

Medicare Advantage

Increasing 2014-2017 Med Adv Enrollment Estimates Across the Managed Care Sector

With 2015 Medicare Advantage (MA) plan bids submitted earlier this month, we review 2014 open enrollment results through the lens of our proprietary county-by-county benefit database and update our Medicare Advantage model for 2014-2017. It has become increasingly clear that seniors find the Medicare Advantage value proposition compelling and thus are willing to accept more benefit disruption than was previously appreciated. The 2014 open enrollment period saw MA penetration rates increase broadly across all levels of value-add, including 100+ bps increases at the lowest levels (<\$20 benefits PMPM). This was very much a positive surprise vs. our previously conservative estimates and is crucial to our increasingly constructive outlook for MA membership growth over the next several years. Post our deep-dive on 2014 enrollment results, we take up our 2015-2017 enrollment growth #s to 7.2%/8.1%/7.9% from 4.0%/7.1%/7.1% respectively, now reflecting an updated view of lower senior sensitivity to downward changes in Medicare Advantage benefit levels. In addition, we now reflect a modest level of share shift based on plan-specific Star ratings, with HUM expected to again take share in 2015 from UNH/WLP. Overall this analysis provides increased confidence in our positive MA thesis, and we increase EPS estimates by 3%/7%/1% for 2014-2016 for HUM to \$7.80/\$9.12/\$10.43 respectively, as 2014 moves in-line with consensus and 2015-2016 moves ahead of consensus by 3-5%. We reiterate our Overweight rating and \$150 price target on HUM.

- **We are hosting a conference call today at 11a ET** to discuss our analysis. Dial in is 1-800-857-2942 (US), 1-517-623-4820 (outside US), Passcode: HEALTHCARE. To view our detailed analysis, see accompanying slides: [link](#).
- **Increasing our industry Med Adv enrollment estimates.** We are increasing our 2015 industry enrollment growth est by 350 bps to 7.2% and our 2016/2017 estimates by ~100 bps each to 8.1% and 7.9%, respectively, reflecting greater-than-anticipated senior interest in products with more moderate benefit levels. Our analysis indicates that geographies with average plan benefits less than \$20, or 2% better than traditional Medicare, still saw penetration increase of 100+ bps during 2014 OEP, with moderately higher-than-anticipated increases in penetration across all benefit levels. In addition, we updated our estimates for MA rates going forward (-320 bps for the industry in 2015, followed by flat to slightly down in 2015-16).

Managed Care / Health Care Services

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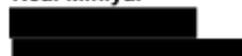


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J.P. Morgan Securities LLC

Equity Ratings and Price Targets

Company	Ticker	Mkt Cap (\$ mn)	Price (\$)	Rating		Price Target	
				Cur	Prev	Cur	Prev
Aetna	AET US	29,408.05	80.57	OW	n/c	82.00	81.00
Cigna	CI US	24,702.03	90.00	OW	n/c	95.00	n/c
Health Net	HNT US	3,240.12	40.04	N	n/c	40.00	n/c
Humana	HUM US	19,256.62	122.93	OW	n/c	150.00	n/c
UnitedHealth	UNH US	77,857.32	78.17	OW	n/c	90.00	n/c
WellPoint	WLP US	31,033.16	106.06	N	n/c	114.00	n/c

Source: Company data, Bloomberg, Morgan estimates. n/c = no change. All prices as of 17 Jun 14.

See page 16 for analyst certification and important disclosures.

