UnitedHealth Group

Fischbeck Focus: Reviewing the state of Medicare Advantage

Reiterate Rating: BUY | PO: 675.00 USD | Price: 516.73 USD

16 January 2024

Equity

Despite questions, things largely unchanged

UNH missed consensus MLR by 100bps causing questions about trend, which combined with negative development fed into fears that 2024 guidance (for UNH and peers) could be at risk. UNH had a bullish tone, remaining confident in 2024 guidance for EPS, MLR and OptumHealth margins, and there is some real reason for this to be true. First, despite the 100bps Q4 MLR miss, MLR was only 7bps above 2023 guidance, so the implied Q4 miss is more like 30bps (the other 70bps is that consensus was below guidance). Meanwhile, UNH pointed to higher seasonal costs (RSV, COVID, vaccines and related pull through of other services) as the cost driver which all else equal would not be expected to repeat. Finally, this higher utilization means better coding, which should lift rates next year and help mitigate things to the extent that they persist. When viewed that way, a 7bps higher baseline (largely seasonal), which comes with a built in revenue offset, isn't enough to shake 2024 guidance. Overall, we believe that MLR concerns are overblown, but acknowledge that the Market likely will need to see at least Q1 (probably Q2) until giving them credit for it. We maintain our 2024/25 EPS ests and roll out 2026 ests. Our $675 PO represents 24.0x 2024E EPS, unchanged vs prior. Reiterate Buy.

We need to calm down. 2023 was unusual, 2024 less risky

The degree of difficulty in getting 2023 MA trend right is something that the Market isn't appreciating. In 2022, we estimated that hospital volumes were 8% below the LT trend line. In 2021 and 2022, MCOs said commercial trend was above the trend line (young people used the system normally + got COVID), but MA and Medicaid were below trend. So when volumes returned in 2023, they were particularly depressed in Medicare, and so the snap back in Medicare was bigger. The magnitude of the reversion was missed by every major MCO, hospital and Medtech company, but the Market seems to be penalizing multiples as if they got trend wrong in a normal year. As utilization moves back to the trend line (we estimate we are now 3% below the hospital trend line) the degree of variability narrows and MCOs will be better positioned to price.

Fischbeck Focus: the state of the MA market

This quarter, we focus on the state of the Medicare Advantage (MA) market: where we are in catching MA trend, industry expectations for 2024 growth, and implications for sustainability of margins.

Estimates (Dec) (US$)	**2022A**	**2023A**	**2024E**	**2025E**	**2026E**
EPS	22.20	25.11	28.18	31.85	35.99
GAAP EPS	21.18	23.85	26.89	30.53	34.64
EPS Change (YoY)	16.7%	13.1%	12.2%	13.0%	13.0%
Consensus EPS (Bloomberg)			27.84	31.43	35.51
DPS	6.40	7.29	8.37	9.62	11.06
Valuation (Dec)					
P/E	23.3x	20.6x	18.3x	16.2x	14.4x
GAAP P/E	24.4x	21.7x	19.2x	16.9x	14.9x
Dividend Yield	1.2%	1.4%	1.6%	1.9%	2.1%

Key Changes

(US$)	Previous	Current
2024E Rev (m)	397,329.7	394,368.3
2025E Rev (m)	426,850.0	420,798.5
2026E Rev (m)	NA	453,323.2
2026E EPS	NA	35.99

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Stock Data

Price	516.73 USD
Price Objective	675.00 USD
Date Established	13-Dec-2023
Investment Opinion	B-1-7
52-Week Range	445.68 USD - 554.70 USD
Mrkt Val (mn) / Shares Out (mn)	483,659 USD / 936.0
Free Float	99.7%
Average Daily Value (mn)	1648.39 USD
BofA Ticker / Exchange	UNH / NYS
Bloomberg / Reuters	UNH US / UNH.N
ROE (2024E)	26.3%
Net Dbt to Eqty (Dec-2023A)	33.3%
ESGMeter™	High

See page 9 for abbreviations

Timestamp: 16 January 2024 12:05AM EST

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Income Statement Data (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premiums	257,157	290,827	315,029	334,962	360,221
Net Investment Income	NA	NA	NA	NA	NA
Total Revenue	**322,132**	**367,533**	**394,368**	**420,798**	**453,323**
Total Cost of Benefits and Claims	(210,842)	(241,894)	(265,210)	(282,000)	(302,906)
S,G & A (Including Commissions)	NA	NA	NA	NA	NA
Total Operating Expenses	**(295,727)**	**(339,264)**	**(361,851)**	**(384,526)**	**(412,774)**
Pre-Tax Operating Earnings	**26,405**	**28,269**	**32,518**	**36,272**	**40,549**
Income Tax Expense	(5,704)	(5,968)	(7,286)	(7,899)	(8,795)
Operating Earnings After Tax	**21,084**	**23,566**	**26,131**	**29,115**	**32,358**
Net Income (Reported)	**20,120**	**22,381**	**24,933**	**27,909**	**31,147**
Diluted Shares	950	939	927	914	899
Operating Earnings Per Share	22.20	25.11	28.18	31.85	35.99
Net Income (Reported) Per Share	21.18	23.85	26.89	30.53	34.64

