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HUM - Q1 2018 Humana Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 adjusted common diluted EPS of \$3.36. Expects 2018 adjusted common diluted EPS to be \$13.70-14.10.



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PRESENTATION

Operator

Good morning. My name is Andrew, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Humana Inc. First Quarter 2018 Earnings Conference Call. (Operator Instructions)

Amy Smith, Vice President of Investor Relations, you may begin your conference.

Amy K. Smith - *Humana Inc. - Vice President of IR*

Thank you, and good morning. In a moment, Bruce Broussard, Humana's President and Chief Executive Officer; and Brian Kane, Chief Financial Officer, will discuss our first quarter 2018 results and our financial outlook for the full year. Following these prepared remarks, we will open up the lines for a question-and-answer session with industry analysts. We encourage the investing public and media to listen to both management's prepared remarks and the related Q&A with analysts.

This call is being recorded for replay purposes. That replay will be available on the Investor Relations page of Humana's website, humana.com, later today.

Before we begin our discussion, I need to advise call participants of our cautionary statement. Certain of the matters discussed in this conference call are forward looking and involve a number of risks and uncertainties. Actual results could differ materially. Investors are advised to read the detailed risk factors discussed in our first quarter 2018 earnings press release as well as in our filings with the Securities and Exchange Commission. Today's press release, our historical financial news releases and our filings with the SEC are all also available on our Investor Relations site.



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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*

Good morning, and thank you for joining us. Today, we reported adjusted earnings per share of \$3.36 for the first quarter of 2018 and raised our full year 2018 adjusted EPS guidance to \$13.70 to \$14.10. We continue to expect strong individual Medicare Advantage membership growth of 180,000 to 200,000 members for full year 2018, and all segments are performing well.

We are pleased that we continue to consistently deliver strong financial results while significantly advancing our consumer-focused health strategy, demonstrating excellence and operational execution. We continue to be very active in building our primary care model.

In March, we acquired the remaining 51% interest in MCCI and officially launched Conviva, bringing together our fully owned and JV primary care assets in South Florida and Texas under one brand and one management team.

In addition, in April, we acquired Family Physicians Group, one of the largest value-based providers serving Medicare Advantage and Managed Medicaid HMO patients in Greater Orlando with a footprint that includes 22 clinics. This brings our total owned JV and alliance clinics to 224, including 138 in Florida. With FPG, we advanced our payer-agnostic primary care strategy, and we continue to look for options to accelerate capability development and geographic expansion of our value-based primary care and MSO support models.

We also continue to advance our strategy to integrate clinical programs that intersect health care and lifestyle, including in the home, where our Kindred transaction will be an accelerant of our strategy. The Kindred shareholders recently approved the Kindred at Home transaction, and we have been steadily -- steadfastly moving forward with the development of the integrated clinical model.

One benefit of the Kindred at Home transaction structure is that it allows us to focus on advancing our care models and associated impact on lowering the cost of care. We are beginning to develop new clinical models, moving from reactive, point-in-time, triggered-based models of post-acute intervention to proactive, always-on models that leverage moments of influence for our members, including through Kindred at Home's care kit delivery capabilities.

We are focused on in-home clinical and telehealth capabilities, including condition-specific best practices and robust clinical pathways. We can improve the quality of care by using data analytics to predict when a member is at risk or an acute event and using that data to arm the physician and in-home clinicians with comprehensive view of the member. As a result, we believe we can prevent an unnecessary hospital admission or an emergency room visit.

We are creating test-and-learn pilots for a subset of Humana members in certain markets that we plan to launch when the transaction closes. Some of the initiatives we are assessing include: improving the time to start of home health care by reducing -- by reduced administrative and other barriers; improving communication with a primary care physician; and seamless medication reconciliation and access to Humana pharmacists as well as other Humana resources and community support.

In addition, leveraging our partnership with our private equity partners, TPG and Welsh, Carson, Anderson & Stowe, together, we entered into an agreement to acquire Curo Health Services, a leading hospice operator. Upon closing of the transaction, which we expect to occur subsequent to the closing of the Kindred transaction, we intend to merge Curo with Kindred at Home.



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Kindred at Home is the largest home health provider in the nation and, combined with Curo, would be the largest hospice operator in the nation. Curo brings highly capable management team and a tech-enabled centralized model for hospice care. By combining its strengths with those of Kindred at Home, patients will benefit from a better health care experience as their care team, physicians, social workers, family members and caregivers help them navigate the continuum of home health, palliative care and hospice in an integrated fashion.