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- **We expect market share to shift modestly again in 2015, benefitting HUM.** While UNH and WLP saw slight Star improvement for 2015, both are still disadvantaged here vs. peers (UNH 3.5 & WLP 3.3 vs. for-profit peers in 3.8-4.0 range), adding to competitive pressure when the bonus demo ends next year. Suboptimal Star ratings will likely drive a combination of above-average benefits reductions, physician network culling and plan exits (as well as potentially forcing UNH to add premiums to some zero-premium products). As a result, we conservatively estimate enrollment growth for 2015 to be flat for both UNH and WLP, with market share losses offsetting underlying market growth. Dissecting our county-by-county benefit database, we find that in 90% of those counties where UNH and WLP would see steepest cuts in 2015, HUM offers a competing product within the county. As a result, we are increasing our 2015 HUM MA enrollment growth forecast to 10% from 4% previously, assuming HUM can pick up 25% of UNH's and WLP's assumed market share losses.
- **Raising HUM 2015 EPS by 7% with de minimis updates to rest of coverage universe.** We are raising our HUM 2015/216 EPS estimates by 7%/1% for 2015/2016 respectively, reflecting our increased market model projections coupled with updates to our MA margin progression based on mgmt's latest commentary. With de minimis changes to the rest of our coverage universe and our UNH MA update already incorporated into published #s (updated in our May 2014 note, [2014 Medicare Advantage Review and Thoughts on the Road Ahead](#)), our MCO PTs are largely left intact.
- **We reiterate our long-term thesis on MA and reiterate our \$150 HUM PT.** Following our analysis, we reiterate our long-term constructive thesis on MA and our Overweight rating / \$150 PT on HUM, increasing 2015 estimates by 7%, owing to our higher estimates for MA enrollment growth (both higher est industry growth plus market share gains) and earnings. We continue to see a path to \$10+ of EPS by 2016 for Humana with another \$1+ of potential upside from additional capital deployment and PBM outsourcing optionality.
- **Our analysis is driven by proprietary actuarial database** that translates publicly posted benefit information into the estimated "value-add" of each MA plan vs. traditional fee-for-service – a key driver of enrollment. Combining this with county/plan specific CMS enrollment data allows us to estimate current and future rebates down to the county/plan/member level and roll up to membership-weighted averages for each company and the industry. This data fills a key gap for investors in understanding how the MA program can absorb the next few years of reimbursement cuts toward FFS parity without threatening long-term viability. Since our initial report in May 2013, we have released over 15 reports surrounding our MA value-add work.

Aetna

Overweight

Company Data	
Price (\$)	80.57
Date Of Price	17 Jun 14
52-week Range (\$)	81.25-60.32
Market Cap (\$ mn)	29,408.05
Fiscal Year End	Dec
Shares O/S (mn)	365
Price Target (\$)	82.00
Price Target End Date	31-Dec-14

Aetna Inc (AET;AET US)

FYE Dec	2011A	2012A	2013A	2014E	2015E (Prev)	2015E (Curr)
EPS Reported (\$)						
Q1 (Mar)	1.48	1.41	1.56	1.98A	-	-
Q2 (Jun)	1.39	1.38	1.62	1.64	-	-
Q3 (Sep)	1.46	1.61	1.61	1.62	-	-
Q4 (Dec)	1.03	1.00	1.45	1.26	-	-
FY	5.36	5.39	6.24	6.50	6.77	6.80
Bloomberg EPS FY (\$)	5.16	5.13	5.88	6.54	-	7.21

Source: Company data, Bloomberg, Morgan estimates.

Investment Thesis, Valuation and Risks

Aetna (Overweight; Price Target: \$82.00)

Investment Thesis

Our Overweight rating on AET reflects below-average reform exposure and most importantly an increasing recognition of the company's ACO positioning. We see the Coventry acquisition as providing increased visibility on earnings for 2014/2015, with likely upside to synergies and the accretion estimates going into reform implementation uncertainty.

Valuation

We have an Overweight rating on Aetna. Our year-end 2014 price target of \$82 is based on a P/E of 12x our 2015 cash EPS estimate, below the peer group average and slightly above its current relative valuation.

Risks to Rating and Price Target

Risks to our rating and price target for Aetna include the potential for medical cost trends to accelerate faster than expected, potential for commercial membership pressure to persist, and changes to the commercial pricing landscape and Medicare / Medicaid reimbursement. With an estimated third of earnings coming from the large group commercially insured segment, should larger full-risk employers choose to exit the health benefits market and instead offer employees a stipend to buy coverage in exchanges (a risk we see as fairly low), we believe Aetna would likely be the most negatively impacted plan in our coverage universe.

