Equity Research
7 September 2016

U.S. Health Care-Managed Care

2Q16 Review: A Deep Dive on Exchanges

INDUSTRY UPDATE

U.S. Health Care-Managed Care
POSITIVE
Unchanged

U.S. Health Care-Managed Care
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As is well known at this time exchanges continue to pressure earnings across the managed care industry. Medical costs trends began deteriorating in the second half of 2015 and have continued to worsen since. Exchanges are clearly a drag on earnings and remain a source of uncertainty for plans participating on the market in 2017. One of the key investor concerns is the implications of broad-based exchange plan exits (primarily by AET, UNH and HUM) on the remaining plans. Within our coverage universe while ANTM and CNC will have the most exposure to counties with just one plan. However, actual impact to earnings will vary by each company's exchange strategies / products. Overall we believe Centene products and network solutions remain differentiated, making them more attractive to younger and healthier individuals and this advantage should be largely sustainable in 2017.

1) There is significant investor focus on medical cost trends and commentary from the companies suggests that core trends remain moderate. **2)** Exchange losses accelerated across the board, driven by higher utilization. **3)** On average companies are guiding for an increase in cost trends for 2016. **4)** On average MLRs was roughly flat in the second quarter y/y. **5)** Commercial MLR's increased 186bps Y/Y in 2Q16 to 82.1%. **6** In the most recent quarter, EBIT margins decreased 15bps from the prior year to 5.92%. **7)** We expect net investment income to continue to represent a historically low portion of aggregate net income in 2016. **8)** In 2Q16, after the impact of enrollment from exchanges for the 2016 plan year, there was a 0.2% sequential increase in membership. **9)** Overall organic commercial membership trends were negative in the quarter. **10)** The headline unemployment rate has fallen meaningfully from prior highs reached in October 2009 to 4.9% in July. **11)** Relative to First Call consensus EPS estimates, second quarter results were better than expected. **12)** Overall trends across a broader set of metrics in 2Q16 were mixed for the managed care group. **13)** In the second quarter, eight of ten companies beat our EPS estimates by an average of 10.7%. **14a)** Reserve quality in days-in-claims payable increased slightly in the quarter on a sequential basis and on a year over year basis. **14b)** We stress the importance of cash flow trends because it is impossible to manipulate the reserve balances without seeing deteriorating cash flow. **15)** In 2Q16, companies spent roughly $482 million for share repurchases (down from $618 million in 1Q16) and another $861 million on dividends to shareholders. **16)** The average Medicare MLR was 83.2%, down 169bps year over year. **17)** Medicaid managed care medical loss ratios were down 136bps annually to 87.5%. **Please join us for a conference call today summarizing our thoughts on 2Q16 earnings season for Healthcare Services**:

Date and Time: Wednesday, September 7, 2016, 10:00am ET

Dial-in: 1-800-706-8249 **Passcode**: 76875504

Completed: 07-Sep-16, 01:13 GMT Released: 07-Sep-16, 04:10 GMT

CONTENTS

2Q16 REVIEW: INTRODUCTION

A Deep Dive into Exchanges

Summary Take-aways

- As is well known at this point, **exchanges are clearly a drag on earnings. With margins deteriorating by 594bps on average in the second quarter**.
- With broad based plan exits, **the risk of being the only plan offered in a specific county in 2017 (and more so in 2018) has increased**. Across our coverage universe **Anthem has the most exposure** (with 135K lives). There is a relatively large drop off the next plans with Centene (with 32K lives) and Humana (with 15K lives).
- On **average rates are expected to increase by 24% in 2017**. And with significant rate increases **we expect some membership attrition in 2017** on exchanges.
- Exchange **Strategies / Products clearly vary by company**. We believe **Centene's products / network solutions are differentiated**, making them more attractive to younger and healthier individuals and this advantage should be largely sustainable in 2017.
- **Over the longer-term additional government intervention is required to stabilize the market**. We do not believe that public exchanges will survive past 2018 without regulatory changes.

What's happening on-exchanges?

1) As is well known at this time exchanges continue to pressure earnings across the managed care industry. Medical costs trends began deteriorating in the second half of 2015 and have continued to worsen since. As indicated in the chart below, relative to initial 2016 guidance **margins on Individual ACA compliant plans deteriorated by an average of 564bps (694bps excluding Centene) through the second quarter. With the losses in our coverage universe alone now expected to be roughly $2 billion in 2016.** As a reminder we had previously estimated 2015 industry wide losses were approximately $5 billion.

(Please note we are currently Rating Suspended on Molina Healthcare)

FIGURE 1
Individual ACA Compliant Plan Performance: 4Q15 Vs. 2Q16 (in 000s)

	AET	ANTM	CI	CNC	HUM	UNH
Revenues	$4,000,000	$6,500,000	$400,000	$2,000,000	$3,400,000	$4,400,000
EBIT Estimates (As of 4Q15)	$0	$65,000	$4,000	$80,000	($176,000)	($500,000)
% EBIT Margin	*0.0%*	*1.0%*	*1.0%*	*4.0%*	*-5.2%*	*-11.4%*
EBIT Estimates (As of 2Q16)	($350,000)	($325,000)	($20,000)	$100,000	($384,000)	($850,000)
% EBIT Margin	*-8.8%*	*-5.0%*	*-5.0%*	*5.0%*	*-11.3%*	*-19.3%*
Margin Deterioration	(875)bps	(600)bps	(600)bps	100bps	(612)bps	(795)bps

Source: Company Documents and Barclays Research
Note: We are currently restricted on Molina

2) With trends worsening through the second quarter, Aetna, UnitedHealth and Humana announced broad market exits. In particularly, **Aetna** reported exiting 11 of the 15 exchange markets in 2017. The company will remain on the Delaware, Iowa, Nebraska and Virginia exchanges. **Humana** will be exiting the Alabama, Arizona, Colorado and Utah exchanges and reducing its footprint in Florida. **And UnitedHealth** will remain on just three exchanges namely, Nevada, New York and Virginia and exit the remaining 32 exchanges. In addition to the publicly traded companies there are several other private / non-profit plans exiting as well. In Figure 2 below we summarize the exits to the best of our knowledge.

FIGURE 2
2017 Announced Market Exits

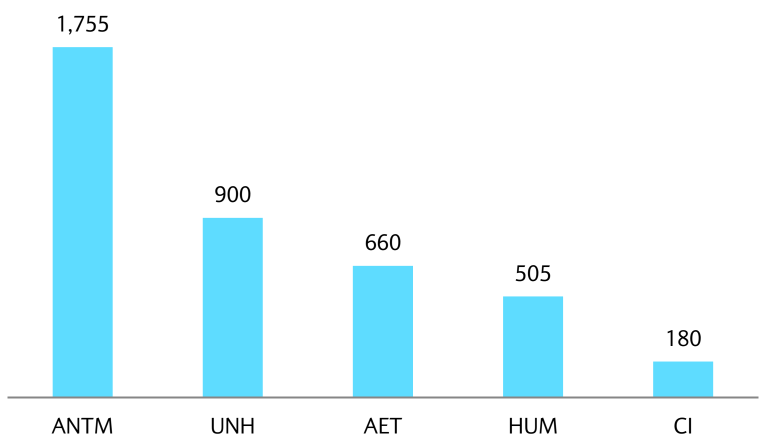
State	2016 # Carriers	Current Enrollment	2017 Announced Market Exits
Alabama	3	195,047	Humana & United
Alaska	2	23,028	Moda Health Plan
Arizona	8	203,064	Aetna, Health Choice, Humana & United
Arkansas	4	73,643	United
California	12	1,572,074	United
Colorado	8	145,930	Humana & United
Connecticut	4	116,019	HealthyCT & United
Delaware	2	28,256	-
District of Columbia	2	17,300	-
Florida	6	1,742,806	Aetna, Humana (scalingback) & United
Georgia	9	587,833	Aetna, Cigna & United
Hawaii	2	14,564	-
Idaho	5	94,000	-
Illinois	9	388,176	Aetna (except CVH), Land of Lincoln & United
Indiana	8	196,241	South Eastern Indiana Health & United
Iowa	4	55,088	United
Kansas	3	101,553	BCBS & United
Kentucky	8	93,687	Aetna, United, Wellcare
Louisiana	4	214,143	United
Maine	4	84,059	Aetna
Maryland*	5	115,000	United
Massachusetts	10	223,778	United
Michigan	13	345,804	United
Mississippi	3	108,668	United
Missouri	5	290,197	United
Montana	3	58,112	-
Nebraska	4	87,824	United
Nevada	3	88,142	-
New Hampshire	4	55,183	-
New Jersey	5	288,571	United & Oscar
New Mexico	4	54,863	Presbyterian
New York	15	271,964	Wellcare
North Carolina	3	613,477	Aetna & United
North Dakota	3	21,604	-
Ohio	15	243,714	InHealth Mutual & United
Oklahoma	2	145,328	United
Oregon	10	147,108	Oregan Co-Op & LifeWise
Pennsylvania	9	439,235	United
Rhode Island	3	34,670	-
South Carolina	3	231,845	Aetna & United
South Dakota	4	25,994	Dakota Care & Wellmark
Tennessee	4	268,860	United
Texas	17	1,306,179	Aetna, Scott & White & United
Utah	4	175,633	Humana
Vermont	2	225,027	-
Virginia	9	421,892	-
Washington	11	200,000	-
West Virginia	2	37,284	-
Wisconsin	15	239,031	United
Wyoming	1	23,770	-
Total / Average	**6**	**12,735,268**	

Source: Healthinsurance.org, state filings, HHS and Barclays Research

3) With no formal updates from Anthem and Centene, we assume they will maintain their current footprint on exchanges in 2017. Not surprisingly exchange exposure remains an overhang for plans that will remain on exchanges. That said it's important to note that thus far in 2016 Anthem and Centene have outperformed peers on exchanges, with Centene actually being profitable overall. Broadly speaking we believe the outperformance is driven by a few factors:

- **As it relates to Anthem** pre-ACA the company operated the largest Individual book of business relative to peers. In 2013 we believe Anthem lead the individual market with roughly 1.8 million individual members, compared to less than 1 million members at UnitedHealth and Aetna. The experience around underwriting the Individual market coupled with better operating leverage, likely provided Anthem some advantage. Additionally, **grandfathering of individual policies (especially in CA) was likely a material positive in 2014 and 2015**.