Turning to Medicaid. I'd like to thank our talented and dedicated Medicaid associates. As a result of their tremendous efforts, we received a notice of intent to be awarded a comprehensive Medicaid contract under Florida's Statewide Managed Medicaid program in 10 of the state's 11 regions, including the South Florida, Tampa, Jacksonville and Orlando metro areas. And we anticipate being able to continue to serve members in region 1, creating a statewide offering.

The comprehensive program combines the traditional Medicaid, or TANF, and long-term care programs. While we are currently statewide for the long-term care program and we only serve 5 regions for TANF, although not final until an official protest period has concluded, we are pleased with the award of 10 regions in the comprehensive program, an achievement accomplished by only one other payer. This is a testament to the strong Medicaid capabilities that we have built over the last several years.

The award of a continued and expanded presence in the state will allow us to bring our integrated care delivery strategy to more Medicaid beneficiaries in more areas across the state. As we indicated last quarter, we are seeing certain states to begin -- make a greater link between Medicare and Medicaid long-term support services capabilities for the D-SNP population.

The Florida award further reinforces our belief that the combination of our LTSS business and the strength of our Medicare Advantage offerings with our integrated care delivery model positions us to be a strong competitor to serve the Medicaid dual-eligible population.

Another key element of our strategy is to simplify processes and improve the member and/or patient experience by removing friction points for our members and providers.

For example, as a result of changes we've made to our MyHumana website, including the addition of more benefit information and improvements in navigation, we are seeing more members prefer our digital channel over calling, including for those members coming to the site to pay their bill. From 2016 to 2017, our digital self-service rate improved 16% to nearly 54%.

In addition, we have implemented sophisticated analytics to drive predictive call routing, including analytics that match members with the most appropriate representative based on member communication style and the reason for the call. As part of this initiative, our IVR picks up words a member says to why they are calling, and we route them to the call -- the call to the appropriate representative based on their training level. These initiatives improve customer satisfaction and reduce call transfers by nearly 153,000 or approximately 12% for the first quarter of 2018 as compared to the first quarter of 2017.

We continue to look for ways to enhance the member experience further. We are currently piloting a program to train representatives to handle both mail order pharmacy and health plan-related questions regarding their medical and pharmacy benefits, which is further reducing call transfers between representatives.

As a result of initiatives like this, we continue to lead the industry in quality of the consumer experience. In the recently released 2018 Temkin Experience Ratings among nationwide carriers, we ranked #2 after TRICARE, a program that includes Humana. The ratings are based on customer responses to 3 questions around their interaction with the company, including to what degree they were able to accomplish what they wanted to do, how easy it was to interact and how they felt about these interactions. Although we have work to do, we are pleased with this recognition.

Before I turn the call over to Brian, I wanted to discuss the broader outlook for Medicare Advantage. In April, CMS issued the final 2019 rate notice. After many years of rate reductions following the implementation of the Affordable Care Act, we are beginning to see a more favorable regulatory environment, which we believe is a result of the growing support for Medicare Advantage.



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There's a clear recognition that the Medicare Advantage program provides affordable coverage for beneficiaries, reduces overall health care costs and improves clinical outcomes. The favorable rate notice for 2019 is indicative of this underlying tone.

Participants in MA generally receive benefits in excess of those available under traditional Medicare, typically including reduced cost-sharing, prescription drug benefits, care coordination, techniques to help identify members' needs, complex case management, tools to guide members in their health care decisions, disease management programs and wellness prevention programs. Our data shows that relative to traditional Medicare, our Medicare Advantage plan generates significant per-member, per-month cost savings across a broad spectrum of services, including post-acute, outpatient, physician and home health services, among others.

Similarly, Humana helps members access quality care in skilled nursing facilities and avoid higher-cost inpatient rehab and LTAC settings. Accordingly, Humana members are less likely to be admitted to inpatient rehab or LTAC relative to traditional Medicare.

CMS also recognizes that the issues go beyond traditional health care. We are pleased that CMS is permitting Medicare Advantage organizations to offer tailored, supplemental benefits with flexibility to target the social determinants of health, as recommended by a licensed medical professional. Social determinants, such as food insecurity and social isolation, can have a profound impact on member's health and an important part of the continuum -- part of the care continuum is ensuring that we are able to address these needs.

