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Humana Inc. (HUM)

Q3 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to Humana's Third Quarter 2026 Earnings Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

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

Lisa Stoner

Vice President-Investor Relations, Humana Inc.

Thank you, and good morning. We will begin this morning with brief remarks from Jim Rechtin, Humana's President and Chief Executive Officer, and Chief Financial Officer, Celeste Mellet. Following these remarks, we will host a question-and-answer session with industry analysts.

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 2026 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 and posted remarks, 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 reference to earnings per share, or EPS, made during this conference call refer to diluted earnings per common share. Finally, 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.

With that, I'll turn it over to Jim.

James A. Rechtin

President, Chief Executive Officer & Director, Humana Inc.

Thank you, Lisa, and good morning, everyone, and thank you for joining us. We have just one headline today, and that is that we are in a good place. Execution is strong and improving. Signs point to our strategy working. We are increasingly seeing the tangible results of our team's good work. The results are positive for our members, our patients, and their health. And the results are contributing to our margin and earnings growth recovery, which is moving from on plan towards being ahead of plan.

As usual, I will frame my comments today around the four drivers of our business. One, product and experience, which drive customer retention and growth. Two, clinical excellence, which delivers clinical outcomes and medical

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margin. Three, highly efficient operations. And four, capital allocation and growth in both CenterWell and Medicaid.

Let's start with product and experience. Our 2026 membership, both new and returning, is performing in line to better than expected. Our 2027 product positioning also appears to be in line with expectations. Our product portfolio positions us largely as we expected at the time of bids. We believe our portfolio will deliver the margin progression in 2027 that is necessary to put us on track for a 3%-plus margin in 2028.

And importantly, our portfolio is focused on providing our members simple, affordable, and predictable coverage. It does this by protecting the benefits and services that seniors consistently identify as most important.

So far, AEP performance is ahead of our initial expectations. Our recapture or retention of our members impacted by plan exits has been particularly strong, but we are also seeing new sales ahead of plan. And while it remains very early in AEP, we currently anticipate that our membership will be up for 2027.

Turning to clinical excellence, I'm just going to say again that we are thrilled with our bonus year 2028, or BY 2028, results. Our Star Ratings approached the highest ratings Humana has ever achieved, with a member-weighted Star Rating of 4.17. I'm proud of this team. This is truly the result of 65,000 associates working together to drive better experiences and health outcomes for our members.

I'm going to provide just a few examples to bring this to life. Compared with the prior year, 663,000 more care opportunities were met, 534,000 additional members completed an annual preventative visit, 28,000 members received an overdue mammogram. This allowed us to identify 600 previously undetected breast cancers, many at an earlier stage than they otherwise would have been found.

93,000 members completed an overdue colorectal cancer screening. This allowed us to identify 100 previously undetected cases of pre-cancers and cancers. And 73,000 members living with diabetes received an overdue eye exam. This allowed us to identify 17,000 previously undetected diagnoses of diabetes-related eye disease, which is a leading cause of vision loss.

Detecting these conditions early is critical to successfully treating them and managing the conditions. The improvement that the team has driven in the Stars program over the last two years is truly remarkable and it's driving a real difference for our members. From a financial perspective, as we shared in the 8-K and audio file in October, our BY 2028 results significantly exceed our goal of top quartile.

As a reminder, results at roughly top quartile is the level of Stars performance that we believe is necessary to sustain a 3% margin and have competitive product. At or near top quartile performance is what is sustainable on an ongoing basis. We will have years close to top quartile, we will have years slightly above top quartile, and we will have years like this year well above top quartile.

However, we will manage the business assuming a level that approximates top quartile. That means our benefit structure and our broader cost structure must be tuned to and work closer to top quartile results, not at top decile. As a result, we anticipate a one-time tailwind in 2028. We expect to utilize some of this tailwind for one-time investments. These investments will help solidify our Stars capability and accelerate our efforts to improve the customer experience and improve clinical outcomes.

We also expect additional one-time return to shareholders. We do not believe we can productively invest the full tailwind, and thus we will pass some through to shareholders. Once we have more information on 2028, which

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includes competitive dynamics, membership and product dynamics, and regulatory environment, we will quantify the level of and the expected use of the tailwind. We'll size how much we will invest, and we will explain roughly how much we'll pass through to earnings.

