UnitedHealth Group Inc. (UNH) CEO Discusses Q2 2013 Results - Earnings Call Transcript

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UnitedHealth Group Inc. (UNH) Q2 2013 Earnings Call July 18, 2013 8:45 AM ET

Operator

Good morning. I will be your conference operator today. Welcome to the UnitedHealth Group Second Quarter 2013 Earnings Conference Call. [Operator Instructions] As a reminder, this call is being recorded.

Here are some important introductory information. This call contains forward-looking statements under U.S. federal securities laws. These statements are subject to risks and uncertainties that could cause actual results to differ materially from historical experience or present expectations. A description of some of the risks and uncertainties can be found in the reports that we file with the Securities and Exchange Commission, including the cautionary statements included in our current and periodic filings.

This call will also reference non-GAAP amounts. A reconciliation of non-GAAP to GAAP amounts is available on the Financial Reports and SEC Filings section of the company's Investors page at www.unitedhealthgroup.com.

Information presented on this call is contained in the earnings release we issued this morning and in our Form 8-K dated July 18, 2013, which may be accessed from the Investors page of the company's website. [Operator Instructions]

I would now like to turn the conference over to the President and Chief Executive Officer of UnitedHealth Group, Stephen Hemsley.

Stephen J. Hemsley

Good morning, and thank you for joining us this morning to review our first half 2013 and the longer-term future we continue to build at UnitedHealth Group.

The performance of the quarter and the first half of this year reflect many of the themes we are focusing on with intensity across UnitedHealth Group: growing by serving more people with higher and more consistent quality with compassion and a better, more modern and personal consumer experience; making health care more affordable by enabling the health care consumer, the care provider and the system itself to become a more effective system of health and wellness; advancing the performance and value of this enterprise for shareholders through operating and capital disciplines in both growth and strategic diversification, as well as dividend and share recapture.

We see several of these elements in our first half performance in a number of ways such as the consistent, broad-based growth across each of our market-facing business groups; medical cost trends that have remained in check and will help to keep health benefits affordable; the increasing pace in product innovation and adoption as nearly 6 million consumers now embrace our incentive product design and our rapidly growing portfolio of consumer tools; the rapid acceleration of deeper and more integrated performance-based payment relationships with care providers that will reach above 25 billion by this year end; and the increase in our dividend to more than $1 billion annually even as we sustain $3 billion in share buyback.

We have a great deal more to do. We are far from performing to our potential. Although we are seeing steady advancements on many fronts, we are redoubling our commitment to consistent execution in the core fundamentals of our businesses. We are determined to accelerate the pace of innovation and the adoption of simpler and more modern approaches and technologies and ever better approaches consistently delivering higher-quality care and access and to make health care more understandable and affordable for both the individual consumer and for our society.

Our performance in the first half of 2013 was characterized by this growing business momentum, continued service expansion and diversification across the enterprise.

In the second quarter, UnitedHealth Group earned $1.40 per share, up 10% year-over-year with revenues over $30.4 billion, up 11.5% year-over-year. As expected, the consolidated operating margin decreased slightly year-over-year by 30 basis points as the consolidated medical care ratio increased to 20 basis points to 81.5%, reflecting our continued strong growth and diversification into government benefit programs. And accelerating growth from our services, international and fee-based businesses produced a 90 basis point rise in the consolidated operating cost ratio to 15.9%. The level of services growth has become so meaningful that it continues to outstrip steady efficiency gains from our multi-year initiatives enhancing quality, simplicity and system-wide productivity, as well as our concentrated focus on cost management across UnitedHealthcare, Optum and UnitedHealth Group.

While this ratio has increased, it remains largely a reflection of the ongoing growth and diversification across UnitedHealth Group. Cash flows from operations were $1.5 billion in the quarter and $2.5 billion through 6 months. We decreased our debt-to-total capital ratio by 160 basis points during the quarter to 34.6% at June 30 and ended the quarter with $1.2 billion in available cash.

Last month, our board increased our dividend by 32% to an annual rate of $1.12 per share and renewed our share repurchase program with a fresh authorization for the repurchase of 110 million shares. These decisions reflect confidence in the strength and consistency of our underlying earnings and cash generation capacities into the future.

In the current quarter, UnitedHealth Group continued its pattern of steady, consistent growth and market share gains, and we see more growth to come in the next few years in areas such as commercial and consumer benefits through public and private exchanges, Medicare Advantage, state Medicaid expansions, Medicaid long-term care, dual-eligible MMEs, military and veteran benefits and services, the emerging Brazilian market and the continuing maturation of Optum's broad range of services for consumers, care providers, payers and other participants in the health system as a whole.

Let's review second quarter business results, starting with UnitedHealthcare where the story remains one of remarkable growth and continued market share gains. Over the past 12 months, UnitedHealthcare has been the fastest-growing health benefits company, increasing the number of people served by more than 9 million. This includes more than 2.9 million people in TRICARE and another 4.7 million people from Amil in Brazil, both new markets for us. Overall growth has been driven by offering distinct and innovative consumer benefits and services shaped to respond to local market needs and affordable price points for consumers.

UnitedHealthcare has designed a comprehensive system of capability that aligns modern, incentive-based benefit designs with easy and convenient consumer empowerment tools that engage effective clinical care wellness programs, which in turn channel naturally into incentivized, performance-based care delivery access. This aligned system leverages better informed and incentive consumer and care provider behaviors to produce sustainable cost and performance advantages and deeper, more innovative relationships with consumers, care providers and plan sponsors across all market segments. Effective incentive alignment with consumer benefits through the care provider rewards is a critical component to sustainably improving broader accountability and effective payer to care provider integration.

We are the market leaders in consumer value plans with nearly $6 million high deductible or consumer incentive plans in force. We are leaders in consumer transparency tools with innovative mobile applications that enable effective use of information specific to each consumer. We're further along in value-based care provider contracting than any other company and our pace is accelerating with more than $50 billion in accountable care performance contracts expected by 2017, if not sooner. These programs offer varying levels of integration with care providers, depending on their ability to affect health outcomes and assume financial risk. Year-by-year, these programs are helping transform how health care is delivered, paid for and rewarded.

This quarter, UnitedHealthcare's organic growth was led by the initiation of services for TRICARE in the West region for 2.9 million members in the military and their families. This is the first time this contract has moved to a new service provider in more than 15 years and we encountered challenges as we engaged in this complex and massive transition. We have learned from these initial challenges and regret any disruption this may have caused to men and women we are privileged to serve, and we're deeply grateful for the collaborative working relationship with the Department of Defense, the TRICARE Management Activity, the TRICARE Regional Office West and the surgeon generals of the respective services, the military treatment facilities and their fine leaders.

Having quickly advanced from these initial challenges, we remain committed to consistent excellent service and the value of innovation in going forward for these programs.

UnitedHealthcare's Employer & Individual business added a net 235,000 people year-to-date and is performing strongly across-the-board. Growth continues to be strong across the government benefit markets as well. Through the first half of the year, UnitedHealthcare remains the largest, and once again, fastest-growing Medicare Advantage participant. And Part D and Medicare Supplement both continued to perform strongly. Medicare Advantage products have grown to serve 355,000 more people through the first 6 months, and our full array of Medicare product offerings has grown to serve over 1 million more seniors this year.

Medicaid growth stands at 110,000 people through the first 6 months despite a divestiture impacting 60,000 people earlier this year. Care for chronic and complex populations remains a distinctive capability for this business and a major forward growth driver with recent awards to serve long-term care and dual-eligible beneficiaries in Arizona, Florida, New Mexico, New York, Ohio and Washington State.

For the second quarter, UnitedHealthcare generated operating earnings of $1.9 billion with solid contributions from all businesses. The commercial medical care ratio improved 10 basis points year-over-year. We are performing slightly better on outpatient costs despite the continued migration of clinical services from inpatient settings. We continue to experience lower hospital inpatient usage as we expected, and inpatient costs are in line with our projections.

Overall, 2013 full year commercial cost trends are tracking in line with our initial projections of 5% to 6% with unit prices remaining a core driver of increases.

UnitedHealthcare's results include Amil, which is now 90% owned. With Amil, our international business has grown to serve 260,000 more consumers in the first half of the year, remain solidly ahead of its growth and financial plans for the year and is well-positioned to continued growth and market share gains, driven by its distinctive market offerings and clinical engagement model.

We continue to be gratified by the growing response to Optum's market-leading offerings and capabilities. Each of Optum's businesses posted double-digit top line gains. And overall, Optum revenue rose 21% over last year. Operating margin expanded 170 basis points to 6.1% despite the increasing mix of pharmacy services revenues. As of today, we are more than halfway through our pharmacy migration. And since January 1, OptumRx serves a total of about 8 million new consumers, including these migrations and new business.

For the first 6 months of the year, total Optum operating earnings rose 80% to just over $1 billion. Optum's strong first half 2013 performance is proving that the broader health system and its constituencies create a natural end market for services, a market we have sized at more than $500 billion annually.

Historically, this market has been fragmented and served primarily by smaller single-point solutions. We see the opportunity to bring together the services and capabilities we offer and provide broader, more integrated solutions to larger, more diverse clients while continuing to deliver even more effective stand-alone products and services to our traditional customer base.

We are focusing our investments on roughly 10 product families and freeing up resources through this more disciplined focus and the related productivity gain to fund further development and innovation on behalf of the clients and consumers we serve. These actions are driving stronger and more consistent margin performance across all Optum's businesses.

The collective performance of our diverse UnitedHealthcare and Optum businesses ultimately comes through in UnitedHealth Group's strong overall results. As we indicated earlier in our commentary, UnitedHealth Group consolidated revenues grew 11.5% and net earnings grew 10% to $1.40 per share in the second quarter.

We expect full year 2013 net earnings in the tighter range of $5.35 to $5.50 per share. Our second half earnings performance will benefit from the timing of Part D earnings and contributions and Optum's continued performance gains. Our balance sheet is strong and our cash flows from operations are expected in the range of $7.2 billion to $7.6 billion this year. We already targeted returning up to $4 billion of that to shareholders, and our recent dividend increase now puts us in an annual dividend payment pace of more than $1 billion.

Looking forward, our outlook remains consistent, strongly positive in the long term with familiar near-term challenges coming in 2014 and 2015 as we indicated last quarter.

We expect pressure on the pace of revenue growth next year, given both rate and membership pressures in Medicare Advantage. We see further business and product integration advances, further medical affordability gains and intense focus on driving lower operating costs to improve and sustain our competitive positions serving key health benefit markets and continuing strong cash flows.

The next phases of the Affordable Care Act should bring growth and expansion in the Medicaid business, as well as to Optum and some meaningful financial challenges as well. For instance, on the Medicare side, the challenge is intensified meaningfully and include nondeductible taxes combined with the continued significant underfunding of Medicare Advantage. We remain committed to Medicare Advantage as the most valuable and fastest-growing Medicare benefit offering available to American seniors.

By 2016, Medicare Advantage will, in effect, be reimbursed at parity with original Fee-for-Service Medicare. And at the same time, it will continue to deliver better benefits at lower costs because of effective medical cost management and far better consumer-focused services and technologies, none of which are present in the current Medicare Fee-for-Service system.

2016 should represent a final baseline pivot for Medicare growth for years to come, and America's demographic trends are compelling. Well more than 3 million people will enter Medicare each year, and UnitedHealth Group is uniquely positioned to emerge as the market leader. These long-term growth trends informed our approach to our 2014 Medicare bids, which will remain under review by CMS through the summer. Our decisions for 2014 focus on balancing program sustainability, margin protection and cash flow generation of our MA business measured on a long-term multi-year basis. We are aggressively and consistently addressing the operating and marketing costs of our Medicare programs without compromising the exceptional support and services we offer to the seniors we are serving through these important benefits.

