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HUM.N - Q3 2025 Humana Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day and thank you for standing by. Welcome to the Humana third quarter earnings call. (Operator Instructions) Please be advised that today's conference is being recorded.

I'd now like to hand the conference over to Lisa Stoner, Vice President of Investor Relations. Please go ahead.

Lisa Stoner - Humana Inc - Vice President, Investor Relations

Thank you, and good morning. I hope everyone had a chance to review our press release and posted remarks, which are available on our website. We will begin this morning with brief remarks from Jim Rehtin, Humana's President and Chief Executive Officer; and Chief Financial Officer, Celeste Mellet. Following these remarks, we will host a question-and-answer session, where Jim and Celeste will be joined by George Renaudin, Humana's President of the Insurance segment; and David Dintenfass, President of Enterprise Growth.

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 2025 earnings press release as they relate to forward-looking statements, along with other risks discussed in our SEC filings. We undertake no obligation to publicly address or update any forward-looking statements in future filings or communications regarding our business or results.

Today's press release, our historical financial news releases and our filings with the SEC are 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. Any references to earnings per share or EPS made during this conference call refer to diluted earnings per common share.

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

With that, I will turn the call over to Jim.

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Thanks, Lisa, and good morning, everyone, and thank you for joining us today. Before we get started, I just want to take a second to acknowledge the tragedy that occurred here in Louisville last night, it's had quite an impact on the community, and our thoughts go out to the community and all the families who are impacted.

With that, let me turn to the quarter, and let me hit the headlines. As you have already seen, we delivered a solid third quarter in line with our expectations. Our third quarter medical cost trends continue to be in line with expectations, and we also continue to anticipate our full year 2025 EPS outlook of approximately \$17. We remain committed to achieving individual MA pretax margin of at least 3% over time, and the external environment continues to evolve largely in line with expectations, and we are executing against our plan.

I'll now briefly describe the progress we are making operationally. And as usual, I will frame my comments today around the four drivers of our business. The first of those is product and experience, which drive customer retention and growth. Second is clinical excellence, which delivers clinical outcomes and medical margin. Third is highly efficient operations. And fourth is our capital allocation and growth in CenterWell and Medicaid. I'm going to spend most of my time today on product and experience as well as clinical excellence.

Let me start with our Medicare product and experience. So first, I want to emphasize that it's very early in AEP. We have roughly two weeks of incomplete data. And while we will provide a sense of what we are seeing, this is very much subject to change.

Second, I want to reinforce how we think about growth. Our focus is on maximizing customer lifetime value and customer NPV. That's our focus. The way we do that is delivering an exceptional experience that fuels member retention. Other key growth levers like benefit design and member and product mix and channel mix are all tightly aligned with our operational capacity so that we can absorb, onboard and serve members in a way that maximizes lifetime value in NPV.

Third, I want to reinforce again that we are confident in our pricing, and we're pleased that we expect to return to growth. We will take as much growth as possible from improved retention. This is unquestionably desirable growth, and we welcome new sales. However, we are prepared to take targeted actions to slow new sales if we reach the point where the volume risk is negatively impacting member experience.

We do recognize that you want us to provide a specific growth target. We do not think that focusing on a net growth target is the right metric because as I just shared, growth through retention is desirable, and we will take as much of it as we can. We also will not give a specific number around new sales targets because the amount that we can absorb is dependent upon member product and channel mix.

So now as to what we are seeing, new sales are at the high end of the range -- the high end of the anticipated range of outcomes that we expected in AEP. Channel mix has meaningfully improved relative to prior years. We have greater volume in our own distribution channel with select high-performing partners and in digital distribution.

This channel mix tends to be correlated with customer segments that have a higher lifetime value and are more engaged. We are also seeing favorable product mix, including higher than initially expected sales in plans with 4 stars and greater. We are not seeing outsized sales in areas where competitors have exited plans. We are experiencing significantly reduced Humana plan-to-plan mix with plan-to-plan sales down year-over-year.

We believe that this is likely an early indicator that our stable benefit strategy and changes to our customer service approach are working to reduce voluntary attrition, though we need more time to validate this assumption. So while it's early, we feel good about what we are seeing so far in AEP. And as we have said previously, we will continue to monitor new sales volume and manage it dynamically. We are prepared to take further mitigating actions as we did heading into AEP if it appears that new sales will put member experience at risk.

We do recognize that there's a lot of interest in our overall growth strategy and the ongoing AEP. So I'm pleased that David Dintenfass will join Celeste, George and I for Q&A today. David joined the company nearly two years ago as President of Enterprise Growth. He came to Humana with 30 years of experience across a range of industries, including financial services, where he was focused on customer segmentation, acquisition, driving an experience that fuels retention to ultimately drive sustainable and profitable growth. David's consumer-focused experience and perspective has been and is instrumental to our journey to become a consumer healthcare company.