Balance Sheet Data (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Fixed Income Securities	NA	NA	NA	NA	NA
Total Cash and Investments	27,911	29,628	32,559	36,599	42,149
Total Assets	**245,705**	**273,720**	**284,712**	**298,729**	**315,268**
Reserves	21,690	21,690	21,690	21,690	21,690
LT Debt	54,513	58,263	62,543	62,543	62,543
Total Liabilities	**159,358**	**174,801**	**175,610**	**171,218**	**166,611**
Total Equity	**86,347**	**98,919**	**109,102**	**127,511**	**148,657**
Total Equity (Ex FAS 115)	**86,347**	**98,919**	**109,102**	**127,511**	**148,657**
Book Value per Share (Reported)	90.92	105.40	117.66	139.49	165.34
Book Value per Share (Ex FAS 115)	NA	NA	NA	NA	NA

Ratios (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Expense Ratio	0%	0%	0%	0%	0%
Loss Ratio	82.0%	83.2%	84.2%	84.2%	84.1%
Combined Ratio	**82.0%**	**83.2%**	**84.2%**	**84.2%**	**84.1%**
Avg Assets / Avg Eq (Ex FAS 115) Ratio	2.8x	2.8x	2.7x	2.5x	2.2x

Growth Rates (YoY) (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premium	13.7%	13.1%	8.3%	6.3%	7.5%
Net Investment Income	NA	NA	NA	NA	NA
Total Revenue	12.9%	14.1%	7.3%	6.7%	7.7%
Operating Earnings per Share	16.7%	13.1%	12.2%	13.0%	13.0%
Asset	15.8%	11.4%	4.0%	4.9%	5.5%
Reported Book Value per Share	13.6%	15.9%	11.6%	18.6%	18.5%

Performance Metrics (Dec)

(US$ Millions)	2022A	2023A	2024E	2025E	2026E
Operating ROE	26.9%	26.8%	26.3%	25.6%	24.2%
Operating ROE (Ex FAS 115)	25.9%	25.4%	25.1%	24.6%	23.4%
Operating Return on Average Assets	9.2%	9.1%	9.4%	10.0%	10.5%
Operating Margin	6.5%	6.4%	6.6%	6.9%	7.1%
Long Term Debt to Cap Ratio (Ex FAS 115)	38.7%	37.1%	36.4%	32.9%	29.6%
Net Income % Operating Income	95.4%	95.0%	95.4%	95.9%	96.3%
Amtz of DAC % Pretax Profit bef Amtz of DAC	0%	0%	0%	0%	0%

Company Sector

Managed Health Care

Company Description

UnitedHealth Group (UNH) is one of the largest Managed Care Organizations (MCOs), serving members both in the US and internationally. UNH is the most diversified payer, either by product line, geography or customer type. The company's operating segments include United Healthcare, OptumRx, OptumInsight, and OptumHealth.

Investment Rationale

The company's scale and diversity should position UNH well, while the strong trajectory at Optum provides a unique growth opportunity.

Stock Data

Average Daily Volume	3,249,288

Quarterly Earnings Estimates

	2023	2024
Q1	6.26A	6.80E
Q2	6.14A	7.03E
Q3	6.56A	7.47E
Q4	6.16A	6.87E

Fischbeck Focus: State of the MA market

In the Fischbeck Focus section, we choose a theme to explore in more detail, either in response to recent investor questions or because of an unexpected development in the quarter. This quarter, we focus on the state of the Medicare Advantage (MA) market: where we are in catching MA trend, industry expectations for 2024 growth, and implications for sustainability of margins.

Trend: MA margins came under pressure through the year

After coming off a strong year in 2022, when both earnings estimates and multiples continued to creep up, 2023 was a disappointment. Specifically, the most exciting subsector in the industry - Medicare Advantage, unexpectedly showed broad based signs of margin pressure. At the same time, the government began to clamp down on reimbursement which was slated to take effect in 2024, increasing the uncertainty around any margin recovery.

Insurers expected some amount of MLR pressure in 2023

Heading into the year, three of the major MA insurers (Which represent >55% of the market) had already anticipated a modest increase in MLR, which was built into initial guidance. UNH cautioned it was being conservative by including a cushion for 'acuity changes', pent up COVID demand, and flu costs. HUM pointed out that it had recently cut a significant amount of corporate costs and was reinvesting those savings into benefit designs to grow membership. Meanwhile CVS pointed to growth being somewhat dilutive.