Aetna: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	47,195	56,841	61,842	67,587	Operating revenue	13,966A	14,249	14,278	14,349
SG&A	(8,373)	(10,363)	(11,413)	(12,372)	SG&A	(2,490)A	(2,547)	(2,582)	(2,745)
Operating income	3,729	4,302	4,479	4,761	Operating income	1,322A	1,089	1,046	846
Net interest (income) / expense	(313)	(296)	(309)	(329)	Net interest (income) / expense	(86)A	(86)	(62)	(62)
Other income / (expense)	(215)	(155)	(145)	(140)	Other income / (expense)	(40)A	(38)	(38)	(38)
Pretax income	3,202	3,851	4,026	4,292	Pretax income	1,196A	964	946	745
Income taxes	(1,102)	(1,658)	(1,784)	(1,850)	Income taxes	(510)A	(411)	(405)	(332)
Net income - GAAP	2,241	2,344	2,386	2,582	Net income - GAAP	722A	591	579	451
Diluted shares outstanding	359	360	351	342	Diluted shares outstanding	365A	360	358	357
EPS	6.24	6.50	6.80	7.56	EPS	1.98A	1.64	1.62	1.26
EPS - Recurring	6.24	6.50	6.80	7.56	EPS - Recurring	1.98A	1.64	1.62	1.26
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	1,412	2,127	1,974	1,919	Revenue growth	32.6%	20.4%	8.8%	9.3%
Investments	21,115	21,537	21,968	22,407	EBIT growth	20.1%	15.4%	4.1%	6.3%
Accounts receivable	1,522	1,552	1,583	1,615	EPS growth	15.7%	4.2%	4.6%	11.1%
Current assets	30,654	34,695	37,408	40,644					
PP&E	722	704	718	742	SG&A ratio	17.7%	18.2%	18.5%	18.3%
Goodwill	9,248	9,118	9,197	9,286	Operating margin	7.9%	7.6%	7.2%	7.0%
Total assets	49,872	53,634	56,520	59,958	Tax rate	34.4%	43.1%	44.3%	43.1%
					Net margin	4.7%	4.1%	3.9%	3.8%
Total debt	8,253	8,114	8,451	8,998					
Total liabilities	35,846	38,573	40,217	42,264	Debt / Capital (book)	37.0%	35.0%	34.1%	33.7%
Shareholders' equity	14,026	15,061	16,303	17,695					
					Return on assets (ROA)	4.9%	4.5%	4.3%	4.4%
					Return on equity (ROE)	18.3%	16.1%	15.2%	15.2%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

Cigna

Overweight

Company Data	
Price (\$)	90.00
Date Of Price	17 Jun 14
52-week Range (\$)	91.63-67.87
Market Cap (\$ mn)	24,702.03
Fiscal Year End	Dec
Shares O/S (mn)	274
Price Target (\$)	95.00
Price Target End Date	31-Dec-14

Cigna Corporation (CI;CI US)

FYE Dec	2012A	2013A	2014E	2015E
EPS Reported (\$)				
Q1 (Mar)	1.24	1.72	1.83A	-
Q2 (Jun)	1.49	1.78	1.79	-
Q3 (Sep)	1.69	1.89	1.91	-
Q4 (Dec)	1.60	1.39	1.73	-
FY	6.02	6.79	7.26	7.91
Bloomberg EPS FY (\$)	5.91	6.87	7.31	8.04

Source: Company data, Bloomberg, [REDACTED]. Morgan estimates.

Investment Thesis, Valuation and Risks

Cigna (*Overweight; Price Target: \$95.00*)**Investment Thesis**

We believe Cigna's solid business momentum and strong Medicare Advantage and International segment positioning continue to leave a positive risk/reward with the stock trading at ~12x our 2014 EPS estimate, particularly given Cigna's below-average exposure to the 2014 healthcare reform uncertainty.

Valuation

We rate Cigna Overweight. Our YE 2014 price target of \$95 is based on a target P/E of 12x our 2015 EPS estimate. Cigna has historically traded at a discount to the group, but now that it has successfully executed on its PBM option, exited the VADBe reinsurance business, and carries less exposure to reform risk in the initial years, we think a narrow gap is warranted.

Risks to Rating and Price Target

As with Cigna's peers, medical cost trends could accelerate faster than expected and also, the pricing environment could get more competitive, although Cigna does have below-average exposure to the commercial risk segment. Enrollment growth in the Medicare Advantage segment may be more modest than expected with the potential for rate pressure and 2014 minimum MLR floors to compress margins. Cigna has above-average balance sheet exposure relative to its peers, and run-off books may require future capital infusions should future reserve studies show a need for more capital.