Now to turn to clinical excellence, I will focus on Stars performance. Just to recap the key messages from our 8-K and audio file released in early October, we are disappointed but we are not surprised by our bonus year '27 Stars results. The results are consistent with our baseline planning scenario and our outlook remains the same as we previously communicated at our investor conference in June.

We did see operational gains in Q4 of 2024 that have continued into 2025, and we feel good about our operational progress this year. More specifically, in our current measurement year, bonus year '28, we are seeing meaningful year-over-year improvement across the vast majority of metrics. We also continue to see week-over-week improvement as recently as October, and we are showing 600,000 more gaps closed year-over-year as our momentum continues to remain steady.

Given the Stars program is measured on a curve, it would not be prudent to share additional results at this time. However, once the hybrid season is complete in the second quarter of next year, we will provide some additional visibility into our final operating results. However, we will not speculate on thresholds. All in, the takeaway remains that we continue to be confident that we are on the right track to return to Top Quartile Stars results in bonus year '28.

Now, I'm going to turn to our highly efficient operations where we are making meaningful progress. I'm going to share a couple of examples. We recently partnered with Genpact to outsource elements of our finance capabilities. This will both improve our capabilities and it will reduce cost. We also have a newly introduced agentic AI platform, which is helping deliver capabilities like Agent Assist that help our call center advocates and agents focus on supporting our members. This is helping to improve call accuracy and deliver faster response times, which drive better outcomes and experience.

Collectively, we expect these items to generate greater than \$100 million of savings over a few years while also improving the quality of our operations. These changes are a small sample of our multiyear transformation, which will include near-term tactical cost programs, but also longer-term efforts that change how we operate.

Now, turning to capital allocation. We have freed up capital by selling a non-core asset, the Enclara Pharmacia business and are working to sell additional non-core assets. We also agreed to deploy capital to a deal that is expected to close this month in Florida, The Villages Health, which

provides primary and specialty care services at the fastest-growing retirement community in the country. We also continue to feel good about our CenterWell Pharmacy strategies. We continue to develop our direct-to-consumer capability, and we are also moving into direct-to-employer opportunities.

So in conclusion, we are pleased with our solid performance year-to-date, and we continue to have confidence in the full year 2025 outlook. We feel good about our pricing and the outlook for AEP 2026. Bonus Year '27 Stars results were disappointing but consistent with our expectations and the outlook for Bonus Year '28 Stars continues to trend in the right direction, and we remain confident in a return to top quartile results.

With that, I will turn it over to Celeste for a few remarks before we go to Q&A.

Celeste Mellet - Humana Inc - Chief Financial Officer

Thank you, Jim. Our third quarter results reflect solid execution and underlying fundamentals, including membership and patient growth, revenue and medical cost trends that continue to develop consistent with our expectations.

In addition, we experienced some favorability in the quarter, which enabled higher than previously anticipated investments. These investments were focused in areas that both accelerate our transformation and where we have seen strong returns to date, such as Stars and clinical excellence as well as in areas such as network management, which position us well for the future.

We are pleased that our year-to-date performance and outlook support reaffirmation of our full year adjusted EPS outlook of approximately \$17, while also making an additional approximately \$150 million in incremental investments, including the higher investments in the third quarter. As a reminder, we included the Doc Fix in our guidance for '25. If it is not implemented for '25, we may invest all or a portion of the onetime savings into items that position the company for long-term success.

Now, turning to the balance sheet and capital deployment. I would first like to comment briefly on the days in claims payable or DCP metric. Our DCP changes, both sequentially and year-over-year were largely driven by items that are generally timing in nature and not related to claim reserve levels, including changes in processed claims inventory and provider payables.

And as previously discussed, the year-over-year comparison was further impacted by changes related to the Inflation Reduction Act. Importantly, the estimate for claims Incurred But Not Reported, or IBNR, remain largely consistent in these periods, even with our year-over-year decline in individual MA membership. As we have previously shared, we believe this serves as a better indicator of the consistency in our reserve methodology and the relative strength of our claims reserves.

Now, moving to our ongoing efforts to increase the efficiency of our balance sheet. As Jim mentioned, we completed an asset sale during the third quarter and are continuing to pursue the sale of additional non-core assets while also making significant progress on capital optimization, the details of which we will share when we complete the execution.