The depth of the underfunding of these benefits to seniors is causing us to exit certain market areas, reduce the number of plan offerings and reduce benefits in the majority of the local markets we serve commensurate with our review of the competitive position and long-term sustainability of our services for each individual market.

We are shaping our networks to ensure we are delivering health care with local care provider partners who deliver high-quality care and provide a sustainably low medical cost structure and to increasingly share in the results of collaborative efforts to bring greater quality and consistency of care to seniors, including the most elderly and those with chronic conditions.

These steps can be expected to moderate member growth in 2014 in contrast to our strong growth experience over the last few years. We will engage our members further by increasing our use of in-home health reviews and in-home services. Even with these actions, we expect pressure on 2014 Medicare Advantage margins. The severe underfunding of the MA program for 2014, combined with the ACA tax impact and continued sequestration effects are too significant a burden to ask seniors to bear alone and still expect this important franchise to remain attractive to them.

Beyond Medicare Advantage and some remaining unknowns focused around ACA implementation in the individual and small group markets, we expect the general narrative of UnitedHealth Group's performance for 2014 to be largely the same as 2013. Our commercial benefits, international, Medicaid and military businesses should all continue to perform well. Optum will continue to grow strongly and contribute comparatively more of our overall performance as virtually every Optum business and product line is growing and performing well and is expected to continue on that path.

We will continue to be good stewards of shareholder capital, continuing to balance investments across our businesses and returning more capital to shareholders in both dividends and share repurchase.

From 1999 through the end of 2013, we have returned more than $40 billion to shareholders through dividends and share repurchase even as we have grown and enriched the capabilities, the market positions, the value and the forward potential of this enterprise.

We remain optimistic about our capacity to serve society and to create value for the people and customers we serve as well as for the health system at large. And we look forward to an expanding discussion of our strategy, growth and performance at our investor conference, which this year will be on December 3 in New York.

As usual, this morning, we have a full complement of leaders here and would ask the operator to open the call to our questions. Only one per speaker, please. Thank you.

Question-and-Answer Session

Operator

[Operator Instructions] We'll take our first question from Matt Borsch with Goldman Sachs.

Matthew Borsch - Goldman Sachs Group Inc., Research Division

I wanted to just ask a little bit more about Medicare Advantage. You made a comment, if I heard it correctly, about final baseline EBIT in 2016 as a base for growth once we're fully at parity. Did I hear that correctly? And do you -- are you implying that EBIT is -- in Medicare Advantage is down from -- on a downward slope in '14 and '15 and then normalizing in '16 and growing from there?

Stephen J. Hemsley

Yes, well, I'm glad you asked the question because I don't think that if it went out that way, that's not what our intent was. Basically, continued funding pressures, some of them mechanical, the impact of the ACA and so forth will continue basically to get the funding mechanisms for Medicare Advantage to be at parity with Fee-for-Service. Once that funding is leveled at that basis, the programs are thought to then be neutral to each other from that perspective. And therefore, one could expect, given the strong performance of the Medicare Advantage program, that the growth could even accelerate from that point because you've got this significant demographic trend. You have a very attractive program, and the Medicare Advantage program will still have meaningful advantages in terms of benefits, medical management capacities, consumer engagement and relationship capacities that the Fee-for-Service system simply doesn't have right now. So that's why I think our outlook on Medicare Advantage in the long term is so positive because, in essence, we have to navigate through these next couple of years where some of the mechanical funding actions will take place. But even in those periods and those have been, in my view, in effect, Medicare Advantage has continued as a broad national program to prosper and grow. So I don't know how it will play out in 2014 and '15 as these elements play in on the funding -- to get funding in essence to neutrality. But from 2016 forward, that neutrality should then baseline this program and it will be Medicare Advantage with its, I think, compelling advantages compared to the Fee-for-Service system. And we think the prospects for growth after that are quite compelling. That's really what we tried to get across.

Matthew Borsch - Goldman Sachs Group Inc., Research Division

Yes, that makes sense. You also characterized, in terms of next year, that the impact would be to moderate member growth for 2014. Do you imply by that, that you do expect growth but it's just at a slower rate?

Stephen J. Hemsley

Well, we really didn't comment on that direction. What we were intending to say is actions that we are taking to make sure that program is competitive and viable in as many markets as we can possibly continue to advance in. So along those lines, we outlined a series of steps that we're taking that maybe Jack Larsen wants to count on that. But again, we are focused on operating that program to its maximum potential in serving as many American seniors as we can through that program and making sure that it continues to perform in terms of growth, margin protection, cash flow attributes, et cetera, and to maximize the performance of the program, recognizing the funding pressure that's on and recognizing that there might be limitations to how much seniors can actually bear the underfunding actions that are being taken with respect to the program. Jack?

Jack Larsen

Thanks, Steve. I would just add maybe a bit of an exclamation point on some of the changes that we're contemplating for our business next year and I think Steve went through them well. We're looking at benefits. We're going to be adjusting our -- planning some market withdrawals, I think, at a more modest end, perhaps 5% or so, with most of those members having an opportunity to enroll in another UnitedHealthcare plan. We'll be narrowing our networks consistent with achieving better cost, better outcomes and better management of our stores [ph]. And Matt, we haven't really seen how our competitors are taking to all these, too. So I would say, at this distance, I think the only thing we can really say is that our performance at the membership growth line is likely to be more moderate compared to the last couple 2 or 3 years where we have grown very well.

Operator

And we'll go next to Justin Lake with JP Morgan.

Justin Lake - JP Morgan Chase & Co, Research Division

First, just wanted to check and see if there's any updated view you can share with us on 2014 EPS growth overall.

Stephen J. Hemsley

Well, Justin, we thought that question might come up. We don't really comment on next year's guidance in the current midyear quarter. I would say that with that said, earnings growth is clearly our focus for 2014 and we are intense about that. But we have to recognize that there is a great deal in front of us to achieve that. As we just mentioned, certainly strengthening Medicare Advantage given the significant 2014 funding shortfall and the steps we need to take to make sure that program continues to be vital is on the front of the list of that. There's also ongoing work in the commercial markets, with pressures on our own individual business, the continued market migration to lower price point insurance products and fee-based conversions. And those are all occurring kind of in the backdrop of a normal competitive dynamics intention. We remain respectful of medical cost trends despite the success in keeping trends in check, and particularly, given the measured economic recovery. We need to make continued investments in Optum in the emerging categories of private exchanges, Medicare risk and revenue cycle, house calls, ever larger and longer-term care provider relationships, Optum cloud products, and in general, we are committed to continuing to fund ongoing innovation and adoption. And then last, we want to think about headwinds. Investment income, we'll see probably short-term pressure as current portfolios actually turn over and transition from kind of capital gain realization mode into higher-yielding portfolios for the longer term. So with that series of headwinds in front of us, experience has taught us to be somewhat cautious and to be sure we consider and respond to these headwinds before we offer a sense of 2014. So we are not prepared to do that, but I would say we are intensely focused on solid earnings growth for 2014. But we have to work our way through that as we stand really in the mid-year of '13.

Justin Lake - JP Morgan Chase & Co, Research Division

Great. And then my actual question was more of just a follow-up on Medicare Advantage. Just to make sure I'm clear on what you've laid out here is you felt like 2014 and '15 are looking like a -- obviously, you're going to be under pressure. But by the end of 2015 going into '16, do you expect that '16 growth to reaccelerate and you feel like you'll still, after all this pressure, given what you're doing from a cost perspective and managing, you're going to have -- and you feel like the benefits that you still have left out there for seniors after these costs will still be enticing and you expect growth to be in line with what you've seen over the last couple of years and potentially even accelerate? Was that a right -- was that the correct takeaway?

Stephen J. Hemsley

I think you generally have it correct. I think you may have a more precise notion of it than we would having to operate the program. So I can't tell you that on January 1, 2016, that there will be some kind of a light will go on, et cetera. But you have exactly the direction of our thinking on this program correctly. That as we navigate through the next couple of years and the pressures that, I think, are well acknowledged on the program, we intend to operate it in a -- in such a way that we are maintaining the vitality of that program, protecting its margins, maintaining the vitality of its benefits and its distinctions to consumers, to seniors that need these programs and that we think that, as you reach that point of neutrality, which is about 2016, that the growth dynamics of that should accelerate, yes.

Justin Lake - JP Morgan Chase & Co, Research Division

And so do you see the program will be bigger than it is today or not -- or smaller than it is given the -- given what's facing you when you get to 2016? And that's it for me.

Stephen J. Hemsley

That's the third installment of your single question. Obviously, Justin, from that discussion, we expect in the long term that the needs of the American seniors and what the values we can bring to the Medicare program suggest that is a very strong long-term growth platform.

Operator

And we'll go next to Chris Rigg with Susquehanna.

Christian Rigg - Susquehanna Financial Group, LLLP, Research Division

I just want to follow up on Medicare Advantage again and make sure. I understand what you're talking about in terms of reimbursement and the pressures in '14 and '15. But when we think about the business near term, particularly fourth quarter this year and how you market to seniors, will you take your foot off the accelerator somewhat in terms of marketing, or do you think you have to accelerate the spending this year to maintain what you have and potentially grow? And just if you could give us any context on how the suspending might change year-to-year, that would be helpful.

Stephen J. Hemsley

Yes, I might offer -- take it at my level that how we're going to approach and deploy resources to the market from a marketing point of view at this point in time is really a little, I would say, a level of competitive intimacy that I'd rather not share. I would say that our commentary was more along the lines of the fact that we are going to be shaping networks to be more focused, to really focus on the high-performance assets as it relates to seniors, that the benefit reductions that are fairly broad based, those are the elements that I think will play into more conservative growth prospects for '14. I think that getting into what our marketing plan is, might be a little bit more than we would like to get into this morning.

Operator

And we'll go next to A.J. Rice with UBS.

Albert J. Rice - UBS Investment Bank, Research Division

Maybe I'll switch gears a little bit. There's been some developments, obviously, around the ACA since we last had you guys on the conference call, the employer mandate delays, some documentation delays and then we've also gotten some information on the exchanges in some states. I know you said you'd be opportunistic, particularly around the exchanges. Can you comment about, A, does any of those developments that have occurred in the last few months change your perspective on those opportunities that are available to you maybe looking out next year and beyond for the ACA?

Stephen J. Hemsley

I think I'll have Gail and Jeff Alter kind of comment on that. I would just say, again, like to calibrate the perspective we're bringing to it. Long term, we're positive with respect to those channels as they form and as they became areas where we think we can participate and add value. The near-term dynamics are more challenging for us and maybe that's specific to our particular profile of business. So near term, we have tended to be more cautious with respect to those, and I think generally, the elements that have been occurring reinforce those tendencies.

Gail Koziara Boudreaux

Good morning. It's Gail Boudreaux. I think Steve hit on the core principles. We've been, I think, modest in our participation in the exchanges. But I think the biggest story, quite frankly, is there is significant change going on across the overall commercial markets. So as we think about our business, we're focused both inside and outside of the exchange around affordable benefit offerings for our consumers. So what we're talking about in terms of our network and our intentional integration of product, clinical and network strategies is really core to both what we're doing inside and out of the exchange. We're participating in about a dozen exchanges as you can see from what's been publicly disclosed. And quite frankly, at this stage of the game, we've kept a very disciplined process around that. We think that there is a huge opportunity over the long term, and we're going to participate to learn in those exchanges. In terms of what's happened on the overall reform implementation, at this stage, we're preparing our business. And as I said, much of what we're doing, we're doing for both inside and outside of the exchange because we think affordability and consumer engagement are probably the most critical pieces.

Operator

We'll go next to Kevin Fischbeck with Bank of America.

