

Centene Corporation

Quick takes from the call; updating ests

Reiterate Rating: NEUTRAL | PO: 76.00 USD | Price: 70.86 USD

Exchanges performing better on MLR and growth

Centene (CNC) beat its internal Q3 by \$0.20, largely due to better Commercial MLR. Exchange MLR is better than expected while growing faster than expected. CNC attributed this to its established franchise/brand, as well as the better industry growth from enhanced federal subsidies. Significant special enrollment period growth is usually problematic due to negative risk adjustment and pent-up demand, but this year, CNC is not seeing pent up demand as many members came directly from Medicaid. Meanwhile, when there is strong industry growth, then usually the risk pool is better. CNC has been through two rounds of Wakely data and has visibility into its risk adjustment payables: now \$1.8B (vs \$1.5B in Q2) and its allowance for insolvent peers of \$314m went up by \$9m. As this membership annualizes in 2024, it sets up at least \$3B of revenue growth while expanding margin (CNC is just below the 5-7.5% margin target, with in-line MLR but higher year 1 commissions, which should drop in year). With the quarter we are raising our 2023 estimates but maintaining 2024/25. We are raising our PO to \$76 from \$72 (11.6x 2024E EPS vs 11.0x previously) on the better 2023 increasing visibility into 2024. 2024 guide looks to us reasonable, but we reiterate our Neutral rating given low visibility into growth given MA performance, RFP risk and exchange regulatory risk.

Redeterminations on track

40% or 1m through redeterminations is on track for membership and acuity. MLR was as expected for a retro-rate adjustment that was a 40bps drag. States providing actuarially sound rates, usually with acuity adjustments. 25% of members who lose coverage rejoin, and 70% of them have no gap in coverage. Leavers have lower MLR than stayers, but rejoiners have MLR around the stayers (as CNC expected).

Sees growth ahead, not just about margins

CNC framed itself as more than a margin recovery name, indicating growth is a key part of the story. Medicaid: North Carolina Medicaid expansion, Oklahoma contract wins and a robust RFP pipeline. Exchanges a solid business. We project PDP should grow in 2024, which is more about adding drug spending and potential cross sell into MA PDP over time. Committed to MA which should be multi-year tailwind. Reiterated LT 12-15% EPS CAGR.

Estimates(Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	5.15	5.75	6.60	6.55	7.33
GAAP EPS	2.27	2.03	4.94	5.12	5.79
EPS Change (YoY)	2.8%	11.7%	14.8%	-0.8%	11.9%
Consensus EPS (Bloomberg)	5.12	5.73	6.48	6.62	7.41
Valuation (Dec)					
P/E	13.8x	12.3x	10.7x	10.8x	9.7x
GAAP P/E	31.2x	34.9x	14.3x	13.8x	12.2x
Dividend Yield	0%	0%	0%	0%	7.1%
EV / EBITDA*	8.4x	7.6x	8.0x	8.8x	8.3x
Free Cash Flow Yield*	8.3%	13.3%	21.0%	17.0%	17.9%

* For full definitions of *IQmethod*SM measures, see page 4.

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Timestamp: 24 October 2023 10:19AM EDT

24 October 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	72.00	76.00
2023E Rev (m)	147,349.9	149,991.5
2024E Rev (m)	136,936.8	136,949.1
2025E Rev (m)	143,042.3	143,103.9
2023E EPS	6.45	6.60

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Stock Data

Price	70.86 USD
Price Objective	76.00 USD
Date Established	24-Oct-2023
Investment Opinion	B-2-9
52-Week Range	60.83 USD - 87.84 USD
Mkt Val (mn) / Shares Out (mn)	38,354 USD / 541.3
Average Daily Value (mn)	217.68 USD
BoFA Ticker / Exchange	CNC / NYS
Bloomberg / Reuters	CNC US / CNC.N
ROE (2023E)	14.6%
Net Dbt to Eqty (Dec-2022A)	24.7%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BoFA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BoFA ESGMeter Methodology".