With respect to capital deployment, we will remain prudent in our near-term approach, taking a balanced view to evaluating capital investments and returns. Accordingly, our '25 outlook does not contemplate additional share repurchase activity beyond the buybacks in the second quarter, which offset dilution from stock-based compensation.

From an M&A perspective, we see significant opportunities to take advantage of the current market dislocation and acquire attractive small to midsized provider businesses, such as our pending acquisition of The Villages Health, while remaining focused on managing our debt-to-cap ratio. Our debt-to-cap ratio at the end of the quarter was 40.3%, down from 40.7% as of June 30, and we continue to target a ratio of approximately 40% over the longer term.

Looking ahead, I echo Jim's message that we feel good about our '26 pricing and the outlook for AEP. In addition, we are executing on the plan that we laid out at our Investor Day in June, managing the levers within our control with a focus on delivering best-in-class clinical excellence,

transforming the company to enable scalable growth and driving enhanced operating leverage. We believe that these efforts will allow us to return the business to its full earnings power while driving better outcomes and experiences for our members, patients and associates.

With that, I will turn the call back to Lisa to start the Q&A.

Lisa Stoner - Humana Inc - Vice President, Investor Relations

Thanks, Celeste. Before starting the Q&A, just a quick reminder that fairness in those waiting in the queue we ask that you please limit yourself to one question. Operator, please introduce the first caller.

QUESTIONS AND ANSWERS

Operator

Andrew Mok, Barclays.

Andrew Mok - Barclays Services Corp - Analyst

I understand that it's too early to share any membership growth projections, but I was hoping you'd be able to offer a framework for the level of new growth that you're comfortable with before it starts to impact your operational capacity. And based on your prepared remarks, are you already starting to pull some of those levers you mentioned?

David Dintenfass - Humana Inc - President - Enterprise Growth

So this is David Dintenfass. First of all, it's good to be on my first Humana earnings call, I'm really glad to be part of this team. So Andrew, let me just take a step back and I'll answer your question, but let me just make sure the approach to growth is really clear, and Jim touched on this. Our focus is increasingly on the lifetime value and NPV of our membership. And so growth is an outcome of that, but also our current membership and retaining them is a primary objective.

How do we do that? How do we drive lifetime value and our margin objectives that we shared at Investor Day? So number one, we have to have appropriate pricing. We have to price for risk, and that is a very collaborative process working with underwriting.

It goes to number two, which is that there's been a bit of a cycle, right, which is why there's all this question about is growth good or is growth not good. And that really comes from an approach that says, we're going to grow on plans that, frankly, don't have a very attractive margin. They're attractive for the customer. We bring them in and then those plans can degrade over time.

The problem is if you overgrow in those low-margin plans, you say growth might not be good. We don't think that's the right long-term strategy. We know that our customers don't want their plans to be changing constantly. So instead, what we've done is try to stabilize the margin across all of our plans. So that no matter where growth might come from, that growth is attractive for the long term.

That goes to number three, which is a focus on the customer. So increasingly, we're saying, how do we design our plans, and we're saying, let's start with what the customers most want, which is stability, especially on their core medical benefits, and we've tried to provide that this year. Now, this is in the context that we've had two years where we've been cutting benefits, and we've also exited markets where we didn't think the margin profile is where we needed to be. That's put us in a really good position this year to follow the customer and have more stability.

And that goes to number four, the final part, which is what we talked about at Investor Day and Jim touched on as well, which is we need to differentiate the experience in the long term. Product is important, but it's only part of the equation. If we have products that have appropriate pricing for risk, then it's about attracting members, retaining them, getting to do all the things clinically and on Stars that drive true lifetime value.

So with that approach, you asked how much growth can we handle from an operations perspective. We are working through that very dynamically. We're not sharing a number in part because we are working on operations. The principle we have is that, first of all, let's make sure that all of our members have a great outcome, and we're retaining them at a better rate. We committed to much better retention at Investor Day, and we are fully committed to make progress on that next year.

But as far as new membership, we want to make sure that every new member comes in has a great experience as well and that we're able to retain them. And we're working very dynamically across all parts of the operation to make sure that we're balancing the new member growth through our ability to consume the volume.

Operator

Ann Hynes, Mizuho.

Ann Hynes - Mizuho Securities Asia Ltd - Analyst

I know you don't want to give a growth number for MA membership, but can you give an update on your diversification strategy? I know you're trying to shift some members out of H5216. Can you give us an update how that strategy is going?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. Let me touch on that. And I'm going to start by just being very clear about what our intent is around the diversification strategy. What we are trying to do, first and foremost, is deconsolidate 5216. So I think as many of you are aware, roughly 43% to 45% of our membership has been in 5216 over the last few years. That is putting too much risk in a single contract. We should be thinking about this from a portfolio standpoint. We should have a portfolio of contracts. We should have reasonably even membership across that portfolio so that if any one contract does not perform in a given year, there is less risk to the entire business.