At first, results tracked well, but quickly the industry's view changed

Our first data point on margins was when insurers reported first quarter results in April, at which point they all sounded positive on utilization and implied upside to initial guidance. At the time, HUM was the only company to signal some potentially MLR pressure (but modest and still within the range), but this was due to membership growth coming in much better than expected, rather than any cost issue.

However, by June, around the time insurers had to submit bids for 2024, the commentary entirely reversed course, with all the major MA insurers raising MLR expectations unexpectedly. Margin expectations continued to trend down further in the third quarter. Ahead of Q4, it mostly appeared rebased expectations had caught up with the reality of cost increases (with UNH, CNC and CI reaffirming utilization trends), with the exception of CVS, which raised MLR again for the 3rd time at an investor conference last week.

So far, in Q4, UNH said that core cost trend was largely as expected (though FY23 MLR was 10bps above guidance from late November) due to higher seasonal costs (RSV, COVID and vaccinations, with some extra pull-through on other services, particularly for patients who hadn't seen a doctor in a while).

Exhibit 1: Insurers began to see pressure on Medicare Advantage margins throughout 2023

Summarizing MCO commentary on MLR over time, with emphasis on MA

				FY 2023					
	% of Premiums in MA	% of MA Market	Initial 2023 vs 2022	1Q23 Update	2Q23 Update	3Q23 Update	4Q23 Update	4Q23 Actual	Initial 2024 vs 2023
UNH	60%	28%	Raised MLR	Reaffirmed	Raised MLR	Raised MLR	Reaffirmed	MLR 7bps higher	Raised MLR
HUM	85%	18%	Raised MLR	Favorable	Raised MLR	Worse MA MLR			
CVS	50%	10%	Raised MLR	Reaffirmed	Raised MLR	Raised MLR	Raised MLR		Raised MLR
ELV	20%	6%	Lowered MLR	Reaffirmed	Reaffirmed	Reaffirmed			
CNC	15%	4%	Lowered MLR	Lowered MLR	Worse MA MLR	Reaffirmed	Reaffirmed		Raised MLR
CI	20%	2%	Lowered MLR	Lowered MLR	Reaffirmed	Lowered MLR	Reaffirmed		
MOH	15%	1%	Stable MLR	Reaffirmed	Worse MA MLR	Worse MA MLR			
ALHC	100%	0%	Increased MLR	Reaffirmed	Cautious guidance	Cautious guidance			

Source: Company Filings, BofA Global Research

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Implications for 2024 still unclear, but likely below target

One of the best parts of the insurance business model is that if costs spike unexpectedly, companies can always reprice to target margins the following year. In the case of MA, where repricing happens in June for the following year, a burgeoning cost issue in June may not be fully repriced for the following year and we may have to wait until 2025 before margins fully normalize.

When MCOs are maintaining/improving margins and beating numbers, it implies they are doing a good job forecasting costs, and investors feel better that they will continue doing a good job in the future. However, when they miss numbers, investors start to worry, not only that there is now downside to current year earnings forecasts, but to future years as well, as the pricing set 6-18 months in advance is generally predicated on the same assumptions used for the current period, which were proven wrong. As a result, investors often put low multiples on low earnings estimates during periods of trend pressure, which in our view is historically the best time to be buying managed care.