For example, a member who is food insecure may have to make decisions not to fill their prescriptions so that they can buy food. If a member is not taking their needed medication on a regular basis, it's likely their health will deteriorate.

The additional flexibility provided by CMS for 2019 will allow us to include some targeted supplemental benefits for our members that will directly address these types of needs and improve health outcomes.

In summary, we are proud of our significant accomplishments in the first few months of 2018 and excited about the opportunities that lie ahead.

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

Brian Andrew Kane - Humana Inc. - CFO

Thank you, Bruce, and good morning, everyone. Today, we reported adjusted EPS of \$3.36 for the first quarter. This exceeds our previous expectations, primarily due to favorable current year medical utilization in our Retail segment relative to our initial expectations, some of which is attributable to a lower-than-previously expected flu impact and also to positive prior period medical claims reserve development in our Group and Specialty segment. Consequently, we raised our adjusted EPS guidance to a range of \$13.70 to \$14.10 from our previous guidance of \$13.50 to \$14. We expect second quarter adjusted EPS to approach 27% of the full year number.

For the first quarter of 2018, adjusted EPS of \$3.36 compares to adjusted EPS of \$2.75 in the first quarter of 2017. The year-over-year increase includes, among other items, the impact of a significantly lower tax rate year-over-year, partially offset by investments made in the first quarter of 2018, both as a result of the Tax Reform Law. These investments include investments in our employees, primarily the establishment of an annual incentive program for a broader range of associates, as well as raising the minimum wage to \$15 per hour. Additionally, we are making investments in the communities we serve as well as spending on technology and on our integrated care delivery model to drive longer-term value creation and sustainability.

With regard to the flu, our consolidated benefit ratio for 1Q 2018 was negatively impacted by approximately 35 basis points from the incremental flu expense relative to a typical flu season. Most of the impact came from the Retail segment and our Medicare Advantage business. While it was more severe than last year's, the flu season peaked sooner than we initially expected when we gave guidance and, accordingly, came in a bit below our previous expectations.

I will now turn to our segment results. All segments are performing well, reflecting strong operational focus and the effective execution of our strategy.



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In our Retail segment, we experienced significant Medicare Advantage enrollment growth during the annual election period. This has been coupled with early positive indicators of medical utilization relative to our expectations, primarily lower inpatient authorizations, while prior period development has been in line with our expectations.

In addition, as discussed previously, the negative impact of the more severe flu season was not as high as we initially expected. Accordingly, we raised our full year Retail segment pretax income guidance to a range of \$1.45 billion to \$1.61 billion from a range of \$1.425 billion to \$1.6 billion.

The updated pretax income guidance balances the positive early medical utilization indicators we have seen, with a recognition that we have relatively limited actual claims experienced at this point in the year, along with a significant number of new members. As such, our guidance does not assume those favorable trends will continue throughout the year. To date, we have not seen any indicators that would suggest our new members are performing differently than our initial expectations.

Additionally, as a reminder, the year-over-year decline in Retail segment pretax in the first quarter was expected and is primarily due to the investment of the meaningful 2017 individual MA outperformance into our benefit design for 2018, investments made in 1Q '18 as a result of the Tax Reform Law, lower expected prior period development and a more severe flu season than last year. These items are partially offset by significant operating cost efficiencies in 1Q '18, driven by productivity initiatives implemented in 2017.

With regard to our Medicare Advantage bids for the 2019 plan year, as you know, we are in the midst of the 2019 bid season. As we prepare our bids, we are analyzing both the pretax and post-tax impacts of the HIP moratorium, the benefits of tax reform, the final rate notice and potential competitor actions.

From a competitive perspective, we are limited in what we will say about our 2019 bid strategy until our bids are approved later in the year. Suffice to say, as we always strive to do, we will take a balanced approach to membership growth and margin by offering a compelling product to our members in recognition of the significant rate and tax tailwinds. We also intend to drive meaningful EPS growth in excess of our long-term target of 11% to 15%.

Before discussing the other segments, I would like to echo Bruce's gratitude to our Medicaid associates for their dedication and tireless efforts that resulted in the Florida Medicaid contract award. We are working through the membership and revenue implications, but we do believe that there will be material upside relative to our current contract.

