September 4, 2018 10:15 PM GMT

## ANTM

# With Great PBM Disruption Comes Great Profit Opportunity … and $25+ in '21e EPS; Moving to OW, PT $368

| Stock Rating | Industry View | Price Target |
|---|---|---|
| Overweight | In-Line | $368.00 |

Upheaval of the pharmacy benefits (PBM) landscape via competitor M&A and government-led drug pricing reform positions ANTM for underappreciated share gain and accelerated profit growth. Following the UNH/Medco 2012/13 PBM transition playbook, we are ~8% above '21 consensus EPS and upgrading to OW.

WHAT'S CHANGED

| Anthem Inc (ANTM.N) | From | To |
|---|---|---|
| Rating | Equal-weight | **Overweight** |
| Price Target | $273.00 | **$368.00** |

**Rapid evolution of the PBM market and model greatly advantages an integrated managed care (MCO)/PBM solution, in our view, just as Anthem is bringing its PBM in-house.** As the dust settles on what has been an extremely active ~11 months in the space from M&A to regulatory changes, we view the integrated MCO/PBM as the winning model in a post-drug-rebate/increased transparency world (Exhibit 5). As this shift occurs over the next 2-5 years, we see a step-function opportunity for Anthem, which has outsourced its PBM to Express Scripts, to benefit from both exiting the contract (Exhibit 3) and adding incremental scale.

**The playbook to effectively transition a PBM and accelerate growth was written in 2012/2013...and executed by what is now Anthem leadership.** In our view, a direct analogy can be drawn between UnitedHealth integrating its PBM from Medco into its PBM (OptumRx) in 2011-14 and Anthem in 2018-21 as the market tilts toward an integrated medical/PBM solution (Exhibit 8). Based on our analysis of filings and transcripts, OptumRx significantly outgrew what should have been reasonably expected (Exhibit 11). We thus model an incremental $1.1 billion in PBM-driven pretax profit in 2021 for Anthem, the first full year post-transition, comprised of management's estimate of $800M from exiting its contract and an incremental $300M driven by increased PBM penetration of its health plan lives (Exhibit 13). Additionally, we think it should not be underestimated that Anthem CEO Gail Boudreaux was the CEO of

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**Anthem Inc ( ANTM.N, ANTM US )**

Healthcare Facilities & Managed Care / **United States of America**

| | |
|---|---|
| **Stock Rating** | **Overweight** |
| **Industry View** | **In-Line** |
| **Price target** | **$368.00** |
| Shr price, close (Aug 31, 2018) | $264.73 |
| Mkt cap, curr (mm) | $72,018 |
| 52-Week Range | $268.04-179.44 |

| Fiscal Year Ending | 12/17 | 12/18e | 12/19e | 12/20e |
|---|---|---|---|---|
| **ModelWare EPS ($)** | 11.63 | 15.51 | 17.15 | 19.69 |
| **Prior ModelWare EPS ($)** | - | - | 16.94 | 19.03 |
| **P/E** | 19.4 | 17.1 | 15.4 | 13.4 |
| **Consensus EPS ($)§** | 12.01 | 15.49 | 17.10 | 19.70 |
| Div yld (%) | 1.2 | 1.2 | 1.3 | 1.4 |

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
§ = Consensus data is provided by Thomson Reuters Estimates
e = Morgan Stanley Research estimates

**QUARTERLY MODELWARE EPS ($)**

| Quarter | 2017 | 2018e Prior | 2018e Current | 2019e Prior | 2019e Current |
|---|---|---|---|---|---|
| Q1 | 4.68 | - | 5.41a | 5.87 | 5.87 |
| Q2 | 3.34 | - | 4.25a | 4.71 | 4.71 |
| Q3 | 2.24 | 3.67 | 3.67 | 3.97 | 4.18 |
| Q4 | 1.29 | 2.18 | 2.18 | 2.38 | 2.38 |

e = Morgan Stanley Research estimates, a = Actual Company reported data

UnitedHealthcare (the health insurance business of UnitedHealth Group) in 2011-14, the exact timeframe that UnitedHealth/OptumRx successfully integrated its PBM from Medco. We thus see lower-than-typical execution risk.

**We see PBM growth as a positive feedback loop for core growth, including Medicare Advantage & Medicaid, as well as for enhanced capital deployment.** Tighter integration of pharmacy with medical benefits should both enhance Anthem's margins and opportunities to compete for new business in Medicare & Medicaid. In addition, we model heightened capital deployment, which could consist of tuck-in M&A akin to recent deals or share repurchases, as the PBM accelerates free cash generated and access to unregulated capital starting in 2020. **In total, we now model high-teens average earnings growth through 2021, equating to $25+ in 2021e EPS, versus previous high-single-/low-double-digit targeted growth by management and 2021 consensus EPS of $23.51.**

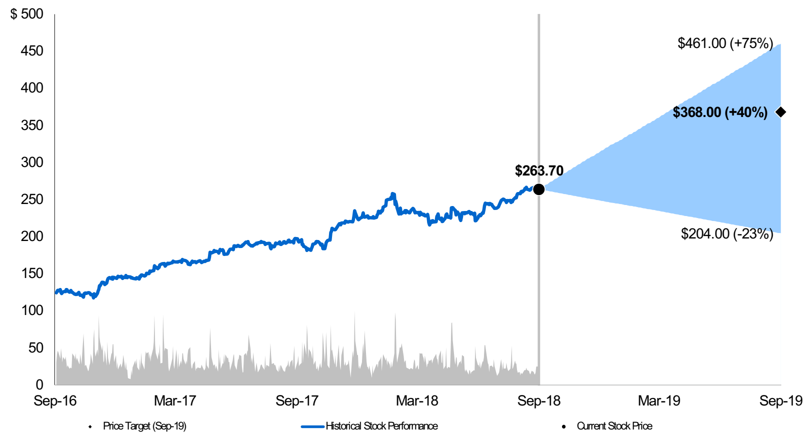
**Despite accelerating growth, Anthem trades at a relative discount.** At the current ~16x NTM P/E, shares are trading below their 5-year average P/E discount to UnitedHealth (UNH) and in-line with their discount premium to Humana (HUM); see Exhibit 29. With forward earnings growth averaging in the high teens over the next 3 years in our model, versus ~8% over the past 5 years, we see compelling value relative to our coverage and broader healthcare.

**Our $368 price target, up from prior $273, is based on a ~16x P/E multiple applied to our base case 2021e EPS of $25.28, discounted back to 2020.** There are 3 operational drivers of our price target raise: (1) in-sourcing of PBM ($39); (2) underappreciated PBM growth ($18); (3) accelerated core growth including capital deployment ($18); see Exhibit 2. Our base case multiple assumes no expansion from the current NTM P/E, with our price target the full first-year benefit post-PBM transition and a roll-forward from our prior price target. Our bull case valuation of $461 assumes PBM profit growth accelerates and drives outsized enrollment growth resulting in multiple expansion, while our bear case valuation of $204 is driven by inability to execute on the PBM transition and membership losses.

**Where we could be wrong.** (1) Execution of Anthem's PBM on-boarding does not run smoothly resulting in membership dissatisfaction, enrollment declines, and profit loss. (2) Government growth fails to materialize / gain scale slowing overall growth rate. (3) Pricing competition, particularly in Government business, puts pressure on margins.

**Risk-Reward Snapshot: Anthem (ANTM, OW, PT $368)**

# PBM Opportunity & Execution Drives Upside




Source: Thomson Reuters, Morgan Stanley Research estimates

**Price Target $368**

We calculate our price target by applying a 16x P/E multiple, in-line with the 1-year average NTM multiple, to our base case FY21E EPS of $25.28 discounted back to 2020.

**Bull $461**

**~18x Bull case FY21E EPS of $28.16 discounted back 1 year.**

**PBM transition exceeds goals and results in incremental enrollment gains.** Membership accumulation continues in base business, with PBM efficiencies driving both greater PBM profitability and penetration than the base case as well as health plan enrollment growth. The bull case multiple of ~18x halves the historical discount to UNH & HUM.

**Base $368**

**16x Base case FY21E EPS of $25.28 discounted back 1 year.**

**PBM transition captures ESRX savings plus incremental membership penetration upside.** Transition of PBM lives from ESRX in 2020 runs smooth, adding an incremental $1.1B in pre-tax earnings, $800M of which is from better ESRX pricing and the remaining $300M from better penetration within health plan book. Medicare/Medicaid and capital deployment accelerate non-PBM growth. Our 16x base case P/E multiple is in line with the 1-year NTM P/E average.

**Bear $204**

**12x Bear case FY20E EPS of $17.06.**

**Failure to execute on PBM transition results in lost profit opportunity and enrollment.** Our bear case multiple of 12x is a slight discount to the 5-year historical average.

## Investment Thesis

- Anthem has consistently grown membership over the past several years across its self-funded and fully insured businesses.
- The transition in-house of its pharmacy benefits business (PBM) from Express Scripts will result in a significant profit opportunity, inclusive of savings from better terms than current contract, as well as greater penetration within covered health plan members.
- Medicare Advantage and Medicaid should continue above-market growth, leveraging greater PBM efficiencies as well as a more integrated approach.
- Coming out of the failed CI merger, ANTM has flexibility to deploy capital for share purchase or M&A.

## Key Value Drivers

- **Commercial MLR:** Reducing commercial MLR by ~50 bps adds ~$0.40 to EPS.
- **Medicare MLR:** Reducing Medicare Advantage MLR by ~50 bps adds ~$0.20 to EPS

## Potential Catalysts

- Update on PBM transition
- New Medicaid contracts
- Medicare Advantage enrollment
- Capital deployment
- 3Q18 earnings

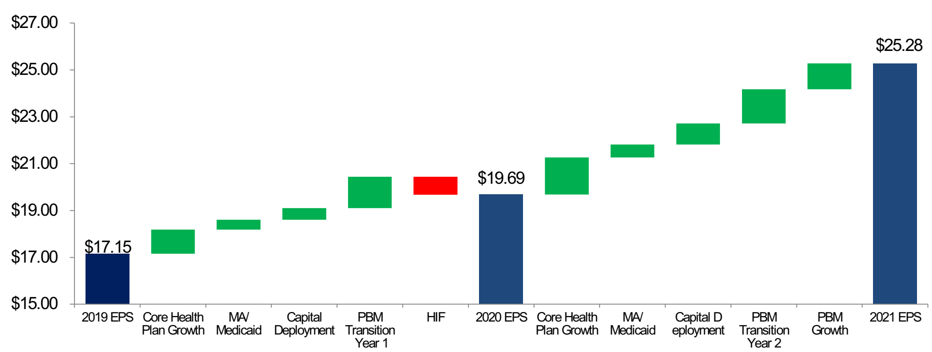
## Risks to Achieving Price Target

- PBM transition is delayed or poor execution results in lower profitability or lost members.
- Capital deployment is delayed.
- Pricing pressure on government and commercial businesses result in margin contractions.

# ANTM — Upgrade to Overweight from Equal-weight

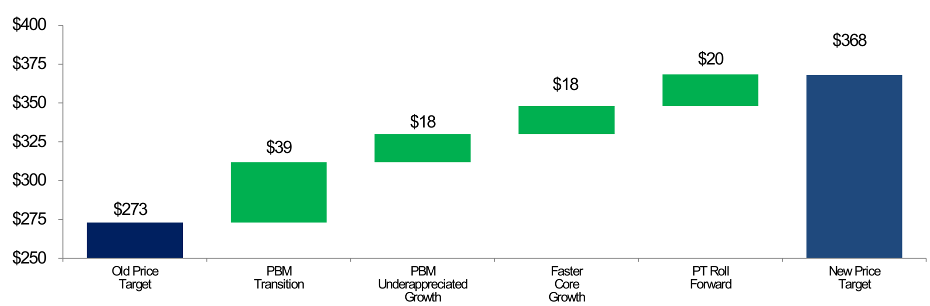
*We are upgrading Anthem (ANTM) from EW to OW and increasing our price target to $368 from $273. We see a clear path to an inflection in earnings growth trajectory from mid- to high single digits today to low double digits from the new management, driven by: (1) the move of its PBM from ESRX to in-house in 2020; (2) incremental penetration of its PBM into its existing health plan businesses; and (3) continued success in its government programs (Medicare Advantage & Medicaid), which will benefit from a more efficient PBM and drive enhanced capital deployment. ANTM currently trades at a 3.5x discount to UNH, its closest MCO peer, substantially wider than the average over the last 5 years. With growth likely to accelerate in the near/midterm and a valuation discount clear of M&A noise, we see a catalyst for shares over the remainder of 2018 heading into 2019 guidance in January.*