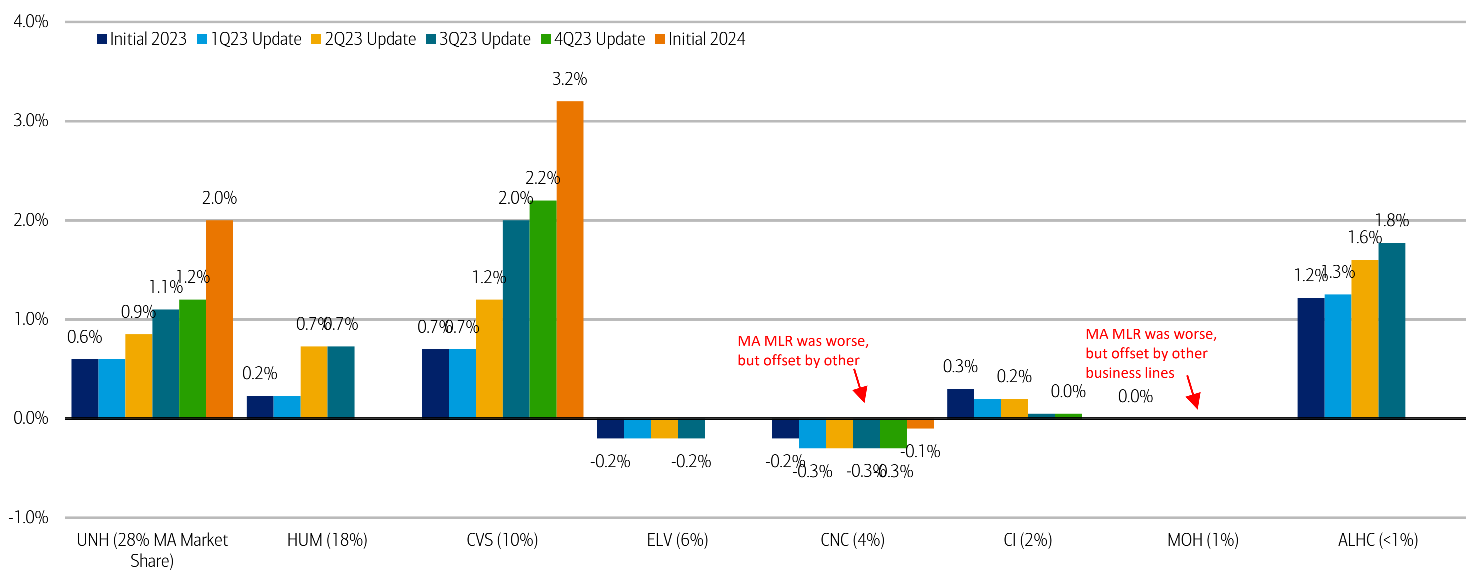
Insurers claim to have caught 'elevated utilization' in time for 2024

Therefore, when companies began to talk about increasing MLR in June, the first question investors asked was if the insurers had caught the issue in time for when they submitted their bids 2024 in June. For the most part, companies have assured investors that they did catch at least some of the costs in time (eg UNH indicated that it fully caught the cost pressure, while HUM and CVS indicated that it caught some, but not all of the cost pressure when they bid in June).

But since MLR continued to be pressured in 2023, its likely not fully baked in

However, the fact that insurers only really communicated to investors that cost trend was elevated after bids were due, and that MLR generally continued to disappoint in 3rd quarter and now even 4th quarter (at least at CVS and UNH), suggests that to some degree margins will continue to be depressed in 2024. Supporting that view, all of the MCOs who have already given MLR guidance (UNH, CVS and CNC) each see higher Medicare MLR in 2024. However, we note that in the case of MA MLR, at least part of the 2024 pressure is from rate cuts, rather than cost trend.

Exhibit 2: For most Medicare Advantage companies, MLR continues to drift upwards past 2022 levels
Difference between most current MLR guidance at time of update versus 2022 results by company



Source: Company Filings, BofA Global Research
Note: UNH 4Q23 update reflects reported FY23 results

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Appears MLR not going back to 2022 levels just yet

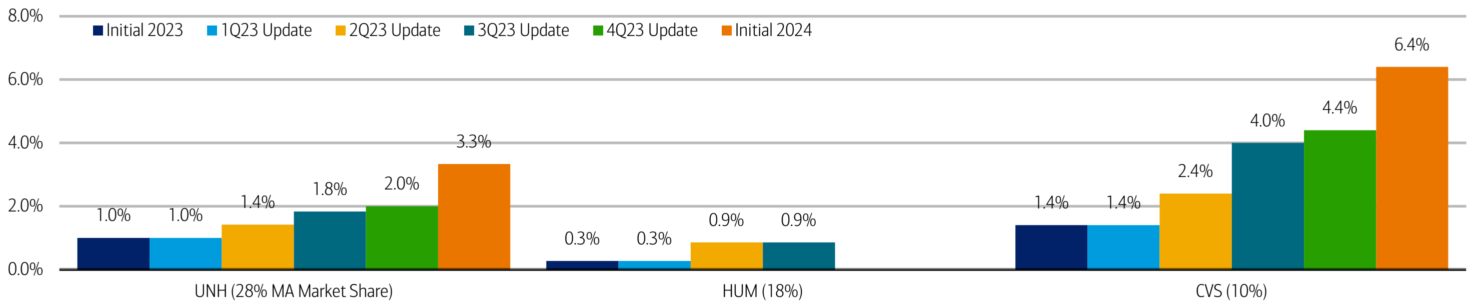
If we try to take a closer look at the major MA platforms, and assume that all of the MLR guidance raises over 2022 levels are related to MA (divided MLR increases by MA premium mix) it implies MLRs have increased 100-400bps in 2023. Ideally, we would have been looking for decreased MLR in 2024, to get back to 2022 levels of margins. However, both UNH and CVS guided up an incremental 150bps-200bps. Part of this increase, is likely caused by not catching the elevated utilization in time to be fully contemplated in 2024. The rest is likely due to reimbursement changes. For one, CVS is facing a 380bps headwind from Stars (though it claims it is absorbing only 180bps), while UNH is facing 80bps of gross pressure from stars as well. Additionally, the 2024 rates include risk model revision changes which are an additional source of revenue pressure in the 100-300bps range.

