPS to be approx. $25.00.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q3 2022 Humana Inc. Earnings Call. (Operator Instructions) I would now like to turn the call over to your host, Lisa Stoner, Vice President of Investor Relations. You may begin.

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

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Susan Diamond, Chief Financial Officer, will discuss our third quarter 2022 results and our updated financial outlook for 2022. Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. Joe Ventura, our Chief Legal Officer, will also be joining Bruce and Susan for the Q&A session. We encourage the investing public and media to listen to both management's prepared remarks and the related Q&A with analysts. This call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, humana.com, later today. Before we begin our discussion, I need to advise call participants of our cautionary statement. Certain of the matters discussed in this conference call are forward-looking and involve a number of risks and uncertainties. Actual results could differ materially. Investors are advised to read the detailed risk factors discussed in our latest Form 10-K, our other filings with the Securities and Exchange Commission and our third quarter 2022 earnings press release as they relate to forward-looking statements and to note in particular that these forward-looking statements could be impacted by risks related to the spread of 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 and future filings or communications

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

Call participants should note that today's discussion includes financial measures that are not in accordance with generally accepted accounting principles or GAAP. Management's explanation for the use of these non-GAAP measures and reconciliations of GAAP to non-GAAP financial measures are included in today's press release. Finally, any references to earnings per share or EPS made during this conference call refer to diluted earnings per common share.

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

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

Thank you, Lisa. Good morning, everyone. We appreciate you joining us. Our third quarter 2022 results reflect the continuation of solid fundamentals and strong execution across the enterprise as seen throughout the year. We reported adjusted earnings per share of $6.88 for the quarter, above our initial expectations. The strength of the quarter allowed us to raise our full year 2022 adjusted EPS guidance by $0.25 to $25 at our September Investor Day. We are pleased to affirm this recently raised outlook representing a compelling 21% growth over 2021.

Susan will share additional detail on our third quarter performance and our full year expectations in a moment. We appreciate the opportunity to share our value creation framework at our recent Investor Day as well as the subsequent engagement with investors over the last several weeks. We are excited about the company's future and our focus on executing against our strategy to deliver on the commitments communicated. As previously discussed, achievement of our midterm earnings target of $37 in adjusted EPS in 2025 and is underpinned by a return to at or above industry Medicare Advantage membership growth by 2024.

Now that we've seen competitor plans for 2023, and the annual enrollment period is underway, we are happy to provide initial expectations for 2023 membership growth today. Based on our understanding of the competitive landscape, we are anticipating individual Medicare Advantage full year growth of 325,000 to 400,000 members. This represents an expected growth rate of 7.1% to 8.7%, in line with our expectation of high single-digit industry growth.

As we've spoken about previously, we've made substantial investments in our MA product offering and are confident in our strong competitive position. Through targeted surveys and deep analytics, we've designed products to meet -- better meet our members' needs. For example, 100% of our dual eligible plans will offer the healthy option allowance, which allows our members the flexibility to direct funds to pay for healthy food, over-the-counter items, transportation, health supplies, rent and utilities. We are differentiated in this benefit through the wide breadth and flexibility of spending categories as well as the rollover feature we offer in many geographies.

Outside our specific consumer segment strategies, we also improved plan offerings for our broader membership. For example, for our $0 premium HMO and LPPO products, we believe we're at parity or above the key competitor plan value in approximately 80% of our markets.

We also expanded the footprint of our $0 premium LPPO product now offered in over 2,400 counties, a 34% increase year-over-year to better serve members looking for low-cost options with network flexibility. All combined, we believe our plans are providing unique solutions to seniors most urgent needs, providing both affordability and value, which is actually important given current economic conditions and knowing many seniors on fixed incomes.

Beyond our product investments, evolving our distribution capabilities remain a focus, and we are continuing to advance our omnichannel strategy. As we've previously discussed, we've been working closely with our external partners to improve sales quality through a variety of initiatives.

We are confident that we'll continue to maintain strong partnerships and drive better quality through this channel, such as improved retention and better customer satisfaction. Meanwhile, we continue to enhance the capabilities in our internal channels, which tend to provide higher quality sales. We are leveraging improved analytics and artificial intelligence for all inbound calls to drive improved experiences for both our agents and our customers.

We believe this, in combination with our refreshed marketing strategy, will result in an increase in internal sales of approximately 20% year-over-year. Our ability to maintain our leadership position in the MA industry is supported by our excellence in quality and customer experience. Our success demonstrated in areas such as our Star ratings, where 96% of our MA members enrolled in plans rated 4 stars and above for bonus year 2024.

Humana has achieved the highest percentage of members in 4-plus star contracts across all our national competitors for 5 consecutive years. Our commitment to quality is also evidenced in our CMS audit results where we once again saw a significant improvement in our overall results for CMS has recently completed triennial audit when compared to our 2019 program on it.

