

Anthem, Inc. (ANTM)

Overweight

Positive First Quarter for New CEO, We See Renewed Focus Driving LT Upside

CONCLUSION

We believe it was a solid first earnings call for new CEO Gail Boudreaux highlighting a number of positive key initiatives including further investment into technology platforms and a renewed focus on ANTM's historically lagging government business. We see the reiteration of long-term guidance (10-14% EPS growth) but at the high end as a confidence builder for our Overweight thesis with priorities shifting to 1) organic growth, 2) M&A, and lastly 3) repurchases, compared to the repurchase heavy focus in years past.

- **We believe we saw a tone change from ANTM on investing in technology with 25% of tax reform benefit funding incremental investment.** We think ANTM could look to M&A in order to build out their technology platforms, including consumer facing digital platforms, and product development capabilities. However, we believe they could also make key hires in the area in order to build the right team for future development. Overall, we see this leading to improved customer satisfaction, medical cost management, and member engagement potentially through ER diversion programs that we view as the most impactful, similar to what peers such as UNH are rolling out.
- **We see ANTM renewing their focus on MA and see it becoming a larger portion of the business, but not as big as peers such as UNH.** Currently, we estimate MA represents ~12.5% of premiums for ANTM compared to the large cap peer average of 30.5%. However, we view management's comments and the recent acquisitions of high quality MA plans (HealthSun and America's 1st Choice) as indications that this is changing. We believe ANTM's focus on product innovation in group, an area they have exerted much focus on in the past, and retail will drive organic growth in the low to mid double digits over the next few years.
- **We are fans of ANTM's new JVs with other Blues plans with BCBS of MN adding ~345K Medicaid members to ANTM's book.** So far, ANTM has made 2 of these partnerships with another 240K member partnership with BCBS of LA during 2017. We believe ANTM's local market share will help them win new contracts and drive further Medicaid growth. However, we see a need for ANTM to develop a narrow, low cost Medicaid focus provider network in order to be more successful in the Medicaid industry.
- **2018 Cost Trend guidance up 50 bps from 2017 to ~6%, but we believe this is due to conservatism from ANTM (6 beats since 2010) and a bad flu season.** We estimate ANTM's restatement of cost trend, reflecting the contractual rate paid to providers, lowers historical cost trends by ~100 bps, which brings historical cost trends more inline with peers. One area that could drive upside is VBC, which is an area that we believe new CEO Gail Boudreaux could improve in year 1, while incremental investments into vertical integration and technology could drive upside long-term.

RISKS TO ACHIEVEMENT OF PT & RECOMMENDATION

Increased medical cost trends, reimbursement, competition and the CI deal being blocked.

COMPANY DESCRIPTION

Second largest managed-care company with a focus on commercial plans.

YEAR	REVENUE (US\$ m)						EARNINGS PER SHARE (US\$)					
	Mar	Jun	Sep	Dec	FY	FY RM	Mar	Jun	Sep	Dec	FY	FY P/E
2017A	22,526.7	22,398.2	22,426.0	22,680.3	90,031.2	0.7x	4.68	3.37	2.65	1.29	11.99	20.7x
2018E	22,903.6	22,798.6	22,600.5	22,819.4	91,122.1	0.7x	4.88	4.40	3.79	2.02	15.10	16.4x
2019E	24,398.1	24,386.6	24,274.1	24,538.4	97,597.2	0.7x	5.28	4.86	4.19	2.31	16.63	14.9x

PRICE: US\$247.85

Price as of the close January 31, 2018.

TARGET: US\$278.00

16.7x our 2019E EPS of \$16.63

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	US\$260.00	US\$278.00
FY18E Rev (mil)	US\$91,463.2	US\$91,122.1
FY19E Rev (mil)	US\$97,278.8	US\$97,597.2
FY18E EPS	US\$12.95	US\$15.10
FY19E EPS	US\$14.28	US\$16.63
52-Week High / Low	US\$259.04 / US\$151.77	
Shares Out (mil)	263.3	
Market Cap. (mil)	65,259	
Avg Daily Vol (000)	1,528	
Book Value/Share	US\$114.27	
Net Cash Per Share	US\$4.75	
Debt to Total Capital	0.4%	
Yield	0.00%	
Fiscal Year End	Dec	

Price Performance - 1 Year



Source: Bloomberg

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Earnings Comparison and Guidance Table

- **Reiterating our Overweight rating and raising our PT to \$278 (up from \$260).** Our \$278 price target is based on 16.7x (down from 18.2x) our 2019E EPS of \$16.63 (up from \$14.28). We have raised our estimates to reflect our increased confidence in ANTM's long-term growth profile and the positive impact from tax reform. We lowered our multiple to fall more inline with post tax reform multiples, however we believe ANTM deserves a premium to the peer group average of 16.3x given their incremental investment into technology and consumer facing platforms along with a renewed focus on the faster growing government business (Medicare and Medicaid).

