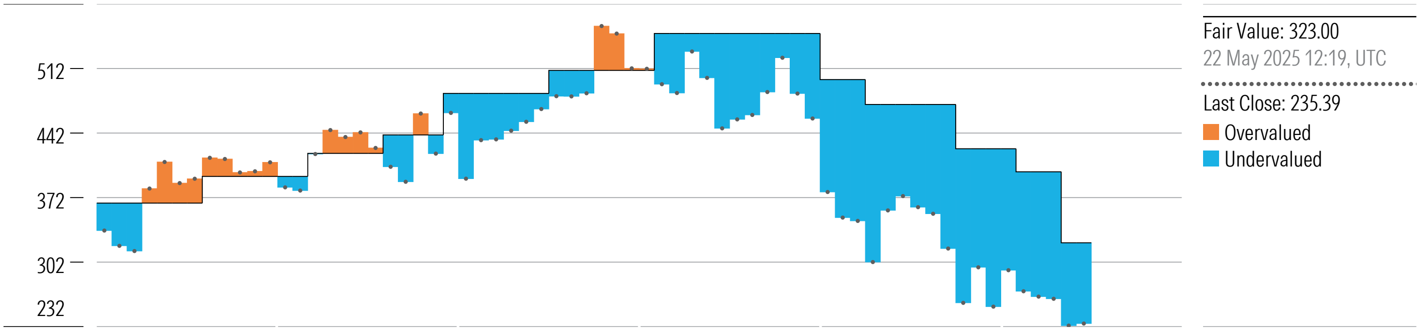
Morningstar Equity Analyst Report | Report as of 17 Jun 2025 03:34, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 1 of 23

Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

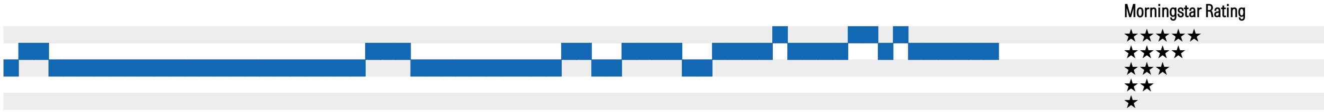
Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
235.39 USD 16 Jun 2025	323.00 USD 22 May 2025 12:19, UTC	0.73	28.41 USD Bil 16 Jun 2025	Narrow	Mid Value	Very High	Standard	4 Jun 2025 05:00, UTC

Price vs. Fair Value



	2020	2021	2022	2023	2024	YTD	
	1.04	0.96	1.00	0.83	0.60	0.73	Price/Fair Value
	12.62	13.74	11.10	-9.93	-43.81	-6.87	Total Return %

Morningstar Rating



Total Return % as of 16 Jun 2025. Last Close as of 16 Jun 2025. Fair Value as of 22 May 2025 12:19, UTC.

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The primary analyst covering this company does not own its stock.

[1] The ESG Risk Rating Assessment is a representation of Sustainalytics' ESG Risk Rating.

Humana: Management Makes Bull Case for Long-Term Shareholders at Analyst Day

Analyst Note Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

Humana held its analyst day on June 16, 2025, in which it highlighted its near- and long-term earnings potential. Shares were treading water in after-hours trading following that event.

Why it matters: Humana's outlook through 2027 looks likely to stay constrained by its Medicare Advantage, or MA, challenges, which the market appears focused on, but management's longer-term outlook exceeds our base-case expectations and could eventually boost shares if achieved.

- In that bull case, management expects at least $3.3 billion in pretax profit growth by 2028, or more than double our 2025 expectations, which could boost adjusted EPS to roughly $40 per share from slightly more than $16 expected in 2025 before settling into a double-digit growth rate thereafter.
- While ongoing MA risks cast uncertainty around that profit goal, in our opinion, we appreciate that the team is focusing on factors that it can control to improve profits, with the potential profit growth balanced about equally in core business profit growth and in enterprise operating leverage.

The bottom line: Humana's shares look heavily discounted below our $323 fair value estimate, and investors could be highly rewarded if management comes close to meeting the team's profit growth goals, which we view as a bull-case scenario worth over $550 per share for valuation purposes.

- We recently raised our Morningstar Uncertainty Rating on Humana to Very High from High because of the increasing regulatory scrutiny in MA. As the most concentrated MA insurer, Humana could be

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Sector
Healthcare

Industry
Healthcare Plans

Business Description

Humana is one of the largest private health insurers in the US, and the firm has built a niche specializing in government-sponsored programs, with nearly all its medical membership stemming from Medicare, Medicaid, and the military's Tricare program. Beyond medical insurance, the company provides other healthcare services, including primary-care services, at-home services, and pharmacy benefit management.

subject to a big clawback of recent overpayments and lower ongoing margins in that business.

- Our narrow moat rating appears intact, albeit dependent on an MA turnaround and manageable overpayment clawbacks.

Long view: We appreciated management's perspective on the longer term, which assumes that weak margins in both Medicare Advantage and Medicaid eventually improve by controlling what it can control rather than external pressures fully easing.

Business Strategy & Outlook Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

Humana remains a top-tier medical insurer, paying US caregivers to provide services through an integrated and value-based approach while also making the insurance experience easy to navigate for end users. Perhaps not surprisingly, given its founding as a nursing home in the 1960s, Humana places a special focus on serving elderly people, especially in its top-tier position in Medicare Advantage plans. Given US demographic trends and the increasing penetration of Medicare Advantage plans in the eligible population, Humana remains at the forefront of one of the fastest-growing areas in US medical insurance.

Within Medicare Advantage, the government aims to pay insurers like Humana the same amount that the traditional Medicare program pays to provide benefits for its consumers on a risk-adjusted basis. Then the insurer aims to lower the costs associated with caring for users by making them healthier while also providing additional benefits and generating a profit. Given that dynamic, incentive alignment with care providers appears more important in this product than in other health insurance products, and Humana sees this alignment as its key differentiator from other health insurance players. The company aims to place Medicare Advantage members with primary-care physicians that operate in value-based arrangements, which can encourage those providers to improve quality and costs. Humana owns some of these providers, including primary-care practices and acquired assets of the largest home healthcare provider in the United States, Kindred at Home. Also, the firm provides pharmacy benefit management functions, managing that key health input in an integrated fashion primarily for internal members.

While especially powerful in Medicare Advantage, this integrated approach benefits Humana in its other target markets too, including Medicaid and military plans. While ongoing MA challenges may constrain profits through 2027, management expects to more than double its earnings base from 2025 to 2028 before settling into a more normalized earnings growth trajectory in the double digits in the long run.

Bulls Say Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

- With its prowess in Medicare Advantage plans, Humana looks likely to benefit from strong demographic trends and increasing popularity of that program in the long run.

