

Centene Corporation

Redetermining our outlook to Neutral

Rating Change: NEUTRAL | PO: 72.00 USD | Price: 61.27 USD

Downside likely limited, but upside still unclear

We are upgrading Centene (CNC) from Underperform to Neutral as we no longer see a significant downside case. The company is now trading below 10x 2024E EPS, which is historically a floor for MCO valuations, while the new earnings expectations have been rebased to (at least partially) include most of the major risks (RFP losses, Medicaid redeterminations, MA margins). We do not yet have visibility into the timing of operational improvements, and we are lowering our PO to \$72 from \$79 to reflect this uncertainty (11x 2024E EPS vs 12x previously). Getting closer to redetermination clarity suggests that risk-reward is starting to swing towards the positive as sentiment bottoms, but valuations are likely to remain depressed while we work through repurchases and MA improvement over the next year+, resulting in our Neutral rating.

Redeterminations risk to be addressed in next 12 months

With CNC now trading at a 25% discount to its 5-year P/E multiple and 2024 earnings expectations revised down 13% (\$6.60 guidance vs \$7.63 originally), it now appears to us that many of the key risks are priced in. Medicaid redeterminations could drive further negative earnings revisions in the next couple of quarters as states cut enrollment and the risk pool worsens, but any near term margin pressure should be repriced as states update rates through 2024, leaving 2025 largely intact.

Major contract awards, Medicare Stars remain overhangs

With valuations pointing to limited downside, and redeterminations resolving over the next 12 months, we move to Neutral. However, there are still a few key uncertainties that may limit upside. By early 2024, two key states (TX + FL) which represent more than 10% of EPS will announce re-procurement awards. While CNC has already factored some modest membership losses into guidance, a more severe scenario could reduce estimates, but more importantly hit sentiment. Meanwhile, the company's ability to compete in Medicare Advantage hinges on improving Stars performance, making 2026 ratings (released in October of next year) a critical catalyst.

Estimates(Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	5.15	5.75	6.45	6.55	7.33
GAAP EPS	2.27	2.03	5.66	5.14	5.81
EPS Change (YoY)	2.8%	11.7%	12.2%	1.6%	11.9%
Consensus EPS (Bloomberg)	5.12	5.73	6.47	6.62	7.42
Valuation (Dec)					
P/E	11.9x	10.7x	9.5x	9.4x	8.4x
GAAP P/E	27.0x	30.2x	10.8x	11.9x	10.5x
Dividend Yield	0%	0%	0%	0%	8.2%
EV / EBITDA*	8.8x	8.1x	8.8x	9.6x	8.8x
Free Cash Flow Yield*	8.9%	14.2%	21.3%	10.2%	11.3%

* For full definitions of *IQmethod*SM measures, see page 5.

05 September 2023

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-3-9	B-2-9
Inv. Rating	UNDERPERFORM	NEUTRAL
Price Obj.	79.00	72.00

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Stock Data

Price	61.27 USD
Price Objective	72.00 USD
Date Established	5-Sep-2023
Investment Opinion	B-2-9
52-Week Range	60.83 USD - 93.58 USD
Mrkt Val (mn) / Shares Out (mn)	35,760 USD / 583.6
Average Daily Value (mn)	190.70 USD
BofA Ticker / Exchange	CNC / NYS
Bloomberg / Reuters	CNC US / CNC.N
ROE (2023E)	14.1%
Net Dbt to Eqty (Dec-2022A)	24.7%
ESGMeter™	High

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Timestamp: 05 September 2023 06:01AM EDT

iQprofileSM Centene Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	4.6%	5.2%	4.6%	3.9%	8.2%
Return on Equity	11.5%	13.1%	14.1%	13.2%	28.1%
Operating Margin	2.4%	2.3%	2.4%	2.5%	2.6%
Free Cash Flow	3,181	5,092	7,624	3,663	4,023

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.3x	1.8x	2.4x	1.3x	1.3x
Asset Replacement Ratio	0.6x	0.6x	0.7x	0.7x	0.8x
Tax Rate	14.5%	17.8%	24.1%	24.0%	24.0%
Net Debt-to-Equity Ratio	21.3%	24.7%	1.5%	-0.4%	NA
Interest Cover	NA	NA	NA	NA	NA