Now, turning to BY 2029 Stars, we continue to drive strong operational performance, running roughly 5% ahead of last year's quality improvement rate on a per-member basis in key HEDIS metrics at the end of Q3. We feel confident that we will achieve our goal of top quartile performance for BY 2029. Regarding highly-efficient operations, our multi-year transformation is progressing as anticipated. And we look forward to providing a more detailed update on this work at a December investor event.

Finally, let me turn to capital allocation. I'll start with Medicaid, where we have implemented contracts in six new states over the last three years, with our Medicaid footprint now spanning 13 states, including 11 active states and contracts awarded with implementations pending in Georgia and Texas.

Our Medicaid membership has grown by 104,000 members in 2026, largely driven by the start of the Michigan HIDE-SNP and the statewide Illinois FIDE-SNP programs, as well as the carve-in of dual eligibles in the South Carolina Medicaid program. We are excited about these integrated dual programs, and we believe we are uniquely capable of delivering great outcomes for members and for states.

Within CenterWell Primary Care, we have driven strong growth this year, adding nearly 147,000 members, or 30% growth, including the acquisition of MaxHealth in the first quarter. And we recently established a new partnership with BlackRock, which we are very excited about. Celeste will touch on this more in a moment.

In conclusion, we are driving strong execution across the company, which has us on a positive trajectory. We are pleased with our 2026 performance to date and our increased full-year outlook. We are incredibly proud of our BY 2028 Stars results and expect to maintain top quartile results for BY 2029. We are positioned as we expected for the 2027 AEP. And we expect to make meaningful progress on MA margin expansion next year. And finally, we remain on track to deliver on our Investor Day commitments in 2028, which we will mark to market for you at the investor update on December 10.

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

Celeste Mellet

Chief Financial Officer, Humana Inc.

Thank you, Jim. I will touch on our 2026 performance and improved full-year EPS outlook before providing more detail on our continued balance sheet efficiency and capital optimization progress, including the recently announced JV with BlackRock. Starting with 2026, based on available information to date, cost trends are in line to better than our expectations for both new and existing members.

Our performance to date supports an increase in our full-year adjusted EPS outlook from at least $9 to at least $9.50. We also continue to maintain and build prudent reserves, with IBNR up sequentially, despite the seasonal shift where pharmacy costs make up a greater proportion of total benefit costs as we move through the year. All in, we are executing and delivering results better than initial guidance and remain on track to double our individual MA pre-tax margin this year, excluding the Stars headwind.

Turning to the balance sheet, we have continued our efforts to increase the efficiency of the balance sheet and fortify our foundation. And our significant progress reflects relentless focus on execution. We expect two major

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transactions to close this quarter. First, we will complete the divestment of our minority interest in Gentiva. Total pre-tax proceeds will be approximately $900 million.

In addition, we recently announced and closed a new joint venture with BlackRock, which replaces the previous longstanding JVs with Welsh Carson. Our new JV has substantially enhanced our balance sheet efficiency and increased our financial flexibility, while significantly reducing our cost of capital, reflecting the maturity of the business.

With the new structure, we will have the option to purchase clinics from the JV beginning in 2028. If we have not acquired all of the clinics by the end of 2033, BlackRock will have the right to exit the JV through a sale process. And we have the right to submit the first offer to acquire any remaining clinics. Importantly, the significantly reduced cost of capital under the new arrangement drives a substantial reduction of the JV-related liabilities on the balance sheet.

We anticipate that this transaction will drive a reduction of approximately 130 basis points in the GAAP debt-to-cap ratio in the fourth quarter. Further, we no longer need to fund the previously pending put option in 2027, which, if debt-funded, would have increased our debt-to-cap ratio by approximately 130 basis points next year, all else equal. We will continue to evaluate a pipeline of initiatives to drive further efficiency and resiliency.

Before going to Q&A, let me reiterate the headline that Jim shared. We have momentum. We are executing on our Investor Day commitments and delivering on the earnings power and value of the company while driving better health outcomes and experiences for our members and our patients.

I will now turn the call back to Lisa to start the Q&A.

Lisa Stoner

Vice President-Investor Relations, Humana Inc.

Thank you, Celeste. Just a quick reminder that in fairness to those being in the queue, we ask that you please limit yourself to one question this morning. Operator, please introduce the first caller.

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QUESTION AND ANSWER SECTION

Operator: Our first question comes from Stephen Baxter with Wells Fargo.