And finally, we are proud that Humana has been named the best overall Medicare Advantage insurance company by U.S. News & World Report, which created an honor role based on the centers for Medicare and Medicaid services newly released Star ratings for Medicare Advantage plans.

Additionally, Humana ranked as the best company for member experience and was declared the best company for low premium availability. The durability of our success in these areas reflect our differentiated capabilities, including highly diversified value-based care solutions and locally oriented provider relationship models, the use of deep analytics and digital capabilities, first-mover deployment of interoperability, as well as customer-centric products and solutions.

The entire organization is focused on efforts to continuously raise the bar on quality and member experience so that our members can receive better outcomes, and we will continue our relentless pursuit of maintaining our industry-leading results.

Turning to our $1 billion value creation initiative. I'm pleased to share that we have line of sight to fully realize the $1 billion goal in 2023, which will support the investments for MA growth in 2023 that I just described. The effort has required difficult choices, focused execution and changes in the company, which we have already started to show positive results that we expect to continue over the near and long term.

While the former $1 billion goal has been achieved, we are committed to ongoing improvement in operating leverage with a target of approximately 20 basis points annually on a business mix adjusted. Going forward, we intend to continue our historical focus on productivity, utilizing a framework that has been enhanced with the best practices learned through our value creation efforts. We are focused on running our business in a way that will create sustainability driving operating leverage while creating a culture that promotes continuous improvement, workflow efficiency and technology adoption to automate and assist our work wherever possible.

We are encouraged by the early indications of the sustainable productivity framework. As an example, I'd like to highlight productivity efforts in our pre-authorization process where we're leveraging an in-house artificial intelligence solution to automatically match incoming faxes to the correct authorization requests. This solution creates administrative efficiencies across millions of inbound images. We are also scaling this solution to multiple business units such as pharmacy and are also expanding the application of this type of AI to provide decision support to clinicians, which will result in improvements to authorization turnaround times, reduction in friction for providers and creating a better member experience.

Before turning it over to Susan, I'd like to say thank you to our 63,000 employees that bring their best self to work every day and make our success possible. I appreciate all they do for our members and patients. I would also like to thank our shareholders for their continued support. We expect -- we are excited about the strong fundamentals of the industry we operate within, our competitive positioning in the MA market for 2023 and beyond, the scaling of our health care services offerings and opportunities to compound our growth through local market integration and continued cost discipline in capital deployment.

We look forward to delivering against the commitments we shared with you at Investor Day. With that, I'll turn the call over to Susan.

Susan Marie Diamond - *Humana Inc. - CFO*

Thank you, Bruce, and good morning, everyone. Today, we reported adjusted EPS of $6.88 for the third quarter, representing 42% growth over third quarter 2021. Results in the quarter came in above initial expectations driven primarily by lower-than-anticipated medical cost trends in our individual Medicare Advantage and Medicaid businesses.

Recall that we raised our full year adjusted EPS guidance by $0.25 to $25 at our Investor Day in September, which we affirmed today. Our revised full year guidance anticipated the strength of the quarter and reflects a compelling 21% growth in adjusted earnings for 2022, while funding incremental marketing to support the 2023 AEP selling season and the dilution related to the hospice divestiture.

I will now provide additional details on our third quarter performance by segment, beginning with Retail. Medicare Advantage membership growth and revenue remained in line with expectations. Total medical costs in our individual Medicare Advantage business were lower than initial expectations for the quarter with the favorable inpatient trends seen throughout the year continuing with some moderation.

With respect to group MA, we shared last quarter that we were seeing higher-than-expected non-inpatient utilization. As I mentioned in September, we have been pleased to see positive current year restatements and moderating trends during the third quarter, suggesting that some of the higher trend we described previously was likely due to pent-up demand.

Finally, I would note that while it is early in the season, flu levels are running as anticipated. All in, our Medicare Advantage business is strong and tracking consistent with the updated expectations shared at Investor Day. Our Medicaid business also performed well in the quarter, experiencing lower-than-anticipated medical costs. We updated our full year Medicaid membership guidance from a range of up 75,000 to 100,000 to our current guide of up approximately 175,000 to reflect the extension of the public health emergency to January 2023.

We are prepared for the Ohio contract to go live on December 1, adding approximately 60,000 members at implementation, which is included in our guidance. Group and Specialty segment results were in line with expectations for the quarter with our specialty business continuing to benefit from lower-than-expected dental utilization. We continue to anticipate a reduction of approximately 200,000 employer group medical members in 2022 driven by our disciplined pricing and focus on margin stability. I will now discuss our Healthcare Services businesses. Pharmacy results for the quarter were in line with the increased expectations we communicated in April as a result of the outperformance seen earlier in the year.