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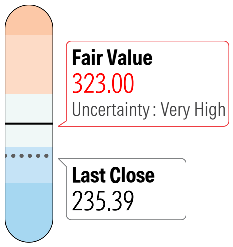
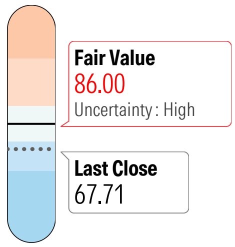
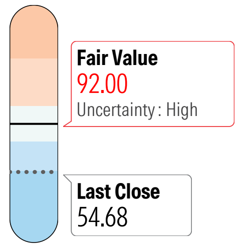
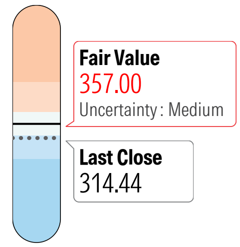
Competitors

	Humana Inc HUM	CVS Health Corp CVS	Centene Corp CNC	The Cigna Group CI
				
Economic Moat	Narrow	None	None	Narrow
Currency	USD	USD	USD	USD
Fair Value	323.00 22 May 2025 12:19, UTC	86.00 12 Feb 2025 18:02, UTC	92.00 12 Dec 2023 18:19, UTC	357.00 30 Jan 2025 16:41, UTC
1-Star Price	565.25	133.30	142.60	481.95
5-Star Price	161.50	51.60	55.20	249.90
Assessment	Undervalued 16 Jun 2025	Undervalued 16 Jun 2025	Undervalued 16 Jun 2025	Undervalued 16 Jun 2025
Morningstar Rating	★★★★16 Jun 2025 21:25, UTC	★★★★16 Jun 2025 21:28, UTC	★★★★16 Jun 2025 21:28, UTC	★★★★16 Jun 2025 21:27, UTC
Analyst	Julie Utterback, Senior Equity Analyst	Julie Utterback, Senior Equity Analyst	Julie Utterback, Senior Equity Analyst	Julie Utterback, Senior Equity Analyst
Capital Allocation	Standard	Standard	Standard	Standard
Price/Fair Value	0.73	0.79	0.59	0.88
Price/Sales	0.24	0.23	0.17	0.35
Price/Book	1.60	1.11	0.97	2.11
Price/Earning	16.61	14.57	7.00	11.39
Dividend Yield	1.50%	3.93%	0.00%	1.85%
Market Cap	28.41 Bil	85.65 Bil	27.21 Bil	84.00 Bil
52-Week Range	212.45—406.46	43.56—72.51	53.99—80.59	262.03—370.83
Investment Style	Mid Value	Large Value	Mid Value	Large Value

- Humana enjoys industry-leading customer satisfaction metrics that positively influence its brand and reputation in the consumer-driven Medicare Advantage and Medicaid insurance sectors.
- Humana's growth trajectory could rebound from current weakness, with management calling for pretax profits to more than double from 2025 to 2028 and grow in the low double digits in the long run at its June 2025 investor day.

Bears Say Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

- Healthcare policy changes may remain a key threat to private insurers like Humana for the foreseeable future.
- With its relatively concentrated operations, any missteps or significant regulatory changes in its target markets could have an amplified effect on Humana's bottom line relative to peers.
- As competitors increasingly focus on the Medicare Advantage market for growth, Humana may eventually face threats to its top-tier position in that attractive market.

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Economic Moat Julie Utterback, CFA, Senior Equity Analyst, 22 May 2025

Humana earns a narrow moat rating, which reflects its top-tier position in the US private health insurance market. Like many of its peers, Humana benefits from cost advantages, although its focus on Medicare-related plans makes it somewhat unique in the industry where intangible assets appear more important than in other medical insurance niches, although we do not recognize intangible assets as a company-wide moat source. Overall, with its ongoing competitive advantages in the US health insurance industry, we expect Humana to typically produce economic profits above capital costs during the next 10 years, although ongoing challenges in the Medicare Advantage market—where Humana did not price its MA plans well for surging utilization in 2024, delivered weak star ratings that may affect bonuses in 2026, and may face substantial clawbacks of recent overpayments—may make that more difficult than usual in the near term.

Medicare Advantage Leadership Keeps Humana's Moat Rating in Narrow Territory

Humana’s cost advantages relate primarily to scale in government programs like Medicare Advantage. For example, Humana enjoys the number-two position in Medicare Advantage, behind only UnitedHealth. While Humana’s market share is generally impressive in this program, that scale is even more admirable considering it competes primarily in retiree-friendly Sunbelt states, including Florida and Texas, versus UnitedHealth that has a broader national network. Humana is typically the number-one or -two Medicare Advantage insurer in the counties in which it offers plans, and Medicare Advantage enrollment share can rise closer to one out of every three in those core local markets. This local scale creates negotiating power over local service providers that cater to seniors in this end market, which we think contributes to its cost advantage over most Medicare Advantage peers.

For background in Medicare Advantage, the government aims to pay insurers like Humana roughly the same amount as the traditional Medicare program to provide benefits for seniors on a risk-adjusted basis. Then, the insurer needs to lower the costs associated with caring for users by making them healthier to provide additional benefits (dental, vision, pharmacy, and so on) while also generating a profit. Within this framework, insurers like Humana need specialized expertise in managing the needs of seniors to improve their health outcomes and ultimately lower costs. Humana has built up this expertise over decades, which generally helps it create a better experience for end users from beginning to end and contributes to intangible assets specifically in that end user-controlled market.

With its focus on making the complex healthcare system simpler and driving better health outcomes for end users, Humana typically leads the health insurers that we cover in terms of customer satisfaction, which we believe creates a brand-related intangible asset in this end market. In the consumer-driven Medicare Advantage market, factors like brand and differentiated benefits play a strong role for decision-makers because MA plans are sold directly to end users rather than through intermediaries,

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like employers, in most of the industry. Also, in Medicare Advantage, the government pays insurers bonuses related to star ratings achieved by each insurance plan (1 being the worst and 5 being the best) on measures of outcomes, processes, patient experience, and access. Typically, Humana stands out positively in terms of star ratings, too, scoring well above peers in 2019-24 ratings. However, the initial read on MA star ratings in 2025 is significantly below what Humana typically produces based on higher regulatory cutoff standards under Democrats and weaker-than-expected scores on phone center operations. These lower star ratings cut into Humana's marketing in 2025 and could put its bonus payments at risk in 2026, if its current legal challenge with the Centers for Medicare and Medicaid Services is unsuccessful as we currently model in our base case. However, in the long run, we expect Humana to improve its star ratings, with a particular focus in one plan where membership is highly concentrated, and we suspect regulatory scrutiny may even decline under Republicans versus the negative environment in recent years under Democrats.

Non-Insurance Markets Are Not Additive, but Not Destructive, to Humana's Moat

While probably not moat-worthy on a stand-alone basis, in our opinion, Humana's ownership of the fourth-largest pharmacy benefit manager and its growing presence in the provider space (primary care facilities and at-home health) help support the outcomes and cost management needed to run successful health insurance plans. Through both direct ownership and partnerships, Humana remains at the forefront of encouraging value-based offerings to boost health outcomes and better manage costs. Management continues to push members toward full-risk arrangements with providers, which could lead to higher profits for Humana and better health outcomes for patients than those in unaligned provider relationships, too.

Regulatory Concerns Create Potential Headwinds for Humana

Our narrow moat rating for Humana is informed by an analysis of potential changes to the US healthcare system, which is the key environmental, social, and governance risk that Humana faces in our opinion as efforts to achieve universal coverage may continue. During the next 10 years, we view scenarios where Humana profitably provides medical and pharmaceutical benefits primarily through government programs, such as Medicare Advantage and Medicaid managed-care plans, as more likely than not. Also, we expect its economic profits to rebound once it turns around its Medicare Advantage business in the intermediate term, even in a negative regulatory scenario that includes substantial but manageable clawbacks.