So that is goal number one. And we feel good that we've taken a step in that direction. It's not something you can fully accomplish in a year, but we feel good that we have taken a step in that direction, and you should see us take incremental steps really over the next two or even three cycles of product.

Along with that, as you deconsolidate 5216, of course, you're going to look to contracts where you have 4 and 4.5 stars to try to create that balance. And so that is what we have done this year. We've looked to some of our contracts that have 4 to 4.5 stars to create that balance.

And right now, we feel good that we are making real progress. We are not at a place after two weeks of data that we're going to want to talk about numbers or get super specific about it. But this was always part of the plan, and we have made good progress from what we can see in the first couple of weeks, and we'll share more as we better understand what that is -- where that's going to land in January.

Operator

Justin Lake, Wolfe Research.

Justin Lake - *Wolfe Research LLC - Analyst*

Just a quick follow-up first. You talked about membership growth at the high end of expectations. Can you share with us what that expectation range is on new membership?

And then my question is, can you give us an update on your percentage of MA individual membership in fully capitated agreements this year? And what do you expect it to be next year? And are you seeing any pushback from providers in terms of giving you these lives back because they're having economic issues making a margin on these benefits?

James Rehtin - *Humana Inc - President, Chief Executive Officer, Director*

Yeah. Hey, Justin, let me hit the first half of that, and then I'm going to hand it to George for the second half of that. On the first half, and I know you expect this answer, but we're not going to give a number. I will just go back to why we're not going to give a number. We are truly looking at multiple things. We are looking at member mix. We are looking at product mix. We are looking at channel mix because each of those impact our operations in slightly different ways.

We are also ramping up operations because that's what you do when you're headed into a solid growth year. And so we are looking at all of those dynamics, and we will make adjustments along the way based on the collective set of things that we're looking at.

And when we say that we will make adjustments, we made adjustments going into AEP. I think people recognize that. There have been reports out on that fact. And we will continue to monitor in AEP, but we'll also be looking at, hey, do we want to think about OEP differently? Do we want to think about rest of year differently? So all those factors are in play, and it just makes it really hard to say, hey, here's a number at this point in time.

With that, I'll hand it off to George.

George Renaudin - *Humana Inc - President - Insurance*

Thanks, Jim. So we have taken measures such as taking Part D risk back where we saw the IRA shift cost in a very significant way. As David mentioned, we have been reducing benefits for two years to reset the product so that it is a product that we and our value-based partners want to grow. And so we've taken those actions.

In addition to those two major actions, we're also -- because of the Stars program, we are also implementing Stars mitigation programs that mitigate the impact of the Stars revenue hit based upon their success and their performance in the Stars program.

So we are taking very specific mitigation tactics, working with our value-based partners, looking for ways to help mitigate any headwinds that they face, work with them every day. We are out in the field talking with them about contract changes that are necessary, and we feel good about the progress we're making there.

So I would just remind you that we've taken actions in the past couple of years. We also, in addition to that, have a Stars mitigation program that's going on. So when you combine those factors, we feel good about where we are with the value-based partners.

Operator

Stephen Baxter, Wells Fargo.

Stephen Baxter - Wells Fargo Securities LLC - Analyst

And I know you're not providing 2026 guidance today clearly, but would love if you could give some initial thoughts on the type of margin that you'll assume for the new to Humana sales growth. Is it reasonable to think that, that would be comparable to the 2% roughly you're targeting ex the Stars headwind for the overall book? And then, obviously, I'm sure it's dependent on mix, but just based on what you know today.

Celeste Mellet - Humana Inc - Chief Financial Officer

Yeah. So as Jim said in the opening remarks, most importantly, we're on track for the plan we laid out at our Investor Day for 2028. And it is too early to provide guidance for 2026, particularly given where we are in AEP. As we think about the margin of the new members to some extent, it will be driven by which contracts they are sold on. So obviously, those that sell on to the 4, 4.5-star contracts will come in at a higher margin. But in aggregate, we continue to expect that our margin for individual MA, excluding Stars would double in 2026 over 2025, and then we'll continue to make progress in 2026.

So it's going to be really, again, like how it comes in is a question of what contracts they're sitting on. But based on all the work we did going into AEP in terms of our product design and our channel mix, we are happy with the margin we're seeing and expect it to be relatively consistent with our overall margin, although some will be above and some will be below.

Operator

Ben Hendrix, RBC Capital Markets.