Turning to Group and Specialty. The segment continues to perform well, with slightly higher fully insured commercial membership than initially expected and medical utilization generally running better than previous expectations, but still within our previous benefit ratio guidance range. We continue to expect core trend of 6%, plus or minus 50 basis points, but biased towards the lower end, again, with the important caveat that we are still very early in the year and our claims experience is relatively limited.

The increase in Group and Specialty segment pretax year-over-year in the first quarter primarily reflects the impact of higher earnings in our fully-insured commercial medical business, including higher favorable prior period development. Consistent with the Retail segment, the pretax results for the Group and Specialty segment for 1Q '18 include the impact of investments made as a result of Tax Reform Law, as described previously, as well as significant operating cost efficiencies in 1Q '18 as a result of productivity initiatives implemented in 2017.

For the full year, we raised our Group and Specialty segment pretax guidance by \$10 million at the midpoint, primarily reflecting prior period medical claims reserve development that we experienced in the first quarter, which we do not forecast in guidance.

Shifting to the Healthcare Services segment. The pretax results in the first quarter were generally consistent with our previous expectations for the segment as a whole. Relative to our initial expectations, our pharmacy business is running in line, while the provider business is running a bit ahead on the back of favorable prior period development, and our clinical business is running just slightly below expectations. Consequently, we continue to guide to pretax income of \$825 million to \$875 million for the full year.



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Similar to the Retail segment, the year-over-year decline in pretax earnings for the quarter was expected. You will recall that we have undergone an optimization process that ensures the appropriate level of member interaction with clinicians, including graduating members into a monitoring program as their needs change and transitioning them out of the care management program when they no longer benefit from these services. This drives higher-quality outcomes and better returns on investment, while leading to reduced segment earnings. The full impact of this optimization is reflected in the quarter and projected full year results.

In addition, the first quarter of 2018 includes the impact of investments made as a result of Tax Reform Law, primarily investments in our employees, as described previously, and significant operating cost efficiencies in 1Q '18 as a result of productivity initiatives implemented in 2017.

From a capital deployment perspective, in the first quarter, we completed our \$1 billion accelerated share repurchase program that began in 4Q '17. We continue to expect to execute additional share repurchases of approximately \$500 million in the back half of the year. Our expectation is that the Kindred and Curo acquisitions will utilize approximately \$1.1 billion in parent cash on a combined basis when the transactions close sometime this summer, though the debt financing plans are still being finalized with our private equity partners.

With regard to sources of parent cash, we expect subsidiary dividends to the parent in 2018 to be approximately \$1.9 billion to \$2 billion, almost all of which will be paid in the second quarter. This represents an increase of approximately \$500 million to \$600 million over the \$1.4 billion we received for full year 2017, primarily reflecting higher regulated subsidiary earnings in 2017 relative to 2016.

As a reminder, there is typically a 1 year lag in our ability to pull cash out of our regulated subsidiaries. Additionally, the parent company receives the cash from the earnings of our Healthcare Services segment immediately.

From an M&A perspective, as I said last quarter, we continue to evaluate strategic acquisitions to build out our capabilities, particularly the primary care arena, but we also look for any other assets that could enhance our other Healthcare Services segments. Additionally, we would also have interest in Medicare Advantage assets that increase our presence in underpenetrated markets.

We continue to target a debt-to-capitalization ratio of 30% to 35%, consistent with rating agency expectations with the ability to go higher for the right strategic opportunity.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ana Gupte with Leerink Partners.

Anagha A. Gupte - Leerink Partners LLC, Research Division - MD, Healthcare Services and Senior Research Analyst

The question was about the difference in the final rate notice from February to April. It should look quite significantly good. Can you tell us what your thoughts are around the margins that you would target then into '18 and into '19 and the progression back to the 4.5% to 5%? Do you think that might accelerate? Or might you again just funnel that back into investments and the like?

Brian Andrew Kane - Humana Inc. - CFO

Sure. Yes, I'd rather not talk about specifically what we'll do from a competitive perspective, of course. But as I mentioned in my remarks, we do intend to guide next year to an EPS target in excess of our long-term target range of 11% to 15%. And I know there's been a lot of questions about that, and so we thought it was important to make sure that was clear. As it relates specifically to our 4.5% to 5% margin target, as we've said



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previously, we expect to make meaningful progress on the road to getting back to that margin level. Just as a reminder and to level set, one of the reasons -- or the major reason why we're below the margin target is because of the tax reform investments that we invested in our associates and in our business. And as we've said, over time, we will work to get back to our 4.5% to 5%. But as I said, we will make meaningful progress in that regard next year and guide to a range above our long-term EPS guidance range.