UNH said it is still at 'target margin', even though it will be lower y/y

That being said, UNH claims that it was able to offset the MLR pressure in 2024 with G&A cuts such that it is still earning 'target margin' in MA, though it seems clear to us that margins on an apples to apples basis are lower. At their Investor Day, UNH essentially acknowledged that it was above its target in 2023, noting that "we can still be at the high end of our target range in 2024 and be down y/y."

Exhibit 3: Closer look suggests MA MLR is now hundreds of basis points above 2022 levels

Difference between most current MLR guidance at time of update versus 2022 results by company, assuming it's all related to MA (dividing by MA premium mix)



Source: Company Filings, BofA Global Research

Note: UNH 4Q23 update reflects reported FY23 results

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Growth expectations at CVS vs UNH raises more questions

When an insurer grows significantly faster than its competitors, it implies that its relative value proposition has improved. The key question is "Why?". If one company's cost structure improved relative to another due to changes in company specific reimbursement or vendor contracting dynamics, and both companies had similar views of cost trend then arguably both companies should be maintaining margins, and capturing their 'fair share' of members (eg HUM should have grown faster than peers in 2023, a year where it identifies $1B of cost savings, without necessarily impacting their margins). However, if one company underestimated cost trend, and priced benefits based on an 'aggressive' or 'incorrect' view of what costs could look like, it would imply that at least part of its growth was unsustainable. With that framework in mind, and the backdrop of all major MA insurers mispricing 2023, we can attempt to parse out bid assumptions in 2024 based on what each MCO's growth expectations are.

Wide delta in growth expectations points to a number of plausible explanations

Most notably, CVS is expecting to grow 4-5x faster than UNH. The magnitude of the variance between two of the largest three carriers is so significant that for it to be rational, it must mean either: **1)** the underlying relative cost structures relative to their payments have dramatically changed, or **2)** the companies built different views about how utilization would trend into 2024 pricing.

UNH likely assumed a bigger reimbursement headwind in 2024 bids

On the first point (the reimbursement component), CVS had a greater headwind from Stars in 2024 than UNH did, meaning it should have been pulling back on benefits to offset lower revenues. However, CVS expected to recapture its stars performance in 2025, so instead of cutting benefits in 2024 and then adding them back in 2025, CVS priced to keep benefits more stable and is taking some margin dilution in 2024. All in, this means that the amount of benefits that each company needs to cut to address the stars headwind according to their strategy, is not as wide as the headline difference. Meanwhile, UNH is most likely facing a much larger headwind than CVS on the risk model revision changes, given it was more exposed to value based care (which tends to drive higher risk scores) through OptumHealth. UNH is also more exposed to duals, the customer subsegment most impacted by the coding changes (since they were more medically complex, they tended to have more codes/person, so any change to coding him them more). Therefore, from a reimbursement perspective, UNH likely did 'assume' a net, bigger headwind to rates.

However, CVS was clearly more aggressive on utilization assumptions

On the component of that (utilization assumptions), the fact CVS still guided up 2023 MLR as recently as last week implies they are still surprised by how utilization continued to increase. On top of this, the fact that they revised up membership forecasts (from +18% to +23%), implies that they are surprised by how competitors priced (potentially implying a differing view on cost trend). We don't yet know HUM's membership growth, but their trend commentary also implies that they will not fully recapture the trend pressure in 2024, and thus used "aggressive" trend assumptions for 2024.