Cigna: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	32,380	33,766	36,345	38,563	Operating revenue	8,496A	8,307	8,411	8,553
SG&A	(7,725)	(8,140)	(8,844)	(9,369)	SG&A	(1,973)A	(1,981)	(2,053)	(2,133)
Operating income	3,083	3,150	3,304	3,584	Operating income	852A	765	807	726
Net interest (income) / expense	1,164	1,202	1,281	1,323	Net interest (income) / expense	277A	306	310	308
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	3,083	3,150	3,304	3,584	Pretax income	852A	765	807	726
Income taxes	(1,010)	(1,173)	(1,230)	(1,319)	Income taxes	(324)A	(282)	(297)	(270)
Net income - GAAP	1,932	1,951	2,074	2,266	Net income - GAAP	501A	483	510	456
Diluted shares outstanding	285	269	262	256	Diluted shares outstanding	274A	271	267	263
EPS	6.79	7.26	7.91	8.86	EPS	1.83A	1.79	1.91	1.73
EPS - Recurring	6.79	7.26	7.91	8.86	EPS - Recurring	1.83A	1.79	1.91	1.73
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	2,795	2,559	3,628	4,746	Revenue growth	10.8%	4.3%	7.6%	6.1%
Investments	-	-	-	-	EBIT growth	14.1%	2.2%	4.9%	8.5%
Accounts receivable	-	-	-	-	EPS growth	12.7%	6.9%	9.0%	12.1%
Current assets	24,478	25,591	27,966	30,569	SG&A ratio	23.9%	24.1%	24.3%	24.3%
PP&E	1,464	1,463	1,471	1,474	Operating margin	9.5%	9.3%	9.1%	9.3%
Goodwill	-	-	-	-	Tax rate	32.8%	37.2%	37.2%	36.8%
Total assets	54,336	56,339	58,922	61,729	Net margin	6.0%	5.8%	5.7%	5.9%
Total debt	5,247	5,232	5,232	5,232	Debt / Capital (book)	33.0%	32.4%	30.1%	28.0%
Total liabilities	43,659	45,424	46,776	48,254	Return on assets (ROA)	3.6%	3.5%	3.6%	3.8%
Shareholders' equity	10,677	10,915	12,145	13,475	Return on equity (ROE)	18.8%	18.1%	18.0%	17.7%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

Health Net

Neutral

Company Data	
Price (\$)	40.04
Date Of Price	17 Jun 14
52-week Range (\$)	40.58-25.40
Market Cap (\$ mn)	3,240.12
Fiscal Year End	Dec
Shares O/S (mn)	81
Price Target (\$)	40.00
Price Target End Date	31-Dec-14

Health Net Inc (HNT;HNT US)

FYE Dec	2011A	2012A	2013A	2014E	2015E
EPS Reported (\$)					
Q1 (Mar)	0.61	0.10	0.62	0.39A	-
Q2 (Jun)	0.76	0.19	0.52	0.53	-
Q3 (Sep)	0.85	0.38	0.83	0.69	-
Q4 (Dec)	0.90	0.36	0.24	0.68	-
FY	3.09	1.03	2.21	2.27	3.05

Source: Company data, Bloomberg, [REDACTED]. Morgan estimates.

Investment Thesis, Valuation and Risks

Health Net (Neutral; Price Target: \$40.00)

Investment Thesis

Health Net is the last essentially single state based publicly traded health plan, with nearly 90% of the company's current membership located in California. Although the state is a mixed bag (onerous regulatory environment represents a negative, while positives include substantial population including dual eligibles opportunity), in our view, Health Net remains an interesting asset of potential strategic interest. To the downside, the 1H'12 earnings shortfall on a variety of medical cost / execution issues highlights the heightened underwriting and earnings volatility that accompanies single-state focused health insurers.

Valuation

We have a Neutral rating on Health Net. Our YE 2014 price target of \$40 is based on a P/E of 13x our 2015 EPS estimate, in line with the peer group.

Risks to Rating and Price Target

With Health Net one of the most-levered plans to the Dual Eligible opportunity, there could be downside risk should the demonstration programs be delayed or should results be pressured; there is also risk to the upside should Dual Eligible margins prove to be better than expected. Medical cost trends could accelerate or decelerate faster than expected, leaving downside / upside to our estimates.