Stephen Baxter
Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Thank you. I was hoping you could expand a little bit more on the 2027 commentary. I guess, maybe potential list of headwinds and tailwinds? And then just thinking about meaningful progress in individual MA margins. Any general sense of what we should be expecting on that front based on what you know today? Thank you.

Celeste Mellet
Chief Financial Officer, Humana Inc.

A

Good morning, Stephen. As we stand here today, we, going into 2027, don't have any known headwinds other than carrying the Stars headwind we have from this year, so no incremental headwinds. And we do have a number of tailwinds. First, we continue to transform our business and are working to reduce both our OpEx and improve our medical costs, really through driving better care outcomes.

Second, we are continuing to move through the J-curve for Medicaid and PCO. Third, as we've talked about earlier in the year, we have significantly improved our product position and price for margin. That was our number one priority in terms of our approach to bids this year. And then finally, we expect fewer new members, which should lead to a lower year one headwind associated with marketing and onboarding and costs like that.

It's too early to call out where we expect the margin to land precisely for 2027. A lot of that will be driven by the ultimate membership size and composition as it relates to AEP. And while it's early and we have a good directional view, and we're happy with what we're seeing, we don't know our retention yet. And we want to see where those numbers land. I would say it's safe to assume that we will make a material improvement both on a Stars-adjusted and Stars-unadjusted basis, that we would expect to be well into the profitability range, even reflecting the Stars headwind for next year.

Operator: Our next question comes from Justin Lake with Wolfe Research.

Justin Lake
Analyst, Wolfe Research, LLC

Q

Thanks. Good morning. Maybe you can give us a little more color on cost trends in the quarter, and kind of how you're seeing coming out of the year? And for 2027, how you're thinking about it? And then can you just give us a little more color on the call-out you had in CenterWell? The year-over-year decline was pretty material, and you talked about one specific market and group of patients being pressured. Thanks.

Celeste Mellet
Chief Financial Officer, Humana Inc.

A

Hi, Justin. So, in terms of the cost trends, as we talked about last quarter, we're at the lower end of the range that we had expected for the year, which was 7% to 8%. We're continuing to see better-than-expected performance on the inpatient side, both in terms of APTs and cost per admissions. And a lot of that favorability has and will continue to flow through to value-based providers who have driven pretty significant improvement this year.

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But we're also seeing favorability on the Part D side, which is really what's helping us to drive our guidance up this year. Going into next year, we're expecting trend to be higher, predominantly driven by the health technology pipeline. So overall, we expect Part D to increase 14% to 15%, driven by the health technology pipeline. We have priced that into our bids, both on the MAPD side and the PDP side of things. On the med cost side, we are expecting things to be slightly higher as well. So overall, in the 8% to 9% for trend versus our range of 7% to 8% trend for this year.

And then in terms of PCO, so we are seeing some pressure in one geography related to a particular set of patients. And we believe we've been able to put a ring around that, and the steps to improve that have already been taken by CenterWell and the payer partners, including Humana. So we have seen on the CenterWell side, a number of changes in terms of their contracting, including terms with payers, terming payers, and the terms with the remaining payers, improving their positioning.

And then on the payers side, including Humana, there are a number of plan exits significantly improved benefit design. And then also pretty aggressive network management. There are some outlying facilities in Florida that have been driving some of the pressure. And we've seen partners across the payer universe take action to address that.

Operator: Our next question comes from Ann Hynes with Mizuho.

Ann Hynes
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you, and good morning. So, thank you for the directional commentary on MA membership for next year. I know that you highlighted growth for 2027. But directionally, can you provide any more growth expectations besides that it'll not be as much as 2026? And within that, maybe just some commentary on the competitive AEP. Any surprises in the competitive environment? Because I thought before you thought membership might be like flat to down for next year. Thanks.

James A. Rechtin
President, Chief Executive Officer & Director, Humana Inc.

A

Yeah, thanks for the question. The product positioning is largely in line with where we expected. What we're seeing is we're seeing outperformance from our distribution channel partners. That really has been the difference. We made a bunch of moves a year ago to improve the quality of our distribution partners, and that is paying some dividends this year. It's been a very good – it's achieved a number of good results for us.

We don't expect anything like last year, obviously. And it's really too early to try to put a number on it at this point. While we have good visibility into new sales and we have good visibility into our retention of members that were on plans that we exited, which is a good sign for retention, we don't really have a good handle on retention at this point. We just don't have the data on that at this point in time. And so when you kind of add it all up, it's hard to give a clear range on exactly where we expect to be.