Primary care organization continues to perform well with results in line with expectations for the quarter. The team is focused on executing on the expansion strategy we shared at Investor Day, and we continue to expect to add approximately 30 to 35 centers to our portfolio through the first quarter of 2023, bringing our total center count to greater than 250. Patients served also continues to grow as expected, and we anticipate serving nearly 250,000 value-based payments by the end of 2022.

Turning to the Home. In our core fee-for-service business, home health episodic admissions for the third quarter are up 5.1% year-over-year, while total admissions are up 6.4% year-over-year. Year-to-date, episodic admissions were up 3.9%, while total admissions are up 5.4%, tracking in line with our full year expectations of a mid-single-digit year-over-year increase. In addition, we plan to expand our value-based home health model to cover an additional 450,000 Medicare Advantage members in the fourth quarter, bringing our total covered lives to approximately 15% as of the end of the year.

From a capital deployment perspective, our debt-to-capitalization ratio decreased by 590 basis points in the third quarter to 39.4% as we retired $2 billion of debt following the divestiture of our majority interest in Kindred Hospice, which closed in August. We continue to anticipate a customary level of share repurchase in 2022, and as a result, expect our debt-to-capitalization ratio to be in the low 40s at the end of the year. I will now take a few moments to provide additional color on our early outlook for 2023, starting with membership.

As Bruce shared, while it's still early in AEP, we remain confident that the investments we made to support 2023 growth has positioned us well, and we are pleased to share our individual MA membership growth expectations today of 325,000 to 400,000 members, which is in line with our expectation of high single-digit market growth. As we always caution this time of the year, it is early in the AEP selling season to the outlook we provided today could change depending on how sales and voluntary disenrollment ultimately come in.

Initial sales volumes are strong and favorable to our expectations. Recall that we have limited visibility into member disenrollment data this early in the AEP season as those results take longer to complete.

But we do expect modestly low attrition in 2023 as a result of our improved benefit offerings, enhanced onboarding support for all new members and increased focus on sales quality and retention by our call center partners. We also advanced our analytic models, incorporating additional granular inputs and machine learning techniques, improving our sales and retention forecasting ability.

Taken all together, these improvements and early results support our confidence in the guidance shared today. With respect to group Medicare Advantage, as we previously stated, growth can vary year-to-year based on the pipeline of opportunities, particularly large accounts going out to bid.

We expect a net reduction in group MA membership of approximately 60,000 in 2023. This reduction is primarily driven by the loss of a large account, partially offset by expected growth in small group account membership. We remain committed to disciplined pricing in a competitive group Medicare Advantage market. With respect to stand-alone PDP, the overall PDP market is declining as more beneficiaries choose Medicare Advantage.

In addition, we remain disciplined in our pricing. And as a result, our Walmart Value plan will not be as competitively positioned, and our basic plan will exceed the low-income benchmark in 3 regions in 2023, driving an expected net decline of approximately 1 million PDP members. As we look beyond 2023, we will evaluate the impact of the various regulatory changes proposed which are likely to result in higher PDP plan premiums broadly and could lead to further industry-wide movement from PDP to MAPD plans given the strong MAPD value proposition.

Our focus remains on creating enterprise value from our PDP plans by driving increased mail order penetration and convergence to Medicare Advantage. Finally, in our Medicaid business, we expect 2023 membership to be flat to slightly up as the new state awards in Louisiana and Ohio will largely offset the impact of redeterminations, which will begin following the end of the public health emergency.

Louisiana has indicated that we will begin the program with 150,000 members, while Ohio will ramp to 200,000 members over the course of 18 months.

Turning now to our expected 2023 financial performance. I would reiterate our commitment to grow 2023 adjusted EPS within our targeted long-term range of 11% to 15%, off of our expected 2022 adjusted EPS of $25.

We will continue with our practice of conservative planning and at this time, expect the current consensus estimate of approximately $27.90 to be in line with our initial adjusted EPS guidance. The earnings growth anticipated for 2023 will put us on a solid path to achieve our $37 adjusted EPS target in 2025. We look forward to providing more specific 2023 guidance on our fourth quarter earnings call in early February.

Before closing, I would echo Bruce's appreciation to our employees for their contribution to our success and to our shareholders for their continued support. We are pleased to report another strong quarter and are excited about our outlook for 2023 and beyond. We look forward to delivering against the commitments we shared with you at Investor Day providing better experiences and outcomes for our members and patients and creating significant value for our shareholders. With that, we will open the line for your questions. In fairness to those waiting in the queue, we ask that you limit yourself to 1 question.

Operator, please introduce the first caller.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Stephen Baxter of Wells Fargo.