Health Net: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	10,984	14,047	18,091	19,062	Operating revenue	3,028A	3,516	3,670	3,834
SG&A	(1,317)	(1,560)	(1,857)	(1,967)	SG&A	(386)A	(379)	(390)	(406)
Operating income	245	352	497	522	Operating income	63A	87	103	99
Net interest (income) / expense	37	11	12	14	Net interest (income) / expense	3A	2	3	3
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	282	362	509	535	Pretax income	66A	89	106	102
Income taxes	(104)	(187)	(280)	(298)	Income taxes	(35)A	(47)	(53)	(52)
Net income - GAAP	177	176	230	238	Net income - GAAP	31A	42	53	50
Diluted shares outstanding	80	77	75	73	Diluted shares outstanding	81A	79	76	73
EPS	2.21	2.27	3.05	3.28	EPS	0.39A	0.53	0.69	0.68
EPS - Recurring	2.21	2.27	3.05	3.28	EPS - Recurring	0.39A	0.53	0.69	0.68
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	433	271	147	166	Revenue growth	(1.5%)	27.9%	28.6%	5.4%
Investments	-	-	-	-	EBIT growth	243.6%	43.7%	41.3%	5.0%
Accounts receivable	-	-	-	-	EPS growth	114.2%	3.1%	34.4%	7.2%
Current assets	2,920	3,751	4,627	4,886	SG&A ratio	12.0%	11.1%	10.3%	10.3%
PP&E	201	231	264	300	Operating margin	2.2%	2.5%	2.7%	2.7%
Goodwill	-	-	-	-	Tax rate	37.1%	51.5%	54.9%	55.6%
Total assets	3,929	4,765	5,679	5,980	Net margin	1.6%	1.3%	1.3%	1.2%
Total debt	499	499	499	499	Debt / Capital (book)	23.5%	26.0%	24.5%	23.7%
Total liabilities	2,300	3,342	4,139	4,371	Return on assets (ROA)	4.5%	4.0%	4.4%	4.1%
Shareholders' equity	1,629	1,423	1,541	1,609	Return on equity (ROE)	11.1%	11.5%	15.5%	15.1%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

Humana

Overweight

Company Data	
Price (\$)	122.93
Date Of Price	17 Jun 14
52-week Range (\$)	127.17-81.15
Market Cap (\$ mn)	19,256.62
Fiscal Year End	Dec
Shares O/S (mn)	157
Price Target (\$)	150.00
Price Target End Date	31-Dec-14

Humana Inc (HUM;HUM US)

FYE Dec	2012A	2013A	2014E	2014E	2015E	2015E	2016E	2016E
			(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)
EPS Reported (\$)								
Q1 (Mar)	1.49	2.95	2.35A	2.35A	-	-	-	-
Q2 (Jun)	2.16	2.63	2.13	2.18	-	-	-	-
Q3 (Sep)	2.62	2.32	1.96	2.03	-	-	-	-
Q4 (Dec)	1.19	0.80	1.15	1.23	-	-	-	-
FY	7.48	8.73	7.58	7.80	8.53	9.12	10.36	10.43
Bloomberg EPS FY (\$)	7.51	8.72	-	7.81	-	8.78	-	9.89

Source: Company data, Bloomberg, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Humana (Overweight; Price Target: \$150.00)

Investment Thesis

Humana's unique earnings profile is the closest thing in the space to a Medicare Advantage pure play with ~60% of operating earnings levered to this segment and a strong market position. Future growth should come from a combination of baby boomer age-ins (turning 65 at the rate of 8,000 per day for the next 18 years), continued market share gains and potential shifts from employers to Medicare Advantage from self-funded employer retiree plans. Based on our proprietary county-level projections of Medicare Advantage plan benefits, we have increased confidence the industry in general and also HUM in particular will be able to continue to profitably grow Medicare Advantage business despite several more years of reimbursement cuts related to the Affordable Care Act. Finally, the capital deployment opportunity continues to be one of the more interesting areas of optionality for Humana, in our view.

Valuation

Our 2014 year-end price target of \$150 is based on a P/E multiple of ~14.5x our 2016 earnings estimate, a premium to where the broader MCO group is trading. We see potential for the stock's P/E multiple to migrate toward a higher premium as focus shifts from execution to above average secular top-line growth rates in the high single digits with margin improvement potential from scale advantages post 2015 cuts.

Risks to Rating and Price Target

For Medicare, meaningful risks are associated with health reform regulations coming in more severe than anticipated, including Medicare Advantage cuts, MLR floor implementation and the ability for plans to price through the industry fee. Finally, Medical cost trend could accelerate/decelerate faster than expected. Much of the past few years has been characterized by low medical utilization across the sector, which has driven sizable earnings upside for the Managed Care group. Humana has benefited from a declining trend environment in all of its segments and there could be downside risk should the trend reverse.