MLR = Medical Loss Ratio; MA = Medicare Advantage; RFP = Request For Proposal; PDP = Prescription Drug Plan

iQprofileSM Centene Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	4.6%	5.2%	4.7%	3.8%	8.1%
Return on Equity	11.5%	13.1%	14.6%	13.4%	28.7%
Operating Margin	2.4%	2.3%	2.4%	2.5%	2.5%
Free Cash Flow	3,181	5,092	8,067	6,526	6,880

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.3x	1.8x	2.5x	2.2x	2.1x
Asset Replacement Ratio	0.6x	0.6x	0.6x	0.6x	0.6x
Tax Rate	14.5%	17.8%	22.6%	24.0%	24.0%
Net Debt-to-Equity Ratio	21.3%	24.7%	-3.0%	-16.8%	NA
Interest Cover	NA	NA	NA	NA	NA

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	125,982	144,547	149,991	33,769	36,071
% Change	NA	NA	NA	NA	NA
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	4,739	5,189	4,961	4,504	4,755
% Change	NA	NA	NA	NA	NA
Net Interest & Other Income	29	644	483	346	362
Net Income (Adjusted)	3,032	3,328	3,597	3,387	3,619
% Change	NA	NA	NA	NA	NA

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	1,336	1,202	2,719	2,665	2,868
Depreciation & Amortization	1,476	1,553	1,306	1,312	1,312
Change in Working Capital	1,376	2,194	3,678	500	500
Deferred Taxation Charge	(132)	(631)	188	696	696
Other Adjustments, Net	NA	NA	NA	NA	NA
Capital Expenditure	(910)	(1,004)	(789)	(817)	(845)
Free Cash Flow	3,181	5,092	8,067	6,526	6,880
% Change	NA	NA	NA	NA	NA

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	13,118	12,074	18,745	22,231	0
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	NA	NA	NA	NA	NA
Property, Plant & Equipment	3,391	2,432	1,889	1,393	0
Other Non-Current Assets	NA	NA	NA	NA	NA
Total Assets	78,375	76,870	84,481	83,898	0
Short-Term Debt	267	82	113	113	0
Other Current Liabilities	NA	NA	NA	NA	NA
Long-Term Debt	18,571	17,938	17,888	17,888	0
Other Non-Current Liabilities	NA	NA	NA	NA	NA
Total Liabilities	51,498	52,757	59,327	58,680	0
Total Equity	26,877	24,113	25,154	25,219	0
Total Equity & Liabilities	78,375	76,870	84,481	83,898	0

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Managed Health Care

Company Description

Centene is a Managed Care Organization (MCO) operating in the Medicaid managed care and specialty services markets. The Medicaid business provides health insurance sponsored by the state and federal government for qualified lower income individuals, children and their families through programs such as Medicaid, State Children Health Insurance Programs (SCHIP), foster care, and the Aged Blind and Disabled (ABD) programs.

Investment Rationale

CNC's upside potential is subject to short-term redetermination risk, and medium-term Medicaid repurchase risk and low visibility into MA growth. That said, CNC's guidance and the below average multiple suggest many of the risks being priced in, likely somewhat limiting downside in the near term, leaving us Neutral.

Stock Data

Average Daily Volume 3,071,947

Quarterly Earnings Estimates

	2022	2023
Q1	1.83A	2.11A
Q2	1.77A	2.10A
Q3	1.30A	2.00A
Q4	0.86A	0.39E

Price objective basis & risk

Centene Corporation (CNC)

Our \$76 price objective is based on an 11.6x multiple on our 2024E EPS estimate. This is below CNC's 2-year forward P/E multiple average of 12.6x as CNC should see slower growth in the near to medium term vs historical levels, as well as higher risk to 2023 and 2024 numbers due to significant swings in industry enrollment lowering pricing visibility, and uncertainty around RFP awards.

Upside risks to our price objective are better-than-expected enrollment growth, lower-than-expected medical costs and better than expected margin improvement.

Downside risks to our PO are lower-than-expected enrollment growth, higher-than-expected medical costs, Medicaid rate pressure, and the potential for unexpected RFP losses.