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

I wanted to ask about the individual Medicare Advantage outlook that you provided for 2023. Appreciate the commentary. I'm expecting retention to be a little bit better. Could you maybe tell us or quantify how much that contributes to your growth outlook? Maybe what would your growth outlook be if you had the same result on retention that you did last year? And then more broadly, any early insight you have on competitive dynamics in 2023, either on plan benefits or for sales channels.

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

We probably -- we won't provide the detail on just how it affects the overall. First thing is just early in the process. But we do want to continue this practice of being transparent with our investors just on where we are in just 2 weeks into the AEP. What we are seeing is that new sales volume has been strong and higher than expected. Our close ratios are higher year-over-year than -- versus what our expectations are. And in addition, our field sales volumes are particularly strong.

The call center channel volumes are slightly down year-over-year, which we expected. As I've mentioned, our term data is nowhere close to being complete. So we have limited visibility into that. But what we do see is that we're seeing improvement in our non-DSNP plans. And in addition, we are incorporating about a 100 basis point improvement in our term rate this year, and that's really a result of what we're seeing in our relationships with our broker along with the product that we've put in place and then just our workflow improvement in both the enrollment area and on the onboarding with our members. So what we see early on is just a really exciting aspect of where we're seeing good growth and that good growth is coming across all parts of the organization with continued improvement in and our relationships with the channels.

Operator

Our next question comes from Kevin Fischbeck with Bank of America.

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

Great. I just want to go back to your commentary about cost trend. It sounds like just because you didn't beat MLR by as much this period. It sounds like what you're saying is that caution is largely as expected and it's more a function of you kind of lowering the MLR guidance with your September outlook? Is that kind of how you would frame it? And I guess just based upon how you've reported so far in Q3 is obviously implications for Q4 MLR versus where consensus is. I just want to make sure that I'm understanding how you thought about Q3 and then how to think about the implications for Q4 MLR?

Susan Marie Diamond - *Humana Inc. - CFO*

Sure, Kevin. So as you mentioned, we are seeing a lower-than-anticipated cost trend with the mid-quarter raise in guidance, it's a little bit confusing, I appreciate. But so the beat in terms of cost trend was relative to our initial expectations for the quarter, which were considered in the $0.25 raise that we announced at our Investor Day in mid-September. So the commentary this morning was relative to our initial expectations. But then again, once we account for the increased guidance, then more in line with what we expected.

In terms of Q3 versus Q4, as we look at current fourth quarter MLR consensus, the estimates currently are 87.6% for retail and 86.7% for consolidated. I would say that right now, they're a little bit light and that given the announcement of the 3Q results today, which were higher than the street estimates and reaffirmation of our full year EPS guide. We would expect that analysts will adjust their models accordingly. And then we would see then an increase in the fourth quarter and full year MLR as a result, which then should be more in line with our current expectations.

Operator

Our next question comes from Justin Lake with Wolfe Research.

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

The -- 2 numbers questions. First, just a follow-up to Steve's question. You said the churn number is down to 100 basis points. So is it just as simple as saying you have 4.5 million members in individual, 1% improvement at 45,000 members to growth versus last year. The math that's simple. And then what drove the 4% decline in Medicare Advantage PMPM in the quarter? And lastly, a lot of questions on RADV.

I was wondering if you could help us understand what a reasonable like fee-for-service adjuster that the industry is looking for at CMS. So when we see that final rate or that final notice in February, what would be a reasonable number for fee-for-service adjuster that you've been lobbying for?

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

I'll take the first question, and then I'll let Susan take the next 2. On the 100 basis points, your math is correct, pretty simple there, Justin. So like always, you amaze me on your ability to back into the number.

Susan Marie Diamond - *Humana Inc. - CFO*

And then, Justin, in terms of the revenue PMPM, there's a few things impacting it. There's always that decline over the course of the year from the seasonality perspective as new members continue to enroll at low -- typically lower risk scores and members passed away and those members passing away tend to have higher risk scores. The other item that you need for this year is just sequestration, which as you know, sort of ended as of the second quarter, but was in place last year.

And so that will have an impact on the year-over-year compare as well. In terms of your question on the fee-for-service adjuster, I mean, honestly, we just aren't in a position to comment and wouldn't want to speculate on what the fee-for-service adjuster would be, is that it would ultimately be based on fee-for-service data to which we just don't have access.

Operator

Our next question comes from Nathan Rich with Goldman Sachs.

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

I wanted to follow up on the outlook for MLR. I think for '23, consensus is roughly flat. I guess could you maybe talk about how you're thinking about the puts and takes to MLR next year? And I guess specifically, are you expecting a normalization of inpatient procedures over the course of the year? And any change to your expectations around utilization, just given the economic pressures you highlighted and maybe utilization of some of the investments that you made in your plans for next year.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure, Nathan. As we think about 2023, there's always a variety of puts and takes that we'll consider. I would say in terms of utilization, and I think we commented on this last quarter, as in respect to our initial expectations, we did not contemplate the better medical cost trend that we have seen develop in 2022.