Humana: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	41,313	47,456	55,230	59,825	Operating revenue	11,712A	11,691	11,910	12,142
SG&A	(6,355)	(7,201)	(7,968)	(8,495)	SG&A	(1,666)A	(1,697)	(1,782)	(2,056)
Operating income	2,304	2,367	2,775	3,039	Operating income	721A	640	602	404
Net interest (income) / expense	(140)	(140)	(140)	(140)	Net interest (income) / expense	(35)A	(35)	(35)	(35)
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	2,164	2,227	2,635	2,899	Pretax income	686A	605	567	369
Income taxes	(779)	(1,011)	(1,235)	(1,322)	Income taxes	(318)A	(264)	(250)	(178)
Net income - GAAP	1,385	1,216	1,399	1,576	Net income - GAAP	368A	340	316	191
Diluted shares outstanding	159	156	153	151	Diluted shares outstanding	157A	156	156	155
EPS	8.73	7.80	9.12	10.43	EPS	2.35A	2.18	2.03	1.23
EPS - Recurring	8.73	7.80	9.12	10.43	EPS - Recurring	2.35A	2.18	2.03	1.23
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	1,138	1,421	1,505	2,097	Revenue growth	5.6%	14.9%	16.4%	8.3%
Investments	7,889	9,477	11,103	12,059	EBIT growth	14.3%	2.7%	17.2%	9.5%
Accounts receivable	1,280	1,538	1,802	1,957	EPS growth	16.8%	(10.6%)	16.9%	14.4%
Current assets	12,300	14,242	16,427	18,261	SG&A ratio	15.4%	15.2%	14.4%	14.2%
PP&E	1,218	1,446	1,652	1,854	Operating margin	5.6%	5.0%	5.0%	5.1%
Goodwill	3,641	3,641	3,641	3,641	Tax rate	36.0%	45.4%	46.9%	45.6%
Total assets	20,735	23,594	25,798	27,643	Net margin	3.4%	2.6%	2.5%	2.6%
Total debt	2,600	2,598	2,598	2,598	Debt / Capital (book)	21.8%	20.3%	19.1%	17.8%
Total liabilities	11,419	13,384	14,763	15,657	Return on assets (ROA)	6.8%	5.5%	5.7%	5.9%
Shareholders' equity	9,316	10,209	11,035	11,987	Return on equity (ROE)	15.3%	12.5%	13.2%	13.7%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

UnitedHealth

Overweight

Company Data	
Price (\$)	78.17
Date Of Price	17 Jun 14
52-week Range (\$)	83.32-63.43
Market Cap (\$ bn)	77.86
Fiscal Year End	Dec
Shares O/S (mn)	996
Price Target (\$)	90.00
Price Target End Date	31-Dec-14

UnitedHealth Group Inc (UNH; UNH US)

FYE Dec	2011A	2012A	2013A	2014E	2015E
EPS - Recurring (\$)					
Q1 (Mar)	1.22	1.31	1.16	1.10A	-
Q2 (Jun)	1.16	1.27	1.40	1.23	-
Q3 (Sep)	1.17	1.50	1.53	1.61	-
Q4 (Dec)	1.17	1.20	1.41	1.51	-
FY	4.73	5.28	5.50	5.45	5.82

Source: Company data, Bloomberg, [redacted]. Morgan estimates.

Investment Thesis, Valuation and Risks

UnitedHealth (Overweight; Price Target: \$90.00)

Investment Thesis

While retrenching of Med Adv margins has slowed overall earnings momentum in 2014/2015, we estimate that by 2015 more than two-thirds of earnings will be in higher growth businesses of Optum, Medicaid, and Med Adv. When coupled with best-in-class business momentum, diversification, and assets, we expect the stock to migrate toward an S&P multiple in the ~15x range.

Valuation

Our Dec 2014 price target of \$90 is based on a multiple of ~15x our 2015E EPS, in line with the premium valuation vs. its peers it has historically maintained and reflecting its relatively high exposure to Medicare Advantage, which we think will benefit from long-term secular growth.