Anagha A. Gupte - *Leerink Partners LLC, Research Division - MD, Healthcare Services and Senior Research Analyst*

Okay. If I could just ask one follow-up. On the -- when you look at the selling season now and in context of the potential CVS-Aetna deal with retail clinics, and you are doing a lot of primary care and you think about your clinical and your distribution strategy, do you have a mixed view of you should do primary care in clinics relative to retail clinics in-store and the like? Or is it one or the other from a strategic perspective?

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

I mean, today, we are looking at all different ways to build and develop clinics, both standalone and retail centers, which today, we do in retail centers, not directly in the store, but adjacent to stores. And we'll continue to look at that. We do see convenience as being an important part of the decisions that individuals make when they choose a primary care clinic.

Operator

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

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

Could you just talk about -- sorry, let me ask you, just on the individual business. This is now the second year that you've been out. It's separated from your operating results and, yet, it's making a pretty substantial earnings contribution to you. How do you look at your strategy going forward about the potential to get back into that business, given how some of the dynamics have changed?

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

Matt, I think we continue to look at that as not being part of our core. I think as we communicated last year in our shareholder meeting that we are very oriented to staying focused on what we do well, and that's in the Medicare individual -- or Medicare group and individual MA market. We found that our clinical capabilities and our long-term engagement with individuals in the commercial market was really tough. It was very transitory. It was a market that seemed to use the health care system on a spot basis. And that really isn't our long-term both strategy and our strength. And we feel there's a significant opportunity in the markets that we're in for significant growth, and we want to stay focused on building the capabilities to service those customers.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

That's great. And if I can just also, one more on Florida and your expansion there. What are your thoughts about the capabilities that you have in that market and generally in terms of taking care of a broader TANF population? Understanding that you already have statewide LTC, as that hasn't historically been your preferred focus area?

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

Yes. We -- as we committed to the shareholders a number of years ago, that we would build our Medicaid platform in concert of being able to serve dual-eligible. And in the state of Florida, we've been working really hard in building our TANF capabilities. And we service 5 regions for a period of



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time in that marketplace. And we've built a fairly sophisticated capability in that marketplace that is portable to any other state. I mean, it's not specific to Florida. We built it on a platform that allows us to expand that. And I think the recent preliminary grant by the state of Florida for us to serve all regions in that marketplace is just an example of the consistency of our operating model. And so I would say that we have the capabilities today to service members. I would say it's just the continued expansion of our procurement process that we'll have to continue to look at as we go from state to state.

Operator

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

Stephen C. Baxter - *Wolfe Research, LLC - Research Analyst*

This is Steve Baxter on for Justin. A question on the services business. In the release, you spoke of a mismatch of the timing of sort of some of the lower revenues in that business and are moving the associated operating expense during the first quarter. Can you help us quantify those costs and how you expect them to trend down throughout the balance of the year to kind of get comfortable with the earnings ramp that's implied in guidance for the rest of the year in that business?

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. Let me give some context around the quarterly progression on HCS without getting into too many specifics. First of all, it's important to note that it's assumed that the Kindred and Curo transactions will close in the latter half of the year, so that -- there's some back-end weighting there. You mentioned the clinical optimization, and that's an important element, which is the revenue goes away, but it takes a little bit of time to remove those costs. I'd rather not quantify that here, but it has a meaningful impact on our quarterly progression. There's also a few onetime expected items on the provider side related to the Conviva acquisition and writing off certain intangibles and the like. So there are a number of things that are assumed in the guidance that results in that quarterly progression. But as I said in my remarks, we feel good about where the numbers are today.

Stephen C. Baxter - *Wolfe Research, LLC - Research Analyst*

Okay. And then a question on the small group market, like some of the discussion there around trends and seeing some increased success with some of the level-funded products you guys are targeting there, coupled with the stop-loss. I was hoping you guys could expand a little bit on what you're seeing there in terms of employer interest in these alternative funding products?

Brian Andrew Kane - *Humana Inc. - CFO*

Well, as we said, they really are, I think, resonating in the marketplace, this notion of effectively an ASO product with a stop-loss wrap. We've seen meaningful growth in that area. And I think the financial performance is also really starting to perform, which we like to see. I think it's an attractive offering that gives our employers flexibility and really tailors the product to their needs. And so I think that's why it's resonating in the marketplace.