And so that certainly should be something that does continue into 2023, although we would expect some offset in terms of risk adjustment given the lower utilization. So that's certainly something that we'll take into account as we estimate MLR for next year, which obviously, we're not prepared to give guidance on that today, but would certainly provide guidance on our fourth quarter call.

In terms of inpatient procedures, I think we've also commented with CMS moving to remove certain items from the inpatient-only list, we frankly expected that to be more flat this year. And frankly, we've been pleased to see continued inpatient to outpatient movement, particularly with orthopedic procedures. The rates of outpatient sort of service is pretty high for some of those procedures. So in theory, we should start to see some moderation in that continued shift.

Just last night, CMS did release the outpatient reimbursement. And within there, there are also some additional changes to the inpatient-only list. That's something we'll have to review in greater detail and consider what, if any, implications we think it will have on further shifting trends for 2023.

But otherwise, for utilization, I would say, we are counting on sort of normal course baseline utilization trends. As we've commented before, there are 2 items we want to continue to watch. One is flu. I mentioned in my commentary that so far that in line with expectations, which -- it is early in the season, but we are anticipating lower than historical levels, given what we've seen in the last few years. We will want to monitor that and see if that does continue or if we start to see an uptick, which we'd have to consider for 2023.

And then finally, I would just mention that we know that health care capacity is constrained. That's something we continue to watch. The labor trends and other factors and is something we will continue to be mindful of as we evaluate our go-forward medical cost trend estimates if we, in fact, start to see some of that return to higher levels. And if the capacity as we've been anticipating some additional utilization as well. So again, not prepared to share guidance today on the MLR, but certainly, we'll do that on our fourth quarter call as we normally do.

Operator

Our next question comes from Gary Taylor with Cowen.

Gary Paul Taylor - *Cowen and Company, LLC, Research Division - MD & Senior Equity Research Analyst*

I guess kind of my key questions were answered. So I just want to go to PDP for a minute where enrollment has been declining since 2017, but coming down 1 million members would be coming down almost 1/3, which is, I think, the largest decline you've seen. So clearly, this doesn't generate a lot of earnings.

I guess I have 2 questions. One is, I think it was Bruce who had made the comment about 20 basis points G&A improvement, business mix adjusted. This is a business with lower G&A. So if you're going to lose a couple of billion dollars of revenue here, how do we think about that impacting sort of that G&A improvement next year?

And then the second piece would just be, is the whole thesis behind PDP, which is kind of originally, it would really set up to be a nice feeder into MA. Is that thesis kind of the bump? Is it less important? Clearly, you've grown very nicely in the last 6 years, 5 years, despite the fact that PDP has been coming down. So I just wanted to get caught up on your thinking around that.

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

Yes. Maybe I'll take the latter point and then let Susan take the question around the operating leverage. Gary, we do still see and we see conversions from PDP to Medicare Advantage on an ongoing basis. And we see that initial relationship we have with them as an opportunity to expand that relationship. One -- two things are happening in PDP. First, there is a few plans that are really at the lower end, and we sort of question how they can get there at the price that they're offering.

And then there's a group of plans that are sort of in the same area we're in. So there's a bifurcation that's happening in the industry, which is really causing people to, I think, to go to the lower end pricing there as a result of just the aggressiveness in the marketplace. And we're not going to follow that direction. But what we do see is also because of the value proposition that's happened in MA that there's a much larger conversion just overall between PDP to MA and results. It's really that PDP is a declining business, not only in our company, but as you look at the industry side.

But to answer your question, we do see it as a -- still as a very viable opportunity for us to expand our MA platform through the PDP conversion as a result of just our relationship with the member. And that is a specific strategy within our company.

Susan Marie Diamond - *Humana Inc. - CFO*

Yes. And then, Gary, to your question on operating leverage. If you recall, we were clear that the 20 basis point commitment was on a business mix adjusted basis, just recognizing across all of our lines of business, we have varying degrees of admin loads. So we remain committed to that target. And with respect to the PDP decline, in particular, as you mentioned, the admin rate does run lower than, say, Medicare for sure. And so that will be accounted for in our ultimate operating expense ratio.

I would just say with this level of reduction, as you said, we will work hard across the enterprise to ensure we get the appropriate amount of variable cost out, but then also take some ground on the indirect cost as well to make sure that the rest of the organization isn't pressured as a result.

Operator

Our next question comes from Scott Fidel with Stephens.

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

Question just around the Home. And first, just interested now that the final home health rates just came out, how that plus 0.7%. How you think about that sort of influencing your thoughts on Home health margins for 2023? And then interested from the contracting perspective for your MA business, there's been a lot of focus amongst the home health industry and recontracting to some different type of models, for example, moving to case rates with some value-based care components to that.