Risks to Rating and Price Target

Healthcare reform represents a pivot point for Managed Care. Considerable uncertainty remains around the 2014 healthcare reform implementation given the multiple moving parts such as exchanges, guaranteed issue, employer dumping, etc. Additionally, the potential for Optum earnings ramp may be slower than expected. Were the earnings ramp here to be more modest than expected (or extend beyond the 2015 target), then that would represent potential downside risk to our numbers and investor sentiment. Finally, UNH faces pressures around medical cost trend acceleration, the potential for increased commercial pricing aggression, and multiple uncertainties in the Medicare Advantage market.

UnitedHealth: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	122,489	127,088	130,732	138,219	Operating revenue	31,708A	31,565	31,740	32,075
SG&A	(19,362)	(21,099)	(22,254)	(23,271)	SG&A	(5,194)A	(5,322)	(5,115)	(5,468)
Operating income	9,623	9,896	10,216	11,080	Operating income	2,054A	2,290	2,862	2,691
Net interest (income) / expense	37	(27)	(12)	8	Net interest (income) / expense	31A	(18)	(20)	(20)
Other income / (expense)	(708)	(649)	(649)	(651)	Other income / (expense)	(160)A	(162)	(164)	(164)
Pretax income	8,915	9,248	9,567	10,429	Pretax income	1,894A	2,128	2,699	2,527
Income taxes	(3,242)	(3,893)	(4,055)	(4,304)	Income taxes	(795)A	(910)	(1,126)	(1,061)
Net income - GAAP	5,673	5,355	5,513	6,125	Net income - GAAP	1,099A	1,217	1,573	1,466
Diluted shares outstanding	1,023	983	947	912	Diluted shares outstanding	996A	987	978	970
EPS	5.54	5.45	5.82	6.72	EPS	1.10A	1.23	1.61	1.51
EPS - Recurring	5.50	5.45	5.82	6.72	EPS - Recurring	1.10A	1.23	1.61	1.51
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	7,276	9,513	10,070	10,666	Revenue growth	10.7%	3.8%	2.9%	5.7%
Investments	2,681	2,735	2,789	2,845	EBIT growth	4.0%	2.8%	3.2%	8.4%
Accounts receivable	2,387	2,434	2,483	2,533	EPS growth	5.0%	(1.7%)	6.8%	15.4%
Current assets	20,380	24,706	25,699	27,190	SG&A ratio	15.8%	16.6%	17.0%	16.8%
PP&E	3,945	4,236	4,639	5,073	Operating margin	7.9%	7.8%	7.8%	8.0%
Goodwill	28,779	28,739	29,348	30,126	Tax rate	36.4%	42.1%	42.4%	41.3%
Total assets	81,882	86,419	89,034	92,516	Net margin	4.6%	4.2%	4.2%	4.4%
Total debt	16,860	16,765	16,765	16,765	Debt / Capital (book)	34.4%	32.9%	31.9%	31.0%
Total liabilities	49,733	52,165	53,267	55,123	Return on assets (ROA)	6.9%	6.4%	6.3%	6.7%
Shareholders' equity	32,149	34,255	35,768	37,393	Return on equity (ROE)	17.8%	16.1%	15.7%	16.7%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

WellPoint

Neutral

Company Data	
Price (\$)	106.06
Date Of Price	17 Jun 14
52-week Range (\$)	110.03-77.40
Market Cap (\$ bn)	31.03
Fiscal Year End	Dec
Shares O/S (mn)	293
Price Target (\$)	114.00
Price Target End Date	31-Dec-14

WellPoint Inc (WLP;WLP US)

FYE Dec	2011A	2012A	2013A	2014E	2015E (Prev)	2015E (Curr)
EPS Reported (\$)						
Q1 (Mar)	2.35	2.34	2.94	2.30A	-	-
Q2 (Jun)	1.83	2.04	2.60	2.25	-	-
Q3 (Sep)	1.77	2.09	2.10	2.09	-	-
Q4 (Dec)	0.99	1.03	0.87	1.84	-	-
FY	7.00	7.56	8.52	8.51	9.54	9.53

Source: Company data, Bloomberg, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

WellPoint (Neutral; Price Target: \$114.00)

Investment Thesis

WellPoint's strong brand and significant size provide meaningful competitive advantages. At over 33 million medical members nationwide, WellPoint is the largest health insurer from an enrollment perspective with its significant scale and broad reach providing the company with unique competitive advantages with regard to provider network discounts and breadth, SG&A leverage, and investment spend capacity. Furthermore, WellPoint holds a Blue Cross and/or Blue Shield license in 14 states, providing the company with the strength of the Blues brand name as well as decreased competition from Not-for-Profit Blues, which are typically the most difficult competitor in any state. While execution in the Consumer business has been an issue, margins lag peers, leaving potential for improvement moving forward. The acquisition of Amerigroup adds not only significant growth potential in the Medicaid Managed Care and Dual Eligibles space but also a strong management team with a history of solid execution, in our view.