Celeste Mellet
Chief Financial Officer, Humana Inc.

A

Ann, if I could add to that, from what we can see across the larger players, I think they're all better positioned than perhaps expected, especially given the number of plan exits across most of the major players. As Jim mentioned, we think a lot of our performance is driven by our really strong relationships with our broker partners. But I do

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think there has been some consolidation of some smaller plans, which is driving a bit better performance from the larger players.

Operator: Our next question comes from Matthew Gillmor with KeyBanc.

Matthew Gillmor
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks for the question. I just wanted to follow up on the PCO costs from the earlier question from Justin. Can you quantify the impact from those higher costs? And do you expect to be able to mitigate all of that for the 2027 period?

Celeste Mellet
Chief Financial Officer, Humana Inc.

A

We have never broken out the overall contribution of PCO. I would say to the enterprise, the impact is not meaningful, it is to PCO itself. We expect to offset most of what we're seeing with the actions that CenterWell has taken, Humana plan has taken, as well as the other payers have taken. Based on what we know today, it should address most of the pressure.

Operator: Our next question comes from David Windley with Jefferies.

David Windley
Analyst, Jefferies LLC

Q

Hi. Good morning. Thanks for taking my question. I wanted to maybe put a finer point on a couple of earlier ones around margin. So I think your expectations for this year were on the individual MA to run slightly below break-even. You're probably maybe slightly above break-even, so 300-ish basis points to your 3% target. Stars, perhaps two-thirds of that. I guess I was wondering if you agree with that, and if we could get perhaps a little bit more thinking on how much operationally this coming year you might span, given that the Stars kicks in and delivers a lot of that.

And then, Jim, the outperformance part of that Stars, if not how you would split it, the thoughts that drive, the decision factors that would influence how you would split it? Thank you.

James A. Rechtin
President, Chief Executive Officer & Director, Humana Inc.

A

Yeah. Hey, let me start with the back end of that question. So again, we will not be ready to quantify this until late next year or possibly even in the 2027 fourth quarter call. Yeah, we'll have to see how things develop. There's a couple things that we have to look at.

So one is, the exact size of what the tailwind will be is not something that you can precisely quantify today. There's a whole bunch of factors that play into that. One is, we will see the gap between us and our top quartile target shrink over the course of the next 15 months. Our competitors will take actions that will improve their average Stars scores. We will have limited actions that we can take to improve ours. Like, we will take what actions we can, but we will have limited actions that we can take. So you will see that shrink over time.

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The second thing that will obviously impact the final tailwind is going to be the size and the mix of our membership, both this year and what we're seeing in AEP a year from now. That will have a meaningful impact, and what that impact is hard to forecast at this point in time. So that's really step one for us.

The second step then is our really looking at, from an operational capacity standpoint, what can we productively invest? To the degree that we have opportunities that increase overall enterprise value over time, we want to take advantage of that. But there will be an operational capacity limitation that we're going to have to manage through. And that is something that we will better understand 12 months from now than trying to predict it today.

But those are really the factors that we will take into account. And what we do know, and I'll just stress this again, is the tailwind will be sufficient, even with all of the factors that I just described, it will be sufficiently large that we will not be able to productively invest all of it. We're not going to spend money to spend money, obviously. And so we know that there will be something. There's just a whole host of things that have to play out before we know exactly what that looks like.

Celeste Mellet
Chief Financial Officer, Humana Inc.
A

Yeah. And if I could, a couple of things on Stars. One, I wouldn't get too far ahead of us in terms of what the tailwind will be. Don't forget about the 30% offset with the value-based care providers. And also, what we're going to talk to you about next month at the investor update. And we continuously talk to you about. And this is how we're planning, is like, what are our sustainable earnings? So, we will talk about 2028 in that manner. And then, of course, we will give you that as we get closer, we will give you what we think the upside will be and how we will spend it.

And as it relates to your question on margin, I'm certainly not going to comment on your estimate of where we are. But I'd say don't underestimate the other actions we are taking here to improve the margin of MA and the rest of our businesses. We said our number one priority in AEP was to price for margin.

Our number two priority was retention, which helps with margin. And then third, a distant third, was growth. We also have been undergoing a significant transformation. You'll continue to have those additional tailwinds into next year, both on the operating cost side and the medical cost side of things. So Stars is important, but it is not the only thing we are working to improve here, and not the only thing we are making significant progress on.