And interested just in Humana's sort of interest and activity level in terms of engaging in some of these types of recontracting considerations for -- from the MA side as compared to from the Home health side.

Susan Marie Diamond - *Humana Inc. - CFO*

Sure, Scott. So your first question on the final rule impact, I know we got some questions previously about the proposed 4.2% reduction. I gave some commentary that from an enterprise perspective, that would have been about a $30 million hit relative to our sort of expectations at the time of bid. And that's a larger hit on the home health business, but mitigated by what would have been a benefit to the health plan with the final rule coming out at 0.7%.

Obviously, that headwind is no longer an issue and it would be slightly positive relative to what we thought at the time of bids, but I would say relatively immaterial, but certainly positive to what it would have been at 4.2%, which we had not contemplated earlier in the year. In terms of your question about how we think about the MA space and home health, Andy mentioned at Investor Day, the work that his team is doing both on implementing a full value-based model, which is inclusive of utilization management, network management, clinical advancement to take full capitated risk on Medicare patients. And as we mentioned in my commentary, we expect to have 15% of our members covered by that model by the end of the year.

In addition, they're also working on value-based reimbursement models for the remainder of our Medicare population initially and then would expect that we would offer -- (inaudible) we would offer those arrangements to other payer, MA payers as well. And so there, we are very focused on the same things, making sure that we're driving appropriate utilization of home health services, but then automating advancement on the clinical side such that we can improve outcomes and would look to structure that contractually where there's some component of a fee-for-service payment but then also participate in the savings that Kindred can help drive in terms of total cost of care going forward under a value-based payment model.

So we would expect to continue to keep you apprised of our progress there. But we do intend to start with the Humana membership. And then once we can demonstrate success then look to take that to our agnostic payers as well.

Operator

Our next question comes from George Hill with Deutsche Bank.

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

I guess, first, I'd ask kind of a big picture question on the recent Star ratings performance. I suspect that you guys had a window into your Star ratings performance before you held the Investor Day and provided the initial guidance. But I'd be interested if you guys have a sense for what the landscape was going to be like as it relates to Star's performance. And I guess, does that kind of increase your optimism and your confidence in kind of outperforming the 2025 targets?

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

We did have an insight into our ratings, but we did not have the ability to understand how the industry was going to perform during the Investor Day meeting. We are continue to remain confident in the capabilities of the company. It gives us more confidence in what we can achieve in our commitment. But I wouldn't say it's going to overly impact that commitment. But I do -- we're very proud of those ratings. I'm very proud of what it means to deliver better health outcomes as well as a better financial performance.

Operator

Our next question comes from Josh Raskin with Nephron Research.

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

I was wondering if you could speak to expectations around growth in the number of lives where you're taking delegated risk in 2023 sort of compared to that 250,000 you'll end the year with? And maybe if you're growing MA and faster in areas that are supported by your own or other value-based care providers. And then if you could just update us your views on potential M&A, specifically around primary care clinic operators?

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

Why don't I take the latter and then Susan can take the former. On the M&A side, we continue to find the best value for use of our capital as really doing in-market acquisitions and being able to roll those into existing primary care clinics that we have in the marketplace. There's not only the ability to leverage the size and scale in the marketplace, but also the administrative productivity we get and just the ability to continue to offer broader value to the payers we serve. So I think that will be most likely scenario.

Of course, we've looked at some of the larger transactions that are out there and have been reviewing that. I think at this time, we're not really convinced that's the right direction for us and we'll continue to do in market. That might change. But based on where the values are trading and what we can do inside our marketplace, we'll probably do medium to smaller acquisitions at this time.

Susan Marie Diamond - *Humana Inc. - CFO*

And then Josh, to your second question, we didn't provide specific guidance this morning in terms of the increase in patients expected in our primary care business for '23. But you can expect that we will provide some commentary on our fourth quarter call. But what I will say more generally is that we certainly expect an increase in patient panel growth in 2023 relative to what we'll deliver in 2022.

And as you said, that's due to the additional centers that we've opened and then the continuing maturation of those centers. Some of that increased growth is also, as you sort of alluded to, predicated on the improved Humana value proposition, which should then help to drive greater panel growth as a result of that. One thing we'll watch pretty closely is Florida, in particular. We've made some nice advancements there in the value proposition. We have a large number of our wholly-owned centers there. And so we're anticipating improved growth within those wholly-owned centers, and that is something, in particular, we'll be watching closely. But we'll certainly provide more commentary on our fourth quarter call in terms of full year expectations for the provider organization patient panel growth.

Operator

Our next question comes from A.J. Rice with Credit Suisse.