**Exhibit 1:** 2019 to 2021 Earnings Bridge




Source: Company Data, Morgan Stanley Research

**Exhibit 2:** Price Target Bridge

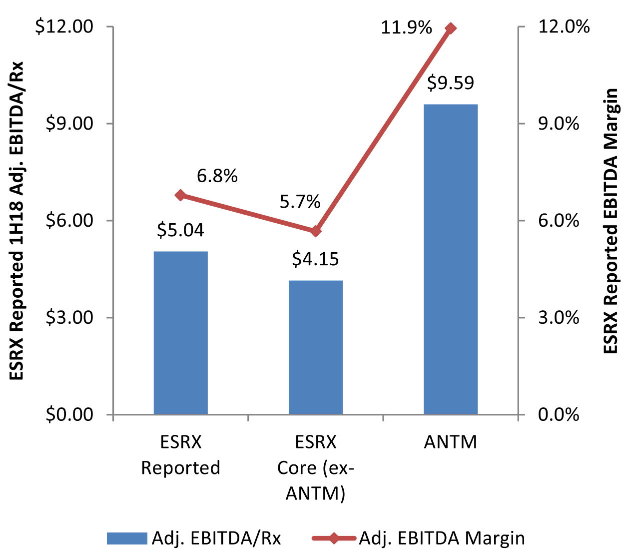



Source: Company Data, Morgan Stanley Research

## (1) Drug Pricing Reform Takes Us from Healthy Skeptics on Anthem's PBM Prospects to Bulls

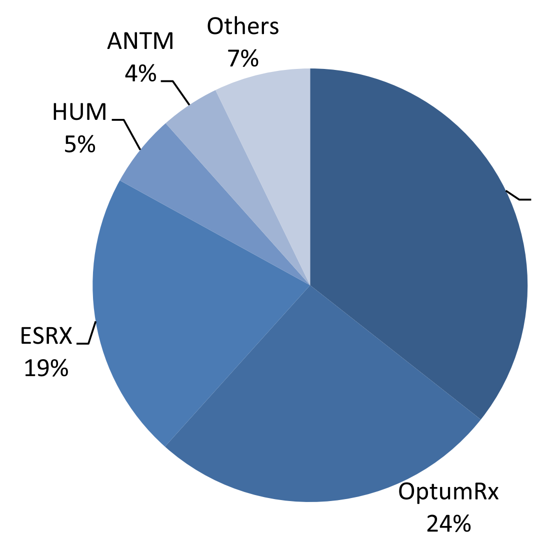
*When Anthem announced that it would be bringing its PBM in-house in October 2017, we were somewhat unconvinced of the potential market impact. Recall that last October, after outsourcing its pharmacy benefits management function to Express Scripts for the better part of the current decade, Anthem announced it would be bringing its PBM function* *back in-house. Starting in 2020 members would transition to the new PBM platform, "IngenioRx," with all members transitioned for 1/2021, with CVS providing some of the back-office functionality, which would transition over the next few years onto a pure Anthem platform in modules (see Solo: A PBM Story). We have not questioned the savings management has estimated from breaking ties with Express Scripts, which include $4B in drug cost savings, 20% (or ~$800 million) of which would drop to the earnings line, as it has been clear that Anthem is more profitable than the average Express Scripts client (Exhibit 3). Our uncertainty was driven by the value in having an undersized PBM (Exhibit 4), which would likely be no better than 4th or 5th in terms of scale and whether that would drive any additional growth beyond the initial cost savings.*

**Exhibit 3:** Anthem Rx Profitability for ESRX 1H18 Relative to Core Book




Source: Express Scripts 2Q18 Earnings Release, Morgan Stanley Research

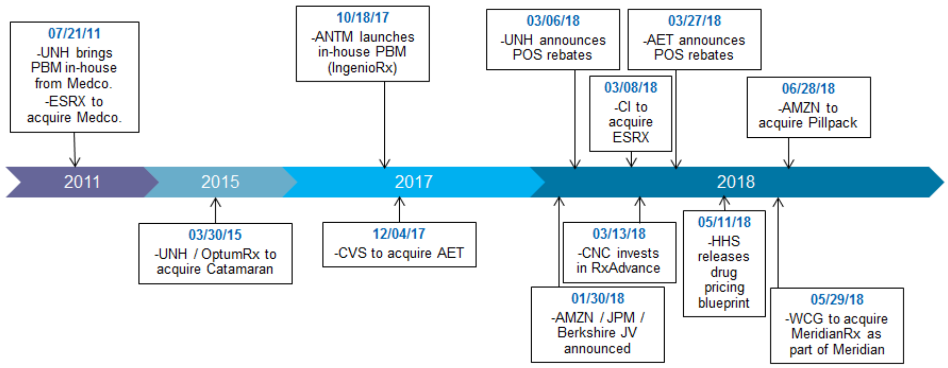
**Exhibit 4:** Anthem Market Share Rx




Source: IQVIA, Company Data, Morgan Stanley Research

**Managed Care / Pharmacy Benefits activity has accelerated considerably in the past ~11 months.** Starting with Anthem's announcement to bring its PBM in-house from Express Scripts in October of last year (see *Solo: A PBM Story*), managed care and pharmacy benefit companies have quickly come together. CVS's announced ~$69B acquisition of Aetna (see *Welcome to Vertical Integration 2.0*) in December has the potential to form a retail-driven vertically integrated provider of medical and pharmacy service akin to UnitedHealth/Optum's physician-driven model (see The Diverging Consumer Strategies of CVS/AET & UNH), while Cigna's ~$67B announced acquisition of Express Scripts would add PBM capabilities if approved by regulators (shareholders have already approved the proposed deal). Not to be left out, Medicaid-focused MCOs have made PBM moves, including WellCare's acquisition of Meridian and potential to switch to a MeridianRx PBM platform (see *Acquiring the 3 M's — Medicaid, Medicare, and Management (of Pharmacy Benefits)*) and Centene's investment in RxAdvance (see here). Between major M&A announcements, structural changes to the pharmacy benefits market have ranged from the announcement of the Amazon/JP Morgan/Berkshire Hathaway venture aimed at reducing healthcare costs (see Amazon, Berkshire, JPMorgan Team Up to Disrupt 18% of GDP), to Amazon's acquisition of PillPack (see *How Can the PillPack Acquistion Change the Healthcare Industry?*) to UnitedHealth and Aetna's respective announcements that combined they would convert ~7 million fully insured lives to point of sale (POS) pharmaceutical rebating (see *Point of Sale Rebates — Coming Soon to a Pharmacy Near You*). **As can be seen from Exhibit 5, it is clear PBM activity has been accelerating, but a question remains: Where will the dust settle?**

**Exhibit 5:** Accelerated Evolution of the PBM Market Over the Past 11 Months




Source: Company Data, Morgan Stanley Research

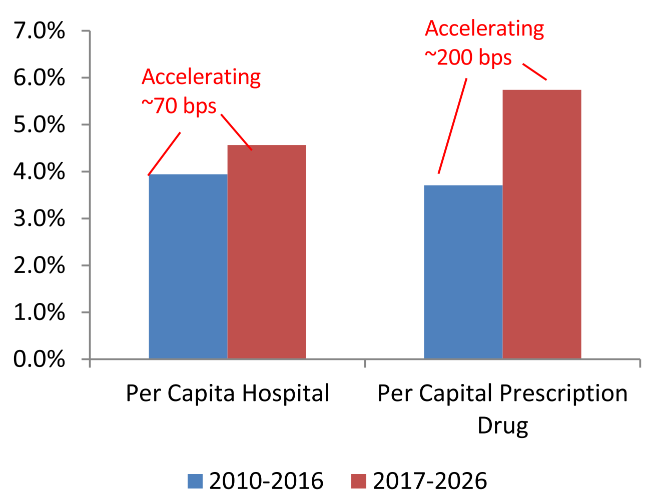
While the faster pace of MCO/PBM activity could be chalked up to overall healthcare vertical integration/consolidation and the quest for growth, we see three other potential driving forces:

- **Over the next decade, pharmaceutical spending growth will likely outpace hospital spending growth.** CMS data released earlier this year on National Health Expenditures (NHE) through 2016 and projections for NHE through 2026 demonstrates the shift. From 2010-2016, per capita spending on hospital care grew 3.9% annually (from $2,662 to $3,357) while prescription drug spending grew 3.7% annually (from $819 to $1,019) over the same period, likely aided by the generics wave. Over the next 10 years, however, CMS projects that while hospital care will accelerate ~70 bps to 4.6% annual growth, prescription drug spend will accelerate ~200 bps to 5.7% annual growth, as specialty pharmaceuticals continue to growth and innovation continues in personalized medicine (Exhibit 6). From the managed care perspective, as medical cost trend has remained fairly stable driven by new plan designs such as high deductible plans and integrated care, pharmaceutical trend management could be a greater opportunity.

- **Outcomes-based pricing, while not yet significant, is a growing opportunity to address cost trend and requires tighter pharmaceutical integration.** In an outcomes based arrangement, the pharmaceutical manufacturer takes on some risk for the outcome of particularly expensive specialty therapies. In its prepared statement to the House Judiciary Committee earlier this month (see *CVS/AET Goes to Washington*), Aetna General Counsel Thomas Sabatino, Jr., said, "To date, we have entered into around 25 such agreements with manufacturers that pay based on therapeutic value delivered while incentivizing appropriate medication management and other services to make these drugs successful" (see full testimony here). From the managed care perspective, we expect these types of agreements to accelerate with the pace of innovation, and see integration of pharmaceutical services, medical care, and data as key to the subtle shift in branded pharmaceutical pricing towards value from the current rebate driven structure.

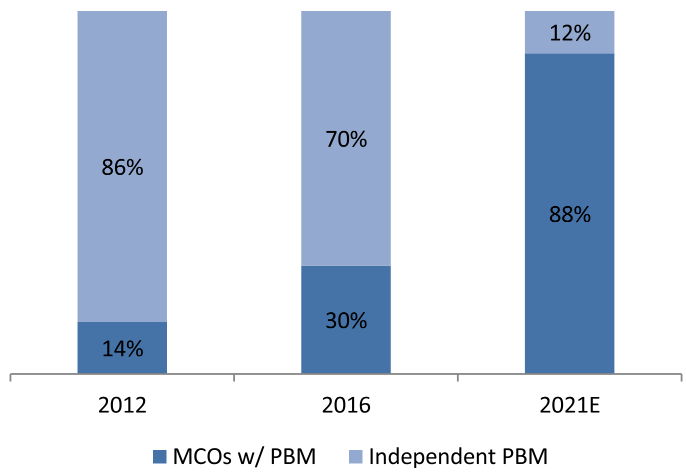
- **We think the ongoing debate on drug pricing and HHS's "Blue Print for Drug Pricing Reform" are an underappreciated boon to the integrated managed care / PBM players.** The Blue Print for Drug Pricing Reform (see here) was announced on 5/11/2018 with the goal of reducing the cost of drugs for individuals in the United States and to increase transparency in the pharmaceutical supply chain. Although it was met with some skepticism, as individual programs have come to light, such as the elimination of the rebate safe Harbor for Medicare Part D, the potential impact across the space has picked up steam. The role of rebates, in particular, have been a debate over the last several months as they have been pointed to as profiting by PBM "middlemen" and adding limited value to the end user of the medication. Given these forces plus pending M&A, that there will be a significant shift in the relationship between managed care and PBMs, with MCO-affiliated PBMs topping 85% share of the US prescription market by 2021E, versus < 15% just 6 years ago (Exhibit 7).

**Exhibit 6:** NHE Per Capita Spending CAGR on Hospital & Prescription Drug, 2010-16 vs. 2017- 26




Source: CMS.gov, Morgan Stanley Research

**Exhibit 7:** Estimated Market Share of US Adj. Rx for MCO-Affiliated PBMs vs. Independent PBMs




Source: IMS/IQVIA, Company Data, Morgan Stanley Research

**MCOs have already begun embracing a post-rebate world.** As we wrote in March 2018, UnitedHealth starting on 1/1/2019 is transitioning to a "point of sale" rebate system for its full risk members (~7 million lives) (see Much Ado About Pharmacy — Decoding UNH's Positioning for the Future of Drug Pricing). In this system, the majority of rebates are given to the individual purchasing the drug, increasing overall system transparency, versus a typical rebate scenario where rebates are paid into a single pool and baked into premiums to reduce the overall cost of all members. Aetna announced shortly after that it would be similarly going to a point of sale rebate system for its ~3 million full risk members (see March press release here).

Anthem has not announced a point of sale rebate system, but we note on its 2Q18 conference call in July, CEO Gail Boudreaux pointed towards its PBM's focus on net cost versus rebates:

*"Well, let me begin first and foremost, that we are very focused on reducing net overall drug prices. I think that really is the goal on industry and certainly our goal as we launch IngenioRx. In terms of the value proposition that we've laid out, the $4 billion growth savings with 20% falling to the bottom line, we are very confident in that, feel it's a prudent number and do not see that changing. But again, we're very supportive of anything as we build this new generation, next-generation PBM of really getting to the lowest net cost. And I think that's what's really important. We're not building this based on a rebate model, but we are building it based on a net lowest cost value model. And again, we're very supportive but we want to ensure that everything that gets implemented really does result in lower cost for consumers. And so that really is our focus will IngenioRx." - 2Q18 Earnings Call*

**We think plan sponsors (employers, governments, etc) will have little incentive to separate medical and pharmacy benefits going forward, creating a significant upside opportunity for Anthem as it brings its PBM in-house.** Prior to the Drug Blue Print release and move to point of sale rebates by UnitedHealth and Aetna, we had begun to see increased interest from plan sponsors in combining benefits. In an April 2018 AlphaWise survey of 52 benefits managers (see PBM Survey: POS Rebates & Integrated Model Gaining Traction w/ ASO Customers), Morgan Stanley Healthcare Services analyst Ricky Goldwasser noted that 54% of respondents prefer an integrated PBM model, up from 43% two years ago (Exhibit 8), and half would consider bundling pharmacy with medical (Exhibit 9). An increased willingness to combined medical and pharmacy benefits combines with limited selection of stand-alone PBMs, as post the pending CVS/AET merger and CI/ESRX merger only ~25% of prescription volume in the US will flow through a non-integrated MCO/PBM.