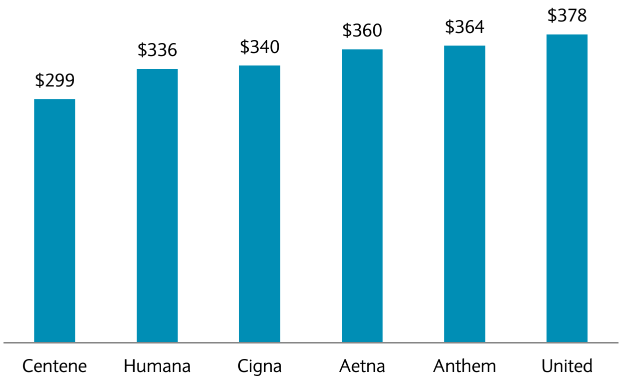
FIGURE 3
2013 Individual Membership by Plan (in 000s)



Source: Company Documents and Barclays Research Estimates

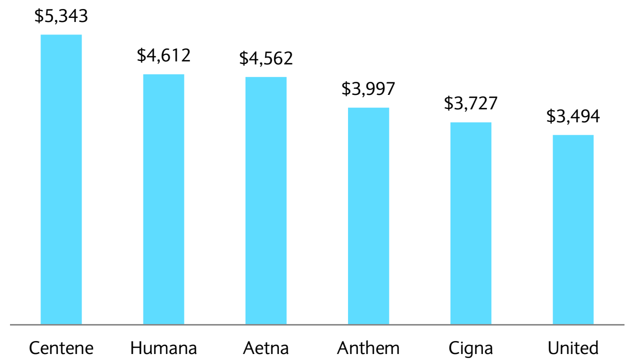
- **And as it relates to Centene** we believe the company's plan design and network breath are differentiated making it more attractive to younger / healthier individuals. For instance, Centene's products are on average low premium, high deductible, higher maximum out-of-pocket expenses (driven by lower metal products). Those with significant healthcare needs tend to shy away from these types of products as they know that they will be using a lot of services. As the chart below illustrates across the 38 federally facilitated exchanges, **Centene's average PMPM** (not weighted by membership) was $299, which was the **lowest across our coverage universe**. On the other hand **Centene's average Maximum out-of-pocket costs** were $5,343, which was **the highest across our coverage universe**. Keep in mind the maximum out-of-pocket expense accounts for deductibles, co-pays, coninsurance and plan actuarial level. And as we look ahead at 2017, we believe the Centene will likely be able to sustain the above mentioned advantage, particularly in counties were market competition will remain relatively strong.

FIGURE 4
Average PMPM



Source: Healthcare.Gov and Barclays Research

FIGURE 5
Avg. Maximum OOP



Source: Healthcare.Gov and Barclays Research

To further illustrate, in Figure 6 on the next page we examined the various plan choices in Broward County, Florida. We chose Broward because the county has roughly 242K exchange members (a very large exchange population). In addition there are seven carriers on the exchange in 2016, including, Aetna, BCBS of FL, Centene, Humana, Molina and UnitedHealth. In simulating the plan choices for members by varying health status, age and subsidy eligibility we found that **Centene often screened as one of the lowest cost options for the younger, healthier subsidy eligible population**. And on **the contrary, Humana** (not surprisingly) often screened as the lowest cost option for older, relatively sicker members.

FIGURE 6

FL Broward County: Plan Comparison

Profile
Age: 30
Gender: Male
Rating Area: Broward, FL
Income: $50K
Subsidy Eligible: No
Medical Utilization: **Low**

Best Option: Aetna (Coventry)

	Aetna	BCBS of FL	Centene	Humana	Molina	United
Estimated Premiums						
Bronze	$2,316	$2,640	$2,640	$2,700	$2,592	$3,072
Silver	$2,820	$2,964	$2,952	$3,192	$3,060	$3,600
Gold	$3,360	$3,720	$3,816	$3,780	$3,600	$3,936
Platinum	-	$5,808	-	$4,512	-	-
Estimated Total OOP Costs						
Bronze	$2,317	$2,639	$2,637	$2,706	$2,588	$3,074
Silver	$2,823	$2,969	$2,953	$3,193	$3,065	$3,603
Gold	$3,356	$3,716	$3,821	$3,783	$3,604	$3,935
Platinum	-	$5,805	-	$4,508	-	-

*As estimated by Healthcare.gov

Profile
Age: 30
Gender: Male
Rating Area: Broward, FL
Income: $20K
Subsidy Eligible: Yes
Medical Utilization: **Low**

Best Option: Aetna (Coventry)

	Aetna	BCBS of FL	Centene	Humana	Molina	United
Estimated Premiums						
Bronze	$372	$684	$684	$756	$636	$996
Silver	$876	$1,020	$1,008	$1,236	$1,116	$1,656
Gold	$1,404	$1,764	$1,872	$1,836	$1,656	$1,980
Platinum	-	$3,852	-	$2,556	-	-
Estimated Total OOP Costs						
Bronze	$368	$689	$687	$756	$638	$997
Silver	$873	$1,019	$1,002	$1,241	$1,115	$1,653
Gold	$1,406	$1,766	$1,871	$1,833	$1,654	$1,985
Platinum	-	$3,855	-	$2,558	-	-

*As estimated by Healthcare.gov

Profile
Age: 50
Gender: Male
Rating Area: Broward, FL
Income: $50K
Subsidy Eligible: No
Medical Utilization: **High**

Best Option: Humana

	Aetna	BCBS of FL	Centene	Humana	Molina	United
Estimated Monthly Premiums						
Bronze	$3,648	$4,152	$4,152	$4,260	$4,068	$4,836
Silver	$4,440	$4,668	$4,644	$5,016	$4,824	$5,712
Gold	$5,280	$5,844	$6,012	$5,952	$5,664	$6,192
Platinum	-	$9,552	-	$7,092	-	-
Estimated Total OOP Costs						
Bronze	$10,122	$11,028	$10,974	$10,733	$10,948	$11,463
Silver	$11,318	$11,547	$11,171	$11,345	$11,698	$9,335
Gold	$10,306	$10,572	$12,387	$9,478	$12,546	$9,716
Platinum	-	$11,572	-	$8,619	-	-

*As estimated by Healthcare.gov

Profile
Age: 50
Gender: Male
Rating Area: Broward, FL
Income: $20K
Subsidy Eligible: Yes
Medical Utilization: **High**

Best Option: Humana

	Aetna	BCBS of FL	Centene	Humana	Molina	United
Estimated Monthly Premiums						
Bronze	$0	$504	$504	$612	$432	$1,200
Silver	$804	$1,236	$1,008	$1,380	$1,176	$2,064
Gold	$1,632	$2,208	$2,364	$2,316	$2,028	$2,544
Platinum	-	$5,904	-	$3,456	-	-
Estimated Total OOP Costs						
Bronze	$6,479	$7,386	$7,332	$7,090	$7,306	$7,802
Silver	$2,925	$3,257	$2,779	$2,903	$3,456	$3,193
Gold	$6,663	$6,930	$8,745	$5,836	$8,904	$6,074
Platinum	-	$7,930	-	$4,977	-	-

*As estimated by Healthcare.gov

Source: Healthcare.Gov, Company Documents and Barclays Research

What happens in 2017?

1) Premium increases will likely cause some membership attrition. On average premium rates on exchanges are expected to increase by 24%. In Figure 7 on the next page we illustrate average rate increases requested by our coverage universe (prior to market exit announcements). The requested increases vary meaningfully by market, for instance in Arizona the range is 6.8% to 123%!