Ben Hendrix - RBC Capital Markets Inc - Assistant Vice President

I was hoping to hear a little bit more about some of your Stars recovery efforts. You noted last month that the latest round of scores did not fully reflect some of the improvements that you've implemented. And now that we've seen how 5216 has performed across the member experience and chronic conditions measures. Can you talk a little bit about the measures or general categories where you feel like you've made the most tangible progress versus the latest data?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. So the operations in this current year are obviously focused on HEDIS and patient safety metrics. And as I kind of referred to in my opening remarks, we're actually seeing strong progress pretty much across the board in those metrics.

And look, again, we remain confident, optimistic, positive about the operating progress that we've made across those range of metrics and the position that will put us in next year as we obviously have another set of metrics that we have to work through in the first and second quarter of next year around CAHPS and HOS and the TTY metrics. So right now, based on the things that we can control this year, it's been broad improved performance that makes us feel good about our overall trajectory.

Yeah, George, do you want to add?

George Renaudin - Humana Inc - President - Insurance

Yeah. Jim, the only thing I would add to that is part of the strategy that David laid out is including the stability. Stability will also help us as we continue to make progress in our termination rates and as well as how our members perceive us through the experience we're delivering through stable benefits. So those are also positive factors to contribute to not just the administrative measures and the health outcome measures that Jim mentioned, but overall to the CAHPS as well.

Operator

Kevin Fischbeck, Bank of America.

Kevin Fischbeck - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

I guess you mentioned three things, I guess, that were giving you comfort in the, I guess, quality of the membership growth that you're seeing so far. I think better channel mix, fewer plan-to-plan sales and then, I guess, lower voluntary disenrollment. Can you just kind of remind us what the MLR or margin differential is between good channel, bad channel, plan to plan, new to plan and then retention versus new membership so we can kind of better think about what it means to have those buckets growing faster? And then just on the disenrollment comment, you talked about better enrollment. Is it back to normal? Is it better than normal that you're thinking about?

James Rehtin - *Humana Inc - President, Chief Executive Officer, Director*

Yeah. Let me touch on two things. And then, David, if you have anything you want to add, jump in here. So we're not going to give explicit margin information here, but let me give you a little bit about the dynamics across the channels that we watch that make us feel better.

The biggest one is actually going back to NPV and long-term value. We see better attrition rate in some channels than others or retention. So that is one piece. We have a different cost of acquisition depending on the channel. So that is another piece that we look at. And then, we tend to find that we have different engagement rates. So when you think about things like Stars, accurate diagnosis, individuals managing their medical care, we see a different engagement rate across channels. And so we look at all of those things when we're then trying to understand what the economic impact is of any given channel. So those are kind of the pieces that we look at.

And then the one other thing I do want to touch on, we do not know right now that we are seeing better retention. We just don't have the data, right? The data is not available at this point in the year. But when we see reduced plan-to-plan sales, that tends to be correlated with better retention. So we don't know what that retention number is going to be right now, but the reduced plan-to-plan sales is correlated with better retention, and we are seeing reduced plan-to-plan sales year-over-year. So those are kind of the components.

Did I miss anything there, David, do you want to throw in?

David Dintenfass - *Humana Inc - President - Enterprise Growth*

Yeah. I think you got it exactly. I don't know if you mentioned, I think there's also different complaint to Medicare Stars outcomes we see by channel. This has been a big factor, especially if you look at the broker channels, and you've seen us take some actions. That's largely based on the quality of how those customers are experiencing that relative to how the Stars outcomes are going to look.

Operator

Joshua Raskin, Nephron Research.

Joshua Raskin - *Nephron Research LLC - Analyst*

I guess I wanted to focus on this LTV and NPV focus that you're talking about. I guess, is this long-term value member as the North Star a strategic shift for the organization? Meaning, are you willing to accept different margin levels in, say, your insurance segment because you can create more margin through CenterWell? I just want to understand how this impacts long-term margins and if this is, in your view, a shift in how you've thought about things in the past as an organization.

David Dintenfass - Humana Inc - President - Enterprise Growth

Yeah, Josh. I think it's an evolution. I think this has always been part of how the company has thought about this. But as I said, part of this question about is growth good, is it not? It comes down to the margin of that growth. And what drives lifetime value? You need to have margin to drive lifetime value. You need to have retention to drive lifetime value.

And we are trying to get to a place where all of our products on the insurance side have a reasonable margin. Trying to get out of the cycle of having low-margin products that are high growth and then you worry about overgrowing in them and then having to drive margin in the out years. We don't think that's great for our sustainability. We don't think it's great for the customers.