**Exhibit 8:** 54% of Respondents Prefer an Integrated PBM Model

| Which PBM business model do you think best meets the needs of your organization? | 2018 | 2017 | 2016 |
|---|---|---|---|
| A standalone PBM model | 27% | 26% | 32% |
| An integrated retail/PBM model | 17% | 15% | 17% |
| An integrated managed care/PBM model | 37% | 30% | 26% |
| No difference | 19% | 26% | 21% |
| Other model | 0% | 2% | 4% |
| *Count* | 52 | 53 | 47 |

Source: AlphaWise, Morgan Stanley Research

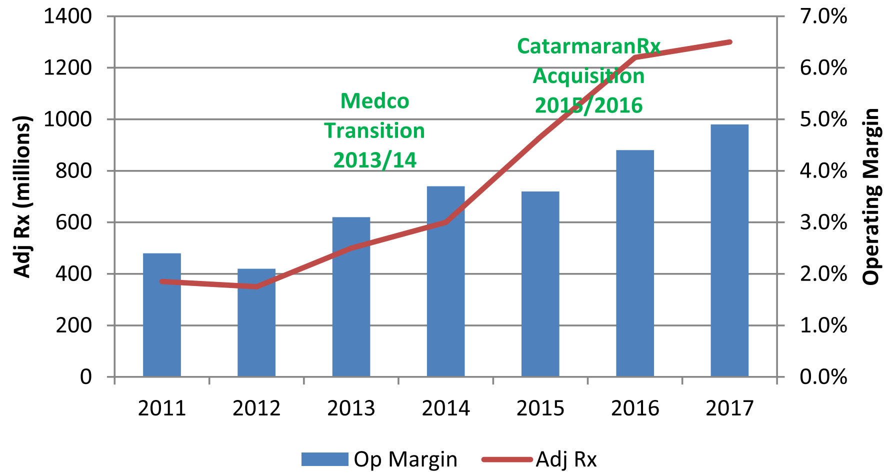
**Exhibit 9:** Half of Survey Population Would Consider Bundling Pharmacy with Medical Benefit

| Would you consider bundling your pharmacy benefit and medical benefit when your contract is up for renewal? | Total | CVS/ Caremark | ESRX | OptumRX / Catamaran | Other |
|---|---|---|---|---|---|
| Yes | 50% | 56% | 52% | 50% | 33% |
| No | 12% | 11% | 5% | 0% | 33% |
| Don't know / Not sure | 38% | 33% | 43% | 50% | 33% |
| *Count* | 52 | 18 | 21 | 4 | 9 |

Source: AlphaWise, Morgan Stanley Research

**Anthem has significant PBM share gain opportunity within its own healthplan book; UnitedHealth is the benchmark.** We estimate that currently Anthem's PBM (via Express Scripts) is roughly 5.5 adj. Rx/member (e.g., ~220 million adjusted Rx compared to Anthem's ~40 million covered lives). This compares to UnitedHealth/Optum Rx, which has ~24 adj. Rx/Life (~1.3 billion adj. Rx to UnitedHealth Care's ~54 million lives). There are reasons for some of the difference, including OptumRx's acquisition of Catmaran in 2015 as well as its success in winning PBM business outside of core UnitedHealth. That said, we see room for Anthem to increase its PBM penetration without winning stand-alone PBM business and drive further profit growth.

**Exhibit 10:** UNH / OptumRx PBM Growth




Source: Company Data, Morgan Stanley Research

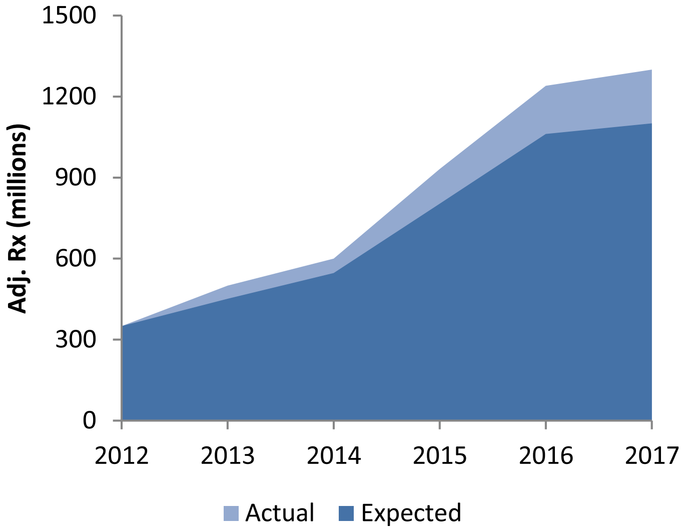
**UnitedHealth's integration of its Medco business in 2012/2013 serves as the guide for the opportunity...** Recall that prior to 2012, UnitedHealth outsourced a large portion of its PBM business to Medco Health Solutions, which was later acquired by Express Scripts (see The PBM Holy Grail). In 2011, UnitedHealth announced that it would begin transitioning its ~12 million lives and ~150 million adjusted Rx onto its OptumRx platform over the course of 2013, so that by 1/1/2014 all UnitedHealth members would have OptumRx as their PBM. As we dug through filings and transcripts of the 2012-2014 time period for UnitedHealth and Express Scripts (we focused on 2012 to 2014 as in 2015 UNH acquired Catamaran, which increased OptumRx's scale by ~70%), we noted 3 observations which point to a significant upside for Anthem as it brings its PBM in-house :

- **OptumRx's total adjusted scripts should have grown by ~40% from the integration of the Medco lives; in actuality in 2012-14 it grew by ~70%** (Exhibit 10). Over the same period of time, total UNH member enrollment grew by ~10%. On an adj/Rx per member basis, UNH grew from ~10 adj Rx/member to ~12.

- **PBM profit margin expanded significantly.** Over the same transition period, PBM margins expanded by ~160 bps after an investment year for on-boarding the PBM in 2012. We suspect some of this was from increased scale/purchasing power, but also view it likely as more efficient operations versus outsourcing to Medco.

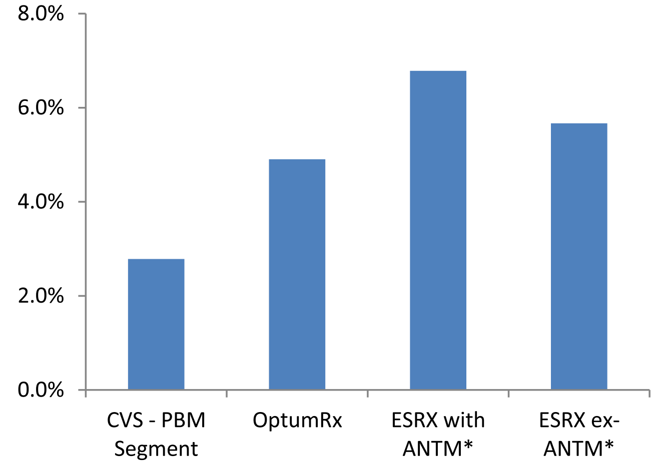
- **Set-up OptumRx to win non-UnitedHealthcare lives in the future.** We note that post its acquisition of Catamaran in 2015, OptumRx has grown to be the 2nd largest PBM, following CVS, by number of adjusted scripts. Despite the perception that being affiliated with UnitedHealth would prevent OptumRx from growing, particularly with smaller health plan customers, it has continued to grow share above expectations (Exhibit 11), most recently mentioning 3 competitive health plan wins on the 2Q18 UNH earnings call (see here).

**Exhibit 11:** OptumRx Reported Adj. Rx versus Expectations from in-Sourcing & CTRX Acquisition




Source: Company Data, Morgan Stanley Research

**Exhibit 12:** As Reported PBM Margin for 1H18




Source: Company Data. Note CVS & OptumRx are reported segment operating margins pre-intersegment eliminations. ESRX is as reported EBTIDA margin

**...and the CEO happens to have been on this journey before.** PBM member transitions to new platforms can be complex and have the potential to result in customer dissatisfaction as new ID cards, procedures, call centers and backend software all offer new touchpoints that could go awry. We therefore do not think it can be overemphasized enough the importance of having leadership that has had this experience. Fortunately for Anthem, CEO Gail Boudreaux, who took the mantle in November 2017, was the CEO of UnitedHealthcare (the health insurance business of UnitedHealth Group) in 2011-14, the exact timeframe that UnitedHealth/Optum integrated its PBM from Medco. We thus see lower-than-typical execution risk given the success of the UNH transition, with a well understood blueprint on how to expand an integrated PBM platform.

**Based on the opportunity to increase PBM scale/penetration, we are modeling $1.1 billion in incremental pre-tax profit growth in 2021 from the PBM alone over 2018, equating to and incremental ~20% EPS growth above core growth the next 3 years.** This compares to the $800 million profit impact estimated by management from the ESRX transition alone, or ~14%. Our base case assumes PBM penetration increases from ~5.5 adj. Rx/enrolled health plan life to ~8 — still significantly lower than UnitedHealth in 2014, with operating margins in the 3.5-4.0% range, also below OptumRx. In Exhibit 13 and Exhibit 14 we provide sensitivities based on prescription penetration and operating margin.

**Exhibit 13:** ANTM PBM In-Sourcing EBITDA Sensitivity to Script Penetration & Incremental PBM Margin

ANTM Current (e.g. ESRX in-sourcing benefit)

UNH Post Medco (2014) ex-Part D

UNH Post Medco (2014) incl Part D

Adj. Rx / Insured Life

| Margin on Incremental PBM Penetration | 5.5 | 7 | 8 | 9 | 10 | 12 |
|---|---|---|---|---|---|---|
| 2.0% | $800 | $900 | $966 | $1,031 | $1,097 | $1,228 |
| 2.5% | $800 | $925 | $1,007 | $1,089 | $1,171 | $1,335 |
| 3.0% | $800 | $950 | $1,048 | $1,147 | $1,245 | $1,442 |
| 3.5% | $800 | $975 | $1,090 | $1,205 | $1,319 | $1,549 |
| 4.0% | $800 | $1,000 | $1,131 | $1,262 | $1,394 | $1,655 |
| 4.5% | $800 | $1,025 | $1,173 | $1,320 | $1,468 | $1,763 |
| 5.0% | $800 | $1,050 | $1,214 | $1,378 | $1,542 | $1,870 |

Updated MS 2021 PBM Base Case

Note: Figures in hundreds of millions of EBITDA. Source: Company Data, Morgan Stanley Research

**Exhibit 14:** ANTM PBM In-Sourcing EPS Sensitivity to Script Penetration & Incremental PBM Margin

ANTM Current (e.g. ESRX in-sourcing benefit)

UNH Post Medco (2014) ex-Part D

UNH Post Medco (2014) incl Part D

Adj. Rx / Insured Life

| Margin on Incremental PBM Penetration | 5.5 | 7 | 8 | 9 | 10 | 12 |
|---|---|---|---|---|---|---|
| 2.0% | $2.29 | $2.58 | $2.77 | $2.95 | $3.14 | $3.52 |
| 2.5% | $2.29 | $2.65 | $2.88 | $3.12 | $3.35 | $3.82 |
| 3.0% | $2.29 | $2.72 | $3.00 | $3.28 | $3.57 | $4.13 |
| 3.5% | $2.29 | $2.79 | $3.12 | $3.45 | $3.78 | $4.44 |
| 4.0% | $2.29 | $2.86 | $3.24 | $3.62 | $3.99 | $4.74 |
| 4.5% | $2.29 | $2.94 | $3.36 | $3.78 | $4.20 | $5.05 |
| 5.0% | $2.29 | $3.01 | $3.48 | $3.95 | $4.42 | $5.36 |

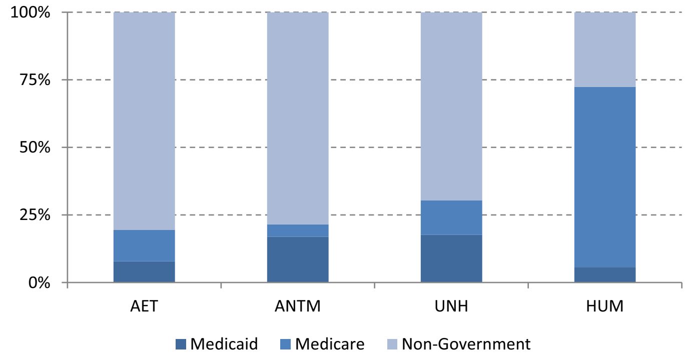
Updated MS 2021 PBM Base Case

Source: Company Data, Morgan Stanley Research

## (2) Medicare Advantage & Medicaid Should Increasingly Contribute to Growth

Medicaid and Medicare Advantage/Part D will likely be continued sources of growth both organically & via M&A. Relative to its two closest diversified comps, ANTM is slightly less penetrated in government business than UnitedHealth and slightly more than Aetna (Exhibit 15). Following two tuck-in acquisitions in Medicare Advantage in 2017, we expect Anthem to continue to invest in growth in government business with its improved PBM serving as a lynchpin to make pricing / margins more competitive with its peers.

**Exhibit 15:** Government Mix of Diversified MCOs




Note: Excludes international, Medicare Supplemental, Military & Part D. Source: Company Data, Morgan Stanley Research

## Medicaid

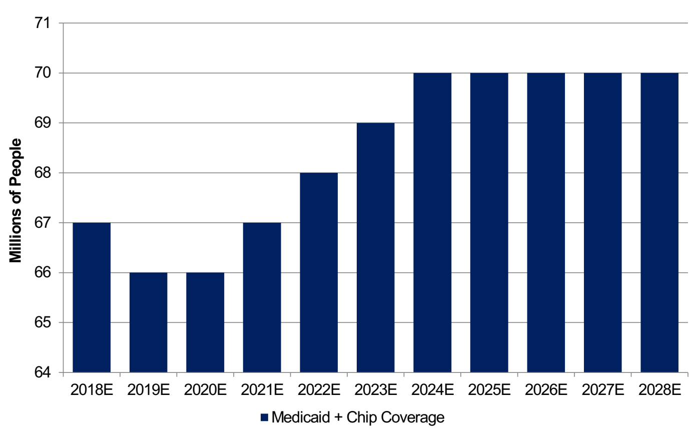
**We have been writing about the improving Medicaid environment,** most recently in *State of Medicaid — What's Changed Since Our March Primer*. While work requirement interest has been increasing, so has Medicaid expansion. We also note the strength of the pipeline, with at least 4 contracts to be awarded in the next 12 months (Exhibit 16). Anthem has repeatedly cited a $80B pipeline of opportunities over the next 5 years that it is actively looking at. The CBO projects Medicaid will add ~3B (+4.5%) people over the next decade (Exhibit 17).