Kevin M. Fischbeck - BofA Merrill Lynch, Research Division

I just wanted to understand a little better this year's guidance. You guys reported a quarter, which beat at least consensus numbers by $0.15. But it looks like you're only raising guidance by $0.05 at the mid-point. So wanted to understand a little bit how you thought about guidance. Is there anything that you thought of, in the back half of the year, that might be a headwind that maybe you weren't anticipating before, that maybe the market wasn't anticipating?

Stephen J. Hemsley

I don't think so, and I might have Dave comment on that. But in essence, we tend to operate within a range and feel comfortable in that range. I think excessive precision here is -- time has taught us to be careful about that and to, in essence, be prudent with respect to the guidance that's offered. I would say that the performance of the business has been strong through the first half and while there is -- the orientation of the business was more challenging to the second half, we are pretty much on course and had -- saw no reason to do anything other than tighten again the range of guidance.

David S. Wichmann

Right. So Kevin, it's David. If you kind of parse through this, the range of $5.35 to $5.50 per share suggests that the second half of the year will not only be stronger than the first half of this year, but also stronger than the comparative half year in 2012. And as we kind of commented on in the first quarter, that's largely due to the change in the seasonal pattern of Part D revenue and profit recognition. While -- Steve had it right, there's very modest pressure, additional pressure, on the back half of the year, I think we've already pointed some of these out. But just to keep in mind, obviously, the last half of the year has 2 quarters of the sequestration impact versus the first half of the year, we're only having one, as an example. And then, of course, as you also see, we have an uptick in a run rate of our growth patterns in the business as well. So that requires some investment, not only in terms of selling, but also in terms of implementation. And then Steve did mention the near-term impact on the higher interest rates than the impact that they have had on our ability to recognize the extensive capital gains that we have in the past. And then the last thing I'd just point out is our tax rate will return to 36.75% level for Qs 3 and 4, which will comparatively impact earnings in the last half of the year.

Kevin M. Fischbeck - BofA Merrill Lynch, Research Division

Okay. But I guess, except for maybe higher interest rates, none of those sound necessarily new, like new headwinds per se?

David S. Wichmann

No, I was just trying to give you some...

Stephen J. Hemsley

No, I just think we're just trying to establish a prudent, balanced, I think, consistent with what our posture has been for the last several years. And the businesses continue to perform well and Optum, in particular, is having a very, very strong year. But we didn't really see a need to change the guidance other than to tighten the range given the fact we only have a half year left.

Operator

And we'll go next to Josh Raskin with Barclays.

Joshua R. Raskin - Barclays Capital, Research Division

Just taking a look at the SG&A changes. It came a little bit higher than what we were looking at. I think you were up 20 basis points. The ratio was up 20 bps in the first quarter and now up 90 in the second quarter and I see the TRICARE piece of it. But I'm just curious what's driving that? Was there sort of -- was there any discretionary spending, any acceleration of planned spending that you thought would be coming? And maybe within that, if you could just give us a baseline to start with the TRICARE revenue contribution, that'd be helpful.

Stephen J. Hemsley

Sure. Dave, you want to respond to that?

David S. Wichmann

Sure. So the operating cost ratio is up 90 basis points year-over-year. It was very much in line with our expectations for this quarter. We mentioned in the script that there are several things contributing to that ratio, predominantly related to business mix changes. As you know, we had one large funding conversion from risk to fee in the first quarter. That obviously will continue to impact us throughout the year. We've also added Amil, which has a higher SG&A ratio. And obviously, we didn't have Amil in the second quarter last year. TRICARE, of course, fee-based contract as well as continuing costs of implementation through the second quarter, again not in place last year. And of course, Optum is growing very quickly, and of course, most of that business is service-oriented and fee-based as well. The only thing I'd point out beyond that, which is all in the script, really, is there's continued cost of implementation for CPCA [ph], ICD-10, the TRICARE implementation and the PBM migration. Those are all items that are inside our numbers for the second quarter and those, for the most part, associated with improved growth prospects for the business going forward. So we're pleased to make those investments. The last thing I'll just say is that, as indicated in the script, is that, obviously, all these things have offset what this management team has done over the past several years. But in particular, in the last year around cost containment efforts and done a very nice job advancing the productivity of the business and really muting the impact of this mix shift on this operating cost ratio.

Joshua R. Raskin - Barclays Capital, Research Division

Got you. I was looking, Dave, more just 1Q increase versus 2Q increase. It looks like there was just sort of a pickup in the second quarter. I understand a lot of the implementation costs and the funding conversion, Amil and the implementation. I know a lot of that was impacting first quarter as well. So was just curious what caused the 70 basis point increase and sort of the year-over-year in 2Q and trying to figure out if TRICARE was big enough to do that, and my guess is that fee-based business probably wasn't big enough to cause that change.

David S. Wichmann

Well, I don't think, if there's anything from our perspective that's out of line in there. I think it is the continued progression in mix. I think Optum continues to be a larger overall factor. And I'm not sure everybody can actually calculate the impact of that, but I think that is probably the largest contributing factor that the business -- that's all operating expenses and growing at a very solid rate. So I think it is, as we have analyzed, it is overwhelmingly mixed even the items in terms of regulatory and so forth, so basically in these numbers year-over-year and in them sequentially. So there is nothing in that, that we see out of line or outside our expectations or plans for the year other than probably an even higher level of performance on the part of our services business, which includes not just Optum, but also the fee -- the significant growth and continued fee-based businesses across UnitedHealthcare. That's where all their commercial growth has been.

John S. Penshorn

Josh, it's John Penshorn. Last November, we said 15.9% plus or minus 30 basis points. That range we affirm and that accommodates the accelerated growth in fee-based services Steve referred to.

Operator

We'll go next to Peter Costa with Wells Fargo.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division

Can you go over for us how OptumRx growth is helping the firm exactly? And we can see it on OptumRx, but some of the improvement bleeds over into the commercial side of the business. What portion is on the commercial side of the business and what portion is on in OptumRx itself? And then can you talk about the growth path of Optum Rx in 2014 and 2015?

Stephen J. Hemsley

Sure. I'll have Dirk respond to that. I mean, it is perfectly in line with the OptumRx's agenda on synchronization and the impact it has extending to the total medicals costs. So Dirk, you want to...

Dirk McMahon

Yes, I think, well, let's start up by talking about the business. I think if you look, our RFP volume is up a bit year-over-year. And if you look at what we see, we don't see a lot of the business changing hands across the PBM space. But what we do see we're actually getting a little more than our fair share and our retention has been pretty good. So if you look at what we try to do, we try to, again, manage total health outcomes as well as our -- as well as improving the cost of care. And we do that, as it was with our synchronization approach, we bring all the data together and optimize the overall spend. So we think that, in addition to our specialty offering in the marketplace, is resonating very well.

Stephen J. Hemsley

So that bleeds to performance for UnitedHealthcare and its businesses, and obviously, for our government programs. So it does, we think, make us distinctive with respect to medical cost trends, with respect to that section of medical cost drugs as well as a growing and vital and more diversified PBM business that we think the potential, once this migration is fully digested and we can focus our full attentions to the external marketplace, I think the growth prospects of that can be quite impressive.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division

Can you quantify for us in any way how much of the improving MLR on the commercial side comes from bringing the Optum business in house?

Stephen J. Hemsley

I don't -- I think that we would be -- it would be too much of back-of-the-envelope kind of response. So we'll take that off-line and we'll kind of bring that kind of thing perhaps back in the next, in our next quarter. We'll comment specifically on the impact of that. I just don't want to shoot from the hip on something like that. So I think it's a very good question and I think we'll take it that way, if that's okay with you.

Operator

And we'll go next to Sarah James with Wedbush.

Sarah James - Wedbush Securities Inc., Research Division

There is obviously a robust conversation going on with parties in D.C. around the sufficiency of 2014 Medicare rate and how that may influence 2015 budgets and rates. Can you give us a read on what you see as the current perception in D.C. of the adequacy of 2014 rate that, initially, it seems to like debut 2014 as more positive than you view it. So I wanted to see if the perception in D.C. has changed throughout your discussions with them. And if you could give us a read on the level of their receptivity compared to previous years to the information you're presenting on where rates should be going forward.

Stephen J. Hemsley

That is a -- that would be a challenging kind of conversation to have in a forum like this. I would say this in a very constructive way, that access to the administration, CMS administration, HHS and so forth has been -- has always been open and fair and constructive dialogue and conversation. They obviously pursue a variety of protocols in establishing the rate process. It is a complicated process. It's multi-faceted. So it's not really possible to have a single conversation about elements such as that. I think our positions with respect to the funding patterns on Medicare Advantage are well articulated and supported. And there is an open dialogue about that and that dialogue is occurring, in essence, all year long. So I do think it's an environment where the parties are working together. I think there is a recognition of the role that Medicare Advantage plays in the marketplace. And I would describe the conversations as very professional and productive. And I think we would have to leave it at that. It is not what I would characterize as some kind of contentious environment at all. These are extraordinarily professional people in the administration that are trying to administer these programs in accordance with the protocols that have been established into the best of their capacities. And we are having an ongoing business dialogue with them on this subject. So I think that's all we can really comment. And that happens in states as well, in Medicaid. It's just the nature of the market.

Operator

And we'll go next to Ralph Giacobbe with Credit Suisse.

Ralph Giacobbe - Crédit Suisse AG, Research Division

First, just wanted to make sure I heard correct that you're planning on exiting 5% of MA markets next year. And if possible, if that's correct, can you give us a sense of what percentage of MA enrollment that represents today? And then second, separately, just wondering, has the delay in employer mandate changed or would you expect it to change discussion at all with employers? I guess, it'd be helpful just to get a sense of how your discussions are going with employers. Is there more pushback? Is there confusion? Is there concern, et cetera? I'm just trying to get a broad sense of the appetite to make changes due to ACA near term.

Stephen J. Hemsley

Sure. Let's take Medicare first.

Jack Larsen

Hey, Ralph. Jack Larsen. So the 5% does relate to our membership. And I really wouldn't call them market excess -- market exits as much as planned withdrawals. So about 150,000 or so of our members will be impacted by member withdrawals. But in turn, about 80-plus percent of those members will have access to another UnitedHealthcare MA product.

Gail Koziara Boudreaux

Ralph, this is Gail Boudreaux. There are a number of questions, I think, embedded around the employer mandate. So let me address that one first and if I get to your issues... In terms of, first, the delay of the employer mandate, we don't really think that, that's going to have a significant impact. Employers who currently offer insurance are going to continue to do that and that's been the course of our discussions. In terms of how our discussions are going with employers, there is a lot of change coming to that marketplace and the intense focus is around affordability, as I said earlier, not just on the exchanges, but across all of our customers. They're looking at value-based plan designs, getting consumers much more engaged, how they integrate clinical programs. So I'd say the real focus is around affordability of coverage and improving consumer engagement and making sure they have real value for the dollars they spend.

Operator

We'll go next to Sheryl Skolnick with CRT Capital Group.

Sheryl R. Skolnick - CRT Capital Group LLC, Research Division

The MA discussion is remarkably more bullish than I thought it would be and maybe that's why your stock is trading up so nicely because it would suggest that 2014 may not be as challenged a year as one might have thought. So I guess, the first question is, is that -- the first part of the question -- is that the correct interpretation that now that you've gone through all this, you've reaffirmed your commitment to the program long term, post-2016, which I think was the point of that discussion, that you're able to find ways to mitigate the impact on both the beneficiary and the company of what is a dramatic underfunding of MA? And then the second question I have relates to capital deployment. Given that discussion about MA, can you either -- give us a sense of where you see the most attractive segments of your market or new opportunities, be they international or existing opportunities like Optum, like commercial, et cetera, where you think are the highest, best use of the capital that you're not already returning to shareholders.