Operator: Our next question comes from Jason Cassorla with Guggenheim Securities.

Jason Cassorla
Analyst, Guggenheim Securities LLC
Q

Great. Thanks. Good morning. I wanted to ask about capital deployment. You've been pretty busy this year on the M&A front. And you've shown material improvements to your debt-to-cap ratio. I guess as earnings and cash flow expand for you in the coming years, can you remind us in terms of how you're thinking about both future acquisition priorities, as well as your thoughts around perhaps restarting share repurchase activity, or anything else along those lines would be helpful? Thanks.

James A. Rechtin
President, Chief Executive Officer & Director, Humana Inc.
A

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Let me start, and then Celeste will jump in as well. At a high level, what we would emphasize is that we are – well, number one, our biggest use of capital is actually the insurance business as we grow. So our single biggest use of capital is funding reserves. And we'll make sure that that's clear to everybody.

Beyond that, the places where we will deploy capital is Medicaid and CenterWell. And obviously, that's not all M&A. That's a combination of both organic growth and M&A. And the focus continues to be in the places where we have been growing and investing over the course of the last couple of years.

So, obviously, we've had a lot of organic growth in Medicaid, and a lot of that growth has been focused on these HIDE, FIDE, and dual SNP plans. We continue to invest in the PCO business, which we think is an important part of the portfolio. It is both a good standalone business. And it reinforces all the things that we are trying to do within Medicare Advantage, which is drive quality, it drives Stars, it drives better outcomes and experience for our members. And it's managing total medical cost at the end of the day.

So, expanding our footprint in PCO continues to be a priority. Again, that's not just M&A. A lot of that is organic. And the decisions between organic and M&A are driven by what is available in the market and what is the price of what is in the market. And so we will be very thoughtful in what is going to deliver the best return on capital. Is it organic or is it M&A?

And we look at those in the same bucket, so to speak. We don't have a separate target for either one. We look at those in the same bucket. So that's kind of how we think about a big picture. Celeste, what would you add?

Celeste Mellet

Chief Financial Officer, Humana Inc.

A

Yeah. And just to clarify, in terms of the capital deployed to insurance, it's the capital required to go into the subsidiaries. So, when you grow membership, when you grow premium, you need to put capital into the subsidiaries. As you know, we put substantial capital, much of which we had freed up from balance sheet work we had done into our insurance subsidiaries this year.

But also, in addition to what Jim was speaking about with M&A, we will, as our earnings power recovers, begin to grow our dividend again. We would like to get the payout ratio to a more normalized level before we do that. But it's important to us to grow our dividend. We know that's important to shareholders.

We have been doing buybacks enough to offset dilution. I would expect that we would increase that, but keep in mind that buybacks are very onerous from a debt-to-cap perspective. So, you basically get twice as much bang for your buck investing in your business than you do buybacks, or I should say, it's twice as onerous to the debt-to-cap.

And finally, I just want to say, we're in a position where we actually, versus a year or two years ago, we have the ability to make choices. And we will be very prudent about managing our balance sheet given the volatility of the business overall and ensuring that we retain our flexibility and our ability to operate through any environment. But we're really pleased to be in a position where we can make choices. We don't have any puts. We don't have to spend a lot of money next year buying in clinics that we can buy later. We love that business, but a lot more flexibility than we had a year ago or two years ago.

Operator: Our next question comes from A.J. Rice with UBS.

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A.J. Rice
Analyst, UBS Securities LLC

Q

Hi, everybody. Historically, Humana was consistently – and I know it's a little bit of a different metric than what you're saying you're focused on now. But you were 90% or so four-Star rated across your membership. And so that was quite a bit higher than a top quartile. And you consistently managed – the business consistently managed for that. Now you're saying, you're focusing on benefit design, reinvestment to manage toward a top quartile performance. Does that just give you more predictability around the business, sort of minimize volatility? I guess it seems like a change. Maybe it's not, but I wonder if you'd comment on that?

And then specifically to the earnings recovery and M&A occurs, I know you've been at that 30% outsource to providers and shared risk arrangements for a while. Do you think you'll have the opportunity to step that up over time? Or is the 30% sort of a number that you're comfortable with and just will sustain?

James A. Rechtin
President, Chief Executive Officer & Director, Humana Inc.