**Exhibit 16:** Medicaid Awards

| Date | State/Program | Event | Beneficiaries |
|---|---|---|---|
| Summer 2018 | Wisconsin LTC (Milwaukee and Dane Counties) | Contract Award | ~1,600 |
| ~ Fall 2018 | Texas STAR and CHIP | Contract Awards | 181,380 |
| January 1, 2019 | New Hampshire | Contract Awards | 181,380 |
| February 4, 2019 | North Carolina | Contract Awards | 1,500,000 |

Source: HMA, Morgan Stanley Research

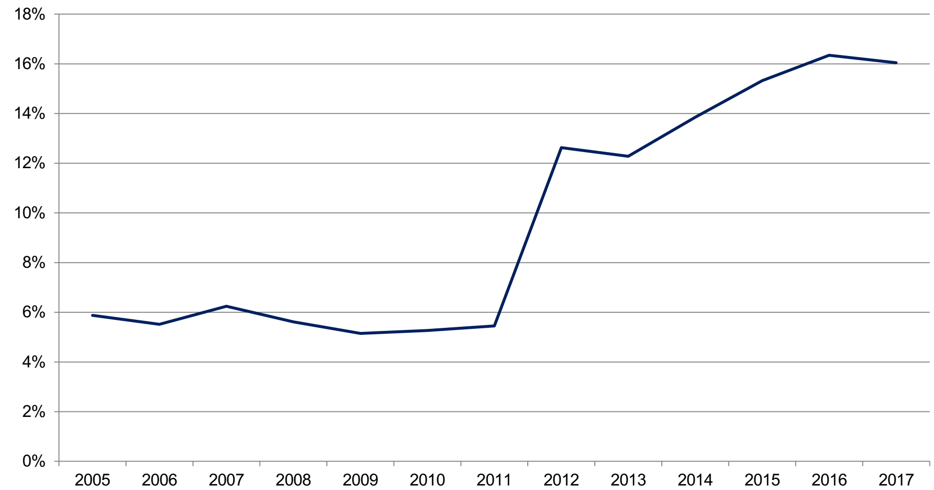
**Exhibit 17:** CBO Estimates for Medicaid Coverage




Source: CBO, Morgan Stanley Research estimates

**Medicaid represents ~16% of Anthem's medical membership.** With ~6.5M members, this book of business is not a large portion of the total company, but has grown from ~6% in 2005 to ~12% in 2013 to the ~16% where it stands now (Exhibit 18).

**Exhibit 18:** Medicaid as a % of Total Medical Membership



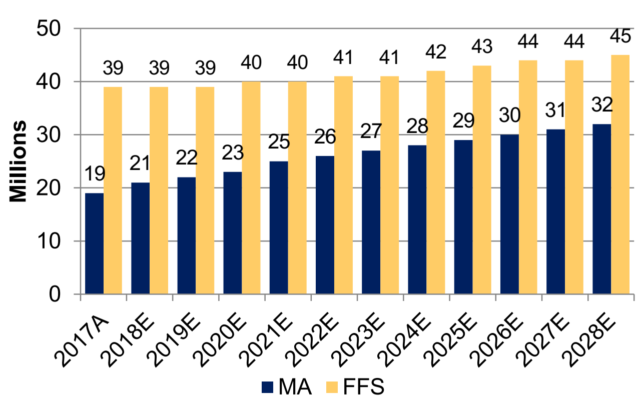

Source: Company Reports, Morgan Stanley Research

**Although Kansas was lost, it was a small contract with minimal EPS contribution.** Recently Kansas released its Medicaid contract awards, which excluded ANTM, one of 3 incumbents in the state. The Medicaid market in Kansas is ~400K lives, of which ANTM served ~130K. This is ~2% of total Medicaid membership and only 0.3% of total medical membership. We estimate that at a 2.5% margin, this only represents ~1% of revenue ($1.2B) and 0.7% of EPS ($0.11) in 2019 when the contract ends. The company is currently protesting the decision.

## Medicare Advantage

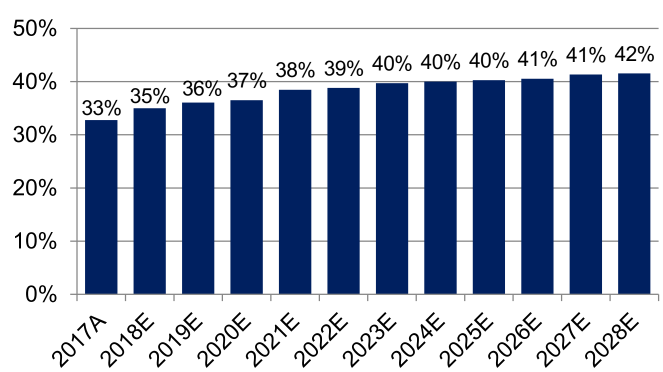
**Medicare Advantage (MA) is one of the fastest growing areas in managed care.** Recall that MA currently represents just under 35% of all Medicare beneficiaries, or ~20M people (Exhibit 19). The CBO estimates that 42% penetration will be reached by 2028 (Exhibit 20). Some of the tailwinds include an aging population and a more online-price comparison savvy population. The appeal of MA is twofold: 1) every company can grow and it is not just a fight for market share and 2) MA is much more profitable for managed care companies given the narrower networks and value based care arrangements.

**Exhibit 19:** MA vs. Traditional FFS Medicare




Source: CBO, Morgan Stanley Research estimates

**Exhibit 20:** MA as a Percentage of Overall Medicare




Source: CBO, Morgan Stanley Research estimates

**Anthem's footprint and market share are growing.** Historically, HUM and UNH have had the largest concentrations of MA populations. ANTM has typically owned low- to mid-single-digit market share through the years (Exhibit 21). In December 2017 and January 2018 the company closed 2 acquisitions in the MA space as noted in our *Capital deployment optionality* section. This expanded the footprint in Florida and South Carolina and slightly increased overall market share. In our *Who has the Medicare Advantage Advantage?* note, we ranked states in terms of attractiveness; South Carolina scored in the top quartile, while Florida was in the second quartile. Notably both have high levels of Medicare population and there room for penetration of MA, or green space.

**Exhibit 21:** MA Market Share

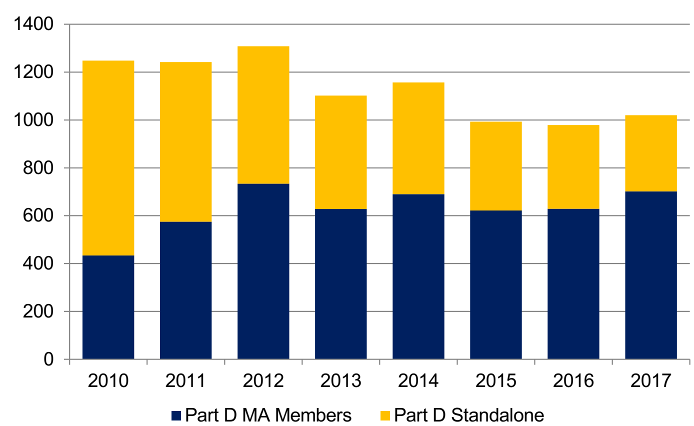
| Market Share | Dec-07 | Dec-08 | Dec-09 | Dec-10 | Dec-11 | Dec-12 | Dec-13 | Dec-14 | Dec-15 | Dec-16 | Dec-17 | Jan-18 | Feb-18 | Mar-18 | Apr-18 | May-18 | Jun-18 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| UnitedHealth | 15.7% | 15.0% | 16.4% | 17.6% | 18.5% | 20.0% | 21.1% | 19.4% | 19.7% | 21.3% | 24.3% | 25.0% | 25.0% | 25.0% | 25.1% | 25.1% | 25.2% |
| Humana | 12.8% | 14.0% | 13.4% | 14.8% | 15.4% | 16.7% | 16.5% | 17.6% | 18.3% | 17.2% | 16.5% | 16.8% | 16.8% | 16.7% | 16.7% | 16.6% | 16.6% |
| Aetna | 2.1% | 3.6% | 3.8% | 3.7% | 3.2% | 3.2% | 6.4% | 6.9% | 7.2% | 7.5% | 7.5% | 8.1% | 8.3% | 8.3% | 8.3% | 8.3% | 8.3% |
| Anthem | 4.2% | 4.6% | 3.7% | 4.1% | 5.2% | 5.0% | 4.2% | 4.2% | 3.5% | 3.4% | 3.5% | 3.7% | 4.3% | 4.3% | 4.3% | 4.4% | 4.4% |
| WellCare | 1.8% | 2.4% | 2.0% | 1.0% | 1.1% | 1.5% | 1.9% | 2.3% | 2.0% | 1.8% | 2.5% | 2.4% | 2.4% | 2.4% | 2.4% | 2.4% | 2.4% |
| Cigna | 0.4% | 0.3% | 0.5% | 1.2% | 0.3% | 3.0% | 3.0% | 2.8% | 2.8% | 2.7% | 2.2% | 2.1% | 2.1% | 2.1% | 2.1% | 2.0% | 2.0% |
| Centene | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.1% | 0.2% | 1.6% | 1.5% | 1.5% | 1.5% | 1.4% | 1.4% | 1.4% | 1.4% |
| Triple-S | 0.0% | 0.6% | 0.5% | 0.5% | 0.8% | 0.8% | 0.7% | 0.6% | 0.7% | 0.6% | 0.6% | 0.6% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% |
| Molina | 0.1% | 0.1% | 0.1% | 0.2% | 0.3% | 0.3% | 0.3% | 0.4% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% |
| **Publicy Traded** | **47.6%** | **51.2%** | **51.4%** | **51.6%** | **52.2%** | **55.4%** | **56.6%** | **56.7%** | **57.3%** | **57.2%** | **59.0%** | **60.5%** | **61.3%** | **61.2%** | **61.3%** | **61.3%** | **61.4%** |

Source: CMS, Morgan Stanley Research

## Medicare Part D

**An opportunity in the Part D (PDP) market could arise as PBM shifts in-house.** Currently the market is dominated by CVS, UNH, and HUM with 5.0-5.5M members each. This compares to ANTM's ~1M members (inclusive of combined MA-PDP members, Exhibit 22). With a more efficient PBM over the next several years, we expect Anthem to be both more competitive for organic Part D business as well as for potential M&A.

**Exhibit 22:** ANTM Medicare Part D (PDP) Enrollment




Source: Company Report, Morgan Stanley Research

## (3) Capital Deployment / Balance Sheet Optionality

**Staying out of fray of large M&A.** Following the termination of its deal to acquire Cigna in 2017, the company has refocused its efforts on tuck-in deals that are more likely to close. While Anthem executes this strategy, others have initiated larger-scale M&A, including AET/CVS, CI/ESRX.

### Anthem's deals since Cigna

**During 2017, Anthem acquired 2 companies focused on Medicare Advantage.** Both deals did not have terms disclosed but were expected to be "slightly accretive" in 2018.

- In September 2017, the company announced its intent to acquire **HealthSun,** which closed in December 2017. The company operates in Florida with MA offerings, with a 4.5 star rating from CMS. The health plan covers ~40K members in southern Florida.

- In October 2017, the company announced its intent to acquire **America's 1st Choice,** which closed in early 2018. The health plan operates in both Florida and South Carolina, with 130K members. Like HealthSun, this company offers MA products.

**More recently, Anthem announced the acquisition of Aspire Health.** In May 2018 the company announced the acquisition, excluding deal terms, which is expected to close in 3Q18. This deal is expected to be slightly accretive starting in 2019. Aspire Health is a palliative care provider, which excludes hospice services. Through the use of algorithms, the integrated care team of physicians, nurses and social workers can work with those most in need to coordinate and manage care. The company has a footprint in 25 states with 20 health plan customers.

*"When we look at acquisitions, and again, I'll go back to Aspire or even what we do with CareMore, it's wrapping around where we put our capital in the more intensive, high cost areas that actually, I think, have a very strong return and we can make a significant difference in the cost of care overall and actually improve quality." - Competitor Conference June 2018*

*"I would like to point to our ASPIRE acquisition because I think that's a great example of the capability that helps us support the Medicare Advantage population, a leading capability that we think we can leverage. So as you think about where our interests lie, we're quite opportunistic. And we are looking at capabilities that help support and drive cost of care and quality in those marketplaces." - 2Q18 Earnings Call*

## What Anthem has said about capital deployment

**Capital priorities reiterated with new CEO.** Right out of the gate, as the new CEO, Gail Boudreaux, committed to continuing its the capital priorities previously laid out. Investing in the business will be the first use, followed by M&A and then through a balance of share repurchases and dividends.

**M&A comments point to more bolt-on deals.** Since the beginning of her tenure, Ms. Boudreaux has signaled that the strategy for Anthem will be smaller deals, rather than the large-scale M&A we have seen from others in the sector.

*"I believe a coordinated, thoughtful, long-term strategy should drive our M&A plan. We will be very disciplined in how we leverage the M&A pipeline to help build Anthem for the long-term, and evaluate how to strategically position and enhance our current asset base to capitalize on the opportunities of tomorrow." - 4Q17 Earnings Call*

After the first two acquisitions under her leadership closed, Ms. Boudreaux pointed to them as shining examples. We expect these deals, along with Aspire, to be representative of the future of M&A at Anthem for the foreseeable future. The deals are highly complementary and do not have high regulatory hurdles.

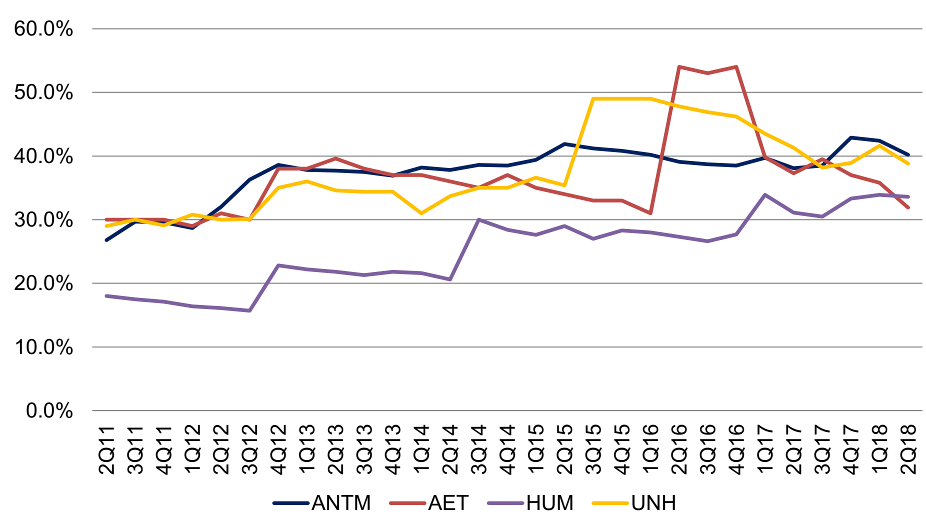
*"During the quarter, we completed the acquisition of America's 1st Choice, which added 135,000 Medicare Advantage lives in Central Florida. This acquisition, along with the acquisition of HealthSun in late 2017, aligns with our strategy to grow our business through deep integration in the markets we serve. " - 1Q18 Earnings Call*

*"More broadly, as we think about M&A, one of the unique things, I think, for Anthem, is our deep market presence and we have significant organic growth opportunities inside of our own business that we're going to leverage and take advantage of. But we also have opportunities because of our scale and local scale to do partnerships and again, more effectively leverage capital in the most efficient way." - 1Q18 Earnings Call*

## Ability to deploy capital

**Leverage is consistent with MCOs and historicals.** Currently, Anthem is operating at a debt to total capital of 43%. As seen below, for large transformative deals (Exhibit 23), the ratio can be flexed into the 50% range. Historically, these companies have operated in the 30-40% range, with movements higher for M&A. Anthem has announced three deals in the last 12 months (Healthsun, America's 1st Choice, and Aspire), which has moved its leverage into the 40s, but leaving room to flex its balance sheet for more tuck-ins.