Amy K. Smith - *Humana Inc. - Vice President of IR*

Thank you. (Operator Instructions) Next question, please?

Operator

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



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

A question about the group MA market. You guys have been growing that pretty nicely. But I think you said that in this quarter, most of the increase was related to sale to existing group accounts, which I assume means commercial accounts where you are selling in the group MA side of things. So if that's the case, it looks like also your larger account ASO business is in decline. So is there any negative implication of those 2 trends that you're selling well with [your own] customers, but you're seeing some attrition in that customer base? And what is kind of, therefore, the long-term outlook on group MA?

Brian Andrew Kane - *Humana Inc. - CFO*

Kevin, so what we meant on that comment about group MA is that in an existing group MA account, where we materially expanded the amount of lives that were covered in that particular group MA account and put more members into the group MA program rather than Medicare Secondary. So that's -- it's unrelated to the commercial side. We also won some nice smaller accounts as well and added organic growth in our existing business there, too. So really, the group MA business is performing quite well, both from a membership perspective as well as from a financial perspective. Obviously, the ASO commercial business, there are some opportunities to cross-sell and the like. That's not where we've been particularly focused, given the fact that we don't have a very large presence in the commercial ASO space. But I think we've been -- and the team has been very successful at going out and finding new accounts and competing where it makes sense from a financial perspective on some of these larger accounts. And so like I said, we feel very good about how the group MA business is progressing.

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

So are you saying a sliced business? Or are you saying MedSup is turning into MA?

Brian Andrew Kane - *Humana Inc. - CFO*

It's called Medicare Secondary. It's effectively a MedSup product that group accounts have the option they could go through a group MA product or more of a traditional sort of supplementary wrap. So -- but in this one instance that I was referring to is that they're putting them into this -- into our group MA product because it's compelling, both from a financial perspective for the account and also offers very attractive benefits for the beneficiary. So it's really a win-win.

Operator

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

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

I just want to talk broadly about -- or ask a question broadly about the benefits of a retail partnership and what you think would be the benefit to Humana and your -- specifically the Medicare Advantage lives to have a more expanded retail partnership.

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

We pride ourselves on partnerships in general. I mean, we've been successful both in providers, retailers, such as our Part D products that we have, along with other people that are part of the health care system. A retailer provides, I think, some interesting access points for customers that are more convenient. We would think that it would be closer aligned to more of a primary care clinic, accented by some lighter care services that could be a referral source for that. But -- and then, obviously, any kind of distribution opportunities that would be created from that. In our Walmart relationship that we've had long-standing, we've had a very successful Part D relationship with them. In addition, we are part of their distribution,



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insurance distribution channel that they have and actually manage a lot of that for them. And we see that being in the stores is helpful and convenient for the customer. And in addition, it just drives further traffic both to the clinical models and in addition to the distribution model.

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

And I'm sorry, just to follow up, Bruce. You've been selling -- and I know you've got folks in their stores. Is there meaningful growth in Medicare Advantage as part of that relationship? Or do you think there's more opportunity outside of the Part D to actually generate new sales leads and growth in MA as well?

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

We have a -- our MarketPoint salespeople are in the stores that would be selling both. They would be selling MA and Part D as a result of that. So that's just another access point for people to -- and as they're in the store to learn more about the benefits of MA and Part D. And so we do have our distribution channel inside the store there, and it's just -- and their customers are making decisions around Medicare.

Operator

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

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

I'm going to ask you about capital deployment. It looks like you've laid out pretty well what you're going to do with the share repurchases you've done already and will do for the rest of the year. I guess, when I think about what you're doing with home health and hospice, my original understanding, and I might have been wrong, was that the Kindred at Home vehicle would be the vehicle to go forward, and the primary focus would be on that self-funding its growth. Now I know you've stepped up and done this Curo, which may have been just an opportunistic one. But do you see -- once you put those 2 together, has that vehicle now got the capability to self-fund what it's going to do in the future? Or do you see more capital commitments there? And I think 2 other areas you mentioned for capital, even in the prepared remarks, MA geography expansion and capabilities expansion in physician acquisitions. Can you give us a sense of what might be the types of size and scope of capital outlays in those areas and whether you think you'll see something this year? Are there projects that you're actively considering at this point?