Stephen J. Hemsley

Sure. First of all, very good observation, which I'd like to make sure we bring in-line. I think our view in terms of Medicare Advantage is really not different than we had indicated last quarter. We believe that program is severely underfunded for 2014. The comments that we're making, if you parse them are, that we are exiting certain markets, we're exiting certain plans, we're narrowing our networks across virtually all the markets, we are taking benefits down across all the markets. So those are not good things for American seniors who engage on these benefits. And those elements will clearly put pressure on both top line for 2014 on Medicare Advantage, an important program for us, and on the margins of that program. So to level set on that basis, that's I think what we said clearly. And we will work through those things. And we are absolutely intense on this program because we think it has a meaningful long-term value to American seniors and to basically the viability of the Medicare program, in total, going forward because it brings in market dynamics around the managing medical costs, around engaging consumers, around holding care providers accountable, elements such as that. That's a long -- that's placed to our competencies. It should be a strong, long-term market, so long as the program is funded appropriately. If it is not funded appropriately, then that -- those market dynamics will change. So I don't think anything has changed about that. We have just worked one more quarter through the tactics of how we will have to navigate through 2014. So to level set that, we are -- we see pressure in '14 and '15 on Medicare Advantage as a product. We're working through those. The program, in our view, has not been funded strongly in the past and '14 was very significant. It's a 750 basis point delta and what we see the cost of that program to be. In terms of allocating capital, we have a diversified model. And that strategy and diversification is a conscious one with the notion of allocating capital opportunistically across the spectrum of that diversified model. We see compelling opportunities and have in the Optum business. There are opportunities that will emerge, we think, in the benefits businesses. And we think that they will emerge over time as more pressure is brought into the overall health benefits marketplace. And we look for opportunities where we can deploy our 3 competencies around local care, market engagement, around information and around enabling technology in international settings. We found Brazil to be a compelling opportunity for that, particularly on our Optum services side. There's probably more market opportunities for us on the international side and we'll continue to look for benefits. But that is going to be probably more opportunistic because we don't see as many of those other than in Optum. I think Optum has a significant opportunity on the international side. We parse our investments based upon cost of capital return thresholds, along those lines, and recognize our responsibilities in terms of returning capital pursuant to dividends and share repurchase. So that's kind of the perspective and that really hasn't changed at all.

Sheryl R. Skolnick - CRT Capital Group LLC, Research Division

Right. So if I could just follow up then. If I'm going to interpret your 2014 comments, I think what I would say is beyond the challenges provided by MA, you see your capital deployment and all the other expertise that you bring to the table as providing the kind of balance perhaps to 2014, offsetting some of the negatives in MA would be the continued pace that you see in the rest of the businesses? And that the challenge in predicting 2014 for us is to balance the negative of the MA against the positives of the other business. The street is interpreting, I think, your comments as meaning flat 2014. And I'm trying to, from my perspective, I think you said balance one against the other, but you didn't commit to flat. Is that correct?

Stephen J. Hemsley

Yes, we have committed to no position on 2014. I think beyond that, that what you're laying out is broadly the way I would -- broadly correct. And that is, we are positive about the other aspects of our business and our capabilities and we're applying them intensively to the pressure that is being put on the Medicare Advantage program that are still working through that. So we haven't declared on 2014. We are focused on growing earnings in 2014 and growing this business, that is our focus and our intensity every year. We have a lot to offer in terms of our diversified business model. And when we feel we have worked through this to the point where we can responsibly offer some direction to the marketplace, we will do that. But I think generally, you have the framework of it correct.

Operator

We'll go next to Ana Gupte with Dowling & Partners.

Ana Gupte - Dowling & Partners Securities, LLC

So a lot of questions on 2014. I'm just trying to get a little more clarity on commercial and Medicare in 2013 as that's the baseline for all the headwinds that you will experience in '14. So on the Medicare side, in the first quarter, you had quite a bit of deterioration in your x commercial medical loss ratio. You brought up sequestration, enhanced Part D and some seasonal patterns of first quarter pressure and so on. It seems to have eased up in 2Q. I'm just trying to understand if it's because of Part D or you've actually done something to improve your base Medicare Advantage business and the potential margin deterioration that you've been experiencing, I think, in 1Q? Or is it prior period reserves or Amil or something else?

Stephen J. Hemsley

I think we'll have Dan comment on it. Clearly, Part D is a factor in it. But I think it's not the only one. So Dan?

Daniel Schumacher

Sure. This is Dan. You have -- you had a lot in there. To Steve's point, absolutely, the biggest difference as you look sequentially, first quarter, second, both on a consolidated basis and in government programs and Medicare, obviously, is the Part D timing. In the first quarter, as you look year-over-year, it actually increased the loss ratio. And as you look at the second quarter, it actually decreased the loss ratio on a year-over-year basis. So that's the biggest swing item. But I'd also tell you inside of Medicare that we also have more favorable development than the first quarter and on a year-over-year basis and that's a little more concentrated in our Medicare business. And from the first to the second quarter in Medicare, we're seeing a little bit better performance on our new growth in Medicare. So those are some of the things that are influencing it with Part D being the most pronounced.

Ana Gupte - Dowling & Partners Securities, LLC

So your view of your own base Medicare business and if you can split out Medicare Advantage and Part D, do you expect deterioration from 2012 or not for the full year '13?

Daniel Schumacher

On the full year, we expect our Medicare Advantage loss ratio to go up. Obviously, we have the significant reimbursement challenges as well as sequestration. And then working against that is our focus on clinical management and so forth. So -- but yes, in aggregate, we expect our Medicare Advantage loss ratio to increase on the full year. As you look at Part D, our performance is strong there. On the full year, our earnings will be up and they're up in large part due to the significant volume growth that we had in Part D. And obviously, the quarter-to-quarter progression is different. But in aggregate on the year, Part D earnings are going to be up.

Ana Gupte - Dowling & Partners Securities, LLC

That's helpful. Then just the follow-up on the commercial side. You had a little bit of margin expansion in 1Q. You had cited the loss of a big, fully insured very high MLR count at the time. You're seeing a little bit of margin expansion in the second quarter. Your days and claims table have gone up by 1 day. All of you are on the hook for this tax for next year or so. Should we expect that either your reserves will strengthen or that your commercial underwriting spread gets better through 3 and 4Q as you build up for that tax burden?

Daniel Schumacher

On the commercial side, yes, we had a decline in our loss ratio again this quarter on a year-over-year basis. We are down 10 basis points. A big portion of that is, obviously, the large case funding conversion that we had at the beginning of the year. And that's being offset by the competitive market environment. We guided at Investor Day to a more than 1 percentage point increase in our full year commercial loss ratio. We've adjusted for that large funding conversion. And we still expect at the mid-point, about a 60 basis point increase in our commercial loss ratio on the full year. So full year commercial loss ratio guidance still in that 81.2% plus or minus 50 basis points.

Stephen J. Hemsley

I think the question is really a baseline one. The commercial baseline for the current year is very solid, very strong. And it will then run into the challenges that you point out, that everybody will run into in the marketplace in '14 and '15.

Operator

We'll go next to Carl McDonald with Citigroup.

Carl R. McDonald - Citigroup Inc, Research Division

Can you roughly quantify the margin compression that you're expecting to see in Medicare Advantage next year? So roughly, are we talking 50 to 100 basis points or something bigger than that?

Stephen J. Hemsley

Yes, well, first of all, we don't really get into margin at that level in the first place. And I think if I could do that at this point in time, we would have more to say about 2014. So that's what we're working through right now. And we have to work through them on a real basis through the specific markets. So I really can't offer guidance with -- at that level of precision, the mid-year of the current year.

Carl R. McDonald - Citigroup Inc, Research Division

Yes, maybe ask it in a different way. If the headwind that you're talking about is 750 basis points, you talked about sort of the seniors' ability to handle adjustments to that, what would you view as being a reasonable amount that a senior could handle in terms of benefit design changes in a given year?

Stephen J. Hemsley

I have no basis to really speculate around that. Let me go back to a couple of things. If you think about it, that spread that you're focusing on, we're attacking by, in part, taking benefits down in a way that maintains the value and viability of the program. And it is -- it runs a spectrum across markets. So it's not like a universal thing. This is done at a relatively precise level market-by-market. Network shaping is also that. We have historically sponsored a very broad, very open access kind of market for our Medicare Advantage. We will be forced to narrow that. We are focused potentially on operating costs across-the-board. So those are the elements that we're really playing. And then, obviously, we are, as I said, we're operating in a way to maintain the long-term viability of the program. But my second point in there was protecting margins. The sustainability of the program has to be that it is one that returns capital. So we are protecting the margins of that program. And that is a market-by-market proposition relative to our set of assets in the marketplace, as well as the way the program is being administered by its sponsor in those markets. It's a complicated proposition, but I can assure you we are focused on closing as much of that gap as possible. And seniors are clearly going to participate in it, pursue the benefit reductions, narrower access. So none of these things, the underfunding of the program is not a good thing for American seniors who benefit from these programs. But we are trying to navigate that in the best way possible to preserve these programs [indiscernible] long term because we think it has compelling long-term growth aspects and value to the administration in terms of what it can do for Medicare.

Operator

We'll go next to Christine Arnold with Cowan.

Christine Arnold - Cowen and Company, LLC, Research Division

Optum seems to be running generally ahead of expectations. Is there any change to the long term Optum objectives that you outlined at Investor Day? And you talked about international being a substantial opportunity. Where else do you see good opportunities in Optum?

Stephen J. Hemsley

Larry, you want to comment?

Larry C. Renfro

Christine, this is Larry Renfro. And I think you know that we put together a, what I'll call, a multi-year business plan back about 18 months ago. We call that One Optum. And when we did that, we wanted to make Optum a more potent solutions organization and we wanted to really position ourselves for the future. And at the same time, we made some financial commitments to you guys on the ROIC being 15% by 2015, a 6% operating margin by 2015 as well as doubling our operating profits so -- of 2011. So those goals that we set at that point in time we're kind of marching down the road. We are hitting those pretty well and meeting expectations and sometimes actually doing better. The initiatives around them are pretty much around simplification, reengineering, business integration. Really, the whole business alignment and we talked a little bit about the PBM. And in 2013, we have now started to pivot toward growth. And part of the growth initiative, and I forget the part of your question, is that we're trying to really have deeper, what I'd call, larger as well as significant relationships with our customers. And that's actually working fairly well for us right now as well. The other part of growth, as we've been talking about this today, comes from what I'll call new opportunities that surround us around this talk about Medicare rates and the pressure that's going on in the industry. So what all that does for us is cause us to really look for the future and we have to put certain development dollars, as well as innovation dollars in to make all this work. I would say that international would fall into that same category in terms of innovation and development. As we work toward doing a lot of these programs that we are doing today in the United States, we'll be putting them into Brazil. So we're confident that we have planned investments. We're balancing those investments with the growth, as well as cost management. But at this point in time, we would pretty much stand by the overall multi-year plan in terms of our guidance to meet or exceed the high end of the range.

Stephen J. Hemsley

So thank you, all. Once again, thank you for your interest in UnitedHealth Group today. We have had a very solid quarter and a strong year-to-date, both for UnitedHealthcare and Optum, and both continue to grow. Our performance trends are positive. I think it reflects in part the value of our diversified business approach and we remain intensely focused on the remainder of 2013 and on 2014 in the long-term success of the enterprise. So thank you for joining us.