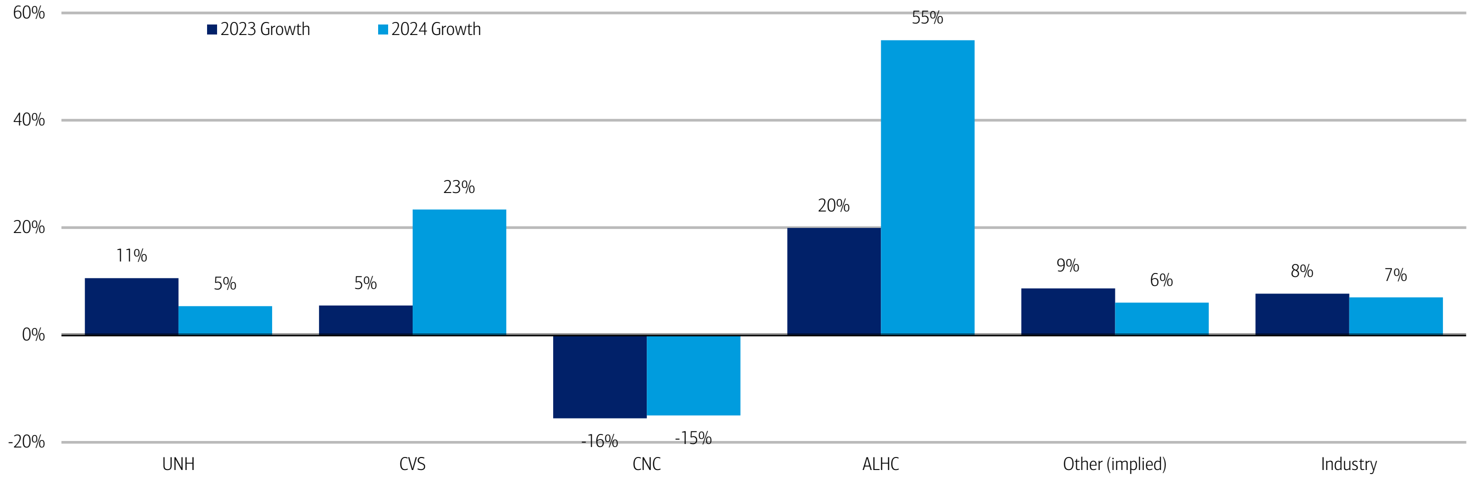
Market share will ultimately shake out based on which impact was bigger

These two factors both point to UNH pricing more conservatively and growing more slowly, but one factor (trend forecasting) implies that UNH will reaccelerate growth in the future as peers have to reprice to costs, while the other factor (higher revenue headwinds), points to UNH continuing to face relative competitive pressure and continued growth below trend in 2025/26 as the rate cut continues to phase in. Given how close to the market rate that UNH was able to grow when it (apparently) had more conservative views on trend and a bigger rate headwind, at this point, it appears likely that UNH will see faster growth in 2025, as some competitors reprice relative to their 2024 pricing, and we would expect to see UNH grow at/above the market rate. We note that even if none of the peers mispriced relative to their guidance, UNH should still grow above average because it is the only company talking about being at the target margin in 2024, so peers likely will price at least for some margin improvement in the out years.

Based on scale of CVS/UNH, unlikely HUM grew more than 8% or less than 4%

Notably, based on these membership figures, and CMS estimates for the industry to grow 7%, it implies that the MCOs not listed here (HUM, ELV, CI, and the rest of the industry) will only grow 6% collectively.

Exhibit 4: Membership forecasts from companies are giving us mixed signals
Highlighting membership growth expectations for companies who have given explicit guidance



Source: Company Filings, BofA Global Research

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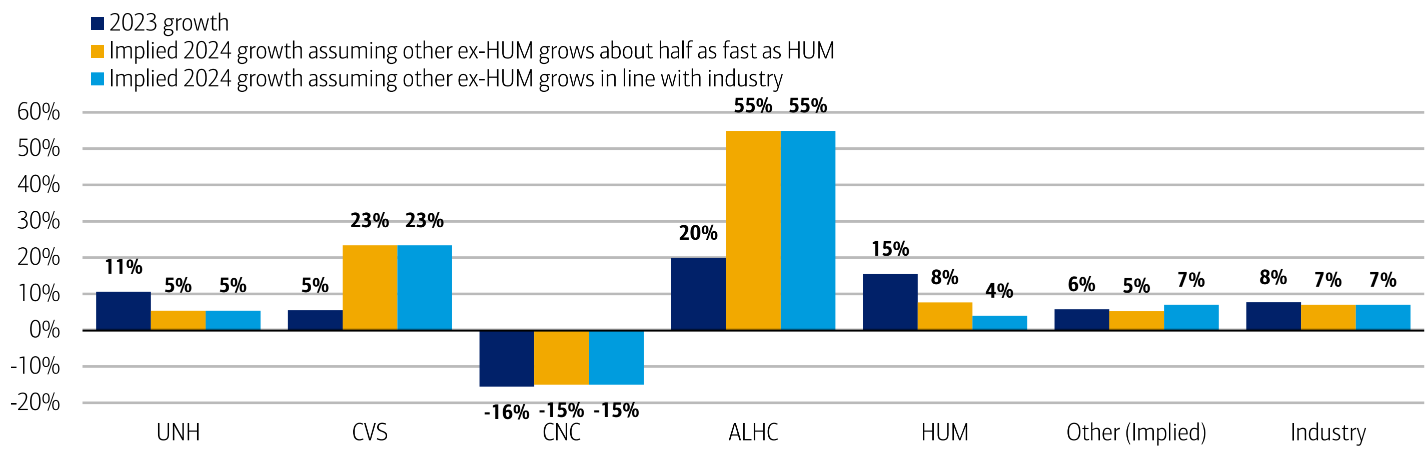
We note that ex-HUM, in 2023 the "other" bucket grew about half as fast as HUM, and if that happened again in 2024, it would imply that HUM would grow 8%. If we assume that the "other" bucket ex-HUM grows in-line with the industry growth rate (which we see as unlikely), it would imply that HUM grows 4%.