Fair Value and Profit Drivers Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

We are keeping our fair value estimate on Humana at $323 per share, which includes our view of increasing regulatory scrutiny on its Medicare Advantage business.

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After a very weak 2024 due to challenges in the Medicare Advantage business, we think the company's profit prospects will remain roughly stagnant through 2026 and then rise materially thereafter as margins rebound in its key government end markets through internal initiatives primarily. Specifically from a weak 2024 base through 2029, we expect high-single-digit revenue growth and midteens adjusted EPS growth on a compound annual basis in our base-case scenario. However, management recently offered up a bull-case scenario that could significantly outpace those base-case assumptions. Specifically, when using management's assumptions on pretax profit growth through 2028, adjusted EPS growth could accelerate to roughly 23% on a compound annual basis, and our bull-case fair value estimate would exceed $550 per share. Shares currently trade well below both our base- and bull-case scenarios though, and to reach recent share prices in the low-$200s we would need to assume a low-double-digit earnings growth compounded annually during the next five years, despite coming off a very weak base year in 2024.

Operationally, most of the company's membership growth will probably come from its fully insured business, particularly the Medicare Advantage business, which can have an amplified effect on results and is currently facing significant challenges. While still one of the fastest-growing end markets in medical insurance, Medicare Advantage is dealing with some growth headwinds, which may decelerate the firm's membership and/or profit growth trajectory, especially in the near future. Also, after higher-than-anticipated medical utilization started cutting into margins in late 2023, the company has prioritized margin improvement after a weak year in 2024. We expect operating margins to return to more normal levels by the end of its five-year forecast period, but there may be fits and starts if Humana cannot increase its star ratings after a weak initial read in October 2024, that could affect bonus payments in 2026, although Humana is currently challenging those ratings in court.

Beyond this operational uncertainty, Humana could face the clawback of overpayments from Medicare to the tune of $9 billion if the Office of Inspector General's estimates of Humana's overpayments in 2023 ($1.7 billion) are accurate and can be extrapolated to the years under scrutiny for clawback (2018-24).

Risk and Uncertainty Julie Utterback, CFA, Senior Equity Analyst, 17 Jun 2025

With significant uncertainty around its profit trajectory and other potential cash outflows due to ongoing challenges in Medicare Advantage, we have raised our Morningstar Uncertainty Rating to Very High, from High previously.

From a concentration perspective, all of the firm's medical membership is tied to government funding. While that exposes Humana to changes in federal and state budget priorities as shown with the recent weakness in Medicare Advantage results due to a mismatch in rates and utilization, we suspect this exposure will be more positive in the long run, especially as the Medicare Advantage population represents one of the strongest growth areas in the industry. However, the magnitude of potential clawbacks in that business look especially daunting and could result in a significant increase in financial leverage, especially if those outflows come due before Humana can turn around its MA business.

We also see other ESG-related risks around potential healthcare policy changes for Humana, especially during future election cycles, as access to universal, affordable coverage remains a key concern of the American public. For example, the Medicare for All scenario debated in the lead-up to the Democratic primaries in 2020 called for the elimination of the private insurance industry, which would have threatened most of the company's operations. While we view the probability of a Medicare for All-like scenario as virtually zero in the foreseeable future, other policy risks may threaten private insurer economic profit margins in future election cycles. After universal coverage levels are approached, we would look for regulators to focus on reducing healthcare inflation rates, perhaps by cutting into MCO profits in the long run.

Capital Allocation Julie Utterback, CFA, Senior Equity Analyst, 22 May 2025

Our Capital Allocation Rating for Humana remains Standard, including weak execution that pushed our investment assessment down to fair in early 2024 from exceptional previously. The company still operates with a sound balance sheet and appropriate distributions to shareholders, in our opinion.

In early 2024, we reduced our assessment of the investment component of our methodology to fair from exceptional on the material mispricing of its Medicare Advantage plans. In the past few years, this has happened two times. In 2022, the company kept prices too high, which led to weak membership growth in this key market, although profit growth skyrocketed that year as a result of not having to onboard new members that often generate lower profits for the insurer than seasoned members. In late 2023 and into 2024, the company misread medical utilization trends and did not price its plans appropriately to maintain margins with this spiking utilization. For 2025, the company's star ratings declined substantially, which will affect marketing in 2025 and bonus payments probably in 2026 (assuming legal challenges are unsuccessful), which could prevent the company from boosting its Medicare Advantage operating margins to its target of 3%. Overall, these ongoing problems in Humana's key end market suggest weaker execution than we previously gave Humana credit for in our investment assessment, which pushed our investment score down to fair from exceptional previously.

Looking beyond those factors, the company's top two capital allocation priorities revolve around investments in its business. First, the company prioritizes organic growth with a particular emphasis on investing in new care providers. Second, it remains interested in acquisitions and partnerships, such as its recent action to turn a minority stake in home healthcare provider Kindred at Home into a full stake. The company has said it plans to continue pursuing an integrated model of care to serve end users primarily in government-sponsored channels such as Medicare Advantage and Medicaid. So we expect more investments (de novo and acquisitions) primarily in its provider channels, including primary-care facility and home healthcare investments. These provider channels are particularly important in managing relatively high-cost patient populations like those served by government-sponsored programs, and we view the combination of provider and insurer assets as powerful from a profitability and moat perspective for companies like Humana.

After investments, Humana prioritizes returns to shareholders, which we view as appropriate. In the category of shareholder distributions, Humana aims to make share repurchases first. For example, in 2024, it repurchased about $1 billion in shares at a moderate discount to our fair value estimate at the time, and the company had roughly $3 billion remaining on its authorization to repurchase shares as of late 2024. Finally, Humana also pays a modest dividend to shareholders, which we expect can be at least maintained despite the weakness in near-term profit prospects. However, if potential clawback outflows require debt financing prior to profits rebounding in Medicare Advantage, the company's balance sheet assessment could drop into the weak category from the current sound.

Analyst Notes Archive

Healthcare Services: Medicaid and PBMs Still Under Fire in Updated Regulatory Moves Julie Utterback, CFA,Senior Equity Analyst,12 May 2025

On May 11 and 12, Republicans revealed updated regulatory stances that included plans to lower drug prices and pull back on Medicaid spending by about $715 billion over the next 10 years versus $880 billion expected previously. Why it matters: In early trading, top-tier Medicaid insurer Elevance and healthcare service providers like HCA and Tenet rose in the low single digits, as the potential Medicaid changes look better than feared. However, PBM-focused firms, like Cigna and CVS, fell on the drug pricing efforts. On May 11, Republican House members revealed a proposed bill that looks likely to cut Medicaid spending less than the initial goal, which may moderately buoy the profits of Medicaid-reliant service providers and managed care organizations. On May 12, President Donald Trump signed an order to lower US drug prices, which could eliminate a key function that PBMs provide to clients, as the government looks likely to undertake drug price negotiations or set prices to lower, most-favored-nation levels. The bottom line: We are keeping our fair value estimates intact for now, as Congress still needs to vote on Medicaid cuts, which are controversial even in Republican districts. Also, few details are known about how drug pricing negotiations would actually work, including how broadly they could reach. If Medicaid legislation passes as the House proposes, we would see the most risk at no-moat Centene, a Medicaid and individual exchange plan provider that faces a high-single-digit fair value cut under this bill plus the potential expiration of individual exchange subsidies. Narrow-moat Cigna faces the most downside risk if the US government starts negotiating drug prices, which is currently a key PBM function. It remains to be seen how broadly this order could reach beyond government programs, though, and service bundling may protect PBMs somewhat.