A

Yeah. A.J., thank you for the question. Let me try to clarify the commentary around Stars to start, and then we'll come back to the second question there. So there's a couple things going on when it comes to Stars that kind of philosophically we're trying to ground into how we run the business. You are right. For a long time, we were able to manage Stars to a 90% four-Star level.

And obviously, our goal is not to hit top quartile. Our goal is to be the absolute best that we can be at Stars year in and year out. And we would love to be at 90% year in and year out. That is what we're going to be fighting to achieve every year. It's what we owe our patients and our members.

The nature of the top quartile metric is a couple of things. One, we put too much emphasis on 4 Stars as opposed to the mix of three-and-a-half, four, and four-and-a-half. And we wanted more orientation to the PMPM impact of each of those step-ups in Star ratings. We wanted that internally because we need that kind of focus internally. And we want that externally because we think it's important that our investors are thinking about the overall PMPM impact, not merely the four-Star percentage impact. So that's part of our thinking.

Part of our thinking is we need a minimum threshold by which we know that we can run the business successfully. And that minimum threshold is what informs how we manage our cost structure and how we manage our benefit structure. And it forces us to put more discipline in how we manage those two things.

So our sitting here saying, hey, we'd love to be at 90%, or let's just say, we'd love to be at top decile. But we're going to manage the business at top quartile, that is a discipline action for us. That is a way for us every single year to say, can our cost structure survive at top quartile? Can our benefits work at top quartile? Can this business be successful long term? We are forcing ourselves to be more disciplined. And I do think that we've probably not conveyed that as effectively as we could since Investor Day last year.

But I think it's important for everybody to understand that. This is for us to manage the business with discipline. We want to and expect to outperform every year. Like that's what we expect of ourselves. But we need to know that target that allows us to understand how we manage the other elements of the business. So that's the logic for what we're doing. And look, over time, we welcome feedback around it, but that's the logic for what we're doing.

And now, let me go to the other question. Celeste, what was the other question?

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Celeste Mellet
Chief Financial Officer, Humana Inc.

A

I can take the other question. Yeah, A.J., just to clarify what Jim was saying, we did call out the top quartile goal at our Investor Day last year. I think it got lost a little bit because there were so many other numbers and moving pieces.

But as it relates to your second question, and you were a little blurry on our end, so I'm going to guess as to what I think you were asking. We have shifted slightly in terms of our thinking about providers. We very much believe that value-based care can drive excellent health outcomes. And we obviously are investing that ourselves in our own business.

But we're really focused on aligning our members to high-quality providers. Not every high-quality provider wants to do risk. Not every high-quality provider wants to be a value-based provider. We don't want to not partner with excellent providers who don't take risk. We want to embrace them as well to ensure that our members are getting the best quality care.

As it relates to this quarter in particular, in terms of our percent in value-based care, we've been really focusing on strengthening the infrastructure and governance needed to manage those relationships effectively and efficiently. And at times, that can lead to us parting ways with some of them, where we don't view them as appropriate value-based care providers because they're not driving the health outcomes that we would expect.

So again, I'd focus you on high-quality providers. Doesn't mean you're going to see a material change in percent of value-based care. But we want to ensure every day that our members are getting the best care possible.

Operator: Our next question comes from Kevin Fischbeck with Bank of America. Kevin, you may be on mute.

Kevin Fischbeck
Analyst, BofA Securities, Inc.

Q

Hey, sorry about that. Just one clarification question and then the real question. As far as this extra Stars earnings in 2028, just want to make sure you are going to say, we're hitting our 2028 number, and then this is a one-time benefit on top of an excess of that is where you think it's going to land right now.

But then I guess the real question is, you talked about the progression on the Medicare individual margin, but there is another, I don't know, $7 or $8 of EPS to get to that $40 number that comes from Medicaid, CenterWell, capital deployment, Group MA. So how do we think about that progression of that earnings stream? Is that ratable in 2027, 2028? Is there a reason to think it's going to be more back-end loaded or front-end loaded there? Thanks.

James A. Rechtin
President, Chief Executive Officer & Director, Humana Inc.

A

Hey, let me start, and then I think Celeste will probably jump in here as well. I'll come back to the Stars question. I think, Kevin, what you were asking is for us to clarify, yes, we've hit our target. And we're well above our target. And if we're managing the business at our target, meaning our cost structure and et cetera, then there should be some overage, some benefit above where we manage the business to on a day-to-day basis. That is accurate.