FIGURE 7

2017 Proposed Rate Increases by State and Company

State	Avg. State Increase	Increase Range	AET	CI	CNC	HUM	MOH	UNH	ANTM
Alabama	39.3%	39.3%				EXIT		EXIT	
Alaska	9.8%	9.8%							
Arizona	68.1%	6.8% to 123%	85.8%	19.2%	48.5%	EXIT		EXIT	
Arkansas	14.9%	8.5% to 23.8%			8.5%			EXIT	
California	13.2%				17.0%		4.3%	EXIT	16.2%
Colorado	20.2%	0% to 40.6%		9.5%		5.4%		34.6%	26.8%
Connecticut	17.8%	7.4% to 32.7%						EXIT	26.8%
Delaware	27.1%	23.9% to 32.5%	24.5%						
District of Columbia	8.9%	0% to 13.3%							
Florida	17.7%	0% - 40.0%	?		?	?	?	EXIT	
Georgia	28.0%	6.0% - 65.2%	15.5%	?		65.2%		44.0%	12.6%
Hawaii	35.0%	26.0% - 43.3%							
Idaho	27.0%	8.0% - 32.0%							
Illinois	43.9%	10.0% - 50.2%	14.3%		22.3%	46.3%		38.4%	
Indiana	18.0%	(5.3%) to 29%			-5.4%			EXIT	29.0%
Iowa	31.0%	5% to 37.8%	30.0%					EXIT	
Kansas	36.2%	14.4% to 49.4%						EXIT	
Kentucky	23.5%	7.6% to 65%	7.1%			33.7%		EXIT	22.9%
Louisiana	26.5%	14.6% to 30.4%				29.5%		EXIT	
Maine	20.7%	14.0% - 24.4%							14.1%
Maryland	28.0%	8.8% - 36.6%		29.8%				EXIT	
Massachusetts	10.4%	(8.3%) - 31.7%			9.8%			EXIT	
Michigan	17.5%	3.2% - 39.0%				39.3%	3.2%	EXIT	
Mississippi*	15.8%	7.0% - 43.0%			7.0%	43.0%		EXIT	
Missouri	15.9%	7.7% to 34.95	15.8%	9.0%		34.9%		EXIT	8.0%
Montana	50.0%	20.0% - 62.1%							
Nebraska	34.8%	34.8%	?					EXIT	
Nevada	15.0%	6.2% to 22.8%						10.4%	14.0%
New Hampshire	18.6%	1.35% - 43.0%			1.4%				6.7%
New Jersey	8.7%	6.2% - 26.0%						EXIT	
New Mexico	24.9%	3.8% to 83.1%					3.8%		
New York*	16.6%	7.4% to 89.1%						28.0%	15.2%
North Carolina	20.4%	7.0% to 29.2%	24.5%	7.0%				EXIT	
North Dakota	4.5%	1.82% - 16.9%							
Ohio	13.1%	(17.5%) - 39.8%	12.2%		-1.0%	39.3%	0.9%	EXIT	9.9%
Oklahoma	47.0%	3.8% to 47%						EXIT	
Oregon*	24.0%	9.8% - 32.0%			9.8%				
Pennsylvania	23.6%	0.9% to 44.8%	17.2%					EXIT	
Rhode Island*	3.6%	(6%) to 5.9%						EXIT	
South Carolina	18.0%	9.0% - 27.2%	27.2%					EXIT	
South Dakota	35.6%	26.8% - 37.9%							
Tennessee	59.0%	14.0% - 62.0%		46.0%		44.3%		EXIT	
Texas	39.7%	6.9% to 58.4%	15.2%	23.5%	15.5%	45.4%	9.6%	EXIT	
Utah	31.0%	4.4% - 42.3%				EXIT	33.8%	EXIT	
Vermont	7.0%	3.7% - 7.56%							
Virginia	22.6%	9.4 to 37.0%	?					11.9%	15.8%
Washington	13.5%	7.4% - 20.0%			7.4%		9.6%	EXIT	
West Virginia	37.0%	32.0% - 39.3%							
Wisconsin	20.0%	(13%) - 38.0%			9.1%		24.0%	EXIT	21.9%
Wyoming	7.4%	7.4%							
Averages	24.2%		24.1%	20.6%	11.5%	38.7%	11.1%	27.9%	17.1%

Source: State Rate Filings and Barclays Research

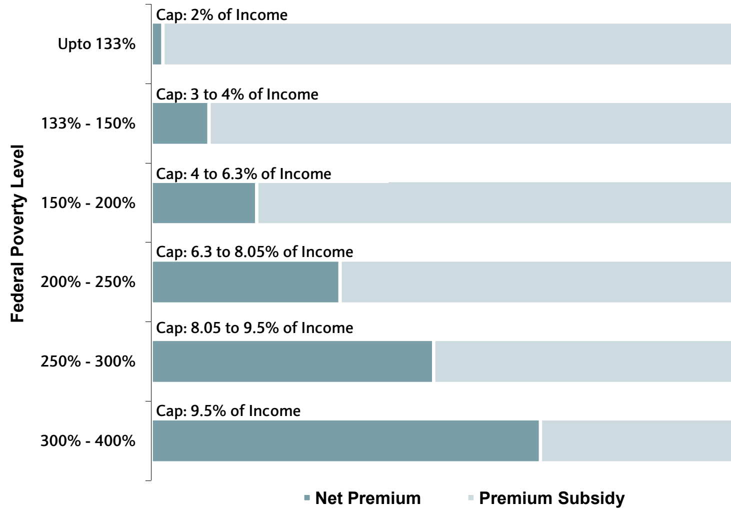
*Note: Figures show APPROVED rate increases (not proposed)

UNH rate increases in Colorado, Georgia and Illinois are subsidiaries/health plans that will continue to operate in 2017

AET exiting all exchanges with the exception of Delaware, Iowa, Nebraska and Virginia

Additionally 17% of the exchange enrollees do not get any financial assistance which could lead to meaningful membership attrition in 2017, further deteriorating the risk pool. As a reminder, premium subsidies essentially cap the amount individuals have to spend on health insurance as a % of total household income. However, premium subsidies are based on a sliding scale which decreases with increase in income level. The more you make the less help you get from the Government. In other words, while the lower income individuals would be insulated from premium rate increases individuals with income over 400% of the FPL would feel the brunt of rate hikes.

Figure 8: Net Premium Caps by Income Level

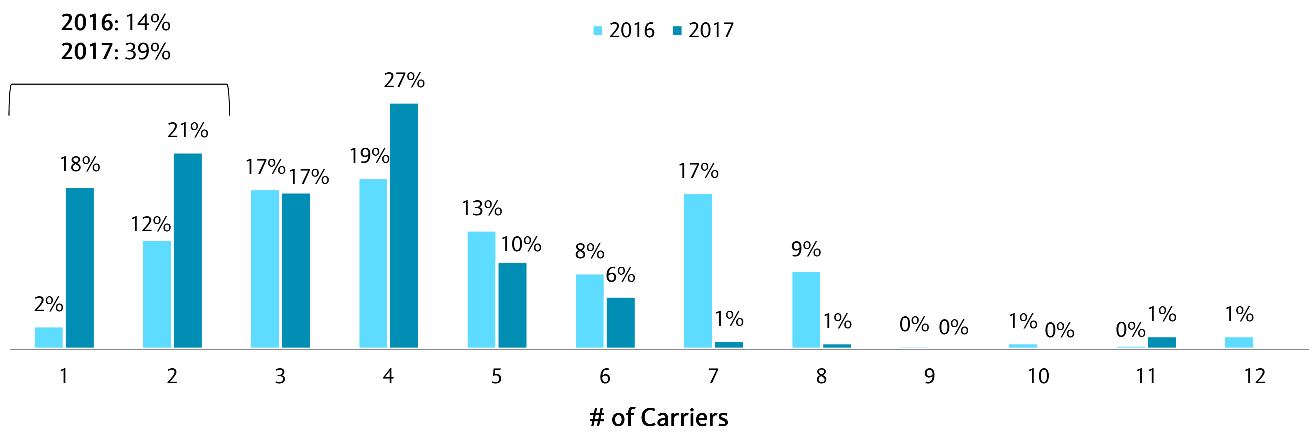


Source: Barclays Research, PPACA

2) Based on our review of plan participation data by county, we note the number of counties with just one plan option will increase from 2.5% to 17.7% in 2017. This equates to 240K lives in 2016, going to 1.7 million in 2017. As a caveat our analysis is based on the HHS database which does not include data on the thirteen state-based health insurance exchanges. At the end of the 2016 open enrolment season roughly 9.6 million individuals (or 76%) had selected a plan via federally-facilitated exchanges and the remaining 3.0 million individuals (or 24%) had selected a plan via state-based exchanges.

FIGURE 9

2017vs. 2016: Number of Health Insures by County (across the 38 Federally Facilitated Exchanges)



Source: Healthcare.gov, HHS and Barclays Research Estimates

Broadly speaking competition on State-based exchanges have been fairly robust and even with a few plan exits the markets will likely be fairly competitive.

FIGURE 10

13 State-Based Exchanges

State	2016 # of Carriers	2017 # of Carriers	Current Enrollment	2017 Announced Market Exits
California	12	11	1,572,074	United
Colorado	8	7	145,930	Humana & United
Connecticut	4	2	116,019	HealthyCT & United
District of Columbia	2	2	17,300	-
Idaho	5	5	94,000	-
Kentucky	8	4	93,687	Aetna, United, Wellcare
Maryland*	5	4	115,000	United
Massachusetts	10	9	223,778	United
New York	15	14	271,964	Wellcare
Rhode Island	3	2	34,670	-
Vermont	2	2	225,027	-
Washington	11	8	200,000	-

Source: Healthinsurance.org, state filings, HHS and Barclays Research

3) Remaining Exchange Plans will likely still see membership growth from plan exits, a trend we are very concerned about. Figure 11 on the next page summarizes exposure to counties by number of carriers (2016 versus 2017). **We note that Anthem would have exposure to 119 counties (in Georgia and Missouri) in 2017 where the company will likely be the sole operator, the 119 counties account for 135K members**. Centene would have exposure to 34 counties (in Mississippi) where the company will be the sole operator. There are currently 32K members in those counties.

FIGURE 11

Exposure to Counties by # of Carriers

2017 (Number of Carriers)	Aetna	Anthem	Cigna	Centene	Humana	United
0	0	0	0	0	0	0
1	0	119	0	34	16	0
2	94	164	21	36	108	0
3	142	137	18	24	80	8
4	15	127	5	113	28	19
5	13	59	1	23	9	8
6	3	27	0	16	8	3
7	0	11	0	5	3	0
8	0	4	0	4	3	0
9	0	0	0	0	0	0
10	0	0	0	0	1	0
11	0	0	0	0	3	0
12	0	0	0	0	0	0
Total	**267**	**648**	**45**	**255**	**259**	**38**
Total (1 Plan Counties)	**0**	**119**	**0**	**34**	**16**	**0**
Total (1-3 Plan Counties)	**236**	**420**	**39**	**94**	**204**	**8**

Source: Healthcare.gov and Barclays Research

What is the Summary?