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	125,982	144,547	147,350	33,643	35,892
% Change	NA	NA	NA	NA	NA
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	4,739	5,189	4,740	4,376	4,749
% Change	NA	NA	NA	NA	NA
Net Interest & Other Income	29	644	655	410	310
Net Income (Adjusted)	3,032	3,328	3,537	3,443	3,682
% 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	3,109	2,725	2,933
Depreciation & Amortization	1,476	1,553	1,258	1,216	1,216
Change in Working Capital	1,376	2,194	4,339	500	500
Deferred Taxation Charge	(132)	(631)	(162)	(4)	(4)
Other Adjustments, Net	NA	NA	NA	NA	NA
Capital Expenditure	(910)	(1,004)	(865)	(893)	(921)
Free Cash Flow	3,181	5,092	7,624	3,663	4,023
% Change	NA	NA	NA	NA	NA

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	13,118	12,074	17,609	18,116	0
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	NA	NA	NA	NA	NA
Property, Plant & Equipment	3,391	2,432	2,233	1,910	0
Other Non-Current Assets	NA	NA	NA	NA	NA
Total Assets	78,375	76,870	84,576	83,957	0
Short-Term Debt	267	82	110	110	0
Other Current Liabilities	NA	NA	NA	NA	NA
Long-Term Debt	18,571	17,938	17,896	17,896	0
Other Non-Current Liabilities	NA	NA	NA	NA	NA
Total Liabilities	51,498	52,757	58,484	57,740	0
Total Equity	26,877	24,113	26,092	26,217	0
Total Equity & Liabilities	78,375	76,870	84,576	83,957	0

* For full definitions of iQmethodSM measures, see page 5.

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 3,112,439

Quarterly Earnings Estimates

	2022	2023
Q1	1.83A	2.11A
Q2	1.77A	2.10A
Q3	1.30A	1.46E
Q4	0.86A	0.78E



Price objective basis & risk

Centene Corporation (CNC)

Our \$72 price objective is based on an 11x 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	Kevin Fischbeck, CFA
	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
	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	Apollo Medical	AMEH	AMEH US	Adam Ron
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Community Health Systems	CYH	CYH US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA
	Oscar Health	OSCR	OSCR US	Kevin Fischbeck, CFA
UNDERPERFORM				
	Brookdale	BKD	BKD US	Joanna Gajuk
	Cano Health	CANO	CANO US	Adam Ron
	Clover Health	CLOV	CLOV 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

US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Pediatric Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
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	$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$	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	$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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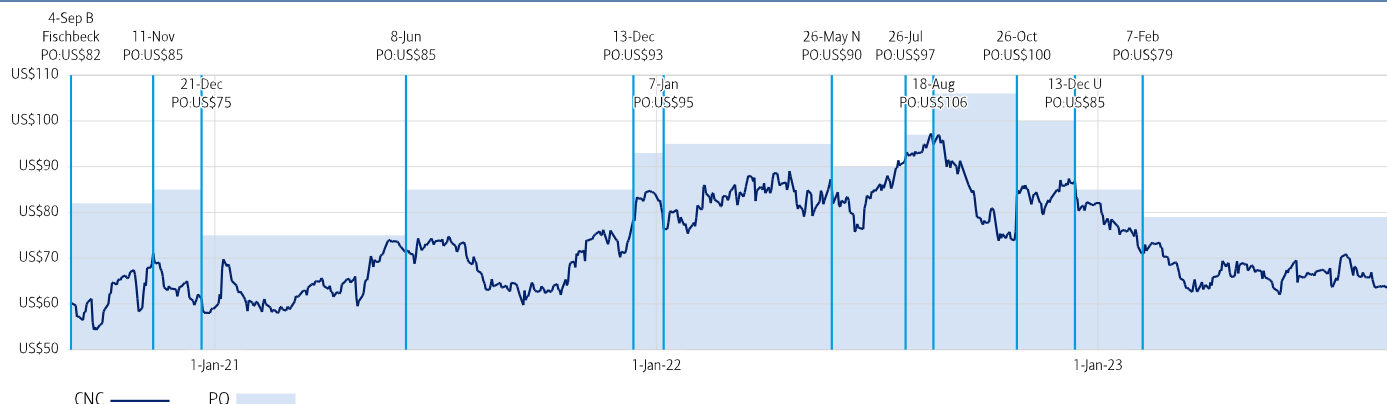
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Centene Corporation (CNC) Price Chart



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 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	236	57.84%	Buy	105	44.49%
Hold	87	21.32%	Hold	38	43.68%
Sell	85	20.83%	Sell	22	25.88%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{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%

^{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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