Valuation

Our Dec 2014 price target of \$114 is based on a multiple of ~12x our 2015 earnings estimate, in line with the stock's historical average discount vs. the group.

Risks to Rating and Price Target

Individual and Small Group exposure leaves uncertainty around exchanges. We estimate that WellPoint derives nearly 30% of its 2012 earnings from the Individual and Small Group markets, which are the most likely to see meaningful disruption with the advent of exchanges in 2014. Improved execution presents upside risk after years of significant missteps with WellPoint's performance in recent years headlined by various self-inflicted missteps, most recently by its challenges in the California Medicare Advantage market. Integration and execution risk also may be heightened following the acquisition of Amerigroup, which should be accretive in its first year (2013). The potential for increased Commercial pricing aggression persists as pricing yields have outpaced commercial cost trends in recent years with publicly traded plan commentary and J.P. Morgan channel checks indicating that the pricing environment

remains largely rational outside of pockets of increased pricing aggression related to minimum medical loss ratio floors. Finally, medical cost trends could accelerate or decelerate faster than expected leaving downside/upside to our estimates.

WellPoint: Summary of Financials

Income Statement - Annual	FY13A	FY14E	FY15E	FY16E	Income Statement - Quarterly	1Q14A	2Q14E	3Q14E	4Q14E
Operating revenue	70,522	73,220	79,005	-	Operating revenue	17,645A	18,233	18,569	18,773
SG&A	(10,061)	(10,554)	(10,963)	-	SG&A	(2,632)A	(2,631)	(2,644)	(2,648)
Operating income	4,860	5,041	5,421	0	Operating income	1,333A	1,329	1,249	1,129
Net interest (income) / expense	56	86	64	-	Net interest (income) / expense	38A	16	16	16
Other income / (expense)	-	-	-	-	Other income / (expense)	-	-	-	-
Pretax income	3,850	4,229	4,617	-	Pretax income	1,130A	1,127	1,046	926
Income taxes	(1,200)	(1,765)	(2,014)	-	Income taxes	(439)A	(475)	(447)	(405)
Net income - GAAP	2,650	2,464	2,603	-	Net income - GAAP	691A	652	600	521
Diluted shares outstanding	304	287	273	265	Diluted shares outstanding	293A	290	287	284
EPS	8.72	8.57	9.53	-	EPS	2.36A	2.25	2.09	1.84
EPS - Recurring	8.52	8.51	9.53	10.62	EPS - Recurring	2.30A	2.25	2.09	1.84
Balance Sheet and Cash Flow Data	FY13A	FY14E	FY15E	FY16E	Ratio Analysis	FY13A	FY14E	FY15E	FY16E
Cash and cash equivalents	1,582	1,105	232	-	Revenue growth	16.1%	3.8%	7.9%	-
Investments	19,543	21,942	27,034	-	EBIT growth	5.1%	3.7%	7.6%	-
Accounts receivable	5,465	5,675	6,123	-	EPS growth	6.7%	(1.7%)	11.1%	-
Current assets	29,746	31,876	33,388	-	SG&A ratio	14.3%	14.4%	13.9%	-
PP&E	1,802	1,747	1,675	-	Operating margin	6.9%	6.9%	6.9%	-
Goodwill	21,632	21,632	29,307	-	Tax rate	31.2%	41.7%	43.6%	-
Total assets	59,575	62,552	64,371	-	Net margin	3.7%	3.3%	3.3%	-
Total debt	14,492	15,041	15,041	-	Debt / Capital (book)	36.9%	37.6%	37.3%	-
Total liabilities	34,809	37,634	39,099	-	Return on assets (ROA)	4.4%	4.0%	4.1%	8.7%
Shareholders' equity	24,765	24,918	25,271	-	Return on equity (ROE)	10.7%	9.8%	10.4%	22.3%

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec

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