ANTM Guidance Table

	Estimates	Consensus	Guidance as of: 4Q17
Total Membership	40.1M		40.0-40.2M
ASO Enrollment	25.3M		25.2-25.3M
Risk Enrollment	14.8M		14.8-14.9M
Revenue	\$91.1B	\$89.1B	\$90.5-91.5
MLR	84.2%		84.2-84.8%
SG&A %	15.3%		15.2%-15.8%
Adjusted EPS	\$15.10	\$12.04	>\$15.00
Operating Cash Flow	\$4.3B		>\$4.0B

ANTM Earnings Comparison

ANTM Income Statement (\$Millions)		4Q16	3Q17	4Q17 Actual	PJC 4Q17E	Q/Q	Q/Q%	Y/Y	Y/Y%	Act. Vs. Est.	% Variance	Cons.	Var fom Cons.
Total Revenue		\$21,731M	\$22,426M	\$22,477M	\$21,747M	\$51M	0.2%	\$746M	3.4%	\$730M	3.4%	\$22,199M	\$22M
MLR		87.2%	87.0%	88.6%	89.6%	155bps		136bps		100bps		89.6%	(98bps)
% SG&A		15.2%	13.6%	15.1%	14.2%	147bps		(9bps)		(93bps)			
% EBIT Margin		4.1%	5.7%	1.3%	3.3%	(439bps)		(287bps)		201bps		1.9%	(60bps)
EPS		\$1.76	\$2.65	\$1.29	\$1.24	(\$1.36)	(51.3%)	(\$0.47)	(26.6%)	\$0.05	3.9%	\$1.27	\$0.02
Segment Analysis (\$Millions)		4Q16	3Q17	4Q17 Actual	PJC 4Q17E	Q/Q	Q/Q%	Y/Y	Y/Y%	Act. Vs. Est.	% Variance	Cons.	Var fom Cons.
Commercial & Specialty		\$9,627M	\$10,052M	\$10,104M	\$10,054M	\$52M	0.5%	\$476M	4.9%	\$50M	0.5%	\$10,340M	(\$236M)
% Operating Margin		2.0%	5.3%	0.7%	5.3%	(462bps)		(127bps)		462bps			
Government		\$11,850M	\$12,037M	\$12,330M	\$11,435M	\$293M	2.4%	\$480M	4.0%	\$895M	7.8%	\$12,296M	\$34M
% Operating Margin		4.5%	3.8%	2.9%	3.8%	(90bps)		(157bps)		90bps			
Total Operating Revenue		\$21,485M	\$22,097M	\$22,447M	\$21,496M	\$350M	1.6%	\$962M	4.5%	\$951M	4.4%	\$22,199M	\$248M
% Operating Margin		3.0%	4.4%	1.7%	4.5%	(274bps)		(134bps)		281bps			
Membership (000's)		4Q16	3Q17	4Q17 Actual	PJC 4Q17E	Q/Q	Q/Q%	Y/Y	Y/Y%	Act. Vs. Est.	% Variance	Cons.	Var fom Cons.
Local Group		15,429K	15,857K	15,870K	15,877K	13K	0.1%	441K	2.9%	(7K)	(0.0%)		
Individual		1,664K	1,696K	1,588K	1,616K	(108K)	(6.4%)	(76K)	(4.6%)	(28K)	(1.7%)		
Total National Accounts		13,291K	13,209K	13,204K	13,134K	(5K)	(0.0%)	(87K)	(0.7%)	70K	0.5%		
Medicare		1,438K	1,498K	1,545K	1,497K	47K	3.1%	107K	7.4%	48K	3.2%		
Medicaid		6,527K	6,433K	6,475K	6,479K	42K	0.7%	(52K)	(0.8%)	(4K)	(0.1%)		