Executives

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Jack Larsen

Gail Koziara Boudreaux - Executive Vice President and Chief Executive Officer of United Healthcare

David S. Wichmann - Chief Financial Officer, President of Operations and Executive Vice President

John S. Penshorn - Senior Vice President

Dirk McMahon

Daniel Schumacher

Larry C. Renfro - Executive Vice President and Chief Executive officer of Optum

Analysts

Matthew Borsch - Goldman Sachs Group Inc., Research Division

Justin Lake - JP Morgan Chase & Co, Research Division

Christian Rigg - Susquehanna Financial Group, LLLP, Research Division

Albert J. Rice - UBS Investment Bank, Research Division

Kevin M. Fischbeck - BofA Merrill Lynch, Research Division

Joshua R. Raskin - Barclays Capital, Research Division

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division

Sarah James - Wedbush Securities Inc., Research Division

Ralph Giacobbe - Crédit Suisse AG, Research Division

Sheryl R. Skolnick - CRT Capital Group LLC, Research Division

Ana Gupte - Dowling & Partners Securities, LLC

Carl R. McDonald - Citigroup Inc, Research Division

Christine Arnold - Cowen and Company, LLC, Research Division

UnitedHealth Group Inc. (UNH) Q2 2013 Earnings Call July 18, 2013 8:45 AM ET

Operator

Good morning. I will be your conference operator today. Welcome to the UnitedHealth Group Second Quarter 2013 Earnings Conference Call. [Operator Instructions] As a reminder, this call is being recorded.

Here are some important introductory information. This call contains forward-looking statements under U.S. federal securities laws. These statements are subject to risks and uncertainties that could cause actual results to differ materially from historical experience or present expectations. A description of some of the risks and uncertainties can be found in the reports that we file with the Securities and Exchange Commission, including the cautionary statements included in our current and periodic filings.

This call will also reference non-GAAP amounts. A reconciliation of non-GAAP to GAAP amounts is available on the Financial Reports and SEC Filings section of the company's Investors page at www.unitedhealthgroup.com.

Information presented on this call is contained in the earnings release we issued this morning and in our Form 8-K dated July 18, 2013, which may be accessed from the Investors page of the company's website. [Operator Instructions]

I would now like to turn the conference over to the President and Chief Executive Officer of UnitedHealth Group, Stephen Hemsley.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Good morning, and thank you for joining us this morning to review our first half 2013 and the longer-term future we continue to build at UnitedHealth Group.

The performance of the quarter and the first half of this year reflect many of the themes we are focusing on with intensity across UnitedHealth Group: growing by serving more people with higher and more consistent quality with compassion and a better, more modern and personal consumer experience; making health care more affordable by enabling the health care consumer, the care provider and the system itself to become a more effective system of health and wellness; advancing the performance and value of this enterprise for shareholders through operating and capital disciplines in both growth and strategic diversification, as well as dividend and share recapture.

We see several of these elements in our first half performance in a number of ways such as the consistent, broad-based growth across each of our market-facing business groups; medical cost trends that have remained in check and will help to keep health benefits affordable; the increasing pace in product innovation and adoption as nearly 6 million consumers now embrace our incentive product design and our rapidly growing portfolio of consumer tools; the rapid acceleration of deeper and more integrated performance-based payment relationships with care providers that will reach above 25 billion by this year end; and the increase in our dividend to more than $1 billion annually even as we sustain $3 billion in share buyback.

We have a great deal more to do. We are far from performing to our potential. Although we are seeing steady advancements on many fronts, we are redoubling our commitment to consistent execution in the core fundamentals of our businesses. We are determined to accelerate the pace of innovation and the adoption of simpler and more modern approaches and technologies and ever better approaches consistently delivering higher-quality care and access and to make health care more understandable and affordable for both the individual consumer and for our society.

Our performance in the first half of 2013 was characterized by this growing business momentum, continued service expansion and diversification across the enterprise.

In the second quarter, UnitedHealth Group earned $1.40 per share, up 10% year-over-year with revenues over $30.4 billion, up 11.5% year-over-year. As expected, the consolidated operating margin decreased slightly year-over-year by 30 basis points as the consolidated medical care ratio increased to 20 basis points to 81.5%, reflecting our continued strong growth and diversification into government benefit programs. And accelerating growth from our services, international and fee-based businesses produced a 90 basis point rise in the consolidated operating cost ratio to 15.9%. The level of services growth has become so meaningful that it continues to outstrip steady efficiency gains from our multi-year initiatives enhancing quality, simplicity and system-wide productivity, as well as our concentrated focus on cost management across UnitedHealthcare, Optum and UnitedHealth Group.

While this ratio has increased, it remains largely a reflection of the ongoing growth and diversification across UnitedHealth Group. Cash flows from operations were $1.5 billion in the quarter and $2.5 billion through 6 months. We decreased our debt-to-total capital ratio by 160 basis points during the quarter to 34.6% at June 30 and ended the quarter with $1.2 billion in available cash.

Last month, our board increased our dividend by 32% to an annual rate of $1.12 per share and renewed our share repurchase program with a fresh authorization for the repurchase of 110 million shares. These decisions reflect confidence in the strength and consistency of our underlying earnings and cash generation capacities into the future.

In the current quarter, UnitedHealth Group continued its pattern of steady, consistent growth and market share gains, and we see more growth to come in the next few years in areas such as commercial and consumer benefits through public and private exchanges, Medicare Advantage, state Medicaid expansions, Medicaid long-term care, dual-eligible MMEs, military and veteran benefits and services, the emerging Brazilian market and the continuing maturation of Optum's broad range of services for consumers, care providers, payers and other participants in the health system as a whole.

Let's review second quarter business results, starting with UnitedHealthcare where the story remains one of remarkable growth and continued market share gains. Over the past 12 months, UnitedHealthcare has been the fastest-growing health benefits company, increasing the number of people served by more than 9 million. This includes more than 2.9 million people in TRICARE and another 4.7 million people from Amil in Brazil, both new markets for us. Overall growth has been driven by offering distinct and innovative consumer benefits and services shaped to respond to local market needs and affordable price points for consumers.

UnitedHealthcare has designed a comprehensive system of capability that aligns modern, incentive-based benefit designs with easy and convenient consumer empowerment tools that engage effective clinical care wellness programs, which in turn channel naturally into incentivized, performance-based care delivery access. This aligned system leverages better informed and incentive consumer and care provider behaviors to produce sustainable cost and performance advantages and deeper, more innovative relationships with consumers, care providers and plan sponsors across all market segments. Effective incentive alignment with consumer benefits through the care provider rewards is a critical component to sustainably improving broader accountability and effective payer to care provider integration.

We are the market leaders in consumer value plans with nearly $6 million high deductible or consumer incentive plans in force. We are leaders in consumer transparency tools with innovative mobile applications that enable effective use of information specific to each consumer. We're further along in value-based care provider contracting than any other company and our pace is accelerating with more than $50 billion in accountable care performance contracts expected by 2017, if not sooner. These programs offer varying levels of integration with care providers, depending on their ability to affect health outcomes and assume financial risk. Year-by-year, these programs are helping transform how health care is delivered, paid for and rewarded.

This quarter, UnitedHealthcare's organic growth was led by the initiation of services for TRICARE in the West region for 2.9 million members in the military and their families. This is the first time this contract has moved to a new service provider in more than 15 years and we encountered challenges as we engaged in this complex and massive transition. We have learned from these initial challenges and regret any disruption this may have caused to men and women we are privileged to serve, and we're deeply grateful for the collaborative working relationship with the Department of Defense, the TRICARE Management Activity, the TRICARE Regional Office West and the surgeon generals of the respective services, the military treatment facilities and their fine leaders.

Having quickly advanced from these initial challenges, we remain committed to consistent excellent service and the value of innovation in going forward for these programs.

UnitedHealthcare's Employer & Individual business added a net 235,000 people year-to-date and is performing strongly across-the-board. Growth continues to be strong across the government benefit markets as well. Through the first half of the year, UnitedHealthcare remains the largest, and once again, fastest-growing Medicare Advantage participant. And Part D and Medicare Supplement both continued to perform strongly. Medicare Advantage products have grown to serve 355,000 more people through the first 6 months, and our full array of Medicare product offerings has grown to serve over 1 million more seniors this year.

Medicaid growth stands at 110,000 people through the first 6 months despite a divestiture impacting 60,000 people earlier this year. Care for chronic and complex populations remains a distinctive capability for this business and a major forward growth driver with recent awards to serve long-term care and dual-eligible beneficiaries in Arizona, Florida, New Mexico, New York, Ohio and Washington State.

For the second quarter, UnitedHealthcare generated operating earnings of $1.9 billion with solid contributions from all businesses. The commercial medical care ratio improved 10 basis points year-over-year. We are performing slightly better on outpatient costs despite the continued migration of clinical services from inpatient settings. We continue to experience lower hospital inpatient usage as we expected, and inpatient costs are in line with our projections.

Overall, 2013 full year commercial cost trends are tracking in line with our initial projections of 5% to 6% with unit prices remaining a core driver of increases.

UnitedHealthcare's results include Amil, which is now 90% owned. With Amil, our international business has grown to serve 260,000 more consumers in the first half of the year, remain solidly ahead of its growth and financial plans for the year and is well-positioned to continued growth and market share gains, driven by its distinctive market offerings and clinical engagement model.

We continue to be gratified by the growing response to Optum's market-leading offerings and capabilities. Each of Optum's businesses posted double-digit top line gains. And overall, Optum revenue rose 21% over last year. Operating margin expanded 170 basis points to 6.1% despite the increasing mix of pharmacy services revenues. As of today, we are more than halfway through our pharmacy migration. And since January 1, OptumRx serves a total of about 8 million new consumers, including these migrations and new business.

For the first 6 months of the year, total Optum operating earnings rose 80% to just over $1 billion. Optum's strong first half 2013 performance is proving that the broader health system and its constituencies create a natural end market for services, a market we have sized at more than $500 billion annually.

Historically, this market has been fragmented and served primarily by smaller single-point solutions. We see the opportunity to bring together the services and capabilities we offer and provide broader, more integrated solutions to larger, more diverse clients while continuing to deliver even more effective stand-alone products and services to our traditional customer base.

We are focusing our investments on roughly 10 product families and freeing up resources through this more disciplined focus and the related productivity gain to fund further development and innovation on behalf of the clients and consumers we serve. These actions are driving stronger and more consistent margin performance across all Optum's businesses.

The collective performance of our diverse UnitedHealthcare and Optum businesses ultimately comes through in UnitedHealth Group's strong overall results. As we indicated earlier in our commentary, UnitedHealth Group consolidated revenues grew 11.5% and net earnings grew 10% to $1.40 per share in the second quarter.

We expect full year 2013 net earnings in the tighter range of $5.35 to $5.50 per share. Our second half earnings performance will benefit from the timing of Part D earnings and contributions and Optum's continued performance gains. Our balance sheet is strong and our cash flows from operations are expected in the range of $7.2 billion to $7.6 billion this year. We already targeted returning up to $4 billion of that to shareholders, and our recent dividend increase now puts us in an annual dividend payment pace of more than $1 billion.

Looking forward, our outlook remains consistent, strongly positive in the long term with familiar near-term challenges coming in 2014 and 2015 as we indicated last quarter.

We expect pressure on the pace of revenue growth next year, given both rate and membership pressures in Medicare Advantage. We see further business and product integration advances, further medical affordability gains and intense focus on driving lower operating costs to improve and sustain our competitive positions serving key health benefit markets and continuing strong cash flows.

The next phases of the Affordable Care Act should bring growth and expansion in the Medicaid business, as well as to Optum and some meaningful financial challenges as well. For instance, on the Medicare side, the challenge is intensified meaningfully and include nondeductible taxes combined with the continued significant underfunding of Medicare Advantage. We remain committed to Medicare Advantage as the most valuable and fastest-growing Medicare benefit offering available to American seniors.

By 2016, Medicare Advantage will, in effect, be reimbursed at parity with original Fee-for-Service Medicare. And at the same time, it will continue to deliver better benefits at lower costs because of effective medical cost management and far better consumer-focused services and technologies, none of which are present in the current Medicare Fee-for-Service system.

