

Centene Corporation

Investor Day: increasing confidence in managing 2024, longer-term growth

Reiterate Rating: NEUTRAL | PO: 80.00 USD | Price: 74.25 USD

Path to 12-15% growth requires execution

CNC raised expectations for 2024 and detailed the path to 12-15% EPS CAGR in 2025+. While it signaled confidence in key initiatives, we reiterate our Neutral rating, as we believe that the algorithm is achievable but visibility is lower as it relies on fixing its MA business (losing money and shrinking) and regulatory stability for the exchanges (2026 could shrink 30% if Congress does not extend subsidies). However, the ability to raise guide this early is a positive. We therefore raise our estimates and PO from \$76 to \$80 (based on 11.9x new 2024E EPS versus 11.6x previously given our increased confidence in guided 2024 EPS).

Redeterminations offset by organic wins, PBM change

Medicaid revenues should decline ~\$5b next year versus the initial expectation of \$10b due to better rate increases (+2.0%-2.5% versus +1.0%-1.5% historically) and new contract wins in AZ/NC/OK starting or annualizing in 2024. Management believes that 80% of net disenrollment will be completed from redeterminations by end-of-year 2023 as many members re-enroll in 2024. On MLR, CNC sees just a 10bps increase y/y as it absorbs 30bps from acuity pressure (previously thought 50bps), offset by 20bps of PBM contract cost improvement. It believes that it can reclaim those 30bps in 2025+ as rates reflect acuity. Post 2024, CNC expects to grow Medicaid revenue long term by 6-7% (versus the industry rate of 5%) through LSD rate increases, modest share gains, and growing penetration on \$150b of untapped government spend.

Growing exchanges nearly 20% while expanding margins

CNC expects >16% growth on exchanges through revenue annualization, rate increases, modest member growth (it sees upside as likely). As a result of higher retention, it expects MLR to drop 140bps, as well as G&A leverage, getting it to its 5.0%-7.5% margin target. CNC assumes MSD-HSD long-term revenue growth versus industry spending growth of 8%.

Rightsizing MA membership and margins as it fixes stars

MA membership should drop mid-teens, with revenues down nearly 20% as CNC begins to reprice to a more sustainable cost structure but makes investments in duals, which should decline less. MLR should still increase 420bps y/y due to the impact of stars, utilization, and rates. From 2024 to 2025, it will focus on membership “stability” and margin improvement, but if it can start to make progress on 85% of members in 3.5+ star plans and SG&A, it could be able to fix margins and get back to HSD revenue growth in 2026+.

Estimates(Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	5.15	5.75	6.60	6.70	7.50
GAAP EPS	2.27	2.03	4.94	5.60	6.41
EPS Change (YoY)	2.8%	11.7%	14.8%	1.5%	11.9%
Consensus EPS (Bloomberg)	5.12	5.73	6.65	6.77	7.51
Valuation (Dec)					
P/E	14.4x	12.9x	11.3x	11.1x	9.9x
GAAP P/E	32.7x	36.6x	15.0x	13.3x	11.6x
Dividend Yield	0%	0%	0%	0%	6.7%
EV / EBITDA*	8.7x	8.0x	8.3x	9.1x	8.6x
Free Cash Flow Yield*	7.9%	12.7%	20.1%	17.4%	18.3%

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

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Timestamp: 13 December 2023 12:05AM EST

13 December 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	76.00	80.00
2024E Rev (m)	136,949.1	143,981.4
2025E Rev (m)	143,103.9	149,774.5
2024E EPS	6.55	6.70
2025E EPS	7.33	7.50

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Stock Data

Price	74.25 USD
Price Objective	80.00 USD
Date Established	13-Dec-2023
Investment Opinion	B-2-9
52-Week Range	60.83 USD - 87.19 USD
Mrkt Val (mn) / Shares Out (mn)	40,189 USD / 541.3
Free Float	99.3%
Average Daily Value (mn)	219.84 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".