Source: Company Data and PJC Estimates

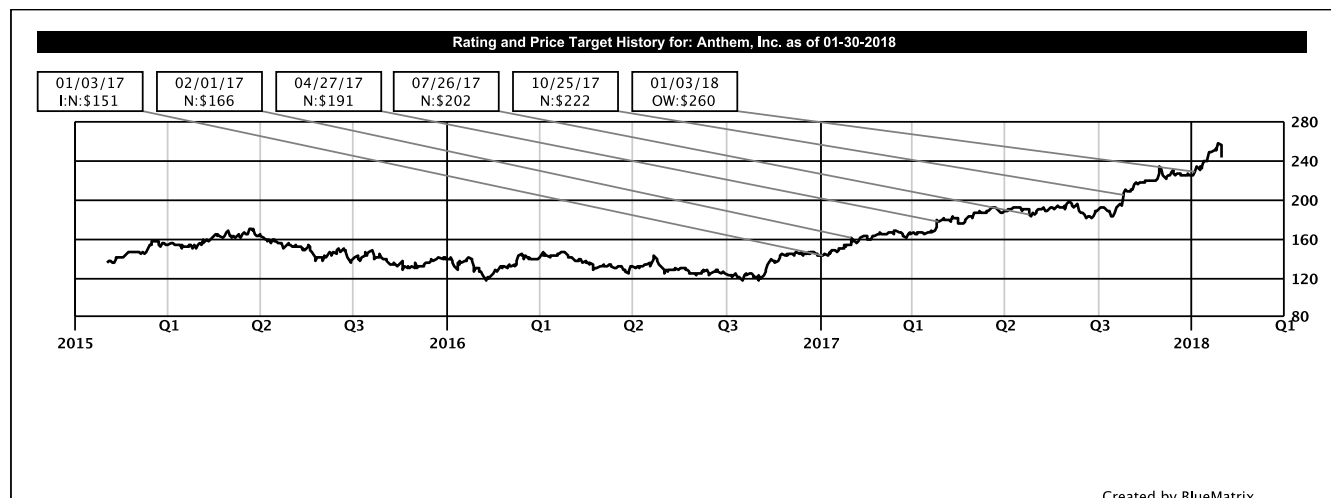
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	2016	1Q17	2Q17	3Q17	4Q17	2017	1Q18E	2Q18E	3Q18E	4Q18E	2018E	1Q19E	2Q19E	3Q19E	4Q19E	2019E
Health Care Premiums	78,860,100	20,951,300	20,813,100	20,797,000	21,086,300	83,647,700	21,231,542	21,108,765	21,000,008	21,147,387	84,487,701	22,612,000	22,550,135	22,524,978	22,699,524	90,386,637
% Change Y/Y	7.5%	10.3%	4.3%	5.1%	4.7%	6.1%	1.3%	1.4%	1.0%	0.3%	1.0%	6.5%	6.8%	7.3%	7.3%	7.0%
ASO Fees	5,298,800	1,363,200	1,378,900	1,289,200	1,349,100	5,380,400	1,456,341	1,481,716	1,384,836	1,447,852	5,770,745	1,529,500	1,559,941	1,463,280	1,531,727	6,084,448
% Change Y/Y	6.5%	4.0%	4.8%	(3.1%)	0.5%	1.5%	6.8%	7.5%	7.4%	7.3%	7.3%	5.0%	5.3%	5.7%	5.8%	5.4%
Other Revenue	35,100	5,000	6,000	10,500	11,600	33,100	5,250	6,300	11,025	12,180	34,755	5,513	6,615	11,576	12,789	36,493
% Change Y/Y	(18.6%)	(47.4%)	(43.9%)	15.4%	100.0%	(5.7%)	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Net Investment Income	853,900	207,200	200,200	329,300	233,300	970,000	210,418	201,789	204,653	212,029	828,888	251,102	269,956	274,236	294,315	1,089,610
% Change Y/Y	28.7%	21.1%	35.5%	14.1%	(5.3%)	13.6%	1.6%	0.8%	(37.9%)	(9.1%)	(14.5%)	19.3%	33.8%	34.0%	38.8%	31.5%
Average Yield Implied	3.5%	3.3%	2.9%	4.9%	3.2%	3.8%	3.1%	3.1%	3.1%	3.1%	3.0%	3.5%	3.5%	3.5%	3.5%	3.4%
Total Revenue	85,047,900	22,526,700	22,398,200	22,426,000	22,680,300	90,031,200	22,903,551	22,798,570	22,600,521	22,819,447	91,122,089	24,398,115	24,386,647	24,274,070	24,538,355	97,597,188
% Change Y/Y	7.6%	10.0%	4.6%	4.7%	4.4%	5.9%	1.7%	1.8%	0.8%	0.6%	1.2%	6.5%	7.0%	7.4%	7.5%	7.1%
Health Care Costs	66,834,400	17,542,800	17,917,200	18,103,600	18,672,600	72,236,200	17,452,327	17,646,927	17,745,007	18,313,637	71,157,898	18,881,020	19,145,065	19,337,693	19,964,231	77,328,010
MLR	84.8%	83.7%	86.1%	87.0%	86.6%	86.4%	82.2%	83.6%	84.5%	86.6%	84.2%	83.5%	84.9%	85.9%	88.0%	85.6%
Selling General & Admin Exp	12,557,900	3,191,300	3,053,800	3,011,100	3,393,400	12,649,600	3,517,436	3,389,517	3,314,589	3,594,580	13,816,121	3,453,023	3,328,103	3,263,977	3,563,874	13,608,978
% SG&A	14.9%	14.3%	13.8%	13.6%	15.1%	14.2%	15.5%	15.0%	14.8%	15.9%	15.3%	14.3%	13.8%	13.6%	14.7%	14.1%
EBITDA	5,655,600	1,792,600	1,427,200	1,311,300	614,300	5,145,400	1,933,788	1,762,126	1,540,926	911,231	6,148,070	2,064,072	1,913,479	1,672,400	1,010,250	6,660,201
% EBITDA Margin	6.6%	8.0%	6.4%	5.8%	2.7%	5.7%	8.4%	7.7%	6.8%	4.0%	6.7%	8.5%	7.8%	6.9%	4.1%	6.8%
EBIT	5,655,600	1,792,600	1,427,200	1,269,400	287,800	5,145,400	1,933,788	1,762,126	1,540,926	911,231	6,148,070	2,064,072	1,913,479	1,672,400	1,010,250	6,660,201
% EBIT Margin	6.6%	8.0%	6.4%	5.7%	1.3%	5.7%	8.4%	7.7%	6.8%	4.0%	6.7%	8.5%	7.8%	6.9%	4.1%	6.8%