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

Just wondering, we talk a lot about, obviously, what you're doing in the primary care arena, and what you're doing with home health. The PBM is -- continues to be a big part of your services offering as well. Any thoughts or updated comments on strategically doing more with that. I know its primary focus over the years has been just to service your internal MA population in your overall membership. But any thoughts on making any moves in that with respect to the PBM?

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

Yes, a few things there, A.J. One is just continuing to grow our penetration in mail order. And what we see is the opportunity to continue to make that convenient for our customers as a result of being able to have home delivery. And what we're really working hard on both the digital experience, but also shortening the time of delivery through having more warehouses closer to where a large number of our members are.

So we are working hard on the opportunity to continue to improve the mail order rate overall. We do have a few customers, I would say, small customers that are utilizing our platform under more of a private label. We've seen that. I think that is an area of opportunity, but not an area of focus for us. We've done a lot of work on the specialty side, and we see the opportunity to continue to grow our specialty business, which is more of a provider-oriented and an agnostic provider orientation and the ability to continue to have stronger relationships with the pharmaceutical side and being able to utilize patient-compliant programs.

So I would say continue to grow our mail order is tough through continuing to improve our experience. And then secondarily, our specialty area. We will look at opportunities to private label or do white label for our delivery, but that probably will be less of the focus.

Operator

Our next question comes from Michael Ha with Morgan Stanley.

Hua Ha - *Morgan Stanley, Research Division - Equity Analyst*

Just wanted to dive a little deeper into next year's MA growth. So based on analysis we've done on planned value and benefit richness, that shows Humana increasing benefit, which is significantly more than your peers and almost double the national average. So stronger benefit coupled the leading Star rating performance and a surprising decline in Star from some of your peers, seemingly it looks like you're positioning into '23 might be the strongest it's been in recent history.

I know you're expecting roughly in line with industry growth next year. But I'm curious, one, how is your MA growth application developed, evolved since early October? And I understand and appreciate the multiyear earnings power that more membership growth can provide. But for '23 specifically, just given the slightly dilutive impact of year 1 MA members, in the event you are able to exceed your growth expectations, how does that impact your ability to reach your target '23 EPS, which gets to the low end of your long-term range. Is there a specific membership growth number that you think could be -- end up being potentially diluted to earing?

Susan Marie Diamond - *Humana Inc. - CFO*

Michael, so in terms of your first question, in terms of how our thinking has developed since sort of before all the data was released, I would say, as the data came out and we commented on Investor Day, we are pleased to see that our positioning is, relatively speaking, in generally where we expected it to be going into 2023, and that the -- certainly the positive rate notice and then in addition, the additional value that our value creation initiative opened up for us in terms of capacity to reinvest into our Medicare product was sufficient to get us back to a really strong value proposition.

We've been able to also validate through discussions with brokers during that time that they are in agreement with our view that we are very well positioned in '23. And I think a number of analysts have also had independent calls where they heard the same thing. So that with further validation. We do recognize that we expect more change within the call center channel this year given some of the changes those partners are making, some comments they've made about reducing marketing, et cetera. And so that's one of the reasons we continue to remain a little bit cautious in terms of our range, recognizing that we'll need to see how that develops.

But I would say, as Bruce mentioned in his commentary, all the early signals are positive, while we recognize it is still early.

In terms of your second question about, is there any level of growth that would compromise our EPS contribution for the year? I would say, from a growth perspective, no, I think we've commented a number of times that new members typically have little to no contribution, but they wouldn't be negative.

They just wouldn't add incremental earnings accretion in the first year. The more relevant metric is retention. Those members obviously are positive in terms of contribution. And so that's why we always watch that closely. And to the degree we see outperformance in retention then we would -- that could be a tailwind for '23. And to the degree, it comes in lower, it could be a headwind. But again, based on everything we're seeing and the strength of our product, we think our retention estimates and the improvement we're expecting is quite reasonable.

Operator

Our next question comes from Lisa Gill with JPMorgan.

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

Just a couple of really quick follow-up ones. One, Susan, you said that flu was kind of trending in line. But just given what we're seeing in the Southern Hemisphere, I'm just curious as to what your expectations are for Q4 and maybe even in the first part of '23. And then just secondly, to the thoughts around the PBM, Bruce, you highlighted the Specialty business. Clearly, there's a number of biosimilars that are coming to the market.

I'm just curious as to how you think about that. Is Humira a big drug when we think about your Specialty business? And is there an opportunity there as we think about late '23, early '24?

Susan Marie Diamond - *Humana Inc. - CFO*

Lisa, so in terms of your first question about flu, so as I mentioned, we are seeing relatively low flu levels. It's very early in the flu season for the fourth quarter, and so we'll certainly continue to watch that.