You also brought up the enterprise value. That's absolutely part of the play here. We know that integrated health is a big part of what we think differentiates Humana and looking at the lifetime value of a customer across the entire enterprise is becoming how we look at all of our activities.

George Renaudin - Humana Inc - President - Insurance

Hey, Josh, if I could just add one other thing to that is as the long term here, I can just tell you that what I've seen over the past couple of years, and we've actually talked about this directly during the investor conference, which is we're taking a multiyear view towards lifetime value. And that longer-term view is having us approach products in a different way in this way that leads to better stability and I think better long-term value for the company.

Celeste Mellet - Humana Inc - Chief Financial Officer

Can I just add, to pile on here. While we are focused on LTV and NPV, we recognize can't have a long term without the short term. So we are balancing the long-term value, the long-term value creation with delivering on the next year or the next quarter. So we are balancing those things. We're not just looking three and five years out.

Operator

AJ Rice, UBS.

AJ Rice - UBS AG - Analyst

Just maybe on the MA market overall, there was some data out from CMS early before open enrollment that they were forecasting the market might not even grow this year. I wonder -- I know you're not commenting on your specific situation, but do you have any feel for where the overall market is? You said in your comments that where there's planned exits, you're not picking up disproportionate numbers of those. Are we finally at an area where the market has been disruptive enough that some people are just choosing fee-for-service again? Is that possibly happening?

And then maybe if I can just ask you on your mitigation efforts during this open enrollment. I believe there's some notice period on commission adjustments that would probably make it tough to do that during the open enrollment. So I'm just trying to understand what are the mitigation factors that you can push on if you see too much growth in a particular area?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. Hey, let me hit the first of those, and then I'll hand it over to David for the question around plan exits and commission growth. On the market growth, I would just point out a few things. One, the forecasts are never right, right? Like they're never right. You can go back and you can look at

the five, six, seven years historically, they're never right. Second, we don't see a reason that the market should grow materially different than the way it did last year or the way it has historically.

And so our expectation is it's going to be somewhere in the mid-single digits growth. And again, this is forecasting. So CMS is not going to be right. We're not going to be exactly right. But we don't see what the big difference is from last year in terms of where the market is at as a whole when you look across all plans. And so our expectation is growth is going to look somewhat like last year at the end of the day. And we will obviously know come January, February, but that's kind of what our expectation is at the moment.

David Dintenfass - Humana Inc - President - Enterprise Growth

Yeah. And AJ, the second part of your question about commissions, you've all seen we've already decommissioned a number of plans. That is a potential lever, but there are other levers. Keep in mind that we own a big part of our own distribution, including our own marketing. So we're able to do other levers beyond commissions if we want to have volume match our operational capacity in the back half of the year.

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

And actually, I'm going to go back to the plexes real quick. The bottom line on the plexes, we don't know if people are going to fee-for-service or if they're going to other plans. But what I would just point out, and we've said this a few times, we are at parity or below the richest plan in the market in many, many geographies. And it just so happens that in a lot of the plexed geographies, we tend to be below or behind other plans in terms of benefit structure. And so that could be playing into it. But again, we don't have enough data to know that for sure.

Operator

Elizabeth Anderson, Evercore ISI.

Elizabeth Anderson - Evercore Inc - Analyst

I was wondering if you could comment on this year's MA enrollment. Obviously, that number -- the decline in membership is coming in not as much as you had originally suspected. Given the sort of short-term dynamics with this year with that membership change, I'd be curious on that. And with all of your comments on retention for next year, how that plays into your plan to sort of double the margin number for 2026?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Can I just ask you to repeat the first part of that? What are we not seeing?

Elizabeth Anderson - Evercore Inc - Analyst

No, I was just saying sort of the change in MA membership numbers for this year. Like how are you sort of seeing that impact the short-term numbers? Does that sort of make any big differences versus your original assumptions in terms of maybe the fourth quarter MLR? And then as we think about 2026, given your focus on retention, how does that play into and contribute to your doubling of the margin number for next year?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Okay. Got it. I missed the 2025 point, so yeah.

Celeste Mellet - Humana Inc - Chief Financial Officer

Yeah. Elizabeth, it's Celeste. In terms of our better-than-expected or lower-than-expected declines in membership this year, the pickup has been driven by two things. One, the retention is better. And two, sales have been on the margin better as well. But in particular, as we've gotten later in the year, the increase in the numbers has been driven by better retention. As it relates to MLR, we don't see an impact to our prior expectations based on what we picked up at the end of this year.

Operator

Scott Fidel, Goldman Sachs.