Net Interest Expense	(723,000)	(235,000)	(189,900)	(150,500)	(163,600)	(739,000)	(194,680)	(193,788)	(192,104)	(193,965)	(774,538)	(195,185)	(195,093)	(194,193)	(196,307)	(780,778)
% of Revenues	(0.9%)	(1.0%)	(0.8%)	(0.7%)	(0.7%)	(0.8%)	(0.9%)	(0.9%)	(0.9%)	(0.9%)	(0.9%)	(0.8%)	(0.8%)	(0.8%)	(0.8%)	(0.8%)
Pre-Tax Income	4,932,600	1,557,600	1,237,300	1,118,900	124,200	4,406,400	1,739,108	1,568,338	1,348,821	717,266	5,373,533	1,868,887	1,718,386	1,478,207	813,943	5,879,423
% Pre-Tax Margin	5.8%	6.9%	5.5%	5.0%	0.5%	4.9%	7.6%	6.9%	6.0%	3.1%	5.9%	7.7%	7.0%	6.1%	3.3%	6.0%
Income Tax	2,258,140	645,700	491,100	350,400	(1,106,500)	380,700	457,385	412,473	354,740	188,641	1,413,239	491,517	451,935	388,768	214,067	1,546,288
% Tax Rate	45.8%	41.5%	39.7%	31.3%	(890.9%)	8.6%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%
Net Income	2,943,739	1,265,400	912,400	707,600	338,800	3,224,200	1,281,722	1,155,865	994,081	528,625	3,960,293	1,377,370	1,266,450	1,089,439	599,876	4,333,135
% Net Margin	3.5%	5.6%	4.1%	3.2%	1.5%	3.6%	5.6%	5.1%	4.4%	2.3%	4.3%	5.6%	5.2%	4.5%	2.4%	4.4%
Avg. Shares Outstanding (Basic)	340,622	341,087	338,327	332,882	343,696	338,998	343,251	342,807	342,362	341,918	342,585	341,474	341,029	340,585	340,140	340,807
Avg. Shares Outstanding (Diluted)	268,125	270,400	270,800	267,000	263,300	267,875	262,856	262,411	261,967	261,522	262,189	261,078	260,633	260,189	259,745	260,411
EPS (Basic)	\$8.64	\$3.71	\$2.70	\$2.13	\$0.99	\$9.52	\$3.73	\$3.37	\$2.90	\$1.55	\$11.56	\$4.03	\$3.71	\$3.20	\$1.76	\$12.71
EPS (Diluted)	\$10.99	\$4.68	\$3.37	\$2.65	\$1.29	\$11.99	\$4.88	\$4.40	\$3.79	\$2.02	\$15.10	\$5.28	\$4.86	\$4.19	\$2.31	\$16.63
% Change Y/Y	8.7%	35.4%	1.2%	8.3%	(26.8%)	9.0%	4.2%	30.7%	43.2%	57.1%	26.0%	8.2%	10.3%	10.3%	14.3%	10.2%

Source: Company reports and Piper Jaffray & Co. Current disclosure information for this company can be found at <http://www.piperjaffray.com/researchdisclosures>.

1/31/2018

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Legend:

I: Initiating Coverage
R: Resuming Coverage
T: Transferring Coverage
D: Discontinuing Coverage
S: Suspending Coverage
OW: Overweight
N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	378	55.83	100	26.46
HOLD [N]	281	41.51	30	10.68
SELL [UW]	18	2.66	0	0.00

Note: Distribution of Ratings/IB Services shows the number of companies currently covered by fundamental equity research in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

Analyst Certification — Sarah E. James, Sr. Research Analyst

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Time of dissemination: 31 January 2018 18:03EST.

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- **Neutral (N):** Anticipated to perform in line relative to the median of the group of stocks covered by the analyst.
- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

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