Humana Earnings: In-Line Medicare Advantage Utilization Keeps 2025 Outlook Intact Julie Utterback, CFA,Senior Equity Analyst,30 Apr 2025

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Humana delivered 60% adjusted EPS growth in the quarter and maintained its 2025 outlook. On an adjusted operating profit basis, medical insurance grew 75%, including a better medical loss ratio of 87.4% versus 89.4% a year ago, while its provider and PBM unit grew 35%. Why it matters: Humana's strong results and unchanged guidance are relieving investors after managed care bellwether and Medicare Advantage leader UnitedHealth reduced its 2025 outlook on higher-than-expected medical utilization in MA. Humana shares rose over 5% in early trading. Like key peer Elevance, Humana asserted that medical utilization was trending about as expected in its Medicare Advantage stronghold, helping Humana generate about 70% of its expected 2025 profits in the first quarter. However, even Humana's primary care physician operations performed well on solid operating trends and value-creation initiatives. This strong performance was in sharp contrast to the weakness in UnitedHealth's Optum Health provider operations this quarter. The bottom line: With Humana tracking toward our near-term expectations and with the potential to greatly expand its profits in the long run, we are keeping our fair value estimate at $400 per share. We continue to view Humana shares as significantly undervalued. Humana earns a narrow moat rating from us, but investors should know that its near-term outlook looks lackluster, especially because of a potentially weak 2026 bonus year after quality ratings fell. While we expect those ratings and related bonus payments to improve over time and boost Humana's profits, recent share prices suggest the market is not looking beyond Humana's near-term headwinds, creating an opportunity for investors with a long-term horizon. Coming up: Republicans appear focused on reducing federal spending on key healthcare end markets. However, we think potential downside risks for Humana are already reflected in its heavily discounted shares.

Medical Services: MCOs Immune, but Tariffs May Cause Near-Term Stress at Providers and Suppliers Julie Utterback, CFA,Senior Equity Analyst,10 Apr 2025

Over the past week, tariff-related news has created significant volatility in the US market, including in medical services-related firms like managed care organizations, caregivers, and medical suppliers.Why it matters: Some of these companies look largely tariff-proof, including managed care organizations like UnitedHealth, while others look merely recession-resistant, including caregivers like HCA and medical suppliers like Baxter. As US-based and US-focused firms, MCOs look largely immune to tariffs. The only concern could be in the near term if the US economy falls into recession and causes a mix shift in medical insurance members from employer to lower-margin Medicaid plans. Providers and medical suppliers could feel more direct effects of higher costs in their supply chains due to tariffs. Of these two, medical suppliers face the more significant profit risk due to multiyear contracts with clients and potential delays in large equipment orders from clients.The bottom line: In February, we reduced our fair value estimate for medical supplier Baxter on near-term tariff concerns, and we do not anticipate making further changes to it. We see most of the medical services firms we cover (MCOs, providers, and suppliers) as undervalued currently. In managed care, our moat ratings were all recently updated during our moat staleness review process. UnitedHealth, Humana, Elevance, and Cigna remain at narrow, while CVS and Centene are now at none. In providers and suppliers, most of our moat ratings were also reviewed in late 2024 or early 2025. They remain narrow for Baxter, DaVita, Fresenius Medical Care, HCA, and Tenet and none for ICU Medical.Coming up: We plan to keep a close eye on how hospital capital expenditure budgets develop and how they could affect medical suppliers in a scenario where tariffs create sticker shock on large equipment especially. Also, investors should be aware of other regulatory factors that could affect the MCOs.

MCOs: Strong Final 2026 Rate Notice for Medicare Advantage Boosts Undervalued Shares Julie Utterback, CFA,Senior Equity Analyst,7 Apr 2025

Late on April 7, the Centers for Medicare and Medicaid Services released its final reimbursement rate notice for Medicare Advantage, highlighting an expected change in per capita revenue of 5.06% in 2026 even after risk-related adjustments. This is up from 2.23% in the January initial rate notice.Why it matters: This announcement represents a first look at how Republicans plan to regulate rates in the important Medicare Advantage market. It appears they will be more generous than Democrats have been in recent years, which is a welcome change of pace for the MCOs we cover.   In after-hours trading, MA-focused insurer Humana traded up about 12%, MA-leader UnitedHealth rose about 6%, and top-tier MA insurer CVS increased about 7%. Even lower-tier MA players Elevance (up 7%) and Centene (up 4%) rose on the news. Also, Cigna, which has no exposure to Medicare Advantage after selling off that business to Health Care Service Corporation in March, inexplicably rose 1% after hours, generally benefiting from the improving market sentiment in the industry. The bottom line: In our valuation models, we previously suspected that the recent lean years in Medicare Advantage under Democrats would give way to more normalized trends eventually, so this good start under Republican rule merely starts that normalization process for MA insurers. We are not changing any of our fair value estimates in the industry and continue to view most of the MCOs we cover as moderately undervalued, including MA-focused insurer Humana which still trades at a roughly 30% discount to fair value even following the after-hours rally. Our moat ratings were all recently updated during our moat staleness review process and remain narrow for UnitedHealth, Humana, Elevance, and Cigna and none for CVS and Centene.

Humana Earnings: Firm Ends 2024 as Expected and Gives Weak Guidance for 2025; Shares Still Cheap Julie Utterback, CFA,Senior Equity Analyst,11 Feb 2025

For 2024, Humana delivered $16.21 of adjusted EPS, which was in line with management's goal of at least $16 per share. For 2025, the company expects earnings in line with its 2024 results, or about $16.25 of adjusted EPS. Shares declined about 5% in early trading on this news. Why it matters: Given the profit levers it is pulling in Medicare Advantage, we did not expect management to remain so literal with its initial 2025 view of at least performing in line with 2024, which has led to lower 2025 detailed guidance than we were anticipating. Despite a 10% expected decline in individual Medicare Advantage membership, we still expect MA margins to improve in 2025 as it exits unprofitable geographies and reduces benefits. However, Humana's overall profits may be constrained more than we had expected by its high growth in Medicare Part D, where managed care organization liabilities are increasing in 2025, and in Medicaid, where there continues to be a mismatch in rates and utilization. The bottom line: Based on this weaker-than-expected near-term outlook, we are trimming our fair value estimate on narrow-moat Humana to $400 per share from $425. We still view Humana shares as significantly undervalued when considering its longer-term prospects. While Humana's outlook through 2026 looks weak because of ongoing challenges in Medicare Advantage, including a potentially weak 2026 bonus year after its quality ratings fell, we expect those ratings and related bonus payments to improve over time, which should boost margins. At current prices, we suspect the market is not looking beyond Humana's near-term headwinds, which appears to be creating an opportunity for investors with a long-term horizon. Coming up: In the next few months, we expect to hear more about Republican priorities for regulatory changes in the industry. While headline risks create uncertainty, we think potential downside risks for Humana's profits are already reflected in its heavily discounted shares.