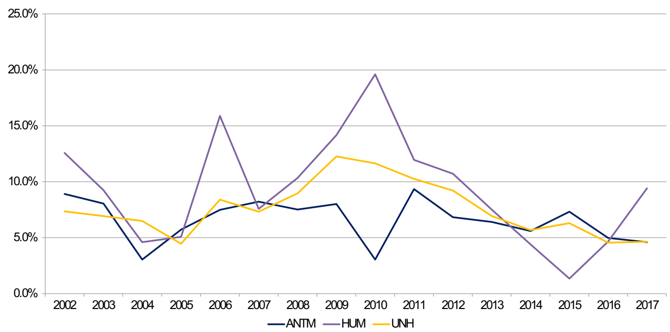
**Exhibit 23:** Diversified MCO Leverage: Debt to Total Capital




Source: Company Reports, Morgan Stanley Research

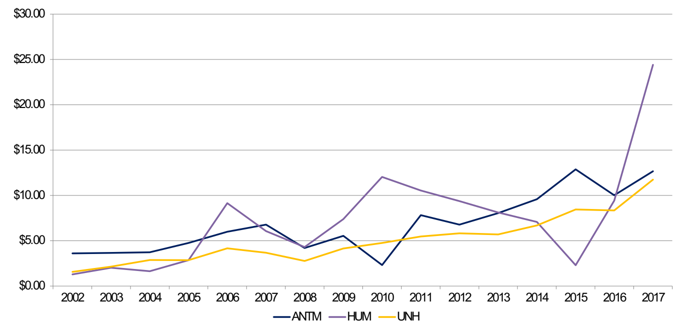
**Anthem is looking fairly attractive from a free cash generation perspective.** Free cash flow yield has converged with UNH (Exhibit 24). Although the yield for HUM increased, it was solely due to the pending deal, which was terminated. On a per share basis Anthem has consistently generated a higher level of free cash than UNH (Exhibit 25), which we view as the closest comp.

**Exhibit 24:** Free Cash Flow Yield (FCF/EV)




Source: Company Reports, Morgan Stanley Research

**Exhibit 25:** Free Cash Flow per Share




Source: Company Reports, Morgan Stanley Research

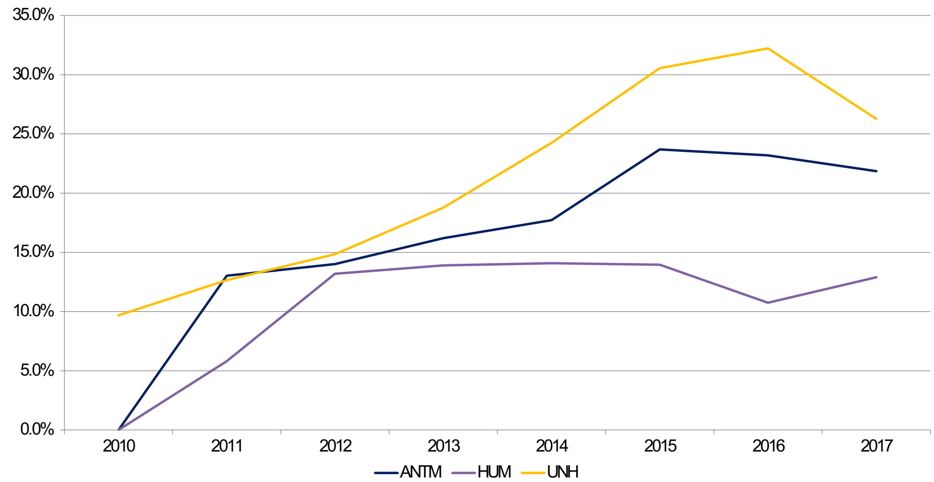
## Dividends

**While rarely discussed, the company does pay dividends.** When discussing capital deployment, dividends is usually the last item mentioned. When taking the reins, Ms. Boudreaux committed to the same capital priorities, with share repurchases and dividends behind M&A and internal investments.

> *"We will prioritize making the necessary investments in the business first, then evaluate what M&A opportunities exist in the market, and then finally, deploy capital to shareholders through a balanced approach of share buybacks and dividends." - Gail Boudreaux 4Q17 Earnings Call*

**On a relative basis, the dividend payout ratio has trailed that of UNH (Exhibit 26).** The gap has widened over the last few years, but it appears to be on the verge of narrowing. We would expect the company to step up the payout ratio in lieu of any significant M&A and lack of opportunities to buy back shares.

**Exhibit 26:** Dividend Payout Ratio




Source: Company Reports, Morgan Stanley Research

## Model Updates / Valuation

Our model has been extended to 2021 and now includes PBM transition in 2020/2021.

- **For 2019, we model EPS of $17.15 vs. consensus of $17.10.** We include the 2019 moratorium on the health insurer's fee (HIF) as well as normalized growth in its core book, including investment for the transition of PBM lives in 2020. We model share repurchases of $2.5B, contributing ~$0.50 (3%) to EPS, inline with historical capital deployment contribution.

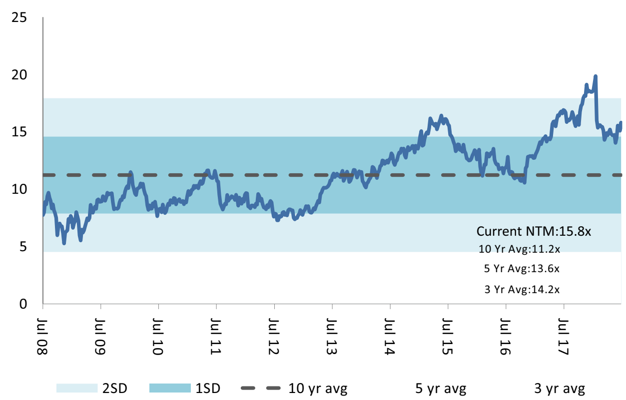
- **Our 2020 EPS estimate is $19.69, inline with consensus, which includes a transition of half of the contribution of PBM lives from ESRX staggered over the course of the year with all lives transitioned by 1/1/2021.** On net, we estimate the PBM will add an incremental ~$1 in EPS (~5%) with normalized growth in its core health plan. We model share repurchases of $4B, contributing ~$5% to EPS as ability to deploy capital accelerates.

- **For 2021, we model EPS of $25.28 vs. consensus of $23.51, although we note there are currently only 5 estimates.** We include a full contribution (~$800 million) from bringing ESRX PBM lives in-house as well as an incremental $300M from growth in PBM penetration. Combined, we model PBM contribution of $1.1B in 2021, equating to an incremental $3 in EPS over 2019 (pre-PBM transition) and ~$2 over 2020 (a partial transition year).

## Valuation

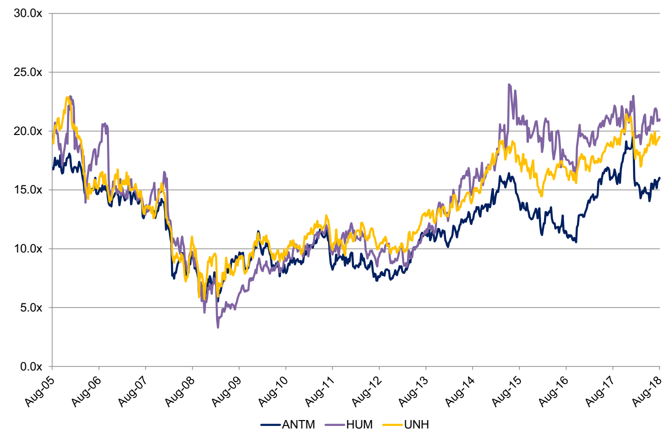
**Despite accelerating growth opportunities, ANTM is currently trading at a discount relative to UNH and HUM.** Currently ANTM is trading at 16x NTM P/E, 15.5x 2019E P/E and 13.5x 2020E P/E (Exhibit 27). Historically, over the last 1, 3, and 5 years, ANTM has traded at a 3x discount to UNH, and a ~5x compared to HUM. Currently, on a NTM basis, ANTM is trading at a ~3.5x discount to UNH and ~5x to HUM, which excludes any PBM earnings (Exhibit 6). In our view, the PBM and the higher earnings growth profile is starting to make ANTM look closer to UNH, meaning a narrower gap is warranted.

**Exhibit 27:** ANTM Historical P/E




Source: Thomson Reuters, Morgan Stanley Research

**Exhibit 28:** ANTM NTM P/E Relative to UNH & HUM




Source: Thomson Reuters, Morgan Stanley Research

**Exhibit 29:** ANTM vs. Peers on P/E Basis

| | Current NTM | 1 Year Avg | 3 Year Avg | 5 Year Avg |
|---|---|---|---|---|
| **ANTM** | **16.0x** | **16.2x** | **14.2x** | **13.7x** |
| HUM | 21.0x | 20.9x | 20.0x | 18.3x |
| UNH | 19.5x | 19.2x | 17.7x | 16.7x |
| S&P 500 | 17.2x | 18.0x | 17.2x | 16.7x |

| | Current NTM | 1 Year Avg | 3 Year Avg | 5 Year Avg |
|---|---|---|---|---|
| ANTM vs. UNH | -3.5x | -3.0x | -3.5x | -3.0x |
| ANTM vs. HUM | -5.0x | -4.7x | -5.7x | -4.7x |
| ANTM vs. S&P | -1.2x | -1.7x | -3.0x | -2.9x |

Source: Thomson Reuters, Morgan Stanley Research

**We are introducing a price target of $368.** We derive our price target by applying a 16x multiple on 2021E earnings of $25.28, which we discount back one year to 2020. The ~16x multiple implies no multiple expansion from current NTM P/E despite an accelerated growth profile. The price target represents a ~40% premium to the current share price. We also ran a DCF analysis (Exhibit 36).

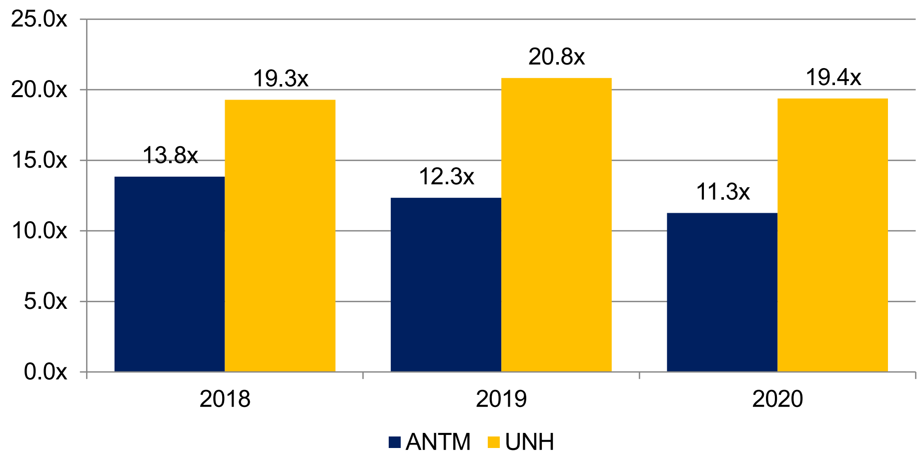
**Bull and bear cases hinge on PBM execution.** Our bull case valuation of $461 consists of a 18x P/E multiple, halving the historical discount to UNH & HUM, applied to our bull case 2021 EPS of $28.00 discounted to 2020. We assume PBM profit approached $1.4 billion via greater penetration of the ANTM core health plan book as well as growth in Medicare & Medicaid. Our bear case valuation of $204 consists of a 12x P/E multiple, a discount to the 5-year average, applied to our bear case 2020 EPS of $17.06. In the bear case, we assume PBM execution is delayed and savings from ESRX fail to reach $800 million, with margin/enrollment pressure on Medicare Advantage and Medicaid.

## Free Cash Flow Yield

**Price to free cash flow metric reveals ANTM is also undervalued compared to UNH.** ANTM's free cash flow per share is growing annually, at a faster pace than UNH. At the same time the price is not reflecting this growth. As a result the free cash flow yield for

ANTM is lower and the gap between the two companies is growing from ~5x in 2018 to ~8x in 2020/2021 (Exhibit 30). As we have outlined above, the company is moving on a growth trajectory closer to UNH, so the gap should be narrowing not widening, in our view.