In summary, we remain nervous about exposure to public health insurance exchanges and believe that congressional action will be needed to sustain these products beyond 2018. We see Anthem as most exposed currently. Conversely, while Centene has exposure as well, we believe that are mitigating factors that make their risks lower.

SUMMARY 2Q16 OBSERVATIONS

Observations from the second quarter earnings season:

1) As always, there is significant investor focus on medical cost trends, and the commentary from the companies suggests that core trends remain moderate and consistent with previous quarters.

2) Exchange losses accelerated across the board, driven by higher utilization.

3) On average companies are guiding for an increase in cost trends for 2016, to account for an expected uptick in utilization and higher pharmacy costs.

4) On average MLRs was roughly flat in the second quarter y/y and were up 12bps sequentially, primarily due to increases among the large national insurers (AET, ANTM and CI especially), attributable to a changing membership mix to increased government exposure and increased pressure from health insurance exchanges.

5) Commercial MLR's increased 186bps Y/Y in 2Q16 to 82.1%, and increased 366bps sequentially.

6) In the most recent quarter, EBIT margins decreased 15bps from the prior year to 5.92% (coming off a relatively difficult comp).

7) We expect net investment income to continue to represent a historically low portion of aggregate net income in 2016.

8) In 2Q16, after the impact of enrollment from exchanges for the 2016 plan year, there was a 0.2% sequential increase in membership as expected while the regional plans showing a drop off.

9) Overall organic commercial membership trends were negative in the quarter, with losses across both the risk and ASO products.

10) The headline unemployment rate has fallen meaningfully from prior highs reached in October 2009 to 4.9% in July.

11) Relative to First Call consensus EPS estimates, second quarter results were better than expected and trended in a positive direction compared to the previous quarter.

12) Overall trends across a broader set of metrics in 2Q16 were mixed for the managed care group. Eight of ten companies beat our EPS estimates.

13) In the second quarter, eight of ten companies beat our EPS estimates by an average of 10.7%.

14a) Reserve quality in days-in-claims payable increased slightly in the quarter on a sequential basis and on a year over year basis.

14b) We stress the importance of cash flow trends because it is impossible to manipulate the reserve balances without seeing deteriorating cash flow trends in the long run, in our opinion.

15) In 2Q16, companies spent roughly $482 million for share repurchases (down from $618 million in 1Q16) and another $861 million on dividends to shareholders.

Medicare Observations

16) The average Medicare MLR was 83.2%, down 169bps year over year.

Medicaid Observations

17) Medicaid managed care medical loss ratios were down 136bps annually to 87.5%.

Costs, PPRD, MLRs and Related Observations

1) As always, there is significant investor focus on medical cost trends, and the commentary from the companies suggests that core trends remain moderate and consistent with previous quarters. For this quarter, **cost trends came in line with expectations**. It seems plans priced for an increase in utilization in 2016, projecting a reversion to historical norms. **On average MLRs were flat in the second quarter y/y to 84.1%, but increased 12bps sequentially. While many company's no longer breakout the commercial MLR, many companies noted increases in expenses from their individual segments.** Medicaid managed care medical loss ratios were down 136bps annually to 87.5%.

Below is commentary from some of the companies in the first quarter of 2016 related to cost trends.

Aetna:

> *"For 2016, our non-ACA commercial pricing incorporated a moderate increase to medical cost trends. Based on year-to-date results, we believe that our non-ACA commercial insured products are performing consistent with this expectation. As a result,* ***we continue to project that our 2016 non-ACA commercial medical cost trend will be in the range of 6% to 7%."***

Anthem:

> *"**We continue to expect 2016 local group medical cost trends to be in the range of 7% to 7.5%."***

Centene:

> *"The HBR improved 250 basis points year-over-year to 86.6%. This was mainly attributable to the product mix shift from Health Net. Importantly,* ***we continue to see as well as anticipate stable medical cost trends."***

UnitedHealth:

> *"Medical cost trends remain steady and consistent with the outlook we shared as we began the year and operating costs remain well controlled.* ***Commercial medical trend remains consistent with the original outlook of 6% plus or minus 50 basis points****. Hospital inpatient admissions per person are lower year-over-year across all UnitedHealthcare businesses. Like most years, there are pockets of higher cost trends, including specialty pharmacy and the increasing use of ER and outpatient services this year. Overall, healthcare cost trends remain in line and controlled"*

2) Exchange losses accelerated across the board, driven by higher utilization. As is well known at this time, in exchanges have presented an ongoing earnings headwind across the managed care industry. Admittedly, that is an understatement. Medical costs trends on exchanges began deteriorating in the second half of 2015 and have continued to deteriorate since. **With the trends in the quarter, Aetna, United and Humana are exiting several exchange markets.**

As Figure 12 on the next page shows, membership in public exchanges for our coverage universe is now 4.29 mm individuals, up 13% over the prior year but down 6% sequentially. Anthem remains the largest in exchanges, though we note that we saw significant growth at both Molina and Centene on a y/y basis.

FIGURE 12

Public Exchange Exposure

	AET	ANTM	CI	CNC	HNT	HUM	UNH	WCG	Total
Exchange Enrollment (1Q14)	230,000	500,000	40,000	39,700	153,000	200,000	NA	NA	1,170,400
Exchange Enrollment (2Q14)	600,000	769,000	100,000	75,000	315,000	622,000	NA	NA	2,499,300
Exchange Enrollment (3Q14)	600,000	751,000	NA	76,000	370,000	601,000	NA	NA	2,413,900
Exchange Enrollment (4Q14)	576,000	707,000	NA	74,500	366,000	554,800	NA	NA	2,293,300
Exchange Enrollment (1Q15)	950,000	898,000	100,000	161,700	360,000	730,800	570,000	NA	4,036,500
Exchange Enrollment (2Q15)	918,000	893,000	NA	167,400	350,000	671,400	550,000	NA	3,810,800
Exchange Enrollment (3Q15)	814,000	824,000	NA	155,600	334,000	609,600	550,000	NA	3,513,200
Exchange Enrollment (4Q15)	750,000	791,000	NA	146,400	310,000	567,300	500,000	NA	3,269,700
Exchange Enrollment (1Q16)	911,000	975,000	NA	683,000	NA	554,300	795,000	NA	4,548,300
Exchange Enrollment (2Q16)	838,000	923,000	NA	618,000	NA	494,900	820,000	NA	4,290,900

Source: Company Documents and Barclays Research

FIGURE 13

2016 Exchange Losses (As of 2Q16; $ thousands except EPS)

2016 (2Q16)	AET	ANTM	CI	CNC	HNT	HUM	UNH
Membership (Avg 1H16)	874,500	949,000	100,000	650,500	NA	524,600	807,500
Revenues	$3,250,000	$6,500,000	400,000	$1,951,500	NA	$2,124,571	$3,802,632
% Total Revenues	*5.2%*	*7.9%*	*1.0%*	*4.9%*		*3.9%*	*2.1%*
Operating Income	($284,375)	($325,000)	($20,000)	$78,060	NA	($239,952)	($722,500)
% EBIT Margin	*-8.8%*	*-5.0%*	*-5.0%*	*4.0%*	NA	*-11.3%*	*-19.0%*
Net Income	($162,218)	($180,537)	($12,512)	$34,574	NA	($120,070)	($434,043)
EPS Impact	($0.46)	($0.67)	($0.05)	$0.21	NA	($0.80)	($0.45)
% Total EPS	*-5.7%*	*-6.2%*	*-0.6%*	*4.8%*		*-9.0%*	*-5.7%*

Source: Company Documents Barclays Research

3) On average companies are guiding for an increase in cost trends for 2016, to account for an expected uptick in utilization and higher pharmacy costs. Broadly, our coverage universe is expecting medical cost trend up roughly 50bps y/y to 6.6% on average, compared to a 6.1% increase in the full year 2015. The commentary from many of the plans was that utilization has persisted at low levels in the past few years and is expected to tick up this year. As expected, medical cost trends were up 90bps y/y in 2015 in line with expectations. Health plans have been projecting a return to normalized utilization levels for a year, which has thus far remained fairly muted. We will continue to monitor cost trends closely throughout the year for any additional uptick. In 2015, Health plans were more successful in pricing for an increase in pharmacy costs to cover the expenses associated with Hepatitis C treatments. In 2016 we remain on watch for any impact that could arise from the introduction of the PCSK9 inhibitors for high cholesterol.

FIGURE 14

Medical Cost Trends by Company

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E
Aetna	8.0%	7.5%	7.5%-8.0%	8.5%-9.5%	7.5%	<5.5%	6.0% +/- 50bps	Less than 4.5%	5.0%-5.5%	6.5%	6.0%-7.0%
Cigna	7.0%	6.9%	6.5%-7.5%	8.0%	6.0%	5.0%	~5.0%	Less than 5%	Below low end of 4.5%-5.5%	5.0%	NA
Humana	5-6%	5-6%	6.0%-7.0%	7.0%	5.0%-6.0%	5.0% - 6.0%	5.0%	4.5% - 5.0%	4.0% - 4.5%	5.5% - 6.5%	NA
UnitedHealth	7.0% -7.5%	7-8%	7.0%-8.0%	7.5-8.5%	5.0%	~5.5%	< 5.5%	5.0%	5.5%	5.5%	6.0% +/- 50bps
Anthem	< 8%	< 8%	8.0%	8.5%-9.5%	6.0% - 6.5%	~7.0%	Low End of 7.0% +/- 50bps	6.0%	6.5%	Lower End of 6.5% - 7.5%	7.0% to 7.5%
Average	**7.3%**	**7.5%**	**8.1%**	**8.3%**	**6.3%**	**5.7%**	**6.1%**	**5.3%**	**5.2%**	**6.1%**	**6.6%**

Source: Company Documents, Barclays Research

4) On average MLRs was roughly flat in the second quarter y/y and were up 12bps sequentially, primarily due to increases among the large national insurers (AET, ANTM and CI especially), attributable to a changing membership mix to increased government exposure and increased pressure from health insurance exchanges. Aetna **overall MLR in 2Q16 was 82.4%, up 127bps from the prior year but 4bps below our estimate.** The year over year increase was a function of a higher commercial ratio (due to public exchanges) and a more normalized government segment MLR. UnitedHealth reported an overall MLR that was up 29bps y/y, which was primarily a result of higher than expected acuity on the public exchanges. Humana reported an MLR that was down 85bps and was 62bps below than our estimate and was driven by improvement in the Medicare business. We have heard earnings reports from several managed care companies including the three largest plans in the country which together will generate over $280 billion in revenues and there were NO signs of significant cost trend acceleration.