PBM Transparency Initiatives Included in New US Spending Bill Julie Utterback, CFA,Senior Equity Analyst,18 Dec 2024

The US federal spending bill expected to pass this week includes pharmacy benefit manager transparency efforts that eliminate rebate- and spread-based pricing benefits for PBMs.Why it matters: Managed care organizations, which own the PBMs, face a mild headwind to their profits from this new regulatory action. PBM clients currently use rebates and spread-based pricing mechanisms to incentivize PBMs to negotiate bigger discounts in biopharmaceutical prices, but this new legislation looks likely to force PBMs to pass those rebates and spreads on to clients. However, we expect PBMs to replace those variable pricing mechanisms with fees to resolve most of that risk to profits. This should result in the potential for a low-single-digit profit headwind for even the most exposed MCO—Cigna—based on our estimates.The bottom line: We maintain our fair value estimates for covered MCOs despite this legislation, because the potential profit headwinds are not enough to materially affect our valuations. Our narrow moat ratings also remain intact, despite the increased risk of regulation by Republicans in recent weeks that have caused shares to decline significantly. We think shares are trading at moderate (Cigna, Centene, and UnitedHealth) to significant (CVS, Elevance, and Humana) discounts to fair value.Coming up: Recent commentary from incoming Republican officials and negative sentiment from the public in the wake of a UnitedHealth executive's killing suggest that the MCOs should brace themselves for more potential policy changes. Republicans appear focused on reducing federal spending on Medicaid expansion and the individual exchanges, while bipartisan support of further PBM regulations or wasteful spending in Medicare Advantage would create more profit risks. Mild positive offsets to those potential risks appear possible, though, in the form of increased outsourcing of government programs to private insurers.

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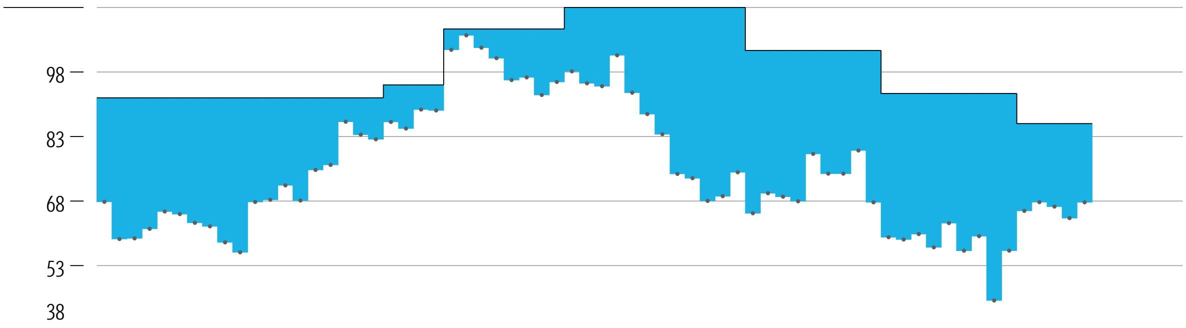
Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

Competitors Price vs. Fair Value

CVS Health Corp CVS



Fair Value: 86.00
12 Feb 2025 18:02, UTC

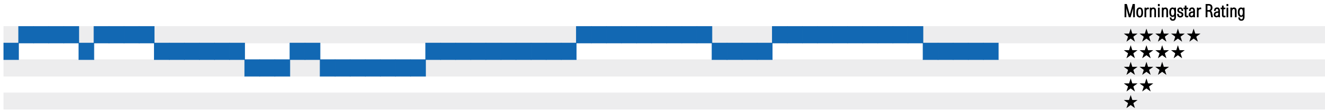
Last Close: 67.71

Overvalued

Undervalued

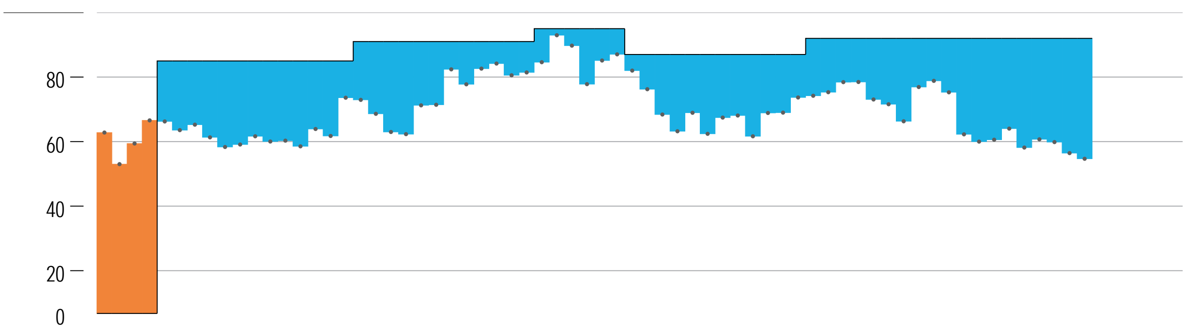
	2020	2021	2022	2023	2024	YTD
Price/Fair Value	0.74	0.96	0.82	0.77	0.48	0.79
Total Return %	-5.37	53.97	-7.53	-12.67	-39.78	53.80

Morningstar Rating



Total Return % as of 16 Jun 2025. Last Close as of 16 Jun 2025. Fair Value as of 12 Feb 2025 18:02, UTC.

Centene Corp CNC



Fair Value: 92.00
12 Dec 2023 18:19, UTC

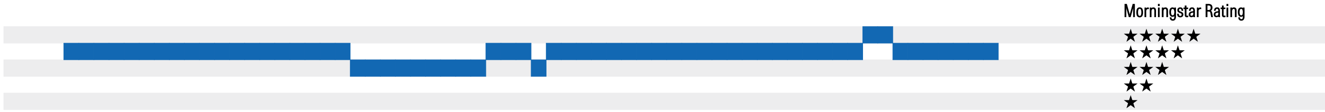
Last Close: 54.68

Overvalued

Undervalued

	2020	2021	2022	2023	2024	YTD
Price/Fair Value	0.71	0.91	0.94	0.81	0.66	0.59
Total Return %	-4.52	37.26	-0.47	-9.51	-18.37	-9.74

Morningstar Rating



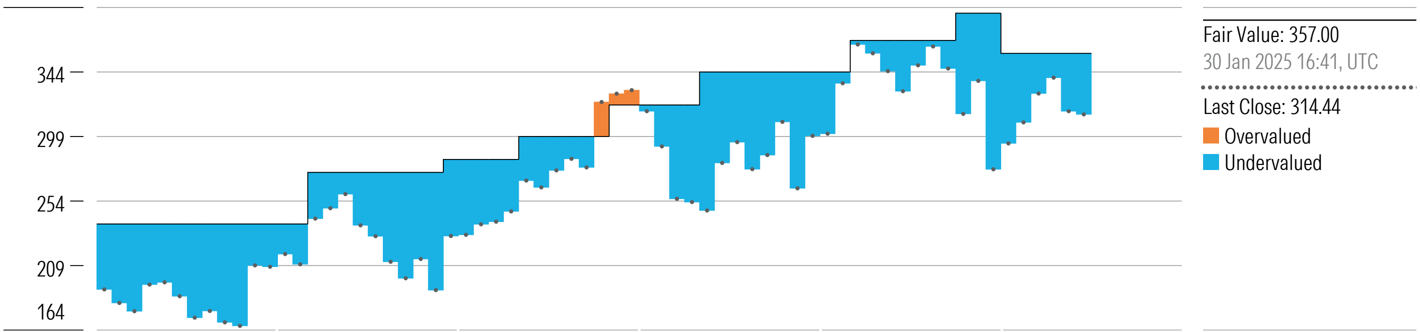
Total Return % as of 16 Jun 2025. Last Close as of 16 Jun 2025. Fair Value as of 12 Dec 2023 18:19, UTC.