In terms of our expectations, we did anticipate in our guide that we would see flu levels higher in the fourth quarter than we've seen in the last 2 years, but not as high as we would have seen pre-COVID. And so far, again, while it's early, the early trends are consistent with our expectations that we'll certainly continue to watch that. For 2023, we then assume some further incremental increase in flu going into next year, assuming that it won't permanently stay at the lower levels we've experienced to date. So we'll certainly keep you guys informed. But so far, we are seeing it run in line with expectations, which are slightly higher than what we experienced previously.

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

And as you talk about Humira, as we look at both the '23 and '24, we continue to see that our existing contracting and the rebates that we receive. And when we compare that to what's in the marketplace today, we don't see a significant benefit coming from that. Now maybe as the competition increases and it becomes more oriented to driving down price. We'll see some benefits. But in the short term, we just don't see the benefits.

Operator

Our next question comes from Steven Valiquette with Barclays.

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

Just a quick question here, following up on the RADV situation. You mentioned that you can't really comment on what the adjustment might be for RADV with the new rule goes into effect on Feb 1, following that 90-day extension. But your investors seem to have just a pretty wide view on the potential impact of the company around the situation just based on some of the inbounds coming into us this week. I was wondering if you could maybe just take a second, just remind investors of the framework of the situation.

And just more color on how heavily you guys are focused on this internally just for context. Is this a potential material risk factor because that expected to really be material relative to your preliminary EPS growth guidance you've already provided?

Just wanted to get more sense for that just to help out investor community around this dynamic.

Susan Marie Diamond - *Humana Inc. - CFO*

Steve, yes, happy to answer that. So as we've disclosed previously, our view is that the proposed rule failed to adequately address the statutory requirement of actuarial equivalents by not applying a fee-for-service adjuster to the RADV overpayment calculations. We've been very proactive in communicating our position and have provided substantive comments to CMS. And actively engaged, hoping that CMS will address these concerns in the final rule. In addition, we've commented a number of times on our internal programs around risk adjustment, and we feel very good about what we feel are industry-leading processes as a respect to Medicare risk adjustment compliance.

And our sophisticated mechanisms for correcting risk adjustment data if we determine there to be errors in that data. This has included internal contract level audits that we perform, which we have reported -- the results of which to CMS, including any identified over payments.

And then as you pointed out, we do have a material risk factor, but it's included in our disclosures related to this item. So definitely I would encourage investors to review that language as it does represent a material item depending on how the final rule comes out.

Operator

Our next question comes from Rob Cottrell with Cleveland Research.

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

Just a couple of follow-ups. First, I appreciate the commentary on stronger-than-expected applications so far in AEP. But can you remind us the typical pacing of applications throughout AEP? How much is back-end weighted? How many applications come through after Thanksgiving in those last 10 days? And then secondly, interested if you can comment on expected utilization rates of some of the more cash-light benefits that you're all offering next year in the healthy option allowance.

Does that utilization increase given it's more of a cash payment to the beneficiary? And does that have any MLR implication?

Susan Marie Diamond - *Humana Inc. - CFO*

Rob, yes, in terms of your first question, in terms of sort of completion over the course of AEP, I would say you definitely see a little bit more back loaded, particularly, say, the last 2 weeks of the AEP selling cycle, represents a disproportionate percentage of the sales.

And so that's why, unfortunately, it generally takes since you get pretty late in the AEP cycle to fully predict what the outcome will be, even as you can imagine, the 2% movement in either retention or sales rates can have a meaningful impact. And so I would say it is back loaded. In terms or even more backloaded. And that's a function of, if a member were to disenroll, they have to enroll another plan. That plan has to communicate it to CMS and then CMS communicated to us, which is why that takes longer for us to be able to see the full completion.

In terms of the cash like benefits and expected utilization, we do expect a very high utilization rate for those benefits. We've seen that for the OTC benefit and food card that we've offered the last number of years, and we expect that to be the case with some of the new services that are included in our offering for 2023. We also included an enhanced rollover benefit. We expect that to also generate some additional utilization as it provides more flexibility to members. We've contemplated all of that, obviously, in our pricing for 2023 and our estimates. And given the high rate of utilization we anticipate, I don't expect that to create any pressure in terms of our guidance for 2023.

Operator

I'm not showing any further questions at this time. I'd like to turn the call back over to Bruce Broussard for any closing remarks.

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

As I stated at the end of my comments, I'll just continue to reiterate, I want to say thank you to our 63,000 employees that really make our success every day and what they do. I also want to thank our investors for continuing to support -- continue to support us. And as you can tell from the call and from our comments, we're excited about the strong fundamentals of the industry and of the company and look forward to continuing to provide you updated progress on us meeting the committed. Thank you for your time today, and we look forward to continuing to have the dialogue on our progression.

Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.