Analyst Certification

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US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Acadia Healthcare	ACHC	ACHC US	Kevin Fischbeck, CFA
	Addus HomeCare	ADUS	ADUS US	Joanna Gajuk
	Agilon Health	AGL	AGL US	Adam Ron
	Alignment Healthcare	ALHC	ALHC US	Adam Ron
	Chemed Corporation	CHE	CHE US	Joanna Gajuk
	Elevance Health Inc	ELV	ELV US	Kevin Fischbeck, CFA
	Encompass Health	EHC	EHC US	Kevin Fischbeck, CFA
	HCA	HCA	HCA US	Kevin Fischbeck, CFA
	Humana Inc	HUM	HUM US	Kevin Fischbeck, CFA
	Option Care Health	OPCH	OPCH US	Joanna Gajuk
	Privia Health	PRVA	PRVA US	Adam Ron
	Select Medical Corp.	SEM	SEM US	Kevin Fischbeck, CFA
	Service Corp.	SCI	SCI US	Joanna Gajuk
	Surgery Partners, Inc	SGRY	SGRY US	Kevin Fischbeck, CFA
	Tenet Healthcare	THC	THC US	Kevin Fischbeck, CFA
	The Cigna Group	CI	CI US	Kevin Fischbeck, CFA
	UnitedHealth Group	UNH	UNH US	Kevin Fischbeck, CFA
	Universal Health Services	UHS	UHS US	Kevin Fischbeck, CFA
	US Physical Therapy	USPH	USPH US	Joanna Gajuk
NEUTRAL				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	Apollo Medical	AMEH	AMEH US	Adam Ron
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA



US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Oscar Health	OSCR	OSCR US	Adam Ron

UNDERPERFORM

	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	Brookdale	BKD	BKD US	Joanna Gajuk
	Cross Country Healthcare	CCRN	CCRN US	Kevin Fischbeck, CFA
	DaVita Inc	DVA	DVA US	Kevin Fischbeck, CFA
	Enhabit Home Health & Hospice	EHAB	EHAB US	Joanna Gajuk
	Pediatrix Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

IQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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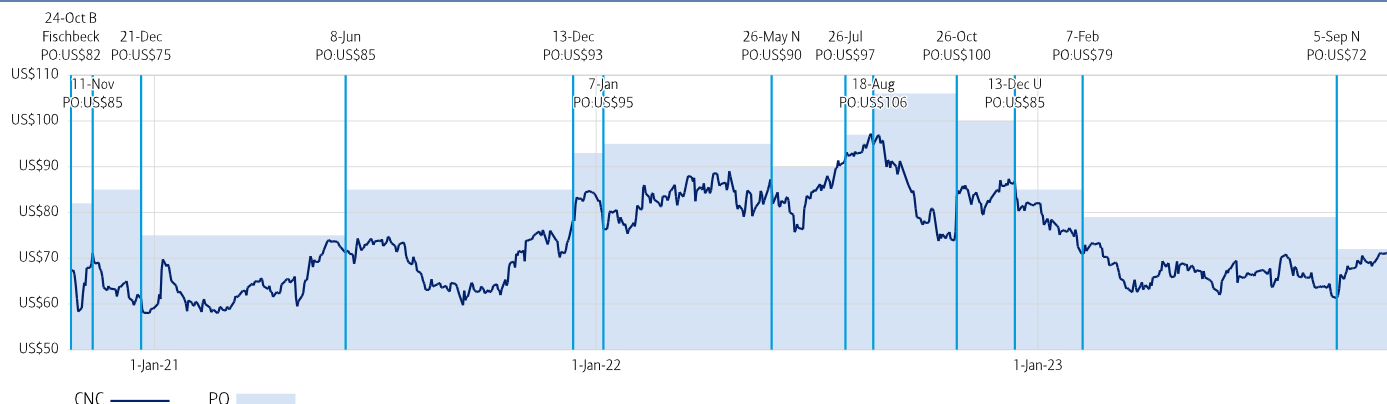
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Centene Corporation (CNC) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Health Care Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	233	60.21%	Buy	113	48.50%
Hold	83	21.45%	Hold	33	39.76%
Sell	71	18.35%	Sell	25	35.21%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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