2016 should represent a final baseline pivot for Medicare growth for years to come, and America's demographic trends are compelling. Well more than 3 million people will enter Medicare each year, and UnitedHealth Group is uniquely positioned to emerge as the market leader. These long-term growth trends informed our approach to our 2014 Medicare bids, which will remain under review by CMS through the summer. Our decisions for 2014 focus on balancing program sustainability, margin protection and cash flow generation of our MA business measured on a long-term multi-year basis. We are aggressively and consistently addressing the operating and marketing costs of our Medicare programs without compromising the exceptional support and services we offer to the seniors we are serving through these important benefits.

The depth of the underfunding of these benefits to seniors is causing us to exit certain market areas, reduce the number of plan offerings and reduce benefits in the majority of the local markets we serve commensurate with our review of the competitive position and long-term sustainability of our services for each individual market.

We are shaping our networks to ensure we are delivering health care with local care provider partners who deliver high-quality care and provide a sustainably low medical cost structure and to increasingly share in the results of collaborative efforts to bring greater quality and consistency of care to seniors, including the most elderly and those with chronic conditions.

These steps can be expected to moderate member growth in 2014 in contrast to our strong growth experience over the last few years. We will engage our members further by increasing our use of in-home health reviews and in-home services. Even with these actions, we expect pressure on 2014 Medicare Advantage margins. The severe underfunding of the MA program for 2014, combined with the ACA tax impact and continued sequestration effects are too significant a burden to ask seniors to bear alone and still expect this important franchise to remain attractive to them.

Beyond Medicare Advantage and some remaining unknowns focused around ACA implementation in the individual and small group markets, we expect the general narrative of UnitedHealth Group's performance for 2014 to be largely the same as 2013. Our commercial benefits, international, Medicaid and military businesses should all continue to perform well. Optum will continue to grow strongly and contribute comparatively more of our overall performance as virtually every Optum business and product line is growing and performing well and is expected to continue on that path.

We will continue to be good stewards of shareholder capital, continuing to balance investments across our businesses and returning more capital to shareholders in both dividends and share repurchase.

From 1999 through the end of 2013, we have returned more than $40 billion to shareholders through dividends and share repurchase even as we have grown and enriched the capabilities, the market positions, the value and the forward potential of this enterprise.

We remain optimistic about our capacity to serve society and to create value for the people and customers we serve as well as for the health system at large. And we look forward to an expanding discussion of our strategy, growth and performance at our investor conference, which this year will be on December 3 in New York.

As usual, this morning, we have a full complement of leaders here and would ask the operator to open the call to our questions. Only one per speaker, please. Thank you.

Question-and-Answer Session

Operator

[Operator Instructions] We'll take our first question from Matt Borsch with Goldman Sachs.

Matthew Borsch - Goldman Sachs Group Inc., Research Division

I wanted to just ask a little bit more about Medicare Advantage. You made a comment, if I heard it correctly, about final baseline EBIT in 2016 as a base for growth once we're fully at parity. Did I hear that correctly? And do you -- are you implying that EBIT is -- in Medicare Advantage is down from -- on a downward slope in '14 and '15 and then normalizing in '16 and growing from there?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Yes, well, I'm glad you asked the question because I don't think that if it went out that way, that's not what our intent was. Basically, continued funding pressures, some of them mechanical, the impact of the ACA and so forth will continue basically to get the funding mechanisms for Medicare Advantage to be at parity with Fee-for-Service. Once that funding is leveled at that basis, the programs are thought to then be neutral to each other from that perspective. And therefore, one could expect, given the strong performance of the Medicare Advantage program, that the growth could even accelerate from that point because you've got this significant demographic trend. You have a very attractive program, and the Medicare Advantage program will still have meaningful advantages in terms of benefits, medical management capacities, consumer engagement and relationship capacities that the Fee-for-Service system simply doesn't have right now. So that's why I think our outlook on Medicare Advantage in the long term is so positive because, in essence, we have to navigate through these next couple of years where some of the mechanical funding actions will take place. But even in those periods and those have been, in my view, in effect, Medicare Advantage has continued as a broad national program to prosper and grow. So I don't know how it will play out in 2014 and '15 as these elements play in on the funding -- to get funding in essence to neutrality. But from 2016 forward, that neutrality should then baseline this program and it will be Medicare Advantage with its, I think, compelling advantages compared to the Fee-for-Service system. And we think the prospects for growth after that are quite compelling. That's really what we tried to get across.

Matthew Borsch - Goldman Sachs Group Inc., Research Division

Yes, that makes sense. You also characterized, in terms of next year, that the impact would be to moderate member growth for 2014. Do you imply by that, that you do expect growth but it's just at a slower rate?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Well, we really didn't comment on that direction. What we were intending to say is actions that we are taking to make sure that program is competitive and viable in as many markets as we can possibly continue to advance in. So along those lines, we outlined a series of steps that we're taking that maybe Jack Larsen wants to count on that. But again, we are focused on operating that program to its maximum potential in serving as many American seniors as we can through that program and making sure that it continues to perform in terms of growth, margin protection, cash flow attributes, et cetera, and to maximize the performance of the program, recognizing the funding pressure that's on and recognizing that there might be limitations to how much seniors can actually bear the underfunding actions that are being taken with respect to the program. Jack?

Jack Larsen

Thanks, Steve. I would just add maybe a bit of an exclamation point on some of the changes that we're contemplating for our business next year and I think Steve went through them well. We're looking at benefits. We're going to be adjusting our -- planning some market withdrawals, I think, at a more modest end, perhaps 5% or so, with most of those members having an opportunity to enroll in another UnitedHealthcare plan. We'll be narrowing our networks consistent with achieving better cost, better outcomes and better management of our stores [ph]. And Matt, we haven't really seen how our competitors are taking to all these, too. So I would say, at this distance, I think the only thing we can really say is that our performance at the membership growth line is likely to be more moderate compared to the last couple 2 or 3 years where we have grown very well.

Operator

And we'll go next to Justin Lake with JP Morgan.

Justin Lake - JP Morgan Chase & Co, Research Division

First, just wanted to check and see if there's any updated view you can share with us on 2014 EPS growth overall.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Well, Justin, we thought that question might come up. We don't really comment on next year's guidance in the current midyear quarter. I would say that with that said, earnings growth is clearly our focus for 2014 and we are intense about that. But we have to recognize that there is a great deal in front of us to achieve that. As we just mentioned, certainly strengthening Medicare Advantage given the significant 2014 funding shortfall and the steps we need to take to make sure that program continues to be vital is on the front of the list of that. There's also ongoing work in the commercial markets, with pressures on our own individual business, the continued market migration to lower price point insurance products and fee-based conversions. And those are all occurring kind of in the backdrop of a normal competitive dynamics intention. We remain respectful of medical cost trends despite the success in keeping trends in check, and particularly, given the measured economic recovery. We need to make continued investments in Optum in the emerging categories of private exchanges, Medicare risk and revenue cycle, house calls, ever larger and longer-term care provider relationships, Optum cloud products, and in general, we are committed to continuing to fund ongoing innovation and adoption. And then last, we want to think about headwinds. Investment income, we'll see probably short-term pressure as current portfolios actually turn over and transition from kind of capital gain realization mode into higher-yielding portfolios for the longer term. So with that series of headwinds in front of us, experience has taught us to be somewhat cautious and to be sure we consider and respond to these headwinds before we offer a sense of 2014. So we are not prepared to do that, but I would say we are intensely focused on solid earnings growth for 2014. But we have to work our way through that as we stand really in the mid-year of '13.

Justin Lake - JP Morgan Chase & Co, Research Division

Great. And then my actual question was more of just a follow-up on Medicare Advantage. Just to make sure I'm clear on what you've laid out here is you felt like 2014 and '15 are looking like a -- obviously, you're going to be under pressure. But by the end of 2015 going into '16, do you expect that '16 growth to reaccelerate and you feel like you'll still, after all this pressure, given what you're doing from a cost perspective and managing, you're going to have -- and you feel like the benefits that you still have left out there for seniors after these costs will still be enticing and you expect growth to be in line with what you've seen over the last couple of years and potentially even accelerate? Was that a right -- was that the correct takeaway?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I think you generally have it correct. I think you may have a more precise notion of it than we would having to operate the program. So I can't tell you that on January 1, 2016, that there will be some kind of a light will go on, et cetera. But you have exactly the direction of our thinking on this program correctly. That as we navigate through the next couple of years and the pressures that, I think, are well acknowledged on the program, we intend to operate it in a -- in such a way that we are maintaining the vitality of that program, protecting its margins, maintaining the vitality of its benefits and its distinctions to consumers, to seniors that need these programs and that we think that, as you reach that point of neutrality, which is about 2016, that the growth dynamics of that should accelerate, yes.

Justin Lake - JP Morgan Chase & Co, Research Division

And so do you see the program will be bigger than it is today or not -- or smaller than it is given the -- given what's facing you when you get to 2016? And that's it for me.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

That's the third installment of your single question. Obviously, Justin, from that discussion, we expect in the long term that the needs of the American seniors and what the values we can bring to the Medicare program suggest that is a very strong long-term growth platform.

Operator

And we'll go next to Chris Rigg with Susquehanna.

Christian Rigg - Susquehanna Financial Group, LLLP, Research Division

I just want to follow up on Medicare Advantage again and make sure. I understand what you're talking about in terms of reimbursement and the pressures in '14 and '15. But when we think about the business near term, particularly fourth quarter this year and how you market to seniors, will you take your foot off the accelerator somewhat in terms of marketing, or do you think you have to accelerate the spending this year to maintain what you have and potentially grow? And just if you could give us any context on how the suspending might change year-to-year, that would be helpful.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Yes, I might offer -- take it at my level that how we're going to approach and deploy resources to the market from a marketing point of view at this point in time is really a little, I would say, a level of competitive intimacy that I'd rather not share. I would say that our commentary was more along the lines of the fact that we are going to be shaping networks to be more focused, to really focus on the high-performance assets as it relates to seniors, that the benefit reductions that are fairly broad based, those are the elements that I think will play into more conservative growth prospects for '14. I think that getting into what our marketing plan is, might be a little bit more than we would like to get into this morning.

Operator

And we'll go next to A.J. Rice with UBS.

Albert J. Rice - UBS Investment Bank, Research Division

Maybe I'll switch gears a little bit. There's been some developments, obviously, around the ACA since we last had you guys on the conference call, the employer mandate delays, some documentation delays and then we've also gotten some information on the exchanges in some states. I know you said you'd be opportunistic, particularly around the exchanges. Can you comment about, A, does any of those developments that have occurred in the last few months change your perspective on those opportunities that are available to you maybe looking out next year and beyond for the ACA?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I think I'll have Gail and Jeff Alter kind of comment on that. I would just say, again, like to calibrate the perspective we're bringing to it. Long term, we're positive with respect to those channels as they form and as they became areas where we think we can participate and add value. The near-term dynamics are more challenging for us and maybe that's specific to our particular profile of business. So near term, we have tended to be more cautious with respect to those, and I think generally, the elements that have been occurring reinforce those tendencies.

Gail Koziara Boudreaux - Executive Vice President and Chief Executive Officer of United Healthcare

Good morning. It's Gail Boudreaux. I think Steve hit on the core principles. We've been, I think, modest in our participation in the exchanges. But I think the biggest story, quite frankly, is there is significant change going on across the overall commercial markets. So as we think about our business, we're focused both inside and outside of the exchange around affordable benefit offerings for our consumers. So what we're talking about in terms of our network and our intentional integration of product, clinical and network strategies is really core to both what we're doing inside and out of the exchange. We're participating in about a dozen exchanges as you can see from what's been publicly disclosed. And quite frankly, at this stage of the game, we've kept a very disciplined process around that. We think that there is a huge opportunity over the long term, and we're going to participate to learn in those exchanges. In terms of what's happened on the overall reform implementation, at this stage, we're preparing our business. And as I said, much of what we're doing, we're doing for both inside and outside of the exchange because we think affordability and consumer engagement are probably the most critical pieces.