Exhibit 5: Based on our estimates, it is unlikely HUM will grow less than 4% in 2024
Estimating HUM's membership growth in 2024



Source: BofA Global Research estimates

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MA is still a good business; competitive fears overblown

The pandemic and subsequent recovery has created an unusually volatile period for health insurers. Historically, healthcare utilization was predictably growing in the low single digit range, with minimal standard deviation, meaning that if MCOs mispriced, MLR implications were generally in the dozens of basis points. However, COVID disrupted patient behavior at an unprecedented scale, driving a huge upfront drop in healthcare utilization, followed by difficult to predict surges in the recovery back to baseline, causing cycles of MLR beats and misses in the triple digits.

Uncertainty made it difficult for insurers/governments to predict costs

After utilization fell across the board in 2020, MCOS talked about commercial trend actually going above normal in 2021 (younger people used the system normally plus they got COVID), MA was below trend and Medicaid was below that. This played out again in 2022 (commercial above, MA below and Medicaid below that). When pricing 2023, MA plans had two years of below average trend data points and likely were somewhat aggressive in where trend would be in 2023. Meanwhile, with MA trend below the baseline, there was more room for utilization to snap back up whenever things normalized, creating a perfect storm for a trend issue.

To underscore how difficult it was to predict this trend, we note that every major MCO got it wrong in 2023, while both hospitals and Medtech (the other players who should have seen this coming) blew away their utilization projections. So in many ways we were still rebounding off of unprecedented disruption in care patterns. It would obviously be better if MCOs got it right, but it doesn't seem logical to assume that things are permanently broken just because they got them wrong in a year like 2023.

Margin revision may be delayed to 2025 if utilization wasn't caught in time

This normally would argue for a strong set up to 2024 as the industry should have been forced to price conservatively after a year of pressure in 2023. However, it's not clear that insurers as an industry were able to fully capture the higher levels of costs in time for bid submissions. The impact of risk coding changes in 2024 further cloud what would normally be a margin mean reversion story. Therefore, the 'boom' period is more likely to come in 2025.

Even if MLR is elevated, MCOs can still demonstrate costs are under control

That said, even if MLR remains under pressure in 2024, it's not too late to reset investor expectations. UNH, CVS, and CNC have now all raised Medicare MLR guidance y/y, and even if it means margins are below targets, if MCOs at least show investors they have a handle on forecasting costs (by beating earnings guidance through MLR upside), it should help restore confidence in 2025 pricing, and possible margin improvement. It is worth reinforcing that beating "the right way" (on MLR not G&A), will be the key to demonstrating that they have a handle on costs, which will be the key to multiple expansion.

Based on company disclosures, unless utilization comes in extremely favorably vs industry expectations, it's clear that MCOs won't be earning target underwriting margins in 2024. Given it is the second year in a row of margin compression, and companies like CVS are still looking to get aggressive on taking market share, it has spurred fears that industry pricing has become irrational and that the market's previous view of 'target margins' is now permanently impaired.

Cost trend unlikely to be this high again in 2024

As noted above, entering 2023, we estimated that hospital volumes were 8% below trend, but after strong growth in 2023, we now estimate that volumes are only 3% below the LT trend. Although volumes are still below trend, which could lead to a continued snap back in 2024, almost by definition, the magnitude of that growth in volumes should be less. However, UNH and peer MCOs are now forecasting that this trend growth continues in 2024, a dynamic which increasingly seems conservative.

Industry wide margin compression fuels concerns of 'new normal'

The bear view on MA is that the sector is too competitive and margin compression is the new normal. UNH is facing margin compression (even though it still expects to be at the high end of its target range), both HUM/ELV are below 'target margins' and CVS, CNC and CI will all be operating at a loss in 2024. Additionally, companies like UNH/CVS/HUM/ELV are increasingly building out healthcare service capabilities which can increase 'non-insurance' earnings of an MA member. This creates the fear that

MCOs can rationally justify earning a lower margin on the insurance side if it means earning the same amount or more at the enterprise level.

However, there are also signs of prices firming, benefiting incumbents

We note that while there is cause for concern, there are also a number of indications that pricing is firming. First, some of the mid-sized plans with high growth ambitions like CNC are slated to shrink its membership 15%+, while MOH and CLOV have also talking about having priced for margin. Meanwhile, some companies such as BHG, OSCR and now even CI are on track to exit the MA market entirely as they concluded (after sinking billions of dollars in M&A/statutory capital) that they cannot compete with the more scaled incumbents.