**Exhibit 30:** Price to Free Cash Flow Per Share

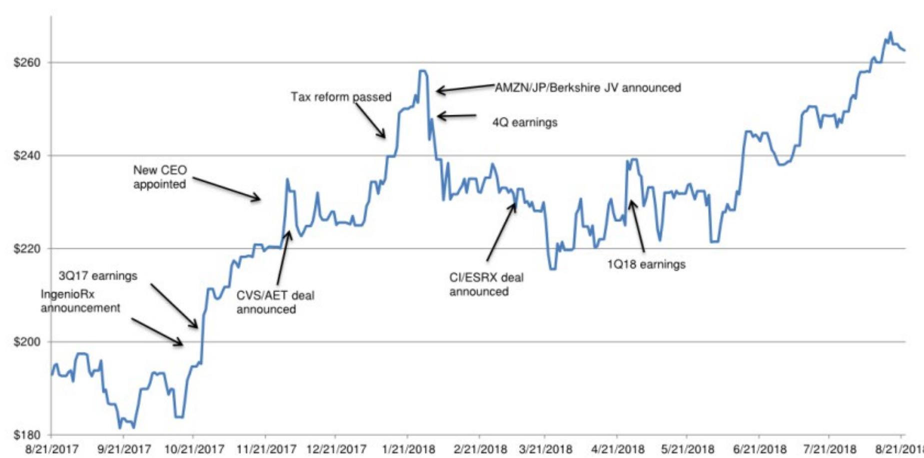



Source: Thomson Reuters, Morgan Stanley Research estimates

## Share Performance

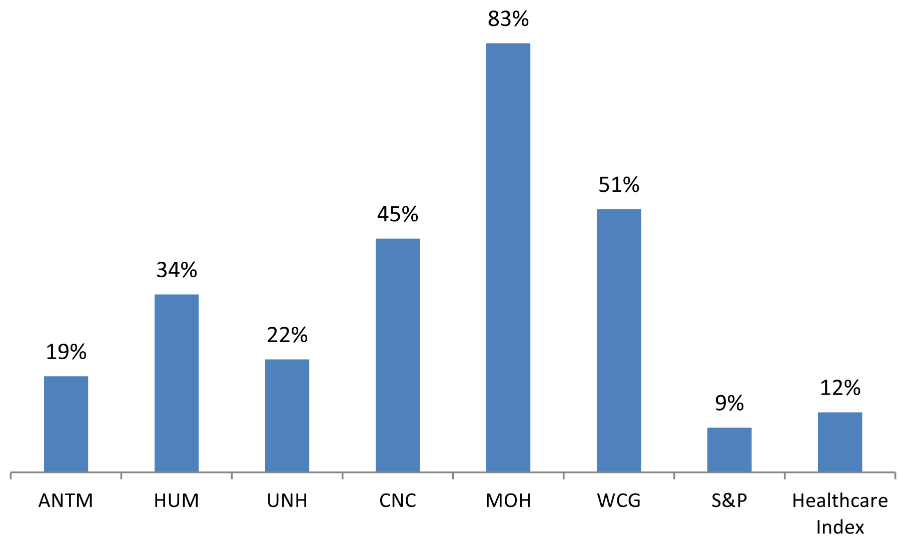
**Following the announcement of its internal PBM the stock has reached new levels.** The stock began to rally following the IngenioRx announcement and the 3Q earnings results (Exhibit 31). Since that time the stock has found new technical levels of support around $220, with recent high approaching $260. The largest downward move this year was related to the AMZN/JPM/Berkshire JV that was announced at the end of January, which we detailed in *Amazon, Berkshire, JPMorgan Team Up to Disrupt 18% of GDP*. We do note, however, YTD ANTM shares have underperformed the non-deal MCOs (Exhibit 32).

**Exhibit 31:** Share Performance with Key News Events




Source: Thomson Reuters, Morgan Stanley Research

**Exhibit 32:** YTD Share Performance




Source: Thomson Reuters

# ANTM Income Statement

**Exhibit 33:** ANTM Income Statement: FY17A - FY21E

| *Consolidated Income Statement* *($ millions, enrollment 000's)* | 2017A | 2018E Q1A | Q2A | Q3E | Q4E | 2018E | 2019E Q1E | Q2E | Q3E | Q4E | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Premiums | $ 83,647.7 | $ 20,902.8 | $ 21,248.4 | $ 20,887.0 | $ 22,794.2 | $ 85,832.4 | $ 22,145.6 | $ 22,550.1 | $ 22,356.5 | $ 24,163.7 | $ 91,216.0 | $ 99,034.6 | $ 106,460.1 |
| Administrative fees | 5,380.4 | 1,408.8 | 1,457.5 | 1,373.7 | 1,440.3 | 5,680.2 | 1,462.1 | 1,506.9 | 1,419.3 | 1,484.6 | 5,872.9 | 6,089.4 | 6,226.6 |
| Other revenues | 33.1 | 30.7 | 8.9 | 12.1 | 15.6 | 67.3 | 15.5 | 15.5 | 13.9 | 18.0 | 62.9 | 72.4 | 83.2 |
| **Total operating revenue** | **$89,061.2** | **$22,342.3** | **$22,714.8** | **$22,272.8** | **$24,250.1** | **$91,579.9** | **$23,623.3** | **$24,072.6** | **$23,789.7** | **$25,666.3** | **$97,151.8** | **$105,196.3** | **$112,769.9** |
| Benefit expense | 72,236.2 | 17,045.9 | 17,727.8 | 17,613.2 | 19,754.0 | 72,140.9 | 18,550.6 | 19,196.3 | 18,931.7 | 21,055.3 | 77,733.8 | 83,946.1 | 90,222.2 |
| Selling expense | 1,395.5 | 318.2 | 323.6 | 490.0 | 533.5 | 1,665.3 | 519.7 | 529.6 | 523.4 | 564.7 | 2,137.3 | 2,261.7 | 2,255.4 |
| General and administrative expense, net of dep.) | 11,254.1 | 3,080.3 | 3,073.8 | 2,790.9 | 3,095.4 | 12,040.4 | 2,600.4 | 2,793.1 | 2,977.1 | 3,296.6 | 11,667.2 | 12,704.3 | 13,316.2 |
| SG&A expense (net of depreciation) | 12,649.6 | 3,398.5 | 3,397.4 | 3,280.9 | 3,628.9 | 13,705.7 | 3,120.1 | 3,322.7 | 3,500.5 | 3,861.3 | 13,804.6 | 14,966.0 | 15,571.6 |
| **EBITDA** | **$4,175.4** | **$1,897.9** | **$1,589.6** | **$1,378.7** | **$867.2** | **$5,733.4** | **$1,952.6** | **$1,553.6** | **$1,357.5** | **$749.7** | **$5,613.4** | **$6,705.0** | **$8,088.9** |
| Depreciation expense | 110.7 | 30.0 | 30.6 | 33.5 | 34.8 | 128.9 | 38.8 | 40.1 | 41.5 | 42.8 | 163.2 | 185.9 | 212.4 |
| **Operating gain (loss), EBITA** | **$4,064.7** | **$1,867.9** | **$1,559.0** | **$1,345.2** | **$832.4** | **$5,604.4** | **$1,913.8** | **$1,513.5** | **$1,316.0** | **$706.9** | **$5,450.3** | **$6,519.2** | **$7,876.5** |
| Amortization of goodwill/intangibles | 168.4 | 79.5 | 93.6 | 93.6 | 93.6 | 360.3 | 95.6 | 95.6 | 95.6 | 95.6 | 382.4 | 390.4 | 398.4 |
| **EBIT** | **$3,896.3** | **$1,788.4** | **$1,465.4** | **$1,251.6** | **$738.8** | **$5,244.1** | **$1,818.2** | **$1,417.9** | **$1,220.4** | **$611.3** | **$5,067.9** | **$6,128.8** | **$7,478.1** |
| Net investment income | 866.5 | 229.2 | 229.3 | 229.3 | 229.3 | 917.1 | 229.3 | 229.3 | 229.3 | 229.3 | 917.2 | 926.4 | 954.2 |
| Interest expense | 1,021.4 | 203.3 | 190.8 | 181.0 | 181.0 | 756.1 | 159.0 | 157.0 | 140.2 | 138.7 | 595.0 | 563.0 | 534.0 |
| **Income before taxes** | **$3,852.1** | **$ 1,814.3** | **$ 1,503.9** | **$ 1,299.9** | **$ 787.1** | **$5,405.1** | **$ 1,888.5** | **$ 1,490.1** | **$ 1,309.5** | **$ 701.9** | **$5,390.1** | **$6,492.2** | **$7,898.3** |
| Income taxes | 121.0 | 467.8 | 450.1 | 406.7 | 288.8 | 1,613.4 | 434.4 | 342.7 | 301.2 | 161.4 | 1,239.7 | 1,864.9 | 2,220.1 |
| **Income before nonrecurring items** | **$ 3,731.1** | **$ 1,346.5** | **$ 1,053.8** | **$ 893.1** | **$ 498.3** | **$3,791.7** | **$ 1,454.2** | **$ 1,147.4** | **$ 1,008.3** | **$ 540.5** | **$4,150.3** | **$4,627.2** | **$5,678.2** |
| **GAAP to NON-GAAP Adjustment:** | | | | | | | | | | | | | |
| Transaction related costs | 165.9 | 9.0 | 0.0 | | | 9.0 | | | | | 0.0 | 0.0 | 0.0 |
| Penn Treaty assessment costs | 253.8 | 0.0 | 0.0 | | | 0.0 | | | | | 0.0 | 0.0 | 0.0 |
| Other Adjustments | (780.2) | 19.1 | (0.5) | | | 18.6 | | | | | 0.0 | 0.0 | 0.0 |
| Tax impact | (314.8) | (33.3) | (22.6) | (22.6) | (22.6) | (101.1) | (23.1) | (23.1) | (23.1) | (23.1) | (92.3) | (94.3) | (96.2) |
| Amortization | 168.4 | 79.5 | 93.6 | 93.6 | 93.6 | 360.3 | 95.6 | 95.6 | 95.6 | 95.6 | 382.4 | 390.4 | 398.4 |
| **Adjusted operated income** | **$3,224.2** | **$ 1,420.8** | **$ 1,123.9** | **$ 964.1** | **$ 569.3** | **$4,078.5** | **$ 1,526.7** | **$ 1,219.9** | **$ 1,080.8** | **$ 613.0** | **$4,440.4** | **$4,923.4** | **$5,980.4** |
| Net realized losses (gains) | (144.8) | 26.1 | (4.0) | - | - | 22.1 | - | - | - | - | - | - | - |
| Other nonrecurring expenses (income) | 33.1 | 7.9 | 4.4 | - | - | 12.3 | - | - | - | - | 0 | 0 | 0 |
| **Net income** | **$3,842.8** | **$1,312.5** | **$1,053.4** | **$893.1** | **$498.3** | **$3,757.3** | **$1,454.2** | **$1,147.4** | **$1,008.3** | **$540.5** | **$4,150.3** | **$4,627.2** | **$5,678.2** |
| **Adjusted Operating EPS (Cash)** | **$12.04** | **$5.41** | **$4.25** | **$3.67** | **$2.18** | **$15.51** | **$5.87** | **$4.71** | **$4.18** | **$2.38** | **$17.15** | **$19.69** | **$25.28** |
| *YOY EPS growth* | *9%* | *16%* | *26%* | *38%* | *69%* | *29%* | *9%* | *11%* | *14%* | *9%* | *11%* | *15%* | *28.4%* |
| **Operating EPS** | **$14.35** | **$4.99** | **$3.98** | **$3.40** | **$1.90** | **$14.42** | **$5.59** | **$4.43** | **$3.90** | **$2.10** | **$16.03** | **$18.50** | **$24.01** |
| *YOY EPS growth* | *56%* | *34%* | *26%* | *21%* | *-59%* | *0%* | *12%* | *11%* | *15%* | *10%* | *11%* | *15%* | *30%* |
| GAAP EPS | $14.35 | $4.99 | $3.98 | $3.40 | $1.90 | $14.29 | $5.59 | $4.43 | $3.90 | $2.10 | $16.03 | $18.50 | $24.01 |
| Wtd. average shares outstanding - fully diluted | 267.8 | 262.8 | 264.5 | 263.1 | 261.7 | 263.0 | 260.0 | 259.2 | 258.5 | 257.7 | 258.9 | 250.1 | 236.5 |
| **Margins** | | | | | | | | | | | | | |
| Benefit expense ratio (% of premiums) | 86.4% | 81.5% | 83.4% | 84.3% | 86.7% | 84.0% | 83.8% | 85.1% | 84.7% | 87.1% | 85.2% | 84.8% | 84.7% |
| SG&A (net of D&A) % of revenues | 14.2% | 15.2% | 15.0% | 14.7% | 15.0% | 15.0% | 13.2% | 13.8% | 14.7% | 15.0% | 14.2% | 14.2% | 13.8% |
| SG&A % of revenues (way that WLP guides/reports) | 14.3% | 15.3% | 15.1% | 14.9% | 15.1% | 15.1% | 13.4% | 14.0% | 14.9% | 15.2% | 14.4% | 14.4% | 14.0% |
| Operating margin (EBITDA margin) | 4.7% | 8.5% | 7.0% | 6.2% | 3.6% | 6.3% | 8.3% | 6.5% | 5.7% | 2.9% | 5.8% | 6.4% | 7.2% |
| EBIT margin | 4.5% | 8.1% | 6.6% | 5.8% | 3.2% | 5.9% | 7.9% | 6.1% | 5.3% | 2.5% | 5.4% | 6.0% | 6.8% |
| Pretax | 4.3% | 8.1% | 6.6% | 5.8% | 3.2% | 5.9% | 8.0% | 6.2% | 5.5% | 2.7% | 5.5% | 6.2% | 7.0% |
| Tax Rate with HIF | 3.1% | 25.8% | 29.9% | 31.3% | 36.7% | 29.8% | 23.0% | 23.0% | 23.0% | 23.0% | 23.0% | 28.7% | 28.1% |
| Adjusted Tax Rate - ex-amort | -5.7% | 22.6% | 26.8% | 27.6% | 30.2% | 26.1% | 20.7% | 20.2% | 19.8% | 17.3% | 19.9% | 25.7% | 25.6% |
| **Trends (YOY)** | | | | | | | | | | | | | |
| Enrollment | | | | | | | | | | | | | |
| Self-funded | 1% | 1% | 1% | 2% | 2% | 2% | 1% | 1% | 1% | 0% | 0% | 1% | 1% |
| Fully insured | 1% | -8% | -8% | -6% | -3% | -4% | 3% | 4% | 4% | 2% | 2% | 3% | 3% |
| Total enrollment | 1% | -2% | -2% | -1% | 0% | 0% | 2% | 2% | 2% | 1% | 1% | 2% | 2% |
| P&L | | | | | | | | | | | | | |
| Premiums | 6% | 0% | 2% | 0% | 8% | 3% | 6% | 6% | 7% | 6% | 6% | 9% | 7% |
| Administrative fees | 2% | 3% | 6% | 7% | 7% | 6% | 4% | 3% | 3% | 3% | 3% | 4% | 2% |
| Operating revenue | 6% | 0% | 2% | 1% | 8% | 3% | 6% | 6% | 7% | 6% | 6% | 8% | 7% |
| Operating income | -15% | 18% | 27% | 37% | 112% | 37% | 3% | -2% | -2% | -14% | -2% | 19% | 21% |
| Pre-tax income | -17% | 20% | 26% | 29% | 506% | 40% | 4% | -1% | 1% | -11% | 0% | 20% | 22% |
| EPS | 9% | 16% | 26% | 38% | 69% | 28.8% | 9% | 11% | 14% | 9% | 11% | 15% | 28% |

