UnitedHealth Group (UNH- $272.57)

Rating: Overweight

Price Target: $310.00

Leveraging the Rally Chassis to Create a "Deeply Personal" EHR; Reiterate Overweight

Investment Summary. During its 3Q18 results conference call on 10/16, management noted the company would soon be rolling out a new, first-of-its-kind EHR. This individual EHR would be released at scale to UNH's 50 million fully benefited members by YE19. The company noted the offering will be fully integrated and fully portable, designed to deliver personalized next-best health actions to patients and their caregivers. We believe this product, along with many other Optum offerings, should drive broad-based adoption across UNH product lines and in theory benefit third-party payers that also use Optum's tools. We still think that these types of investments contribute to the company's status as the industry bellwether. We continue to view the shares as a core holding for large-cap portfolio managers.

Rally is a solid launch point. UNH indicated it will use its Rally Health "chassis" to enable members to easily access and interpret their individual health record. We view the mobile wellness platform as a good starting point for the proposed EHR (Rally currently has 20 million registered users). The Rally digital health asset synthesizes patient data and engages consumers to better-manage their health. This is achieved by helping members select high-quality care providers and allowing them to optimize their own out-of-pocket (and overall) costs.

Impact on consumer engagement and provider EHR market. The company noted Rally should allow patients to assess the care they have been provided and if any gaps in care exist. UNH indicated it intends to offer a similar data capability to providers. This would be provided to the physician in the workflow of the physician's office. The company hopes this will drive better health outcomes and ensure the highest quality of care. The Rally EHR should be able to tap into different EHRs that use APIs and other interoperability standards, which are being more-widely adopted. Rally EHR should be viewed as a consumer engagement tool and not as a threat to legacy provider EHR products.

Reiterate Overweight rating. Overall, we continue to be enthusiastic about UNH's investment in digital capabilities. These tools help employers and plan sponsors minimize their medical cost trend. This, in turn, drives adoption of the UnitedHealthcare (UHC) segment's health plans offerings. We continue to believe that the use of data analytics will advance care delivery and consumer engagement, while reducing the cost of healthcare. We reiterate our OW rating and PT of $310, but note our long-term growth assumptions in our DCF model could be viewed as conservative. We continue to view the shares as highly attractive and perhaps be used to offset the inherent volatility of many large-cap technology stocks.

Current Statistics

Market Cap ($Mil) : $262,341
Avg. Daily Trading Volume (3 mo.) : 2,583,688
52 Wk. Range : $272.81 - $191.36
 Shares Out (Mil) : 962.5

The Disclosure Section may be found on pages 3 - 4.
Valuation

Our $310 price target is supported by our DCF analysis. Our DCF assumptions include mid-to-high single-digit revenue growth over the next several years, long-term growth of 2%, debt to capital of 20%, and a weighted average cost of capital of 8%. The shares trade at about 18x our 2019 EPS estimate, which we view as attractive given the company's track record in growing earnings, generating free cash flow and successfully deploying capital.

Risks

**Development uncertainty.** Managed-care plans have significantly overestimated medical costs over the past six years, and although this has boosted reported earnings, as healthcare costs normalize, rate increases could be insufficient to maintain margins. Healthcare utilization has been depressed since 2008 by the weak economy, benefit redesign, and higher deductibles and copayments, and although we think this is a trend that could continue for awhile, it probably also means that the eventual recovery will come as a surprise. Large numbers of favorable developments in prior periods also constitute headwinds for future periods.

**Risk business evolving.** UnitedHealth has an individual and group book that is small in relation to its total business, but it is affected by the greater difficulty of securing adequate rate increases. The individual business is vulnerable because of increased scrutiny regarding rate review, and the group business is highly competitive. The group mandates tend to be more manageable, but increased costs could cause more small employers to drop coverage altogether.

**Exchange business uncertain.** UNH participated in 24 states in 2015, but lost more than $700 million. After paring its losses in 2016, it exited most markets in 2017. We expect no impact from the elimination of CSRs in 2018.

**Medicare reimbursement.** Medicare accounts for approximately 40% of UnitedHealth Group’s healthcare revenue, and the government continues to look for ways to lower costs and raise revenue through cuts in reimbursement and taxes. Although Medicare Advantage rates stabilized in 2016, changes in reimbursement will affect profitability to a certain degree.

**Medicaid reimbursement.** Medicaid accounts for only 19% of UnitedHealth Group’s healthcare revenue, and although we believe that current fiscal pressures will increase the opportunity for the company to increase its business, Medicaid remains highly competitive and subject to periodic cuts. UnitedHealth has been especially active in re-procurements over the past two years, and we believe that much of the program’s future growth will come from the expanded role of managed care in the management of complex cases like ABD, dual eligibles, and long-term care. We believe that UnitedHealth is well-positioned to expand in Medicaid; most contracts are competitive.

**Changes to the Affordable Care Act.** Any modification, delay, or repeal of the ACA could have a material effect on the revenue and margins of healthcare service providers. The impact of any changes to the ACA will depend on the specific modification and timing, and any theoretical impact on past results is not necessarily a good guide of future performance.

**Optum.** With over 40% of UNH’s operating profit associated with its Optum segment, risks specific to Optum include provider reimbursement, regulatory requirements, and pharmaceutical pricing.
Company Description

UnitedHealth Group is the largest managed-care company in the U.S. The company provides healthcare insurance plans, software and consulting services. It has four operating segments: UnitedHealthcare, OptumHealth, OptumInsight, and OptumRx. UnitedHealth Group was founded in 1977.

Disclosures Appendix

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I = Initiated; 1 = Overweight/OW or before 12/14/16, B=BUY; 2 = Neutral or before 12/14/16, H=HOLD;
3 = Underweight/UW or before 12/14/16, S=SELL; SP=SPECULATIVE BUY before 12/14/16; NR = Not Rated; D = Dropped

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