FIGURE 15

Managed Care Loss Ratios

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	Change	FY '12	FY '13	FY '14	FY '15E	FY '16E	FY '17E
Aetna	80.4%	83.1%	82.3%	83.0%	79.1%	81.1%	81.1%	81.9%	80.5%	82.4%	127bps	82.2%	82.9%	82.2%	80.8%	82.1%	82.7%
Anthem	82.7%	82.7%	82.5%	84.5%	80.2%	82.1%	83.6%	87.0%	81.8%	84.2%	213bps	85.3%	85.1%	83.1%	83.3%	84.9%	85.4%
Centene	89.3%	88.9%	89.7%	89.3%	89.8%	89.1%	89.0%	88.0%	88.7%	86.6%	(256)bps	90.7%	88.7%	89.3%	88.9%	87.1%	87.5%
Cigna	74.9%	78.9%	78.1%	82.0%	75.2%	77.5%	79.3%	80.4%	75.8%	78.8%	130bps	74.7%	80.8%	80.6%	81.1%	80.2%	81.4%
Humana	82.3%	83.1%	83.3%	83.4%	83.1%	85.2%	83.9%	85.8%	84.8%	84.3%	(85)bps	83.7%	83.9%	83.0%	84.0%	84.3%	85.2%
Molina	88.7%	89.3%	90.6%	89.4%	88.7%	88.7%	89.3%	88.9%	89.8%	89.2%	55bps	88.1%	87.1%	89.5%	89.0%	89.3%	89.0%
UnitedHealth	82.9%	81.9%	80.0%	80.1%	81.4%	81.7%	80.9%	82.7%	81.7%	82.0%	29bps	80.4%	81.5%	80.9%	81.8%	81.4%	81.5%
WellCare	89.6%	91.8%	89.8%	89.3%	90.0%	87.4%	87.7%	88.2%	88.7%	85.3%	(212)bps	85.2%	87.5%	90.1%	88.3%	87.6%	88.0%
Averages	**83.8%**	**84.9%**	**84.6%**	**85.1%**	**83.6%**	**84.1%**	**84.2%**	**85.2%**	**84.0%**	**84.1%**	**1bps**	**84.4%**	**84.8%**	**84.8%**	**84.6%**	**84.6%**	**85.0%**

Source: Company Documents and Barclays Research

5) Commercial MLR's increased 186bps Y/Y in 2Q16 to 82.1%, and increased 366bps sequentially. However, it's important to note that two companies UnitedHealth has stopped reporting commercial segment MLRs and Humana recently restated business segments so that commercial MLRs are no longer comparable on an apples-to-apples basis. The largest Y/Y increased in the first quarter was seen at Anthem (up 161bps). As a reminder, **for the full year 2015, average commercial MLR's declined 33bps. We acknowledge given the lack of commercial data from UnitedHealth and Humana it is difficult to determine what the real number is, but it is possible that the "real" average commercial MLR for 2015 was up as a result of exchange pressures.** We provide some qualitative data points regarding commercial cost trends in 2Q16 for the companies that no longer provide this metric:

- **Aetna:** *"For 2016, our non-ACA commercial pricing incorporated a moderate increase to medical cost trends. Based on year-to-date results, we believe that our non-ACA commercial insured products are performing consistent with this expectation."*

- **Cigna:** Cigna no longer breaks-out its guaranteed cost MLR, which makes results incomparable to peers. Instead, the company reports a consolidated commercial MLR, which includes its international business segment, stop-loss products associated with experience rated customers and other benefits like Dental. The new reporting methodology obfuscates the core commercial MLR trend, making a comparison to peers apples and oranges. **All of that said, Cigna showed a year over year increased in the commercial MLR of 130bps.**

- **UnitedHealth**: We continue to believe that the commercial MLR is one of the most important metrics to measure for UnitedHealth Group and 4Q14 was the last time we were explicitly provided this measure by the company.

For some perspective, MLRs declined consistently between 2002 and 2005, but have grown in recent years, including a 154bps spike to 82.5% in 2008. After a modest increase of 61bps in 2009, commercial MLRs fell 88 bps in 2010 to 82.3%. Commercial MLRs were roughly flat for the full-year 2011, and increased back to more historical levels in 2012, up 109bps to 82.0%. In 2013 commercial MLR's increased 57bps to 82.6% on average, before declining this past year by 45bps to an average of 82.1%. The decline in 2014 was largely expected given muted utilization and the favorable impact of the health insurer fee. In 2015 MLR's continued to decline due to muted utilization and improved pricing.

FIGURE 4

Commercial Medical Loss Ratios

Commercial MLRs	2014	2015	2016E	2017E	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	Y/Y	Q/Q
Aetna	80.2%	80.3%	81.6%	82.4%	77.4%	81.8%	80.7%	81.3%	77.8%	83.4%	*157bps*	*556bps*
Anthem	83.1%	83.3%	84.9%	85.4%	80.2%	82.1%	83.6%	87.0%	81.8%	84.2%	*213bps*	*241bps*
Cigna	80.6%	81.1%	80.2%	81.4%	75.2%	77.5%	79.3%	80.4%	75.8%	78.8%	*130bps*	*300bps*
Humana	0.0%	NA	NA	NA	N/A	N/A	N/A	N/A	N/A	N/A	*NA*	*NA*
UnitedHealth	80.9%	NA	NA	NA	76.5%	79.7%	N/A	N/A	N/A	N/A	*NA*	*NA*
Commercial	**81.6%**	**81.3%**	**81.8%**	**82.4%**	**78.3%**	**80.3%**	**81.2%**	**82.9%**	**78.5%**	**82.1%**	*186bps*	*366bps*
YOY Change	*(101)bps*	*(25)bps*	*53bps*	*58bps*	*(53)bps*	*(169)bps*	*(68)bps*	*(84)bps*	*20bps*	*186bps*		

Source: Company Documents, Barclays Research

6) In the most recent quarter, EBIT margins decreased 15bps from the prior year to 5.92% (coming off a relatively difficult comp). In 2Q16 margins were up on a sequential basis, reflecting normal seasonal patterns. Excluding Medicaid plans from the average EBIT margins, the totals were down 44bps Y/Y. **Our estimates through 2016 and 2017 reflect modest EBIT margin growth of ~47bps on average for our coverage**.

FIGURE 16

EBIT Margins 2010-2017E

	2010	2011	2012	2013	2014	2015	1Q16	2Q16	3Q16E	4Q16E	2016E	1Q17E	2Q17E	3Q17E	4Q17E	2017E
Aetna	7.73%	9.80%	8.33%	7.45%	7.15%	7.80%	9.13%	8.46%	8.54%	6.57%	8.17%	8.31%	8.13%	8.28%	6.28%	7.75%
Anthem	8.02%	7.09%	6.95%	6.31%	6.74%	6.63%	8.82%	8.21%	7.08%	3.44%	6.63%	8.51%	7.67%	6.34%	2.65%	6.27%
Centene	3.94%	3.82%	1.06%	2.60%	2.97%	3.25%	0.50%	3.74%	3.44%	3.99%	3.16%	2.64%	3.88%	3.57%	3.79%	3.47%
Cigna	9.48%	10.23%	9.08%	9.35%	9.66%	9.89%	9.33%	9.13%	8.42%	8.11%	8.75%	9.58%	9.83%	9.47%	8.76%	9.41%
Humana	5.48%	6.36%	5.27%	5.58%	4.87%	4.32%	4.21%	5.06%	6.61%	5.18%	5.26%	3.64%	4.74%	6.58%	4.94%	4.96%
Molina	2.57%	2.86%	0.59%	2.06%	2.00%	1.57%	0.88%	1.24%	NA	NA	NA	NA	NA	NA	NA	NA
UnitedHealth	8.35%	8.31%	8.37%	7.86%	7.87%	7.01%	6.65%	6.89%	7.26%	7.31%	7.03%	6.84%	7.26%	7.78%	7.41%	7.33%
WellCare [(a)]	3.55%	7.55%	4.75%	3.68%	1.92%	2.99%	3.42%	6.16%	3.54%	1.82%	3.75%	2.48%	4.25%	3.93%	1.65%	3.08%
Average	**6.30%**	**6.53%**	**5.11%**	**5.30%**	**5.13%**	**5.24%**	**5.17%**	**5.92%**	**6.10%**	**4.98%**	**5.83%**	**5.71%**	**6.28%**	**6.25%**	**4.89%**	**5.78%**
Y/Y Change	129bps	23bps	(142)bps	19bps	(17)bps	12bps	(54)bps	(15)bps	55bps	131bps	58bps	54bps	35bps	15bps	(9)bps	(5)bps
Average-Ex Medicaid	**7.35%**	**7.48%**	**6.39%**	**6.56%**	**6.54%**	**6.56%**	**6.96%**	**7.03%**	**6.97%**	**5.67%**	**6.62%**	**6.77%**	**7.02%**	**7.08%**	**5.61%**	**6.61%**
Y/Y Change	126bps	13bps	(109)bps	17bps	(2)bps	2bps	(50)bps	(44)bps	3bps	124bps	5bps	(20)bps	(1)bps	11bps	(6)bps	(0)bps

Source: Company Documents, Barclays Research

Other Observations

7) We expect net investment income to continue to represent a historically low portion of aggregate net income in 2016. In the chart below, we review the changes in net investment income (investment income less interest expense) for the managed care industry. With current short-term yields at low levels, this issue continues to get worse for the health insurance industry.