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And then the question, of course, has been, what are we going to do with that? And we do expect to invest some, and we do expect some of it to pass through to earnings. The exact quantification is what we won't have for some period of time, but that is how we're thinking about it.

And then on your second question, which again, I can't remember, I'm going to pass to Celeste.

Celeste Mellet
Chief Financial Officer, Humana Inc.
A

Yeah. So, I just want to make sure you're clear on what Jim was saying. Yes, the Stars performance would be in excess of our target for 2028, and Jim did say upfront that we are running towards ahead of plan. And if you think about the things that we laid out, if you think about the waterfall that we gave you at our Investor Day last year that we will update for you next month.

Across every single line item, we are ahead and we will show that to you. So, the 95% of members in four-plus Star plans this year would be upside to that. And we will size that for you as we get closer, depending on all of the factors.

So, as it relates to 2027, again, given where we are in AEP, I'm not going to tell you exactly how far we'll get to. But the same factors that have us ahead of 2028 will effectively make our – steepen the slope to the path. So you will see improvement versus what we would have previously expected in 2027 as well as in 2028. And there are a number of factors, some of which I have called out already, the overall cost transformation, moving through the J-curves for Medicaid and Medicare.

Don't forget that we have undertaken a very significant re-contracting effort in our Group MA business. So last year, we were very significantly negative in Group MA. Excluding the Stars headwind, we have improved 500 basis points. Now, you won't get a full benefit of that till we get our Stars back in 2028, 500 basis points. So it's, again – I said this earlier, it's not just Stars that we're delivering on, it is across the board.

Operator: Our next question comes from Scott Fidel with Goldman Sachs.

Scott Fidel
Analyst, Goldman Sachs
Q

Good morning. Thought it might be helpful if you could spend a little time just talking about how the strategy has sort of evolved around deploying reinsurance in the Medicare Advantage business? It seemed like there was a pretty substantial increase in the use of the reinsurance this year. And just curious in terms of, like as we think about the primary effects of that on the P&L and revenue, and costs or balance sheet? Just sort of if you can sort of walk us through the mechanics of that?

And then, more importantly, on the go forward, in terms of the reinsurance, is that something that you'd look to sort of sustain, or was that more of something that was like a bit more of a one-off for this year, and then you'd look to recede and reduce that? Just mostly curious in sort of how you're thinking about approaching that for 2027? Thanks.

Celeste Mellet
Chief Financial Officer, Humana Inc.
A

Hey, Scott. When we looked at our, I guess, our lack of reinsurance, our view was there was a lot more efficient way to manage the amount of capital that was required to be put into the subs. And that was, to some extent, I

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think, making us uncompetitive. The way I think about it is that previously, we were putting about 12% of premiums into the subs. It's probably just under 10% at the moment. And we are close to where we would want to be if we grow a bit this year. We'll grow a bit this year, we maybe do a little bit more. But you won't see a substantial change in terms of, I think, the overall use of reinsurance into 2027.

That cost is reflected in our – the run rate is reflected in our numbers for this year. I would say it's definitely cheaper than debt funding. You obviously don't get the NII pickup. But we believe there are more efficient ways to use. If we decide to use debt, we believe there are better ways to apply that debt. So we will obviously re-examine this year in, year out, and figure out the optimal way to deploy capital, to fund ourselves, consider all the costs. But I wouldn't expect a change in the next couple of years. So we're pretty happy with where we are right now.

Operator: Our next question comes from Andrew Mok with Barclays.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Hi, good morning. Wanted to follow up on your comment around your capitated partners. It sounded like you absorbed most of the Stars-related headwind and shielded your capitated partners from the downside when you lost your bonus revenue. So just want to better understand how the mechanics of this work with the bonus revenue flowing through to your capitated partners back on the way up? Thanks.

Celeste Mellet
Chief Financial Officer, Humana Inc.

A

Yeah. So yes, we did insulate our value-based care providers to some extent, particularly the higher quality ones. We wanted to ensure that, just given the overall challenges in MA, that they were protected. And the way we allocated it was based on performance. So the best performers got the greatest benefit or the greatest contribution from us.

As you think about the upside to top quartile, right? That is incremental. So you're going to have the full cap offset. If you're thinking just up to where we were targeting, yes, you would see the reversal of that, or you wouldn't see as much of the offset, right, because we're already offsetting some of that for them. But when you get above where we were targeting, that is all incremental. That is, you still have the 30% cap offset.