Source: Company Reports, Morgan Stanley Research estimates

# ANTM Balance Sheet

**Exhibit 34:** ANTM Balance Sheet: FY17A - FY21E

| ***Consolidated Balance Sheet*** | | 2018E | | | | | 2019E | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *($ millions, enrollment 000's)* | **2017A** | **Q1A** | **Q2A** | **Q3E** | **Q4E** | **2018E** | **Q1E** | **Q2E** | **Q3E** | **Q4E** | **2019E** | **2020E** | **2021E** |
| Assets | | | | | | | | | | | | | |
| Cash and cash equivalents | $3,608.9 | $4,630.6 | $4,682.0 | $4,282.5 | $4,148.5 | $4,148.5 | $4,447.1 | $6,052.5 | $5,185.8 | $5,051.8 | $5,051.8 | $7,376.8 | $6,960.9 |
| Total investments available-for-sale, at fair value | 20,976.5 | 19,433.4 | 19,516.9 | 19,536.4 | 19,556.0 | 19,556.0 | 19,575.5 | 19,595.1 | 19,614.7 | 19,634.3 | 19,634.3 | 19,712.9 | 19,791.9 |
| Other invested assets, current | 17.2 | 24.3 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 | 23.8 |
| Accrued investment income | 162.5 | 160.2 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 | 161.6 |
| Premium and self-funded receivables | 6,184.9 | 6,255.9 | 6,918.3 | 6,416.9 | 6,635.0 | 6,635.0 | 6,978.9 | 6,876.6 | 6,825.9 | 7,052.9 | 7,052.9 | 7,755.1 | 8,167.9 |
| Other receivables | 2,266.5 | 2,305.2 | 2,182.6 | 2,168.5 | 2,528.4 | 2,528.4 | 2,469.7 | 2,291.5 | 2,307.0 | 2,687.8 | 2,687.8 | 2,911.2 | 3,118.9 |
| Income tax receivable | 341.9 | - | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 | 154.5 |
| Securities lending collateral | 455.1 | 612.2 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 | 624.6 |
| Other current assets | 2,249.3 | 3,552.3 | 3,106.1 | 3,174.4 | 3,441.8 | 3,441.8 | 3,912.8 | 3,448.6 | 3,374.5 | 3,628.3 | 3,628.3 | 4,007.0 | 4,275.9 |
| **Total current assets** | **$ 36,262.8** | **$ 36,974.1** | **$ 37,370.4** | **$ 36,543.1** | **$ 37,274.1** | **$ 37,274.1** | **$ 38,348.5** | **$ 39,228.8** | **$ 38,272.5** | **$ 39,019.7** | **$ 39,019.7** | **$ 42,727.5** | **$ 43,280.2** |
| Long-term investments, available for sale, at fair value | 593.6 | 534.4 | 520.4 | 523.0 | 525.6 | 525.6 | 528.2 | 530.9 | 533.5 | 536.2 | 536.2 | 547.0 | 558.0 |
| Other invested assets, long-term | 3,343.8 | 3,460.8 | 3,495.2 | 3,507.2 | 3,519.2 | 3,519.2 | 3,531.2 | 3,543.2 | 3,555.2 | 3,567.2 | 3,567.2 | 3,615.2 | 3,663.2 |
| Restricted cash and investments | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Property & equipment, net | 2,174.9 | 2,237.6 | 2,392.2 | 2,488.7 | 2,583.9 | 2,583.9 | 2,675.1 | 2,765.0 | 2,853.5 | 2,940.7 | 2,940.7 | 3,354.8 | 3,842.4 |
| Goodwill | 19,231.2 | 20,185.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 | 20,414.5 |
| Other intangible assets | 8,368.4 | 9,076.0 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 | 9,224.3 |
| Other non-current assets | 565.3 | 832.0 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 | 950.4 |
| **Total assets** | **$ 70,540.0** | **$ 73,300.4** | **$ 74,367.4** | **$ 73,651.2** | **$ 74,492.0** | **$ 74,492.0** | **$ 75,672.3** | **$ 76,657.1** | **$ 75,803.9** | **$ 76,653.0** | **$ 76,653.0** | **$ 80,833.7** | **$ 81,933.0** |
| Liabilities and shareholders' equity | | | | | | | | | | | | | |
| Total policy liabilities, current | $11,011.7 | $10,630.6 | $10,627.2 | $10,778.1 | $12,231.3 | $12,231.3 | $11,521.5 | $11,679.0 | $11,530.1 | $12,976.0 | $12,976.0 | $16,470.2 | $18,384.8 |
| Unearned income | 860.3 | 2,115.9 | 2,089.9 | 2,027.0 | 721.6 | 721.6 | 958.1 | 965.5 | 2,165.0 | 763.7 | 763.7 | 826.1 | 884.8 |
| Accounts payable and accrued expenses | 5,024.4 | 5,816.7 | 5,931.4 | 5,301.9 | 5,772.6 | 5,772.6 | 5,910.7 | 6,044.6 | 5,427.0 | 5,855.1 | 5,855.1 | 5,507.4 | 5,898.8 |
| Income taxes payable | 0.0 | 194.9 | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Securities trades pending payable | 112.6 | 134.7 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 | 159.9 |
| Securities lending payable | 454.4 | 611.8 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 | 624.3 |
| Bank overdrafts/Short term Borrowings | 1,275.0 | 1,125.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 | 1,120.0 |
| Current portion of long-term debt | 1,274.6 | 650.8 | 650.2 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 | 1,273.4 |
| Other current liabilities | 3,343.0 | 3,475.5 | 3,302.8 | 2,650.9 | 2,790.1 | 2,790.1 | 3,674.8 | 3,500.2 | 2,831.5 | 2,953.0 | 2,953.0 | 2,643.5 | 1,179.8 |
| **Total current liabilities** | **$ 23,356.0** | **$ 24,755.9** | **$ 24,505.7** | **$ 23,935.5** | **$ 24,693.1** | **$ 24,693.1** | **$ 25,242.6** | **$ 25,367.0** | **$ 25,131.2** | **$ 25,725.4** | **$ 25,725.4** | **$ 28,624.9** | **$ 29,525.7** |
| Long-term debt, net | 17,382.2 | 18,110.1 | 17,515.4 | 18,110.1 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 | 17,515.4 |
| Reserves for future policy benefits, noncurrent | 647.3 | 666.8 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 | 644.7 |
| Deferred income taxes | 1,726.5 | 1,812.9 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 | 1,902.2 |
| Other noncurrent liabilities | 925.1 | 942.3 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 | 1,074.4 |
| **Total liabilities** | **$ 44,037.1** | **$ 46,288.0** | **$ 45,642.4** | **$ 45,666.9** | **$ 45,829.8** | **$ 45,829.8** | **$ 46,379.3** | **$ 46,503.7** | **$ 46,267.9** | **$ 46,862.1** | **$ 46,862.1** | **$ 49,761.6** | **$ 50,662.4** |
| Shareholders' equity | 26,502.9 | 27,012.4 | 28,725.0 | 27,984.4 | 28,662.2 | 28,662.2 | 29,293.0 | 30,153.4 | 29,536.0 | 29,790.9 | 29,790.9 | 31,072.1 | 31,270.6 |
| **Total liabilities and shareholders' equity** | **$ 70,540.0** | **$ 73,300.4** | **$ 74,367.4** | **$ 73,651.2** | **$ 74,492.0** | **$ 74,492.0** | **$ 75,672.3** | **$ 76,657.1** | **$ 75,803.9** | **$ 76,653.0** | **$ 76,653.0** | **$ 80,833.7** | **$ 81,933.0** |

Source: Company Reports, Morgan Stanley Research estimates

# ANTM Cash Flow Statement

**Exhibit 35:** ANTM Cash Flows: FY17A - FY21E

| *Consolidated Statement of Cash Flow* *($ millions, enrollment 000's)* | 2017A | Q1A 2018E | Q2A 2018E | Q3E 2018E | Q4E 2018E | 2018E | Q1E 2019E | Q2E 2019E | Q3E 2019E | Q4E 2019E | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Operating activities: | | | | | | | | | | | | | |
| Net income (GAAP) | $ 3,842.8 | $ 1,312.5 | $ 1,053.4 | $ 893.1 | $ 498.3 | $ 3,757.3 | $ 1,454.2 | $ 1,147.4 | $ 1,008.3 | $ 540.5 | $ 4,150.3 | $ 4,627.2 | $ 5,678.2 |
| Net realized capital losses and other non-recurring items | (111.7) | 34.0 | 0.4 | - | - | 34.4 | - | - | - | - | - | - | - |
| Stock-based compensation | 169.6 | 42.2 | 35.9 | 50.0 | 50.0 | 178.1 | 45.0 | 45.0 | 45.0 | 45.0 | 180.0 | 180.0 | 180.0 |
| Amortization, net of accretion | 779.7 | 239.7 | 255.4 | 255.4 | 255.4 | 1,005.9 | 252.4 | 252.4 | 252.4 | 252.4 | 1,009.6 | 997.6 | 985.6 |
| Depreciation expense | 110.7 | 30.0 | 30.6 | 33.5 | 34.8 | 128.9 | 38.8 | 40.1 | 41.5 | 42.8 | 163.2 | 185.9 | 212.4 |
| Deferred taxes | (1,272.1) | (51.5) | 53.4 | - | - | 1.9 | - | - | - | - | - | - | - |
| Other noncash items | 297.9 | 19.1 | (0.4) | - | - | 18.7 | - | - | - | - | - | - | - |
| Change in operating assets and liabilities | 367.9 | 588.9 | (886.5) | (907.9) | (249.7) | (1,455.2) | (363.5) | 712.2 | (283.3) | (424.2) | (358.8) | 988.1 | (575.9) |
| Discontinued operations | - | - | - | - | - | - | - | - | - | - | - | - | - |
| **Net cash provided by operations** | **$ 4,184.8** | **$ 2,214.9** | **$ 542.2** | **$ 324.1** | **$ 588.9** | **$ 3,670.1** | **$ 1,426.8** | **$ 2,197.2** | **$ 1,063.8** | **$ 456.4** | **$ 5,144.3** | **$ 6,978.8** | **$ 6,480.3** |
| Investing activities: | | | | | | | | | | | | | |
| Net sales (purchases) of investments | ($2,224.5) | $994.8 | ($99.2) | ($34.1) | ($34.2) | $827.3 | ($34.2) | ($34.2) | ($34.2) | ($34.3) | ($136.9) | ($137.5) | ($138.0) |
| Net purchases of property & equipment | (790.2) | (218.2) | (314.3) | (130.0) | (130.0) | (792.5) | (130.0) | (130.0) | (130.0) | (130.0) | (520.0) | (600.0) | (700.0) |
| Acquisitions, net of cash | (2,079.6) | (1,346.1) | (376.4) | - | - | (1,722.5) | - | - | - | - | - | - | - |
| Other | 11.9 | 3.6 | 11.6 | - | - | 15.2 | - | - | - | - | - | - | - |
| **Net cash provided by investing activities** | **$ (5,082.4)** | **$ (565.9)** | **$ (778.3)** | **$ (164.1)** | **$ (164.2)** | **$ (1,672.5)** | **$ (164.2)** | **$ (164.2)** | **$ (164.2)** | **$ (164.3)** | **$ (656.9)** | **$ (737.5)** | **$ (838.0)** |
| Financing activities: | | | | | | | | | | | | | |
| Net proceeds from commercial paper borrowings | 174.6 | (108.0) | (595.7) | - | - | (703.7) | - | - | - | - | - | - | - |
| Proceeds from short-term borrowings | 835.0 | - | - | | | - | | | | | - | - | - |
| Proceeds from long-term borrowings | 2,642.7 | 173.3 | (1.4) | - | - | 171.9 | - | - | - | - | - | - | - |
| Repayment of short-term borrowings | - | (150.0) | (5.0) | | | (155.0) | | | | | - | - | - |
| Repayment of long-term borrowings | - | - | - | - | - | - | (250.0) | - | (1,339.4) | - | (1,589.4) | - | (1,125.0) |
| Changes in securities lending payable | (624.5) | 157.4 | 12.5 | | | 169.9 | | | | | - | - | - |
| Changes in bank overdrafts | 71.0 | (124.4) | 193.8 | - | - | 69.4 | - | - | - | - | - | - | - |
| Issuance of common stock | - | - | 1,250.0 | | | 1,250.0 | | | | | - | - | - |
| Repurchase and retirement of common stock | (1,997.7) | (394.7) | (400.3) | (350.0) | (350.0) | (1,495.0) | (500.0) | (200.0) | (200.0) | (200.0) | (1,100.0) | (3,000.0) | (4,000.0) |
| Dividends | (704.9) | (191.9) | (196.4) | (209.9) | (208.8) | (806.9) | (214.0) | (227.6) | (226.9) | (226.2) | (894.6) | (920.4) | (937.1) |
| Proceeds from exercise of options, ESOP | 225.3 | 59.4 | 35.4 | - | - | 94.8 | - | - | - | - | - | - | - |
| Excess tax benefits from share based comp | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Other | (190.3) | (48.8) | (4.6) | - | - | (53.4) | - | - | - | - | - | 4.0 | 4.0 |
| **Net cash provided by financing activities** | **$ 431.2** | **$ (627.7)** | **$ 288.3** | **$ (559.9)** | **$ (558.8)** | **$ (1,458.0)** | **$ (964.0)** | **$ (427.6)** | **$ (1,766.3)** | **$ (426.2)** | **$ (3,584.0)** | **$ (3,916.4)** | **$ (6,058.1)** |
| Net increase in cash & equivalents | $ (466.4) | $ 1,021.3 | $ 52.2 | $ (399.9) | $ (134.1) | $ 539.6 | $ 298.7 | $ 1,605.4 | $ (866.7) | $ (134.1) | $ 903.3 | $ 2,325.0 | $ (415.9) |
| Beginning cash & equivalents | 4,075.3 | 3,608.9 | 4,630.2 | 4,682.4 | 4,282.5 | 3,608.9 | 4,148.5 | 4,447.1 | 6,052.5 | 5,185.8 | 4,148.5 | 5,051.8 | 7,376.8 |
| **Ending cash & equivalents** | **$ 3,608.9** | **$ 4,630.2** | **$ 4,682.4** | **$ 4,282.5** | **$ 4,148.5** | **$ 4,148.5** | **$ 4,447.1** | **$ 6,052.5** | **$ 5,185.8** | **$ 5,051.8** | **$ 5,051.8** | **$ 7,376.8** | **$ 6,960.9** |