In 2014, net investment income as a % of pre-tax earnings declined slightly to 9.2%. **In 2015, net investment income as a % of pre-tax earnings decreased to 7.0%.** With interest rates remaining low and higher interest expense (due to M&A) we are forecasting another decline in 2016 to 4.7% of pre-tax earnings.

FIGURE 17

Net Investment Income as a Percent of Pre-tax Income ($ in thousands)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017E
Investment Income	$3,932,030	$4,690,960	$5,202,346	$4,316,333	$3,996,848	$4,108,419	$4,007,865	$4,086,984	$3,971,410	$4,109,007	$4,053,569	$4,190,377	$4,448,934
Interest Expense	($752,049)	($1,202,239)	($1,393,575)	($1,613,120)	($1,526,477)	($1,424,599)	($1,493,569)	($1,715,347)	($1,887,374)	($1,865,496)	($2,190,100)	($2,848,416)	($2,503,308)
Net Investment Income	$3,179,981	$3,488,721	$3,808,771	$2,703,213	$2,470,371	$2,683,820	$2,514,296	$2,371,637	$2,084,036	$2,243,511	$1,863,469	$1,341,961	$1,945,626
YOY Growth		*9.7%*	*9.2%*	*(29.0)%*	*(8.6)%*	*8.6%*	*(6.3)%*	*(5.7)%*	*(12.1)%*	*7.7%*	*(16.9)%*	*(28.0)%*	*45.0%*
Pre Tax Earnings	$14,569,610	$18,405,382	$20,940,805	$16,894,018	$16,701,334	$19,741,477	$21,468,899	$21,072,605	$22,060,649	$24,448,512	$26,656,686	$28,832,379	$30,414,093
YOY Growth		*26.3%*	*13.8%*	*(19.3)%*	*(1.1)%*	*18.2%*	*8.8%*	*(1.8)%*	*4.7%*	*10.8%*	*9.0%*	*8.2%*	*5.5%*
NI as % of Pre Tax	**21.8%**	**19.0%**	**18.2%**	**16.0%**	**14.8%**	**13.6%**	**11.7%**	**11.3%**	**9.4%**	**9.2%**	**7.0%**	**4.7%**	**6.4%**

Source: Company Documents and Barclays Research

Note: 2016 and 2017 Estimates exclude Molina.

Some companies are impacted by this trend more than others. Factors such as leverage, business segment mix and margin levels contribute to these differences. As the chart below shows, certain companies are seeing more relief than others. We project Centene, Humana, UnitedHealth and Aetna will all see modest declines in net investment income as a percentage of pre-tax income in 2016 and we expect Anthem and WellCare to see a modest increase in net investment income as a percentage of pre-tax income in 2016.

FIGURE 18

Change in Net Investment Income Contribution

NII as % of Pre Tax	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017E
Centene	7.4%	10.0%	12.6%	7.0%	(0.5)%	0.3%	(8.8)%	(3.4)%	(3.0)%	1.3%	(1.1)%	(7.3)%	(4.7)%
Humana	19.9%	27.2%	20.1%	23.2%	11.9%	12.8%	11.5%	14.6%	10.9%	10.1%	13.3%	7.9%	9.5%
Molina	19.7%	25.6%	27.2%	11.9%	(11.0)%	151.1%	(8.3)%	(60.7)%	(56.2)%	(36.0)%	(14.9)%	NA	NA
UnitedHealth	5.3%	5.9%	8.0%	2.3%	0.7%	1.7%	1.9%	0.5%	0.4%	1.7%	(0.8)%	(2.3)%	(0.9)%
Aetna	47.1%	41.3%	34.8%	23.9%	42.4%	33.8%	22.4%	24.6%	18.8%	16.2%	12.7%	7.2%	12.1%
Anthem	10.2%	9.6%	10.5%	8.6%	8.0%	9.1%	7.2%	4.7%	1.5%	2.9%	0.5%	0.6%	2.5%
WellCare	4.5%	17.3%	16.9%	22.9%	4.8%	(13.5)%	0.5%	1.6%	2.5%	3.0%	(11.7)%	(9.6)%	(9.2)%
Total	**21.8%**	**19.0%**	**18.2%**	**16.0%**	**14.8%**	**13.6%**	**11.7%**	**11.3%**	**9.4%**	**9.2%**	**7.0%**	**4.7%**	**6.4%**

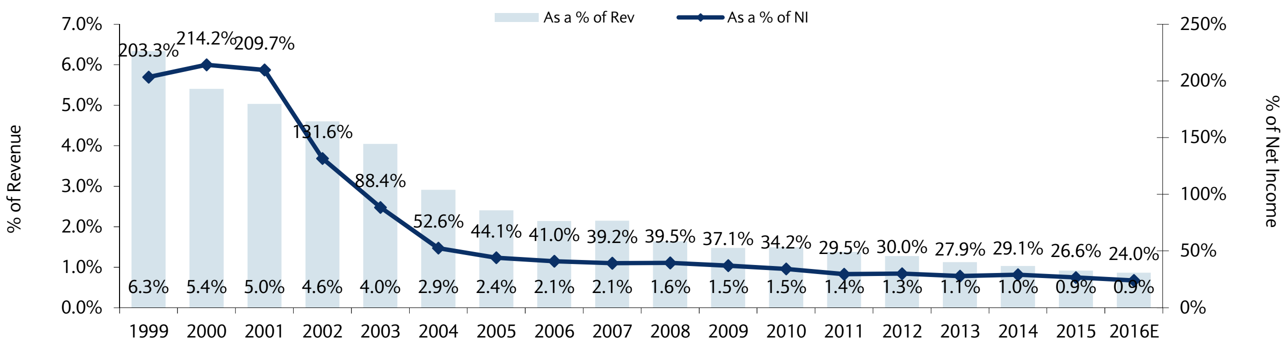
Source: Company Documents, Barclays Research

a) Low short-term yields continued to pressure managed care earnings in the second quarter. Managed care companies are essentially health insurance entities with ancillary service businesses, which mean they are subject to onerous capital requirements. Specifically, insurers are required to maintain certain levels of capital based on the amount of risk premiums that they write. The higher the quality of asset, the less nominal amount that must be held (i.e. fixed income assets are rated higher than equities, Treasuries are ranked higher than corporate bonds, etc.). Because of this, health plans typically hold interest-bearing assets well in excess of liabilities. We have noted on several occasions that insurers tend to maintain very large investment portfolios that are virtually all invested in fixed income securities. As the average portfolio duration is approximately three years (our estimates), securities maturing in the majority of 2008 were likely being reinvested in significantly lower rates.

Importantly, earnings guidance for most companies is predicated on the prevailing level of interest rates at the time of guidance. For 2008, investment income accounted for roughly 39.5% of net income, while in 2009 investment income dropped even further to 37%. In 2010, the ratio fell further to 34%, which is due to continued low levels of investment income and significantly improved earnings, and further to 29.5% in 2011. The ratio improved modestly in 2012 to 30%. In 2013, investment income came in at 27.9% of net income. In 2014 investment income improved slightly, accounting for 29.1% of net income. It's clear that managed care plans have become less reliant on investment returns than they were a decade ago, when investment income accounted for over 100% of net income. **In 2016, we anticipate investment income to come in at 24% of net income.**