And you can follow up with Lisa if you have more questions, but you really have to think about the target and then on top of it, what's below, what's above.

Operator: Our last question today will come from George Hill with Deutsche Bank.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Good morning, guys, and thanks for squeezing me in. I guess I'll just make a minor point of clarification, Celeste. It sounds like if I'm thinking about 2027, you guys are pricing to about 8.5% trend, but trend is currently running, call it maybe 7-ish. So the question is, as we think about margin expansion for 2027, kind of how much of it is coming from the pricing initiatives versus how much of it is coming from internal cost control initiatives? And kind of should we think of this level of conservatism as kind of what Jim termed, like, the new normal disciplined operating model? Thanks.

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Celeste Mellet

Chief Financial Officer, Humana Inc.

A

So to be clear, I said 8% to 9%. I did not say 8.5%, is the range. And the reason for that, as I called out, is in large part driven by our expectation of a very robust health technology pipeline, really driving Part D, the Part D component up to 14% to 15% this year, or closer to 11% to 12%. And then the med costs on the margin a little bit higher as well. We don't price or look at trend in terms of operating. I mean, it is part of operating discipline, but you have to be able to justify the costs that you price into your bids. You can't just add to be conservative. You have to really be able to justify those expenses.

And based on the various pieces, in particular on the Part D side, it drives that higher trend, and that is reflected in our bids. And I would say in terms of the improvement for 2027, a large part of it is going to be driven by the pricing. But you will have continued upsides from some of the other components. We had a benefit from our transformation this year. We had a nice tailwind. If you recall back at the beginning of the year, we walked through all of the things we had done to offset the Stars headwind. We would have very little earnings if we hadn't taken action to offset the Stars headwind. So we have some of that already. The real incremental progress is going to be because of the pricing.

James A. Rechtin

President, Chief Executive Officer & Director, Humana Inc.

A

Yeah. Let me just layer one more thing on there, which is, the way that I would think about what we're trying to do to manage the business, it's less about conservatism and it's more about discipline. It is about running the business in a way where we are planning across multiple years. Looking out and understanding how the external environment may change, good or bad. Being prepared to be able to adapt to those things. And then running with a level of discipline in-year that we are holding ourselves accountable across all pieces, all of the drivers of this business.

The four things that I talk about every single quarter. We need to be operating against all four of those things every single day, every single week, every single quarter, every single year. And so we have to make decisions internally that create visibility and clarity into all four of those elements in a way that our team can go execute successfully against those. That is what we are doing.

That is why we are disciplined about saying, what is top quartile and how do we manage to that? That is why we are disciplined about saying, how do you manage the balance sheet in a way where even when you just had a couple of years of depressed earnings, you can actually take your debt-to-cap down, right? We took our debt-to-cap down in a couple of years that were very difficult for the business.

And we did that because we were disciplined about how we are managing the balance sheet. That is how we want to manage the entire business. And it is less about conservatism, and it is much more about just being disciplined so that we know that we are delivering quarter after quarter, year after year.

James A. Rechtin

President, Chief Executive Officer & Director, Humana Inc.

With that, I want to go back and I want to kind of close where we started this conversation today. We are in a good place. We are executing. We have a strategy that, again, all signs are pointing to it is working. We are increasingly seeing the results of that. And we're seeing the results of our team doing really good work. And this is moving us towards being ahead of plan. You can see this in our earnings guidance today. You can see this in our

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top quartile and better results in Stars. You can see this in how we are successfully managing a robust growth, membership growth in 2026.

And each one of these milestones is evidence that we are, in fact, planning across multiple years. Preparing for the possibility that there may be unexpected external factors that we have to navigate. And we're operating with an improved level of operating discipline day in and day out. We're turning clear goals into action across our team in a shared way. So yes, we have individual accountability, but we also have shared accountability to hit numbers.

We're acting and moving earlier, and we make it easier for the people that we're serving, for our members and our patients. These milestones and momentum are all improving our outlook for the next couple of years and beyond the next couple of years. These are things that create sustained value over time.

I'm truly proud of how our team has responded over the course of the last couple of years. I'm thrilled that more is visible externally. But I'm actually more energized about what we can achieve going forward and where we're headed. And so with that, I just want to say thank you for joining us this morning and for your interest in Humana. And I want to say thank you to the 65,000 associates who serve our members and our patients every day. They are what make all of this happen. And we appreciate your support. And we hope you have a great day. Thank you.

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

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