Source: Company Reports, Morgan Stanley Research estimates

# Discounted Cash Flow (DCF) Analysis

**Exhibit 36:** ANTM DCF

| ***Scenario DCF & Other Valuation*** *($ millions, enrollment 000's)* | | | | | | | |
|---|---|---|---|---|---|---|---|
| Current Market Price | $267.13 | | | | | | |
| Base Case Valuation | $368.00 | | | | | | |
| Base Case % Upside | 37.8% | | | | | | |

| Key Valuation Metrics | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E |
|---|---|---|---|---|---|---|---|
| Market (P/E) - MS Estimates | 17.2x | 15.6x | 13.6x | 10.6x | - | - | - |
| Base Case (P/E) - MS Estimates | 23.7x | 21.5x | 18.7x | 14.6x | - | - | - |

| Discounted Cash Flow Valuation | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E |
|---|---|---|---|---|---|---|---|
| Premiums | $85,832.4 | $91,216.0 | $99,034.6 | $106,460.1 | $112,847.7 | $119,618.6 | $126,795.7 |
| Services/Fees/Other | 5,747.6 | 5,935.8 | 6,161.7 | 6,309.8 | 6,688.4 | 7,089.7 | 7,515.1 |
| Operating Revenues | $91,579.9 | $97,151.8 | $105,196.3 | $112,769.9 | $119,536.1 | $126,708.2 | $134,310.7 |
| EBIT | $5,244.1 | $5,067.9 | $6,128.8 | $7,478.1 | $7,926.8 | $8,402.4 | $8,906.6 |
| *EBIT margin* | 5.7% | 5.2% | 5.8% | 6.6% | 6.6% | 6.6% | 6.6% |
| Plus: Investment Income | 917.1 | 917.2 | 926.4 | 954.2 | 954.2 | 954.2 | 954.2 |
| Adj. Net Op Profit (inc. net inv. income but excl. in | $6,161.2 | $5,985.1 | $7,055.1 | $8,432.3 | $8,881.0 | $9,356.6 | $9,860.7 |
| *adj. Op Profit margin* | 6.7% | 6.2% | 6.7% | 7.5% | 7.4% | 7.4% | 7.3% |
| Less: Provision for Taxes | (1,494.1) | (1,376.6) | (1,622.7) | (1,939.4) | (2,042.6) | (2,152.0) | (2,268.0) |
| *Tax rate* | 24.3% | 23.0% | 23.0% | 23.0% | 23.0% | 23.0% | 23.0% |
| = Adjusted Net Operating Profit After Tax | $4,667.1 | $4,608.5 | $5,432.5 | $6,492.9 | $6,838.3 | $7,204.6 | $7,592.8 |
| Depreciation & Amortization | 489.2 | 545.6 | 576.3 | 610.8 | 665.8 | 699.1 | 734.0 |
| Capital Expenditures | (1,672.5) | (656.9) | (737.5) | (838.0) | (871.5) | (906.4) | (942.6) |
| Change in Statutory Risk-Based Capital | (270.4) | (666.2) | (967.6) | (918.9) | (790.5) | (837.9) | (888.2) |
| (Increase)/Decrease in Working Capital | (1,455.2) | (358.8) | 988.1 | (575.9) | (599.0) | (622.9) | (647.8) |
| = Unlevered After-Tax Free Cash Flow to Parent | $1,758.3 | $3,472.1 | $5,291.8 | $4,770.8 | $5,243.2 | $5,536.4 | $5,848.1 |
| *PV of Operating Free Cash Flow to Parent* | $1,703.9 | $3,159.7 | $4,522.4 | $3,828.8 | $3,951.6 | $3,918.4 | $3,886.9 |
| Target RBC | 375% | 375% | 375% | 375% | 375% | 375% | 375% |
| RBC as % of Prem. Per 100% RBC | 3.3% | 3.3% | 3.3% | 3.3% | 3.3% | 3.3% | 3.3% |

| Discounted Cash Flow Valuation | |
|---|---|
| Weighted Average Cost of Capital (WACC) | 6.5% |
| Intermediate Growth Rate (2017-23e) | 6.0% |
| Terminal Growth Rate (2023+) | 2.0% |
| Discounted Net Cash Flow (2018-2024) | $24,971.7 |
| Discounted Value of Terminal Value | $88,366.1 |
| **Total Discounted Value** | **$113,337.8** |
| Less: Gross Debt, current | ($18,165.6) |
| Plus: Parent Company Cash, current | $2,200.0 |
| = Equity Value | $97,372.2 |
| Shares Outstanding (millions) | 263.0 |
| **= Equity Value per Share ($)** | **$370.23** |

| Valuation Inputs | |
|---|---|
| Beta | 0.7 |
| Risk Free Rate | 2.8% |
| Equity Risk Premium | 6.5% |
| **Cost of Equity** | **7.0%** |
| Cost of Debt | 5.5% |
| **Cost of Debt (After-tax)** | **4.2%** |
| Net Debt Capitalization | 18.5% |
| Equity Capitalization | 81.5% |
| Weighted Average Cost of Equity | **6.5%** |
| Time of Valuation | 2018 |
| Year of Terminal Value | 2024 |

| Financial Metrics | 2018E | 2019E | 2020E | 2021E |
|---|---|---|---|---|
| Diluted EPS - MS Estimate | $15.51 | $17.15 | $19.69 | $25.28 |
| Diluted EPS - Consensus Estimate | $15.49 | $17.10 | $19.70 | $23.51 |

Source: Company Reports, Morgan Stanley Research estimates

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(as of August 31, 2018)
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| | COVERAGE UNIVERSE | | INVESTMENT BANKING CLIENTS (IBC) | | | OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC) | |
|---|---|---|---|---|---|---|---|
| STOCK RATING CATEGORY | COUNT | % OF TOTAL | COUNT | % OF TOTAL IBC | % OF RATING CATEGORY | COUNT | % OF TOTAL OTHER MISC |
| **Overweight/Buy** | **1156** | **37%** | **296** | **40%** | **26%** | **546** | **39%** |
| **Equal-weight/Hold** | **1363** | **44%** | **348** | **48%** | **26%** | **635** | **45%** |
| **Not-Rated/Hold** | **50** | **2%** | **5** | **1%** | **10%** | **7** | **0%** |
| **Underweight/Sell** | **553** | **18%** | **82** | **11%** | **15%** | **223** | **16%** |
| **TOTAL** | **3,122** | | **731** | | | **1411** | |

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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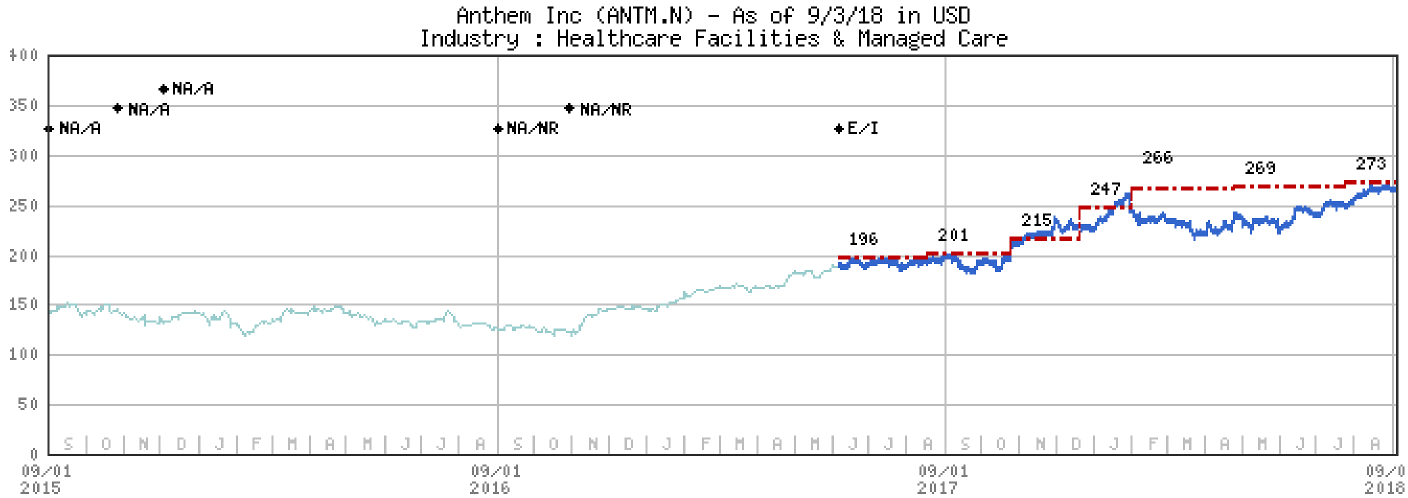
## Stock Price, Price Target and Rating History (See Rating Definitions)




Stock Rating History: 9/1/15 : NA/A; 10/28/15 : NA/A; 12/3/15 : NA/A; 9/1/16 : NA/NR; 10/30/16 : NA/NR; 6/6/17 : E/I

Price Target History: 7/24/15 : NA; 6/6/17 : 196; 8/17/17 : 201; 10/25/17 : 215; 12/20/17 : 247; 1/31/18 : 266; 4/25/18 : 269; 7/25/18 : 273

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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**INDUSTRY COVERAGE: Healthcare Facilities & Managed Care**

| COMPANY (TICKER) | RATING (AS OF) | PRICE* (09/04/2018) |
|---|---|---|
| **Zack Sopcak** | | |
| Aetna Inc (AET.N) | E (12/20/2017) | $199.30 |
| Anthem Inc (ANTM.N) | O (09/04/2018) | $263.70 |
| Centene Corp (CNC.N) | O (06/06/2017) | $146.21 |
| Cigna Corp (CI.N) | ++ | $186.07 |
| Community Health Systems Inc (CYH.N) | U (06/06/2017) | $3.54 |
| HCA Holdings Inc (HCA.N) | U (12/20/2017) | $134.03 |
| Humana Inc (HUM.N) | O (07/12/2018) | $333.09 |
| LifePoint Health Inc (LPNT.O) | E (06/06/2017) | $64.40 |
| Molina Healthcare Inc (MOH.N) | O (08/17/2017) | $137.72 |
| Quorum Health Corp (QHC.N) | E (12/20/2017) | $4.25 |
| Tenet Healthcare Corp (THC.N) | U (12/20/2017) | $32.83 |
| UnitedHealth Group Inc (UNH.N) | O (06/06/2017) | $268.51 |
| Universal Health Services Inc (UHS.N) | E (06/06/2017) | $128.14 |
| Wellcare Health Plans Inc (WCG.N) | E (06/06/2017) | $304.24 |

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.

**INDUSTRY COVERAGE: Healthcare Services & Distribution**

| COMPANY (TICKER) | RATING (AS OF) | PRICE* (08/31/2018) |
|---|---|---|
| **Brian Essex, CFA** | | |
| Medidata Solutions Inc. (MDSO.O) | E (05/21/2018) | $84.98 |
| **Ricky R Goldwasser** | | |
| Allscripts Healthcare Solutions Inc. (MDRX.O) | U (12/13/2016) | $14.61 |
| AmerisourceBergen Corp. (ABC.N) | E (09/14/2017) | $89.17 |
| athenahealth Inc (ATHN.O) | E (10/26/2016) | $153.90 |
| Cardinal Health Inc (CAH.N) | U (11/19/2017) | $51.23 |
| Catalent, Inc. (CTLT.N) | O (09/21/2017) | $41.53 |
| Cerner Corporation (CERN.O) | E (08/10/2017) | $65.11 |
| Charles River Laboratories International (CRL.N) | E (03/03/2010) | $124.71 |
| CVS Health Corp (CVS.N) | O (01/05/2018) | $74.00 |
| Diplomat Pharmacy Inc (DPLO.N) | E (10/01/2015) | $20.23 |
| Express Scripts, Inc. (ESRX.O) | ++ | $88.02 |
| Inovalon Holdings Inc (INOV.O) | U (03/14/2018) | $11.00 |
| Iqvia Holdings Inc (IQV.N) | O (06/18/2013) | $128.04 |
| Laboratory Corp. of America Holdings (LH.N) | O (02/23/2015) | $169.15 |
| McKesson Corporation (MCK.N) | E (09/14/2017) | $123.90 |
| Quality Systems Inc (QSII.O) | U (12/13/2016) | $22.89 |
| Quest Diagnostics Inc. (DGX.N) | O (05/29/2018) | $109.33 |
| Walgreens Boots Alliance Inc (WBA.O) | E (10/06/2017) | $68.56 |

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* Historical prices are not split adjusted.