Operator

We'll go next to Kevin Fischbeck with Bank of America.

Kevin M. Fischbeck - BofA Merrill Lynch, Research Division

I just wanted to understand a little better this year's guidance. You guys reported a quarter, which beat at least consensus numbers by $0.15. But it looks like you're only raising guidance by $0.05 at the mid-point. So wanted to understand a little bit how you thought about guidance. Is there anything that you thought of, in the back half of the year, that might be a headwind that maybe you weren't anticipating before, that maybe the market wasn't anticipating?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I don't think so, and I might have Dave comment on that. But in essence, we tend to operate within a range and feel comfortable in that range. I think excessive precision here is -- time has taught us to be careful about that and to, in essence, be prudent with respect to the guidance that's offered. I would say that the performance of the business has been strong through the first half and while there is -- the orientation of the business was more challenging to the second half, we are pretty much on course and had -- saw no reason to do anything other than tighten again the range of guidance.

David S. Wichmann - Chief Financial Officer, President of Operations and Executive Vice President

Right. So Kevin, it's David. If you kind of parse through this, the range of $5.35 to $5.50 per share suggests that the second half of the year will not only be stronger than the first half of this year, but also stronger than the comparative half year in 2012. And as we kind of commented on in the first quarter, that's largely due to the change in the seasonal pattern of Part D revenue and profit recognition. While -- Steve had it right, there's very modest pressure, additional pressure, on the back half of the year, I think we've already pointed some of these out. But just to keep in mind, obviously, the last half of the year has 2 quarters of the sequestration impact versus the first half of the year, we're only having one, as an example. And then, of course, as you also see, we have an uptick in a run rate of our growth patterns in the business as well. So that requires some investment, not only in terms of selling, but also in terms of implementation. And then Steve did mention the near-term impact on the higher interest rates than the impact that they have had on our ability to recognize the extensive capital gains that we have in the past. And then the last thing I'd just point out is our tax rate will return to 36.75% level for Qs 3 and 4, which will comparatively impact earnings in the last half of the year.

Kevin M. Fischbeck - BofA Merrill Lynch, Research Division

Okay. But I guess, except for maybe higher interest rates, none of those sound necessarily new, like new headwinds per se?

David S. Wichmann - Chief Financial Officer, President of Operations and Executive Vice President

No, I was just trying to give you some...

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

No, I just think we're just trying to establish a prudent, balanced, I think, consistent with what our posture has been for the last several years. And the businesses continue to perform well and Optum, in particular, is having a very, very strong year. But we didn't really see a need to change the guidance other than to tighten the range given the fact we only have a half year left.

Operator

And we'll go next to Josh Raskin with Barclays.

Joshua R. Raskin - Barclays Capital, Research Division

Just taking a look at the SG&A changes. It came a little bit higher than what we were looking at. I think you were up

20 basis points. The ratio was up 20 bps in the first quarter and now up 90 in the second quarter and I see the TRICARE piece of it. But I'm just curious what's driving that? Was there sort of -- was there any discretionary spending, any acceleration of planned spending that you thought would be coming? And maybe within that, if you could just give us a baseline to start with the TRICARE revenue contribution, that'd be helpful.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Sure. Dave, you want to respond to that?

David S. Wichmann - Chief Financial Officer, President of Operations and Executive Vice President

Sure. So the operating cost ratio is up 90 basis points year-over-year. It was very much in line with our expectations for this quarter. We mentioned in the script that there are several things contributing to that ratio, predominantly related to business mix changes. As you know, we had one large funding conversion from risk to fee in the first quarter. That obviously will continue to impact us throughout the year. We've also added Amil, which has a higher SG&A ratio. And obviously, we didn't have Amil in the second quarter last year. TRICARE, of course, fee-based contract as well as continuing costs of implementation through the second quarter, again not in place last year. And of course, Optum is growing very quickly, and of course, most of that business is service-oriented and fee-based as well. The only thing I'd point out beyond that, which is all in the script, really, is there's continued cost of implementation for CPCA [ph], ICD-10, the TRICARE implementation and the PBM migration. Those are all items that are inside our numbers for the second quarter and those, for the most part, associated with improved growth prospects for the business going forward. So we're pleased to make those investments. The last thing I'll just say is that, as indicated in the script, is that, obviously, all these things have offset what this management team has done over the past several years. But in particular, in the last year around cost containment efforts and done a very nice job advancing the productivity of the business and really muting the impact of this mix shift on this operating cost ratio.

Joshua R. Raskin - Barclays Capital, Research Division

Got you. I was looking, Dave, more just 1Q increase versus 2Q increase. It looks like there was just sort of a pickup in the second quarter. I understand a lot of the implementation costs and the funding conversion, Amil and the implementation. I know a lot of that was impacting first quarter as well. So was just curious what caused the 70 basis point increase and sort of the year-over-year in 2Q and trying to figure out if TRICARE was big enough to do that, and my guess is that fee-based business probably wasn't big enough to cause that change.

David S. Wichmann - Chief Financial Officer, President of Operations and Executive Vice President

Well, I don't think, if there's anything from our perspective that's out of line in there. I think it is the continued progression in mix. I think Optum continues to be a larger overall factor. And I'm not sure everybody can actually calculate the impact of that, but I think that is probably the largest contributing factor that the business -- that's all operating expenses and growing at a very solid rate. So I think it is, as we have analyzed, it is overwhelmingly mixed even the items in terms of regulatory and so forth, so basically in these numbers year-over-year and in them sequentially. So there is nothing in that, that we see out of line or outside our expectations or plans for the year other than probably an even higher level of performance on the part of our services business, which includes not just Optum, but also the fee -- the significant growth and continued fee-based businesses across UnitedHealthcare. That's where all their commercial growth has been.

John S. Penshorn - Senior Vice President

Josh, it's John Penshorn. Last November, we said 15.9% plus or minus 30 basis points. That range we affirm and that accommodates the accelerated growth in fee-based services Steve referred to.

Operator

We'll go next to Peter Costa with Wells Fargo.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division

Can you go over for us how OptumRx growth is helping the firm exactly? And we can see it on OptumRx, but some of the improvement bleeds over into the commercial side of the business. What portion is on the commercial side of the business and what portion is on in OptumRx itself? And then can you talk about the growth path of Optum Rx in 2014 and 2015?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Sure. I'll have Dirk respond to that. I mean, it is perfectly in line with the OptumRx's agenda on synchronization and the impact it has extending to the total medicals costs. So Dirk, you want to...

Dirk McMahon

Yes, I think, well, let's start up by talking about the business. I think if you look, our RFP volume is up a bit year-over-year. And if you look at what we see, we don't see a lot of the business changing hands across the PBM space. But what we do see we're actually getting a little more than our fair share and our retention has been pretty good. So if you look at what we try to do, we try to, again, manage total health outcomes as well as our -- as well as improving the cost of care. And we do that, as it was with our synchronization approach, we bring all the data together and optimize the overall spend. So we think that, in addition to our specialty offering in the marketplace, is resonating very well.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

So that bleeds to performance for UnitedHealthcare and its businesses, and obviously, for our government programs. So it does, we think, make us distinctive with respect to medical cost trends, with respect to that section of medical cost drugs as well as a growing and vital and more diversified PBM business that we think the potential, once this migration is fully digested and we can focus our full attentions to the external marketplace, I think the growth prospects of that can be quite impressive.

Peter Heinz Costa - Wells Fargo Securities, LLC, Research Division

Can you quantify for us in any way how much of the improving MLR on the commercial side comes from bringing the Optum business in house?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I don't -- I think that we would be -- it would be too much of back-of-the-envelope kind of response. So we'll take that off-line and we'll kind of bring that kind of thing perhaps back in the next, in our next quarter. We'll comment specifically on the impact of that. I just don't want to shoot from the hip on something like that. So I think it's a very good question and I think we'll take it that way, if that's okay with you.

Operator

And we'll go next to Sarah James with Wedbush.

Sarah James - Wedbush Securities Inc., Research Division

There is obviously a robust conversation going on with parties in D.C. around the sufficiency of 2014 Medicare rate and how that may influence 2015 budgets and rates. Can you give us a read on what you see as the current perception in D.C. of the adequacy of 2014 rate that, initially, it seems to like debut 2014 as more positive than you view it. So I wanted to see if the perception in D.C. has changed throughout your discussions with them. And if you could give us a read on the level of their receptivity compared to previous years to the information you're presenting on where rates should be going forward.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

That is a -- that would be a challenging kind of conversation to have in a forum like this. I would say this in a very constructive way, that access to the administration, CMS administration, HHS and so forth has been -- has always been open and fair and constructive dialogue and conversation. They obviously pursue a variety of protocols in establishing the rate process. It is a complicated process. It's multi-faceted. So it's not really possible to have a single conversation about elements such as that. I think our positions with respect to the funding patterns on Medicare Advantage are well articulated and supported. And there is an open dialogue about that and that dialogue is occurring, in essence, all year long. So I do think it's an environment where the parties are working together. I think there is a recognition of the role that Medicare Advantage plays in the marketplace. And I would describe the conversations as very professional and productive. And I think we would have to leave it at that. It is not what I would characterize as some kind of contentious environment at all. These are extraordinarily professional people in the administration that are trying to administer these programs in accordance with the protocols that have been established into the best of their capacities. And we are having an ongoing business dialogue with them on this subject. So I think that's all we can really comment. And that happens in states as well, in Medicaid. It's just the nature of the market.

Operator

And we'll go next to Ralph Giacobbe with Credit Suisse.

Ralph Giacobbe - Crédit Suisse AG, Research Division

First, just wanted to make sure I heard correct that you're planning on exiting 5% of MA markets next year. And if possible, if that's correct, can you give us a sense of what percentage of MA enrollment that represents today? And then second, separately, just wondering, has the delay in employer mandate changed or would you expect it to change discussion at all with employers? I guess, it'd be helpful just to get a sense of how your discussions are going with employers. Is there more pushback? Is there confusion? Is there concern, et cetera? I'm just trying to get a broad sense of the appetite to make changes due to ACA near term.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Sure. Let's take Medicare first.

Jack Larsen

Hey, Ralph. Jack Larsen. So the 5% does relate to our membership. And I really wouldn't call them market excess -- market exits as much as planned withdrawals. So about 150,000 or so of our members will be impacted by member withdrawals. But in turn, about 80-plus percent of those members will have access to another UnitedHealthcare MA product.

Gail Koziara Boudreaux - Executive Vice President and Chief Executive Officer of United Healthcare

Ralph, this is Gail Boudreaux. There are a number of questions, I think, embedded around the employer mandate. So let me address that one first and if I get to your issues... In terms of, first, the delay of the employer mandate, we don't really think that, that's going to have a significant impact. Employers who currently offer insurance are going to continue to do that and that's been the course of our discussions. In terms of how our discussions are going with employers, there is a lot of change coming to that marketplace and the intense focus is around affordability, as I said earlier, not just on the exchanges, but across all of our customers. They're looking at value-based plan designs, getting consumers much more engaged, how they integrate clinical programs. So I'd say the real focus is around affordability of coverage and improving consumer engagement and making sure they have real value for the dollars they spend.

Operator

We'll go next to Sheryl Skolnick with CRT Capital Group.