Morningstar Equity Analyst Report | Report as of 17 Jun 2025 03:34, UTC | Reporting Currency: USD | Trading Currency: USD | Exchange: NEW YORK STOCK EXCHANGE, INC. Page 13 of 23

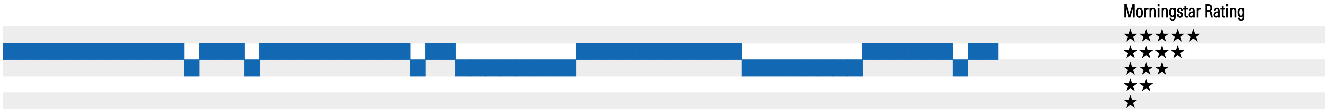
Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

Competitors Price vs. Fair Value

The Cigna Group CI



	2020	2021	2022	2023	2024	YTD	
	0.87	0.81	1.03	0.87	0.72	0.88	Price/Fair Value
	1.82	12.23	46.24	-8.14	-5.91	14.96	Total Return %



Total Return % as of 16 Jun 2025. Last Close as of 16 Jun 2025. Fair Value as of 30 Jan 2025 16:41, UTC.

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Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
235.39 USD 16 Jun 2025	323.00 USD 22 May 2025 12:19, UTC	0.73	28.41 USD Bil 16 Jun 2025	Narrow	Mid Value	Very High	Standard	4 Jun 2025 05:00, UTC

Morningstar Valuation Model Summary

Financials as of 16 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Dec	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Revenue (USD Mil)	92,870	106,374	117,761	126,251	139,347	152,370	166,533	181,571
Operating Income (USD Mil)	3,800	4,013	2,562	3,312	2,398	3,693	4,822	5,629
EBITDA (USD Mil)	4,882	4,793	3,349	4,318	3,496	-4,299	6,114	6,794
Adjusted EBITDA (USD Mil)	5,393	5,800	4,339	4,397	3,567	3,903	6,172	6,846
Net Income (USD Mil)	2,806	2,489	1,207	1,958	1,282	-6,953	3,038	3,707
Adjusted Net Income (USD Mil)	3,208	3,247	1,960	2,017	1,335	2,230	3,081	3,746
Free Cash Flow To The Firm (USD Mil)	3,467	2,977	2,391	1,945	968	-6,928	2,479	2,738
Weighted Average Diluted Shares Outstanding (Mil)	127	124	121	121	121	121	121	121
Earnings Per Share (Diluted) (USD)	22.08	20.00	9.99	16.20	10.61	-57.53	25.13	30.67
Adjusted Earnings Per Share (Diluted) (USD)	25.24	26.09	16.21	16.69	11.05	18.45	25.49	30.99
Dividends Per Share (USD)	3.08	3.46	3.57	3.57	3.57	3.69	5.10	6.20

Margins & Returns as of 16 Jun 2025		Actual			Forecast					
	3 Year Avg	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**5 Year Avg**
Operating Margin %	3.3	4.1	3.8	2.2	2.6	1.7	2.4	2.9	3.1	1.4
EBITDA Margin %	—	5.3	4.5	2.8	3.4	2.5	-2.8	3.7	3.7	—
Adjusted EBITDA Margin %	—	5.8	5.5	3.7	3.5	2.6	2.6	3.7	3.8	3.2
Net Margin %	2.1	3.0	2.3	1.0	1.6	0.9	-4.6	1.8	2.0	0.3
Adjusted Net Margin %	2.7	3.5	3.1	1.7	1.6	1.0	1.5	1.8	2.1	1.6
Free Cash Flow To The Firm Margin %	2.9	3.7	2.8	2.0	1.5	0.7	-4.6	1.5	1.5	0.1

Growth & Ratios as of 16 Jun 2025		Actual			Forecast					
	3 Year CAGR	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**5 Year CAGR**
Revenue Growth %	12.3	11.8	14.5	10.7	7.2	10.4	9.4	9.3	9.0	9.0
Operating Income Growth %	-6.6	20.7	5.6	-36.2	29.3	-27.6	54.0	30.6	16.7	17.1
EBITDA Growth %	-6.9	11.1	-1.8	-30.1	28.9	-19.0	-223.0	-242.2	11.1	-88.8
Adjusted EBITDA Growth %	2.0	32.0	7.5	-25.2	1.3	-18.9	9.4	58.1	10.9	9.6
Earnings Per Share Growth %	-23.9	-2.6	-9.4	-50.1	62.2	-34.5	-642.3	-143.7	22.0	25.2
Adjusted Earnings Per Share Growth %	-23.9	22.3	3.4	-37.9	2.9	-33.8	67.0	38.2	21.6	25.2

Valuation as of 16 Jun 2025	Actual			Forecast				
	2022	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Price/Earning	20.3	17.5	15.7	14.1	21.3	12.8	9.2	7.6
Price/Sales	0.7	0.5	0.3	0.2	0.2	0.2	0.2	0.2
Price/Book	4.3	3.5	1.9	1.6	1.5	2.5	2.1	1.7
Price/Cash Flow	—	—	—	—	—	—	—	—
EV/EBITDA	11.5	9.1	8.9	8.5	10.5	9.6	6.1	5.5
EV/EBIT	16.3	13.2	15.0	11.3	15.6	10.1	7.8	6.7
Dividend Yield %	0.6	0.8	1.4	1.5	1.5	1.6	2.2	2.6
Dividend Payout %	12.2	13.3	22.0	21.4	32.3	20.0	20.0	20.0
Free Cash Flow Yield %	—	—	—	—	—	—	—	—

Operating Performance / Profitability as of 16 Jun 2025	Actual			Forecast				
Fiscal Year, ends 31 Dec	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
ROA %	6.5	5.3	2.6	4.0	2.4	-12.4	4.9	5.5
ROE %	18.3	15.3	7.3	10.9	6.8	-60.9	21.9	22.1
ROIC %	17.7	18.6	12.2	13.5	10.3	13.6	15.8	16.5

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Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
235.39 USD 16 Jun 2025	323.00 USD 22 May 2025 12:19, UTC	0.73	28.41 USD Bil 16 Jun 2025	Narrow	Mid Value	Very High	Standard	4 Jun 2025 05:00, UTC