See page 3 for
acronyms/abbreviations.

iQprofileSM Centene Corporation

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	4.6%	5.2%	4.7%	4.1%	8.8%
Return on Equity	11.5%	13.1%	14.6%	14.0%	29.7%
Operating Margin	2.4%	2.3%	2.4%	2.4%	2.5%
Free Cash Flow	3,181	5,092	8,068	6,986	7,353

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.3x	1.8x	2.5x	2.2x	2.2x
Asset Replacement Ratio	0.6x	0.6x	0.6x	0.5x	0.5x
Tax Rate	14.5%	17.8%	22.6%	24.6%	24.6%
Net Debt-to-Equity Ratio	21.3%	24.7%	-3.0%	-16.3%	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	36,009	37,766
% Change	NA	NA	NA	NA	NA
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	4,739	5,189	4,962	4,556	4,823
% Change	NA	NA	NA	NA	NA
Net Interest & Other Income	29	644	483	699	718
Net Income (Adjusted)	3,032	3,328	3,597	3,506	3,694
% 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	2,949	3,165
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)	(640)	(668)
Free Cash Flow	3,181	5,092	8,068	6,986	7,353
% Change	NA	NA	NA	NA	NA
Share / Issue Repurchase	(297)	(3,096)	(1,902)	(3,250)	(1,500)
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	1,833	(1,130)	200	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	13,118	12,074	18,746	22,042	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	1,216	0
Other Non-Current Assets	NA	NA	NA	NA	NA
Total Assets	78,375	76,870	84,469	84,105	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	59,315	59,252	0
Total Equity	26,877	24,113	25,154	24,853	0
Total Equity & Liabilities	78,375	76,870	84,469	84,105	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 reprocurement 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 2960,417

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

Acronyms

AZ = Arizona

CNC = Centene

HSD = High single digit

LSD = Low single digit

LT = Long-term

MA = Medicare Advantage

MLR = Medical loss ratio

MSD = Mid-single digit

NC = North Carolina

OK = Oklahoma

PBM = Pharmacy benefit manager



Price objective basis & risk

Centene Corporation (CNC)

Our \$80 price objective is based on an 11.9x 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

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.

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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
	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
	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
	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA

US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	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
	Pediatric 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

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

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

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

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

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

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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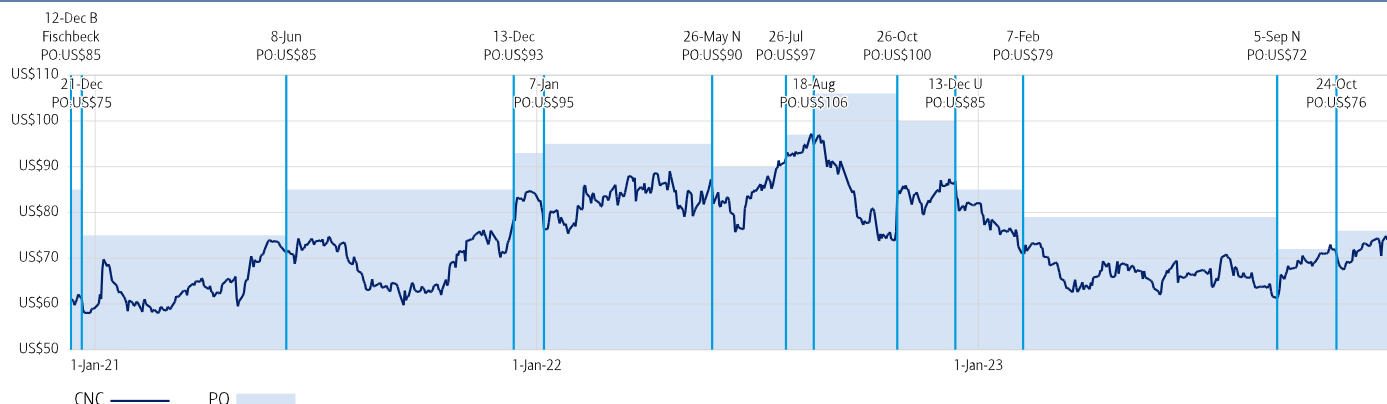
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Centene Corporation (CNC) Price Chart



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%

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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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