Sheryl R. Skolnick - CRT Capital Group LLC, Research Division

The MA discussion is remarkably more bullish than I thought it would be and maybe that's why your stock is trading up so nicely because it would suggest that 2014 may not be as challenged a year as one might have thought. So I guess, the first question is, is that -- the first part of the question -- is that the correct interpretation that now that you've gone through all this, you've reaffirmed your commitment to the program long term, post-2016, which I think was the point of that discussion, that you're able to find ways to mitigate the impact on both the beneficiary and the company of what is a dramatic underfunding of MA? And then the second question I have relates to capital deployment. Given that discussion about MA, can you either -- give us a sense of where you see the most attractive segments of your market or new opportunities, be they international or existing opportunities like Optum, like commercial, et cetera, where you think are the highest, best use of the capital that you're not already returning to shareholders.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Sure. First of all, very good observation, which I'd like to make sure we bring in-line. I think our view in terms of Medicare Advantage is really not different than we had indicated last quarter. We believe that program is severely underfunded for 2014. The comments that we're making, if you parse them are, that we are exiting certain markets, we're exiting certain plans, we're narrowing our networks across virtually all the markets, we are taking benefits down across all the markets. So those are not good things for American seniors who engage on these benefits. And those elements will clearly put pressure on both top line for 2014 on Medicare Advantage, an important program for us, and on the margins of that program. So to level set on that basis, that's I think what we said clearly. And we will work through those things. And we are absolutely intense on this program because we think it has a meaningful long-term value to American seniors and to basically the viability of the Medicare program, in total, going forward because it brings in market dynamics around the managing medical costs, around engaging consumers, around holding care providers accountable, elements such as that. That's a long -- that's placed to our competencies. It should be a strong, long-term market, so long as the program is funded appropriately. If it is not funded appropriately, then that -- those market dynamics will change. So I don't think anything has changed about that. We have just worked one more quarter through the tactics of how we will have to navigate through 2014. So to level set that, we are -- we see pressure in '14 and '15 on Medicare Advantage as a product. We're working through those. The program, in our view, has not been funded strongly in the past and '14 was very significant. It's a 750 basis point delta and what we see the cost of that program to be. In terms of allocating capital, we have a diversified model. And that strategy and diversification is a conscious one with the notion of allocating capital opportunistically across the spectrum of that diversified model. We see compelling opportunities and have in the Optum business. There are opportunities that will emerge, we think, in the benefits businesses. And we think that they will emerge over time as more pressure is brought into the overall health benefits marketplace. And we look for opportunities where we can deploy our 3 competencies around local care, market engagement, around information and around enabling technology in international settings. We found Brazil to be a compelling opportunity for that, particularly on our Optum services side. There's probably more market opportunities for us on the international side and we'll continue to look for benefits. But that is going to be probably more opportunistic because we don't see as many of those other than in Optum. I think Optum has a significant opportunity on the international side. We parse our investments based upon cost of capital return thresholds, along those lines, and recognize our responsibilities in terms of returning capital pursuant to dividends and share repurchase. So that's kind of the perspective and that really hasn't changed at all.

Sheryl R. Skolnick - CRT Capital Group LLC, Research Division

Right. So if I could just follow up then. If I'm going to interpret your 2014 comments, I think what I would say is beyond the challenges provided by MA, you see your capital deployment and all the other expertise that you bring to the table as providing the kind of balance perhaps to 2014, offsetting some of the negatives in MA would be the continued pace that you see in the rest of the businesses? And that the challenge in predicting 2014 for us is to balance the negative of the MA against the positives of the other business. The street is interpreting, I think, your comments as meaning flat 2014. And I'm trying to, from my perspective, I think you said balance one against the other, but you didn't commit to flat. Is that correct?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Yes, we have committed to no position on 2014. I think beyond that, that what you're laying out is broadly the way I would -- broadly correct. And that is, we are positive about the other aspects of our business and our capabilities and we're applying them intensively to the pressure that is being put on the Medicare Advantage program that are still working through that. So we haven't declared on 2014. We are focused on growing earnings in 2014 and growing this business, that is our focus and our intensity every year. We have a lot to offer in terms of our diversified business model. And when we feel we have worked through this to the point where we can responsibly offer some direction to the marketplace, we will do that. But I think generally, you have the framework of it correct.

Operator

We'll go next to Ana Gupte with Dowling & Partners.

Ana Gupte - Dowling & Partners Securities, LLC

So a lot of questions on 2014. I'm just trying to get a little more clarity on commercial and Medicare in 2013 as that's the baseline for all the headwinds that you will experience in '14. So on the Medicare side, in the first quarter, you had quite a bit of deterioration in your x commercial medical loss ratio. You brought up sequestration, enhanced Part D and some seasonal patterns of first quarter pressure and so on. It seems to have eased up in 2Q. I'm just trying to understand if it's because of Part D or you've actually done something to improve your base Medicare Advantage business and the potential margin deterioration that you've been experiencing, I think, in 1Q? Or is it prior period reserves or Amil or something else?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I think we'll have Dan comment on it. Clearly, Part D is a factor in it. But I think it's not the only one. So Dan?

Daniel Schumacher

Sure. This is Dan. You have -- you had a lot in there. To Steve's point, absolutely, the biggest difference as you look sequentially, first quarter, second, both on a consolidated basis and in government programs and Medicare, obviously, is the Part D timing. In the first quarter, as you look year-over-year, it actually increased the loss ratio. And as you look at the second quarter, it actually decreased the loss ratio on a year-over-year basis. So that's the biggest swing item. But I'd also tell you inside of Medicare that we also have more favorable development than the first quarter and on a year-over-year basis and that's a little more concentrated in our Medicare business. And from the first to the second quarter in Medicare, we're seeing a little bit better performance on our new growth in Medicare. So those are some of the things that are influencing it with Part D being the most pronounced.

Ana Gupte - Dowling & Partners Securities, LLC

So your view of your own base Medicare business and if you can split out Medicare Advantage and Part D, do you expect deterioration from 2012 or not for the full year '13?

Daniel Schumacher

On the full year, we expect our Medicare Advantage loss ratio to go up. Obviously, we have the significant reimbursement challenges as well as sequestration. And then working against that is our focus on clinical management and so forth. So -- but yes, in aggregate, we expect our Medicare Advantage loss ratio to increase on the full year. As you look at Part D, our performance is strong there. On the full year, our earnings will be up and they're up in large part due to the significant volume growth that we had in Part D. And obviously, the quarter-to-quarter progression is different. But in aggregate on the year, Part D earnings are going to be up.

Ana Gupte - Dowling & Partners Securities, LLC

That's helpful. Then just the follow-up on the commercial side. You had a little bit of margin expansion in 1Q. You had cited the loss of a big, fully insured very high MLR count at the time. You're seeing a little bit of margin expansion in the second quarter. Your days and claims table have gone up by 1 day. All of you are on the hook for this tax for next year or so. Should we expect that either your reserves will strengthen or that your commercial underwriting spread gets better through 3 and 4Q as you build up for that tax burden?

Daniel Schumacher

On the commercial side, yes, we had a decline in our loss ratio again this quarter on a year-over-year basis. We are down 10 basis points. A big portion of that is, obviously, the large case funding conversion that we had at the beginning of the year. And that's being offset by the competitive market environment. We guided at Investor Day to a more than 1 percentage point increase in our full year commercial loss ratio. We've adjusted for that large funding conversion. And we still expect at the mid-point, about a 60 basis point increase in our commercial loss ratio on the full year. So full year commercial loss ratio guidance still in that 81.2% plus or minus 50 basis points.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I think the question is really a baseline one. The commercial baseline for the current year is very solid, very strong. And it will then run into the challenges that you point out, that everybody will run into in the marketplace in '14 and '15.

Operator

We'll go next to Carl McDonald with Citigroup.

Carl R. McDonald - Citigroup Inc, Research Division

Can you roughly quantify the margin compression that you're expecting to see in Medicare Advantage next year? So roughly, are we talking 50 to 100 basis points or something bigger than that?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Yes, well, first of all, we don't really get into margin at that level in the first place. And I think if I could do that at this point in time, we would have more to say about 2014. So that's what we're working through right now. And we have to work through them on a real basis through the specific markets. So I really can't offer guidance with -- at that level of precision, the mid-year of the current year.

Carl R. McDonald - Citigroup Inc, Research Division

Yes, maybe ask it in a different way. If the headwind that you're talking about is 750 basis points, you talked about sort of the seniors' ability to handle adjustments to that, what would you view as being a reasonable amount that a senior could handle in terms of benefit design changes in a given year?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

I have no basis to really speculate around that. Let me go back to a couple of things. If you think about it, that spread that you're focusing on, we're attacking by, in part, taking benefits down in a way that maintains the value and viability of the program. And it is -- it runs a spectrum across markets. So it's not like a universal thing. This is done at a relatively precise level market-by-market. Network shaping is also that. We have historically sponsored a very broad, very open access kind of market for our Medicare Advantage. We will be forced to narrow that. We are focused potentially on operating costs across-the-board. So those are the elements that we're really playing. And then, obviously, we are, as I said, we're operating in a way to maintain the long-term viability of the program. But my second point in there was protecting margins. The sustainability of the program has to be that it is one that returns capital. So we are protecting the margins of that program. And that is a market-by-market proposition relative to our set of assets in the marketplace, as well as the way the program is being administered by its sponsor in those markets. It's a complicated proposition, but I can assure you we are focused on closing as much of that gap as possible. And seniors are clearly going to participate in it, pursue the benefit reductions, narrower access. So none of these things, the underfunding of the program is not a good thing for American seniors who benefit from these programs. But we are trying to navigate that in the best way possible to preserve these programs [indiscernible] long term because we think it has compelling long-term growth aspects and value to the administration in terms of what it can do for Medicare.

Operator

We'll go next to Christine Arnold with Cowan.

Christine Arnold - Cowen and Company, LLC, Research Division

Optum seems to be running generally ahead of expectations. Is there any change to the long term Optum objectives that you outlined at Investor Day? And you talked about international being a substantial opportunity. Where else do you see good opportunities in Optum?

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

Larry, you want to comment?

Larry C. Renfro - Executive Vice President and Chief Executive officer of Optum

Christine, this is Larry Renfro. And I think you know that we put together a, what I'll call, a multi-year business plan back about 18 months ago. We call that One Optum. And when we did that, we wanted to make Optum a more potent solutions organization and we wanted to really position ourselves for the future. And at the same time, we made some financial commitments to you guys on the ROIC being 15% by 2015, a 6% operating margin by 2015 as well as doubling our operating profits so -- of 2011. So those goals that we set at that point in time we're kind of marching down the road. We are hitting those pretty well and meeting expectations and sometimes actually doing better. The initiatives around them are pretty much around simplification, reengineering, business integration. Really, the whole business alignment and we talked a little bit about the PBM. And in 2013, we have now started to pivot toward growth. And part of the growth initiative, and I forget the part of your question, is that we're trying to really have deeper, what I'd call, larger as well as significant relationships with our customers. And that's actually working fairly well for us right now as well. The other part of growth, as we've been talking about this today, comes from what I'll call new opportunities that surround us around this talk about Medicare rates and the pressure that's going on in the industry. So what all that does for us is cause us to really look for the future and we have to put certain development dollars, as well as innovation dollars in to make all this work. I would say that international would fall into that same category in terms of innovation and development. As we work toward doing a lot of these programs that we are doing today in the United States, we'll be putting them into Brazil. So we're confident that we have planned investments. We're balancing those investments with the growth, as well as cost management. But at this point in time, we would pretty much stand by the overall multi-year plan in terms of our guidance to meet or exceed the high end of the range.

Stephen J. Hemsley - Chief Executive Officer, President and Executive Director

So thank you, all. Once again, thank you for your interest in UnitedHealth Group today. We have had a very solid quarter and a strong year-to-date, both for UnitedHealthcare and Optum, and both continue to grow. Our performance trends are positive. I think it reflects in part the value of our diversified business approach and we remain intensely focused on the remainder of 2013 and on 2014 in the long-term success of the enterprise. So thank you for joining us.