Financial Leverage (Reporting Currency)	Actual			Forecast				
Fiscal Year, ends 31 Dec	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Debt/Capital %	14.6	17.1	27.7	22.0	20.8	28.8	27.3	25.9
Assets/Equity	2.8	2.9	2.8	2.7	2.8	4.9	4.4	4.0
Net Debt/EBITDA	1.2	1.5	2.8	-2.8	-4.3	2.2	-2.4	-2.9
Total Debt/EBITDA	2.1	2.0	2.7	2.6	3.2	5.0	3.1	2.8
EBITDA/ Net Interest Expense	11.5	11.8	6.6	6.3	5.2	5.4	8.0	10.0

Forecast Revisions as of 16 Jun 2025	2025		2026		2027	
Prior data as of 22 May 2025	**Current**	**Prior**	**Current**	**Prior**	**Current**	**Prior**
Fair Value Estimate Change (Trading Currency)	323.00	323.47	—	—	—	—
Revenue (USD Mil)	126,251	126,251	139,347	139,347	152,370	152,370
Operating Income (USD Mil)	3,312	3,312	2,398	2,398	3,693	3,693
EBITDA (USD Mil)	4,397	4,397	3,567	3,567	3,903	3,903
Net Income (USD Mil)	2,017	2,017	1,335	1,335	2,230	2,230
Earnings Per Share (Diluted) (USD)	16.20	16.20	10.61	10.61	-57.53	-57.53
Adjusted Earnings Per Share (Diluted) (USD)	16.69	16.69	11.05	11.05	18.45	18.45
Dividends Per Share (USD)	3.57	3.57	3.57	3.57	3.69	3.69

Key Valuation Drivers as of 16 Jun 2025	
Cost of Equity %	9.0
Pre-Tax Cost of Debt %	6.5
Weighted Average Cost of Capital %	8.2
Long-Run Tax Rate %	25.0
Stage II EBI Growth Rate %	4.0
Stage II Investment Rate %	30.0
Perpetuity Year	15

Additional estimates and scenarios available for download at https://pitchbook.com/.

Discounted Cash Flow Valuation as of 16 Jun 2025	**USD Mil**
Present Value Stage I	9,183
Present Value Stage II	9,227
Present Value Stage III	30,953
Total Firm Value	**49,363**
Cash and Equivalents	329
Debt	11,721
Other Adjustments	0
Equity Value	**37,971**
Projected Diluted Shares	121
Fair Value per Share (USD)	**323.00**

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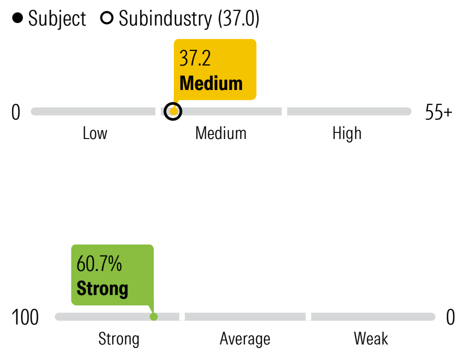
Humana Inc HUM ★★★★ 16 Jun 2025 21:25, UTC

Last Price	Fair Value Estimate	Price/FVE	Market Cap	Economic Moat™	Equity Style Box	Uncertainty	Capital Allocation	ESG Risk Rating Assessment[1]
235.39 USD 16 Jun 2025	323.00 USD 22 May 2025 12:19, UTC	0.73	28.41 USD Bil 16 Jun 2025	Narrow	Mid Value	Very High	Standard	4 Jun 2025 05:00, UTC

ESG Risk Rating Breakdown

Exposure	
Company Exposure[1]	37.2
– Manageable Risk	35.1
Unmanageable Risk[2]	**2.0**
Management	
Manageable Risk	35.1
– Managed Risk[3]	21.3
Management Gap[4]	**13.8**
Overall Unmanaged Risk	**15.8**



- Exposure represents a company's vulnerability to ESG risks driven by their business model
- Exposure is assessed at the Subindustry level and then specified at the company level
- Scoring ranges from 0-55+ with categories of low, medium, and high-risk exposure

- Management measures a company's ability to manage ESG risks through its commitments and actions
- Management assesses a company's efficiency on ESG programs, practices, and policies
- Management score ranges from 0-100% showing how much manageable risk a company is managing

ESG Risk Rating

ESG Risk Ratings measure the degree to which a company's value is impacted by environmental, social, and governance risks, by evaluating the company's ability to manage the ESG risks it faces.

1. A company's Exposure to material ESG issues 2. Unmanageable Risk refers to risks that are inherent to a particular business model that cannot be managed by programs or initiatives 3. Managed Risk = Manageable Risk multiplied by a Management score of 60.7% 4. Management Gap assesses risks that are not managed, but are considered manageable 5. ESG Risk Rating Assessment = Overall Unmanaged Risk = Management Gap plus Unmanageable Risk

ESG Risk Rating Assessment[5]

ESG Risk Rating is of Jun 04, 2025. Highest Controversy Level is as of Jun 08, 2025. Sustainalytics Subindustry: Managed Health Care. Sustainalytics provides Morningstar with company ESG ratings and metrics on a monthly basis and as such, the ratings in Morningstar may not necessarily reflect current Sustainalytics' scores for the company. For the most up to date rating and more information, please visit: sustainalytics.com/esg-ratings/.

Peer Analysis 04 Jun 2025

Peers are selected from the company's Sustainalytics-defined Subindustry and are displayed based on the closest market cap values

Company Name	Exposure			Management			ESG Risk Rating		
Humana Inc	37.2 | Medium	0	55+	60.7 | Strong	100	0	15.8 | Low	0	40+
Centene Corp	36.5 | Medium	0	55+	60.5 | Strong	100	0	15.4 | Low	0	40+
The Cigna Group	34.8 | Low	0	55+	76.1 | Strong	100	0	9.7 | Negligible	0	40+
CVS Health Corp	38.6 | Medium	0	55+	58.9 | Strong	100	0	17.1 | Low	0	40+
UnitedHealth Group Inc	34.1 | Low	0	55+	53.2 | Strong	100	0	16.9 | Low	0	40+

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Appendix
Historical Morningstar Rating

Humana Inc HUM 16 Jun 2025 21:25, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★★★	★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★	★★★★	★★★★★	★★★★	★★★★	★★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★★	★★★	★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★★	★★★★	★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★
Dec 2020	Nov 2020	Oct 2020	Sep 2020	Aug 2020	Jul 2020	Jun 2020	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020
★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★	★★★★	★★★★	★★★

CVS Health Corp CVS 16 Jun 2025 21:28, UTC

Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	Jul 2025	Jun 2025	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025
—	—	—	—	—	—	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★★
Dec 2024	Nov 2024	Oct 2024	Sep 2024	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Feb 2024	Jan 2024
★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★	★★★★
Dec 2023	Nov 2023	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023
★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★★	★★★★	★★★★
Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Apr 2022	Mar 2022	Feb 2022	Jan 2022
★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★	★★★
Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Jun 2021	May 2021	Apr 2021	Mar 2021	Feb 2021	Jan 2021
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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, indepth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss shortterm market-price movements), but we believe these negatives are mitigated by deep analysis and our longterm approach.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our singlepoint star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

When considering a company's moat, we also assess whether there is a substantial threat of value destruction, stemming from risks related to ESG, industry disruption, financial health, or other idiosyncratic issues. In this context, a risk is considered potentially value destructive if its occurrence would eliminate a firm's economic profit on a cumulative or midcycle basis. If we deem the probability of occurrence sufficiently high, we would not characterize the company as possessing an economic moat.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in workingcapital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

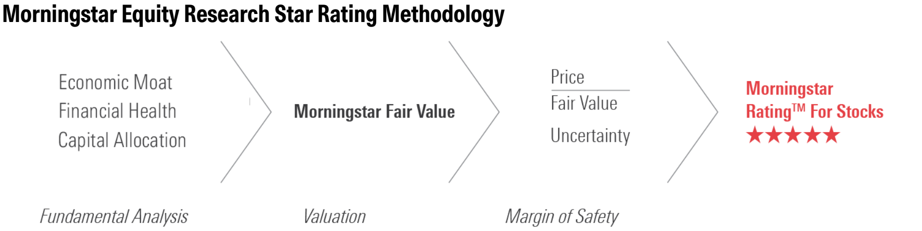
Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating is designed to capture the range of potential outcomes for a company's intrinsic value. This rating is used to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating is aimed at identifying the confidence we should have in assigning a fair value estimate for a given stock.