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. A.J., let me take that one. So I think on other capital in Curo and Kindred, we feel pretty good about how that company is now positioned in terms of the capabilities that it has. Obviously, we'll always look for assets that make sense. Our sense today is that, that business will be able to self-fund as they look for additional opportunities in the home health and hospice space. But that said, we have a very good relationship with our private equity partners. And if something makes sense, we would certainly look at it. But I think it's fair to say that from a sort of material capital deployment perspective, as we sit here today, the \$1.1 billion that I mentioned is a number that I think we can feel pretty good about. As it relates to other potential deployment, it really -- I mean, we're obviously looking at a number of things. I wouldn't be prepared today to commit to something specific in terms of size. We'll look at small transactions, for example, the FPG transaction versus we'll look at larger deals as well. It really, really depends. But I am not prepared today to commit to a specific capital spending levels. But whatever we do, we're pretty disciplined about how we deploy that capital. I think we're judicious about the optimal forms to get that capital. I think the Kindred deal is an example of that. And so we'll always look to deploy our capital optimally.

Operator

Your next question comes from the line of Dave Windley with Jefferies.



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

It's Dave Styblo in for Windley. I just want to come back to the retail comments that you guys had made about early indications of some cost trends that you see there that are looking favorable. I think you had spiked out the lower pre-authorizations, and then, of course, flu was a little bit less than you had guided to. Can you flesh that out and just remind us what the guidance is for? Is that really just less flu and some prior period development? Or are you factoring in any of the early indications from the pre-authorization trends? And any other data points on medical utilization that you could flag for us would be great.

Brian Andrew Kane - *Humana Inc. - CFO*

Sure. So I would say a couple of things. There is some beneficial flu impact in there, but there's also really, focused on the first quarter, some of the early indicators of a positive medical utilization that we've seen. As I mentioned, we haven't assumed that it carries forward. And I think we've been very reasonable in the amount of benefits we've recognized in the first quarter and in our guidance. As I mentioned, we just want to be, again, very prudent about the claims experience, recognizing that we're still early in the year. But particularly on the inpatient side, we are seeing favorability in our authorizations. And I would say the other service categories are running fine as well. And so again, I think it's a good start to the year. We feel very good about how we're positioned from a medical cost trend perspective, particularly for the retail side and the group side. I'm sorry?

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

Okay. And in pharmacy trends, I know you mentioned the in-patient pre-authorizations. Anything on pharmacy...

Brian Andrew Kane - *Humana Inc. - CFO*

Yes, pharmacy, I would say, also running well. Scripts are largely in line with our forecast, maybe slightly better, might be slightly lower than we had anticipated. There are some different mix issues and the like that impacts the cost. But overall, I would say it's -- we're running in line or perhaps slightly better.

Operator

Your next question comes from the line of Gary Taylor with JPMorgan.

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

If I could just follow up a little bit on that last question. One of the things we've noticed from the hospitals this quarter is fairly large jump in acuity growth in the first quarter, probably more noticeable than any real volume pickup. Could you describe what visibility and/or lag you have between seeing inpatient census and pharma claims versus actual acuity of those claims? And I guess, what I'm trying to get at, is there some lag between what you might be seeing on your pre-authorizations versus the actual acuity that comes through the claims once fully quoted?

Brian Andrew Kane - *Humana Inc. - CFO*

We can see preliminary data on that. I think it is fair to say that there is some higher acuity or what we call cost per admission, what we're seeing in the data. It's still something that we're analyzing. And part of it may well be the fact that because more of the admissions are moving to outpatient as opposed to inpatient, what's left is a higher acuity level. But that's something that we are analyzing. But again, overall, from an overall utilization perspective, both rate and volume, we feel good about where we are.



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Operator

Your next question comes from the line of Zack Sopcak with Morgan Stanley.

Zachary William Sopcak - *Morgan Stanley, Research Division - VP on the Healthcare Services and Distribution Team*

I just wanted to go back to the comments earlier on the final rate notice and the opportunity to do supplemental benefits. Can you talk about your capabilities there? Any capabilities you may need to add and what the opportunity you see is over the next couple of years if that remains?