Meanwhile, the argument that MA plans may look to use membership as loss leaders to drive volumes and profits to their provider business is a risk long-term but falls flat as a reason for margin compression today. UNH is the only company who is profitable in these businesses, so cutting your MA margin to steer more volume to your breakeven/money losing provider assets does not make sense for companies valued on EPS. Meanwhile, if this were true, wouldn't UNH and HUM also being growing meaningfully above average in 2024? But even if you believe this thesis, it is all the more reason to own UNH and HUM, who are the most advanced in this strategy and best positioned to monetize the MA membership that they have.

Conclusion: More likely a mispricing than a new normal

Clearly 2023 was a disappointment, as margins did not materialize the way insurers and investors had hoped. After sounding optimistic in the first quarter, MCOs reversed course entirely and MLR expectations only got worse as underlying healthcare utilization increased faster than the industry anticipated. It's not entirely clear that insurers have fully contemplated those higher costs in 2024 bids, just at the time when the government is pressuring rates for the industry. Therefore, we may be facing another year of below average margins.

To us, the most likely answer is that the lower margins for the industry are the result of difficulty pricing to trend post-COVID. The good news is that guidance largely contemplates this, and with trend now closer to normal than in 2022, the potential variability around trend estimates seems much smaller. With smaller companies shrinking and exiting the market, the market actually feels closer to bottoming from a pricing perspective, which bodes well for future margin reversion and speaks to the advantages that the scaled incumbents like UNH have in MA.

Abbreviations

MCO = Managed care organization

MLR = Medical loss ratio

UNH = UnitedHealth Group

CVS = CVS Health

CNC = Centene

MA = Medicare Advantage

MOH = Molina

BHG = Bright Health

OSCR = Oscar Health

CI = Cigna

HUM = Humana

ELV = Elevance

Price objective basis & risk

UnitedHealth Group (UNH)

Our $675 price objective (PO) is based on a 2024E EPS multiple of 24.0x, a premium to UNH's five year historical average of 19.6x. This is justified, in our opinion, by the growing share of earnings coming from Optum as well as the significant growth potential of Optum, UNH's Health Care Services platform, which has higher margins and unregulated cash flow. Our PO is also supported by our sum-of-the-parts (SOTP) valuation.

Downside risks to our PO are that healthcare utilization rebounds faster than expected, that growth targets for Optum are not achieved, or that political/regulatory risk intensifies.

Analyst Certification

I, Kevin Fischbeck, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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
	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
	Oscar Health	OSCR	OSCR US	Adam Ron
	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				
	Alignment Healthcare	ALHC	ALHC US	Adam Ron
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	Apollo Medical	AMEH	AMEH US	Adam Ron
	Brookdale	BKD	BKD US	Joanna Gajuk
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA
UNDERPERFORM				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	Agiliti Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	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

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings	**Numerator**	**Denominator**
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	**Numerator**	**Denominator**
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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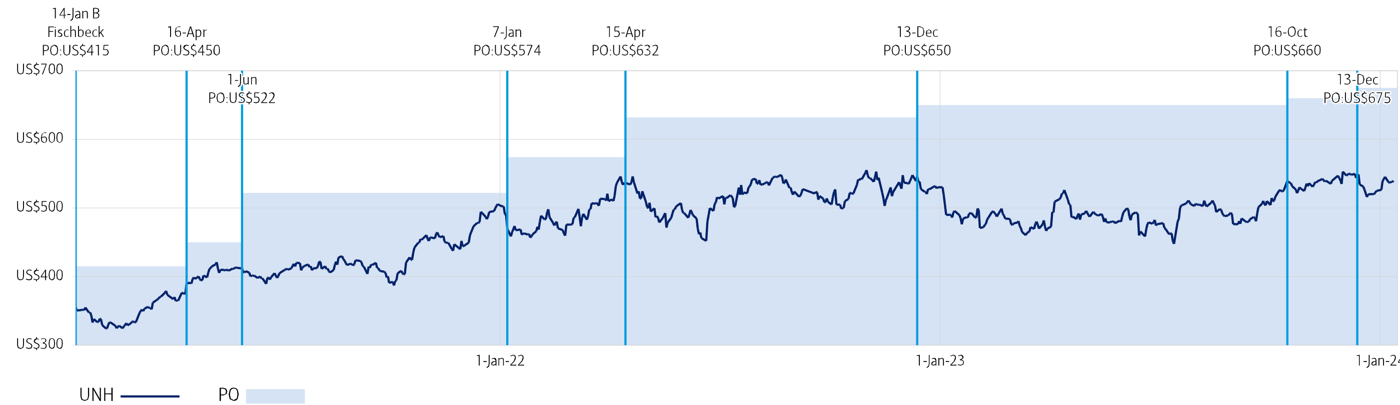
Important Disclosures

UnitedHealth Grp (UNH) 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 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[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]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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