Scott Fidel - Goldman Sachs Group Inc - Analyst

Obviously, knowing that there's still a lot more to play out in the AEP. Just based on the initial comments that you made around the sales tracking to the high end of the scenarios, can you maybe give us some insights in terms of from a product mix perspective? How you're seeing new sales tracking between PPO, HMO and then, I guess, maybe D-SNP products?

And then, also on the LIS PDP commentary around most of the growth coming from the LIS. Just any observations you can give us in terms of where you're seeing that growth coming from in terms of from either competitor exits or other existing plans in the market? Just any observations around that as well.

David Dintenfass - Humana Inc - President - Enterprise Growth

Yeah. I'll take the first part. I think it's really early to be able to project at that level of detail on the growth. We're just a few weeks into AEP. And what we're seeing is that across the board, we're seeing healthy growth on all segments, but not disproportionate in any one segment. We're also not seeing disproportion in any geography at the moment, including the plex markets from our competitors. So it's too early to parse it apart, but it looks like it's much more even than it is choppy.

George Renaudin - Humana Inc - President - Insurance

So on the PDP side, what we're seeing thus far is some strong growth there. And where we expect the majority of it to come from is from our basic and value plans. On the basic side, which I think was your question around the low income, what we saw is that we are below the benchmark in about twice the number of states as we were in '25. And so that will lead to a significant pickup in auto enrollees, and that will include, of course, competitor reassignments. What we've generally seen is that, that is good business in the PDP. And so we are thinking that, that is a very positive development.

Operator

Ryan Langston, TD Cowen.

Ryan Langston - Cowen and Company LLC - Analyst

I'm sorry if I missed this, but what drove the decision to not crosswalk the group MA members from H5216? Is that just you're thinking you're going to get that back to an appropriate star rating for 2028 or other logistical reasons you didn't make that move?

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. I'll jump in on that one. It goes back to two things. One is -- well, really three things. One is our attitude towards having a balanced portfolio of contracts. The second is the desire to provide stability to our members in order to drive retention. And then third is the outlook on Stars. And so it's all three of those things combined that led to that decision.

George?

George Renaudin - Humana Inc - President - Insurance

Yeah, I would just say that another part of that because it's multifactorial, as Jim said, and we've been saying since we've been talking about the group business. So we remain focused on improving the group MA margins through the various renewal cycles to reflect the reimbursement environment as well as the cost environment. And our business so far, we've renewed 91% of our current group members along that line of recovering margin.

So we are making good progress there in the recontracting to improve the margin. We expect fairly solid growth in 2026 with some key new business, including a major airline, a large group in Kentucky as well as Alabama. So as far as Stars go, our plan is to move the group members away from 5216 is not to move our members away at this time because we're making good progress both on the Stars side as well as the margin recovery through the renewal cycles.

Celeste Mellet - Humana Inc - Chief Financial Officer

And if I can pile on again, this is again an example of not crosswalking these. It's balancing the short term and the long term. We could get a bump in the short term, but risk the longer term on Stars, and we're not willing to do that. So it's a balance of what we deliver in '26 versus what we deliver in '28 on that front.

Operator

Jason Cassorla, Guggenheim.

Jason Cassorla - Guggenheim Securities LLC - Equity Analyst

Just it sounds like medical and pharmacy trends coming in line with your expectations for 2025. I think looking back at the Investor Day, you previously assumed trend would remain elevated for '26. There's obviously the mix elements you've talked about, but any early thoughts on how 2026 cost trend development coming in relative to 2025? And then, any way to help quantify how you're thinking about the trend bender opportunity specifically for next year?

Celeste Mellet - Humana Inc - Chief Financial Officer

Yeah, we have talked about in the past that we expect a continuation of the same growth levels in medical and Rx cost trends into 2026. So the mid-ish -- on the higher end of mid on the medical cost side and low double digits on the Rx side of things. So we're not seeing anything that would suggest it should be different than that at the moment.

And then sorry, what was the second part of your question?

Jason Cassorla - *Guggenheim Securities LLC - Equity Analyst*

Yeah. Just any way to help quantify how you're thinking about the trend bender opportunity -- clinical excellence opportunity for next year?

Celeste Mellet - *Humana Inc - Chief Financial Officer*

Yeah. So if you think back to our Investor Day, we talked about the levers of transformation and the clinical excellence trend vendor opportunity is one of our larger ones. We expect to make progress versus what we delivered this year. I'm not ready to size that yet. Some of that will be driven by the size and mix of our membership and then make progress again in '27 and '28, but it's too early to say where that will be just given the number of dynamics that still need to settle down.

Operator

Lance Wilkes, Bernstein.