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

Yes. One of the things about the supplemental benefits, the details are still coming out. So what they are and how they work are going to continue to need to be refined. But in general, over a number of years, we've been working on supplemental benefits through both connecting with charitable organizations and, at the same time, incorporating it in our process and workflow. At this time, I don't think there's anything that I would say that we couldn't deliver through partnerships and other means that would need to be altered in any fashion. I mean, we feel very, very equipped and capable as we look at both our clinical programs and the relationships in our communities.

Operator

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

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

I wanted to ask a general question just to help us think about integrated care opportunities. Can you give us a general sense of sort of the mix of medical costs, sort of percent inpatient, outpatient, drug? And sort of pursuant to that, I'd be curious to know what sort of hip and knee surgeries represent as a percent of total and how much the bundle of care initiatives can save in broad strokes? Any kind of rule of thumb there would be helpful.

Brian Andrew Kane - *Humana Inc. - CFO*

Yes, I'd rather not comment on specifics like that. As we've said in the past, inpatient is probably 25% to 30%; outpatient, another 25%; physician, I think, is 15% or 20%, and we use some capitation in there; and pharmacy is the rest. But I think that's broadly what I would point to. So call it 25% to 30% inpatient; and then call it 20% outpatient; 10% pharmacy; and then the rest sort of other little bunch of different payments we make to our providers and the like; and capitation. So that's how I'd sort of break out the -- or frac out the medical spend. But as it relates to specific hip and knees, I'd rather not comment on that. But I would just say, more broadly, we're always looking for opportunities to engage with our providers in a value-based way, and we think bundles is an interesting opportunity and something that we continue to pursue.

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

We have a number of programs in the test-and-learn phase in different markets, and we have found to have significant benefits both on outcomes and on costs. And we'll continue to pursue those on a more condition-based.

Operator

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

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

Has Florida made any commitment to you to getting you to critical mass on the new product? As I look at the auto assignment algorithm, it says that it won't favor any one plan, but that's not really clear if that means round-robin or if it would at least get you to a minimum critical mass? And then does this win influence how you think about the need to go out and buy mixed books in order to continue your LTSS growth strategy?

Brian Andrew Kane - Humana Inc. - CFO

Why don't I take the first question and then hand it to Bruce. With regard to the sort of allocation, the algorithm methodology, there are some parameters laid out in the proposal. We feel good about the sort of the, what I'd call, the material upside relative to our current revenue and membership. There could be some movement there, but I think we feel pretty good about how the methodology is laid out. Obviously, we got to get through all the protests and the like, but that's really what I'd say on that front.

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

And the second front around the acquisition and being able to build additional capabilities. We feel really good about the capabilities that we have from a clinical point of view and from a service point of view for the Medicaid population, both in the TANF area and in addition in the long-term support service area combined with the Medicare Advantage duals opportunity. Where I think we would constantly look to see if we needed additional capabilities would be in the procurement area where there's already an existing relationship in that particular state or market. And the barriers to entry are much greater outside of just the core capabilities you have. And so it would be more of a procurement review as opposed to a capabilities side.

Operator

Your next question comes from the line of Hima Inguva with Bank of America.

Hima B. Inguva - BofA Merrill Lynch, Research Division - Director

Just looking at the funding map here, you did Curo for \$1.4 billion and Kindred for \$800 million, and then you're guiding towards \$500 million repurchases in the back half of '18. And if you use \$1.1 billion of parent cash, should we expect you to tap the long-term debt markets anytime soon?

Brian Andrew Kane - Humana Inc. - CFO

I'd rather not comment specifically on our financing plans. Obviously, we'll ensure that we're adequately capitalized in a sufficient liquidity. We also have, as you know, a large commercial paper program. But again, just to make sure that you have the math right, it's \$1.1 billion for both Kindred and Curo. So there's a debt financing component that will be done at the asset specifically. It will be nonrecourse to Humana. And so that's where the \$1.1 billion is. Effectively, the \$800 million we talked about before and approximately \$300 million for Curo, that could move a little bit plus or minus, but that's probably how we're thinking about it. But we have sufficient capital to execute what we've laid out.

Operator

There are no further questions at this time. I'd now like to turn the call back over to Bruce Broussard.



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

All right. And thank you again for our investors supporting the organization over the period of time you've been with us as an organization. It means a lot to us. And of course, it's -- we couldn't do what we've done this quarter and throughout the year without the support and dedication of our 50,000 associates, and I thank them. So thank you. And everyone, have a great day.

Operator

This concludes today's conference call. You may now disconnect.

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