Our Uncertainty Rating is meant to take into account anything that can increase the potential dispersion of future

Morningstar Equity Research Star Rating Methodology



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outcomes for the intrinsic value of a company, and anything that can affect our ability to accurately predict these outcomes. The rating begins with a suggested rating produced by a quantitative process based on the trailing 12-month standard deviation of daily stock returns. An analyst overlay is then applied, with analysts using the suggested rating, historical rating data, and their own knowledge of the company to inform them as they make the final Uncertainty Rating decision. Ultimately, the rating decision rests with the analyst. Analysts take into account many characteristics when making their final decision, including cyclical factors, operational and financial factors such as leverage, company-specific events, ESG risks, and anything else that might increase the potential dispersion of future outcomes and our ability to estimate those outcomes.

Our recommended margin of safety—the discount to fair value demanded before we'd recommend buying or selling the stock—widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the potential dispersion of outcomes, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the Uncertainty Rating provides guidance in portfolio construction based on risk tolerance.

Our Uncertainty Ratings are: Low, Medium, High, Very High, and Extreme.

Qualitative Analysis Uncertainty Ratings	Margin of Safety ★★★★★Rating	★Rating
Low	20% Discount	25% Premium
Medium	30% Discount	35% Premium
High	40% Discount	55% Premium
Very High	50% Discount	75% Premium
Extreme	75% Discount	300% Premium

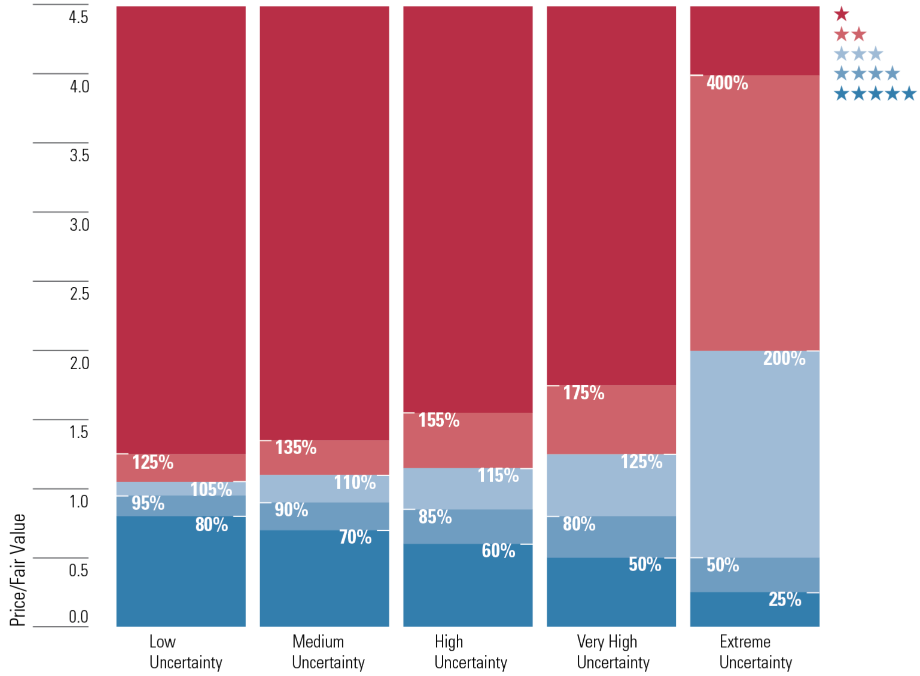
Our uncertainty rating is based on the interquartile range, or the middle 50% of potential outcomes, covering the 25th percentile–75th percentile. This means that when a stock hits 5 stars, we expect there is a 75% chance that the intrinsic value of that stock lies above the current market price. Similarly, when a stock hits 1 star, we expect there is a 75% chance that the intrinsic value of that stock lies below the current market price.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com

Morningstar Equity Research Star Rating Methodology



Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multi-year time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments,

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and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

Capital Allocation (or Stewardship) analysis published prior to Dec. 9, 2020, was determined using a different process. Beyond investment strategy, financial leverage, and dividend and share buyback policies, analysts also considered execution, compensation, related party transactions, and accounting practices in the rating.

Capital Allocation Rating: Our Capital Allocation (or Stewardship) Rating represents our assessment of the quality of management's capital allocation, with particular emphasis on the firm's balance sheet, investments, and shareholder distributions. Analysts consider companies' investment strategy and valuation, balance sheet management, and dividend and share buyback policies. Corporate governance factors are only considered if they are likely to materially impact shareholder value, though either the balance sheet, investment, or shareholder distributions. Analysts assign one of three ratings: "Exemplary", "Standard", or "Poor". Analysts judge Capital Allocation from an equity holder's perspective. Ratings are determined on a forward looking and absolute basis. The Standard rating is most common as most managers will exhibit neither exceptionally strong nor poor capital allocation.

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Sustainalytics ESG Risk Rating Assessment: The ESG Risk Rating Assessment is provided by Sustainalytics; a Morningstar company.

Sustainalytics' ESG Risk Ratings measure the degree to which company's economic value at risk is driven by environment, social and governance (ESG) factors.

Sustainalytics analyzes over 1,300 data points to assess a company's exposure to and management of ESG risks. In other words, ESG Risk Ratings measures a company's unmanaged ESG Risks represented as a quantitative score. Unmanaged Risk is measured on an open-ended scale starting at zero (no risk) with lower scores representing less unmanaged risk and, for 95% of cases, the unmanaged ESG Risk score is below 50.

Based on their quantitative scores, companies are grouped into one of five Risk Categories (negligible, low, medium, high, severe). These risk categories are absolute, meaning that a 'high risk' assessment reflects a comparable degree of unmanaged ESG risk across all subindustries covered.

The ESG Risk Rating Assessment is a visual representation of Sustainalytics ESG Risk Categories on a 1 to 5 scale. Companies with Negligible Risk = 5 Globes, Low Risk = 4, Medium Risk = 3 Globes, High Risk = 2 Globes, Severe Risk = 1 Globe. For more information, please visit sustainalytics.com/esg-ratings/

Ratings should not be used as the sole basis in evaluating a company or security. Ratings involve unknown risks and uncertainties which may cause our expectations not to occur or to differ significantly from what was expected and should not be considered an offer or solicitation to buy or sell a security.

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