FIGURE 19

Investment Income as a Percent of Revenues and Net Income

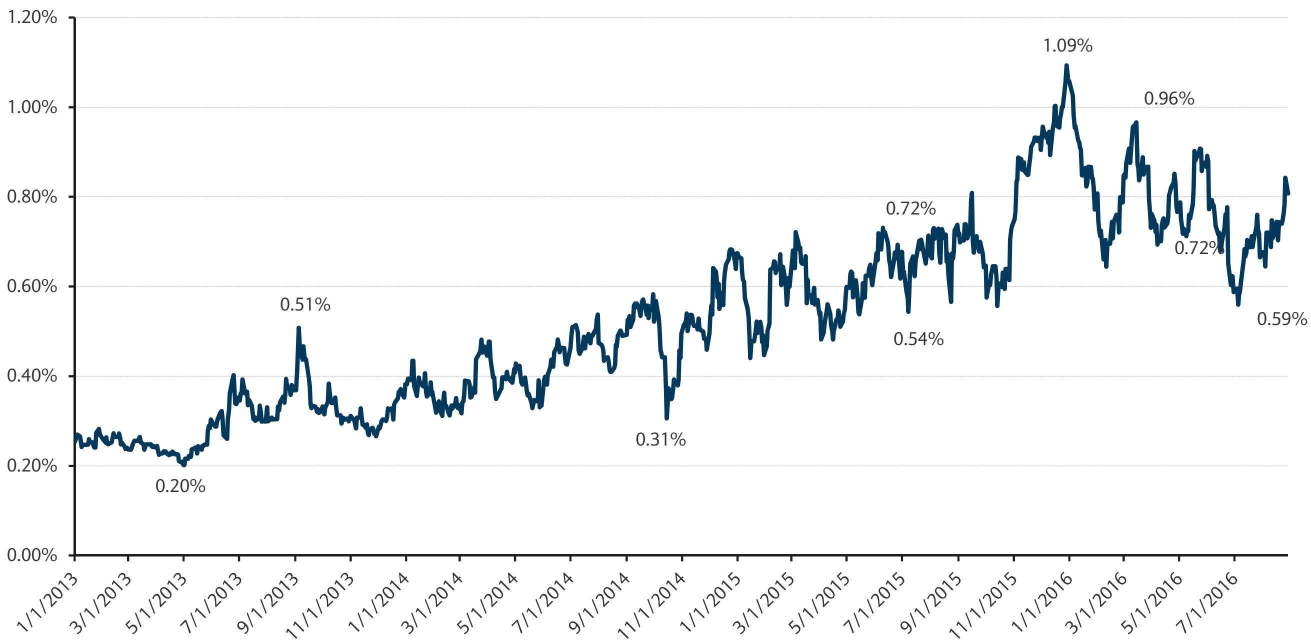


Source: Company Documents, Barclays Research

b) We continue to see weakness in investment yields relative to historical norms, particularly at the short end of the yield curve. Investment income returns are at the lowest levels we have seen in many years, and reinvestment risk will likely continue through the rest of 2016. In late 2008 and into 2009, yields on short-term treasuries declined to their lowest levels. For reference, in June 2007, quoted years on the 2-year T-bill reached just over 5%. In December 2008, the 2 year fell precipitously to a low of just 0.7%. In November 2009, the yield fell again to roughly 0.66%, but rebounded by the end of December to 1.14%. In 2010, interest rates advance to roughly 1.8% in April, before falling to roughly 0.35% in November. Rates rallied toward the end of the year, and reached a peak of 0.75% in December. In early 2011, the yield had been range bound hovering in the range of 0.55%-0.85% or so. In 2012, we saw interest rates dip from a high of 0.39% in the beginning of the year to a low of 0.21% towards the end of the year. In 2013, interest rates remained at depressed levels, hovering between 0.27%-0.51%. In 2014, rates reached a low of 0.30% in October 2014 before rebounding to a high of 0.68% in December 2014. In 2015, rates rose as the Fed increased rates by 25bps in December for the first time since 2006. Now, rates are at relatively low levels, at roughly 0.81%. **Though rates continue to remain at low levels, they should ultimately be a tailwind.**

FIGURE 20

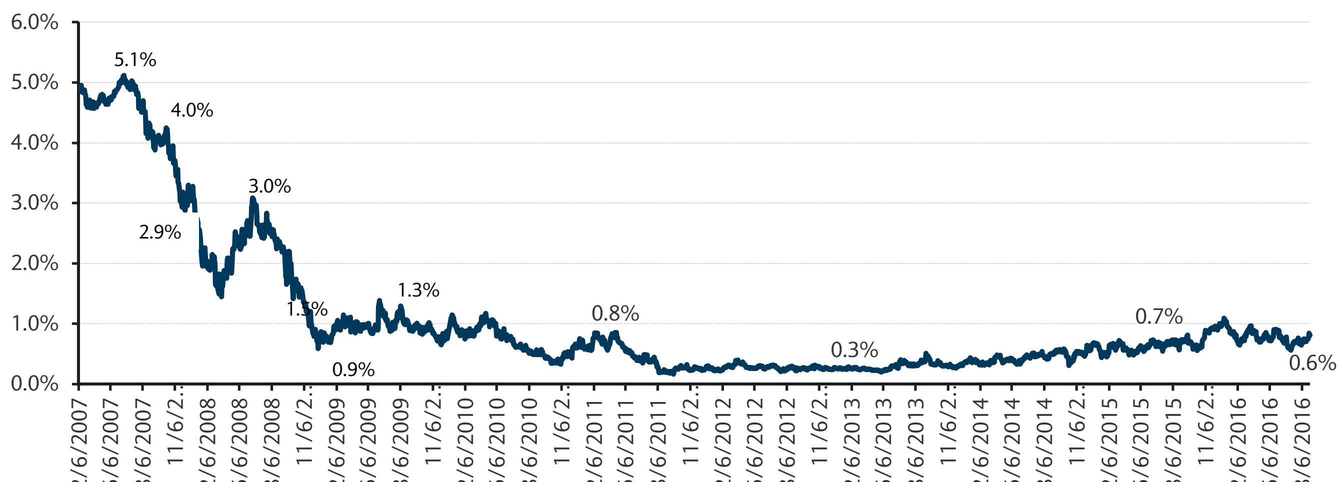
U.S Treasury Two-Year on the Run, 2013 – 2016 YTD



Source: Barclays Live

FIGURE 21

U.S. Two-Year T-Bill on the Run, 2007 - Present



Source: Barclays Live

8) In 2Q16, after the impact of enrollment from exchanges for the 2016 plan year, there was a 0.2% sequential increase in membership as expected while the regional plans showing a drop off. Looking forward, we continue to expect carrier consolidation and the larger health plans to aggregate market share in a post-reform environment. Specifically, the **national plans lost 163K lives, or 0.2%, in aggregate this quarter, while regional plans lost 176K lives, or 4.3%.**

FIGURE 22

Commercial Membership Sequential Changes (in thousands)

National	1Q16A	2Q16A	+/-	Change
Aetna	18,723	18,614	(109)	(0.6)%
Anthem	32,130	31,988	(142)	(0.4)%
Cigna	13,695	13,723	28	0.2%
UnitedHealth	27,530	27,590	60	0.2%
Total	**92,078**	**91,915**	**(163)**	**(0.2)%**
Regional	**1Q16A**	**2Q16A**		
Centene (formely HealthNet	1,519	1,423	(95.5)	(6.3)%
Humana	2,591	2,511	(80.5)	(3.1)%
Total	**4,110**	**3,934**	**(176)**	**(4.3)%**

Source: Company Documents

The cumulative effect of the carrier consolidation trend over the past several years has been pronounced. In the chart below, we highlight changes in commercial membership from the end of 2003 through 2Q16. Over that 45-quarter period, we estimate that the four national plans (including a pro-forma estimate for the combination of Anthem and WellPoint) have added 26.4 million members, exhibiting 40.3% total growth. Conversely, the remaining regional plans have dropped 2.0 million lives over that time, a total decline of 33.2%. We note that these numbers, which include acquisitions, may be slightly skewed considering larger plans are (generally) more likely to expand enrollment through acquisition than relatively smaller regional plans.

FIGURE 23

Commercial Membership Growth 4Q03 - Present: National vs. Regional Plans (in thousands)

National	4Q03A	2Q16A	+/-	Change
Aetna	12,783	18,614	5,831	45.6%
Anthem	23,900	31,988	8,088	33.8%
Cigna	11,493	13,723	2,230	19.4%
UnitedHealth (inc PHS, SIE)	17,355	27,590	10,235	59.0%
Total	**65,531**	**91,915**	**26,384**	**40.3%**
Regional	**4Q03A**	**2Q16A**		
Centene (formely HealthNet	2,822	1,423	(1,398.6)	(49.6)%
Humana	3,065	2,511	(554.7)	(18.1)%
Total	**5,887**	**3,934**	**(1,953)**	**(33.2)%**

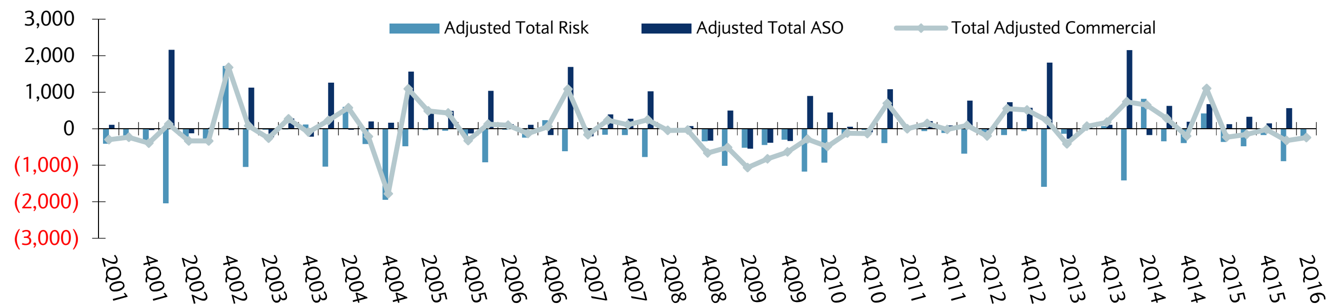
Source: Company Documents and Barclays Research Estimates

9) Overall organic commercial membership trends were negative in the quarter, with losses across both the risk and ASO products. For a couple of years, there has been increasing discussion surrounding competition by commercial health plans. Looking back at history, we are able to discern some predominant trends. In the mid to late 1990s, the industry was still in a growth phase and we witnessed strong expansion. For some perspective, Aetna added 4.6 million commercial members in 1999, more than the net growth of our entire coverage universe over the past five years. In the early 2000's while many companies grew, Aetna began to shed some of those lives. From 2001 through 2003, growth in commercial enrollment for our covered companies was basically flat. In 2005, the group rebounded and added 1.7 million lives.

In 2006, the group added 150K commercial lives. Within that total, there was positive ASO growth of 1.1 million offset by losses in the risk segment of 954K. The trend picked up in 2007, as we saw net organic growth of 1.3 million total commercial members. Of that expansion, ASO membership grew by 2.2 million while risk membership fell by 912K lives. In the full year 2009 losses equated to 3.04 million lives, driven by risk losses of 2.28 million and 766K ASO lives. We note, 2009 represents the largest decrease since we began tracking the data in 2001, and represents losses of more than 3x the next worse year which was 2001, when companies lost 933K lives. In 2012, total commercial membership grew by 952K lives, with ASO membership growth of 2.44 million partially offset by a loss 1.07 million lives in commercial risk products. In 2013, total commercial membership grew by 54K lives, with ASO membership growth of 1.75 million partially offset by a loss 1.69 million lives in commercial risk products. In 2014, total commercial membership grew by 1.5 million lives, with ASO membership growth of 2.79 million partially offset by a loss 1.3 million lives in commercial risk products. **In 2015,** total commercial membership grew by 692K lives, with ASO membership growth of 1.3 million partially offset by a loss of 591K life in commercial risk products.