Lance Wilkes - *Sanford C Bernstein & Co LLC - Analyst*

Could you talk to some of the margin characteristics and long-term margin targets you've got? In particular, in Medicaid, if you could talk to the differences between traditional and duals where you see long-term margins and how you perceive year one margins in that sort of business? And then over in the group MA business, what sort of J curve do you expect as you get new business in there?

And maybe just a quick clarification. You'd mentioned a direct-to-employer opportunity, I think, in CenterWell Pharmacy. So if you could just clarify that as well.

James Rehtin - *Humana Inc - President, Chief Executive Officer, Director*

Do you want to kick off, George?

George Renaudin - *Humana Inc - President - Insurance*

Yeah, I'll start. On the dual opportunity, just keep in mind that when we think about that, and we think about Medicaid since you combine those two, I'll try to hit on both of them. We prioritize our Medicaid business based upon where we think there is a great linkage to duals, including some of the changes that are currently slated for the dual integration states.

And so we have had an industry-leading win rate in procurements and Medicaid. And the reason for how we've targeted those is really to where the dual opportunity remains. And the overall reason for that, of course, is that the duals do have outsized margins compared to the traditional or MA business. And so we see that those do deliver margins in the first year.

Unlike some of the core products all year along, those dual products tend to perform well from a financial standpoint. We're seeing that. We continue to see that happen. We have won a number of Medicaid states. It allows us to increase our dual penetration in a few key markets. I would just point out that in 2026, we'll be moving into the Michigan HIDE program in Illinois, which is, as we've talked about before, a very new dual marketplace. We are also going to be growing into Illinois this year in '26 and we also have an opportunity in South Carolina, where we're carving in the dual eligible. So there's lots of great opportunity in the dual market in Medicaid that we feel very good about.

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. And let me just quickly hit the direct-to-employer. I think people are familiar with the direct-to-consumer work that we've been doing in CenterWell Pharmacy, the partnerships, particularly around some of the GLP-1s. We have also seen some interest in similar programs, but through employers and we've been exploring that space. It's too early to know exactly what that's going to look like, but it is potentially another interesting opportunity for us to take advantage of the capability that we have in our pharmacy business.

Operator

Michael Ha, Baird.

Michael Ha - Robert W. Baird & Co Inc - Senior Research Analyst

I know it's a bit early to think about '27 advanced rate notice, but yesterday, we learned a key data point. And maybe it's unsurprising, but if your reach fee-for-service cost trend for '25 is 8.5%, usually a pretty strong leading indicator for the rate notice and clearly much higher than what was implied for the '26 final notice, I think, over 300 basis points. So when you couple that with CMS' estimate on '27 trends, it feels like you have a starting point in the advanced notice that could be north of 9% on the effective growth rate alone. Clearly, very strong for MA and very strong for Humana.

And again, I know it's early to think about it, but does this roughly make sense and jive with your internal expectations? And wondering if there are any other important variables you think we should also consider heading into the rate notice?

Celeste Mellet - Humana Inc - Chief Financial Officer

Yeah. Look, I think it's -- as we've learned over the last few years, speculating on where the rate notice will land has been a very much more imprecise answer than we would like. So we're not going to comment on sort of where they are, where they're starting, what the headwinds and the tailwinds are. And we'll obviously get a first look at that in the beginning of next year.

Operator

Whit Mayo, Leerink Partners.

Whit Mayo - Leerink Partners LLC - Analyst

I was just wondering if you guys had any views on the changes to the reward factor to EHO for all, whatever it's being called next year and implications on your Stars or more broadly, what you think this means for the industry? I don't think you have any challenges with your duals mix low income or disabled population, but just not sure yet what this actually means.

George Renaudin - Humana Inc - President - Insurance

With regard to the social risk factors that go into that, we're seeing great progress. We're tracking that on a weekly basis as we're tracking all of our Stars progress. And we know that we are making very good progress there. We're seeing week-over-week improvement. So we feel that we're on track for where we need to be to have that factor be positive.

We have a good mix of low income within our product mix, including our dual and even products that don't have as large of a specifically dual population with our group being on 5216, as we've talked about before, we're seeing progress there. And having a good mix of membership on 5216, even with the deconsolidation, we should still be in good shape with the social risk factor members.

James Rehtin - Humana Inc - President, Chief Executive Officer, Director

Yeah. I'd just say, operationally, we feel good. And obviously, it's hard to tell where the thresholds are going to come in exactly. So this is just one of these things that will be difficult to forecast.

With that, I just want to thank everybody for joining us this morning and for your interest in Humana. And I will say again that we're extremely appreciative of our 65,000 associates who are driving the performance that we talk about on these calls and who are serving our members and our patients every day. And so we appreciate your support, and we hope you have a great day. Thanks.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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