FIGURE 24

Commercial Membership Trends: 2001-Present (Organic Basis, in 1,000s)



Source: Company Documents and Barclays Research

While overall trends have improved from 2008-2009, we continue to see a discernible shift from Risk to ASO. As Figure 25 shows, since the beginning of 2001, our coverage universe has gained approximately 1.5 million net adjusted commercial members. However, within that total, Risk membership has fallen by 19.5 million, offset by ASO membership which has grown by 20.9 million. We highlight that we have made over 50 adjustments to account for the effects of mergers, acquisitions, reclassifications and divestitures in order to present an analysis of changes on an organic basis.

FIGURE 25

Commercial Membership Trends: 2001-2015 (in thousands)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	01-'15
Adjusted Total Risk	(1,024)	(909)	(974)	(2,798)	(763)	(954)	(912)	(1,255)	(2,277)	(2,328)	(594)	(1,074)	(1,691)	(1,320)	(591)	(19,466)
Adjusted Total ASO	91	2,039	967	1,598	2,441	1,105	2,169	752	(766)	1,302	1,406	2,023	1,745	2,789	1,283	20,943
Total Adjusted Commercial	**(933)**	**1,129**	**(7)**	**(1,200)**	**1,678**	**150**	**1,257**	**(504)**	**(3,043)**	**(1,026)**	**812**	**949**	**54**	**1,469**	**692**	**1,477**

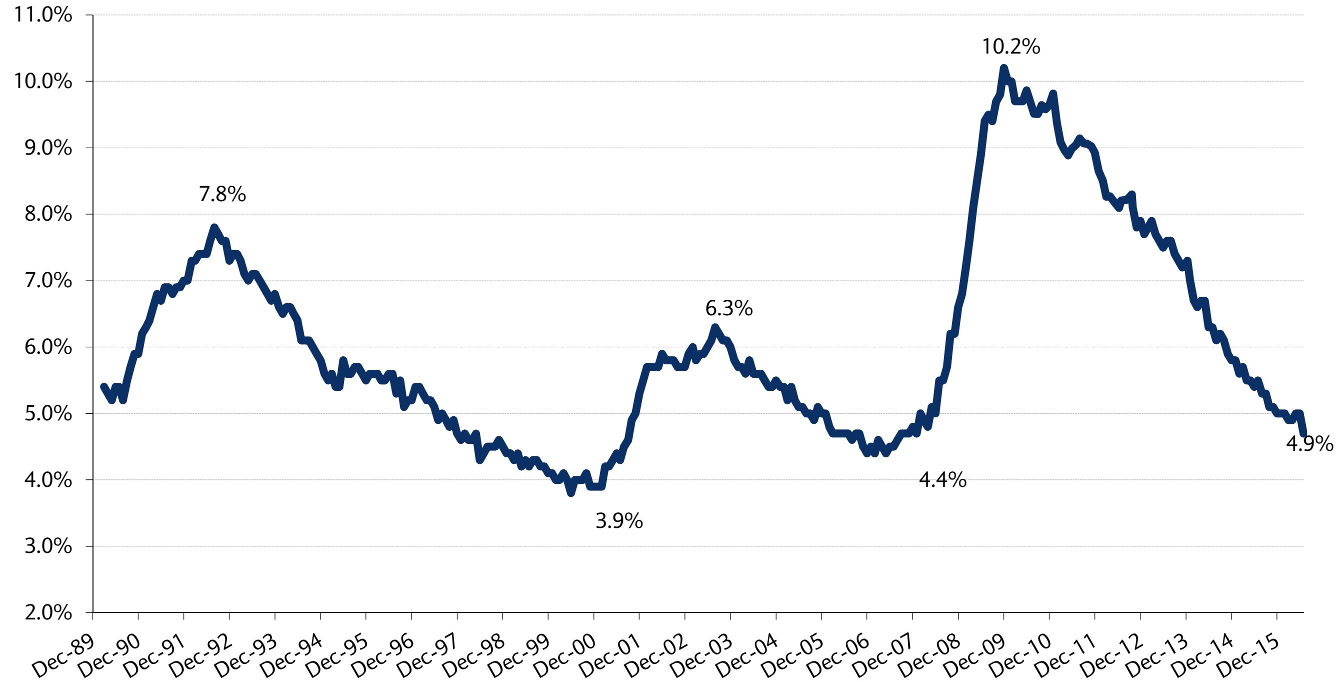
Source: Company Documents and Barclays Research Estimates

10) The headline unemployment rate has fallen meaningfully from prior highs reached in October 2009 to 4.9% in July. As the broader economy has improved we've seen improvements in unemployment trends and we have seen some improvement in commercial membership as well. While this metric has not been a major topic of discussion for our coverage universe of late, we believe most companies are assuming a relatively low unemployment rate to persist throughout the year.

The latest release from the Bureau of Labor Statistics shows that unemployment hit a peak of 10.2% in October 2009, and has since fallen to 4.9% through July 2016. This compares to a peak in the last recession of just 6.3% in June 2003 and a peak in the early 1990's recession of 7.8% in June 1992 (which we are now below).

FIGURE 26

National Unemployment Trends



Source: BLS

11) Relative to First Call consensus EPS estimates, second quarter results were better than expected and trended in a positive direction compared to the previous quarter. Specifically, 8 of the 10 companies we cover reported earnings per share that beat consensus expectations on the date of report. The 80% beat rate was better than last quarter's 70% beat rate, and above the average of 73% of companies beating estimates over the past five years. For some further perspective, since 1Q00, companies have beat consensus estimates 69% of the time, and missed only 15% of the time.

FIGURE 27

Company Reported EPS vs. First Call Consensus Estimates

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Aetna	Miss	Beat	Beat	Miss	Beat	Beat	Miss	Miss	Beat	Beat	Beat	In Line	Beat	Beat	Beat	Beat	Beat	Beat
Anthem	Beat	Miss	Beat	Beat	Beat	Beat	Beat	in line	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Miss	Beat	Beat
Centene	Miss	Miss	In Line	Miss	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat
Cigna	Miss	Beat	Beat	Beat	Beat	Beat	Beat	Miss	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Miss
Healthways	Miss	Beat	Beat	Miss	Beat	Beat	Miss	Miss	Beat	Miss	In Line	Beat	Miss	Beat	Miss	Miss	Miss	Beat
Humana	Miss	Miss	Beat	Beat	Beat	Beat	Beat	Miss	Beat	In Line	Miss	Miss	Miss	Miss	Beat	In Line	Beat	Beat
Magellan	Miss	Beat	Beat	Beat	Beat	Beat	Beat	Miss	Beat	Miss	Beat	Beat	Miss	Miss	Miss	Beat	Miss	Miss
UnitedHealth	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat	Beat
WellCare	Beat	Beat	Miss	Beat	Miss	Beat	Beat	Miss	Beat	Miss	Beat	Miss	Beat	Beat	Beat	In Line	Beat	Beat
Beat	4	7	10	8	10	10	8	3	10	6	7	8	8	9	8	6	7	8
In Line	1	0	1	0	0	1	0	1	0	1	2	1	0	0	1	3	0	0
Missed	8	6	1	4	1	0	3	7	1	4	2	2	3	2	2	2	3	2

Source: First Call, Company Reports and Barclays Research

12) Overall trends across a broader set of metrics in 2Q16 were mixed for the managed care group. Eight of ten companies beat our EPS estimates. Five of ten raised their 2016 guidance projections. This quarter's earnings continued the positive trend from 1Q16. However, cash flow trends were weak in the quarter, driven in part by higher than expected losses on exchanges leading to an increase in reserves. Only one company beat our estimates in the quarter.

FIGURE 28

2Q16 Earnings Metrics versus Estimates

Earnings Actual Vs. Estimates	EPS	2016 Guidance	Revenues	Membership	MLR	CFFO	DCP
Aetna	Beat	Maintain	Beat	Beat	Beat	Miss	Down
Anthem	Beat	Maintain	Beat	Beat	Miss	Miss	Down
Centene	Beat	Up	Beat	Miss	Beat	Miss	Up
Cigna	Miss	Down	Beat	Miss	Miss	Miss	-
Healthways	Beat	Up	Miss	-	-	Beat	-
Humana Inc.	Beat	Up	Beat	Miss	Beat	Miss	Down
Magellan Health Services	Miss	Down	Miss	-	-	Miss	-
Molina Healthcare	Beat	Maintain	Beat	Miss	Beat	Miss	Up
UnitedHealth Group	Beat	Up	Beat	Beat	Miss	Miss	Up
WellCare Health Plans	Beat	Up	Beat	Beat	Beat	Miss	Up
2Q16 Number of Beats/Up	**8/10**	**5/10**	**8/10**	**4/8**	**5/8**	**1/10**	**4/7**
1Q16 Number of Beats/Up	**8/10**	**5/10**	**8/10**	**7/8**	**5/8**	**6/10**	**5/7**
4Q15 Number of Beats/Up	**6/11**	**5/11**	**7/11**	**6/9**	**7/9**	**10/11**	**4/9**
3Q15 Number of Beats/Up	**8/11**	**5/11**	**5/11**	**5/9**	**5/9**	**5/11**	**5/9**
2Q15 Number of Beats/Up	**10/11**	**6/11**	**7/11**	**4/9**	**6/9**	**5/11**	**4/8**
1Q15 Number of Beats/Up	**9/11**	**6/11**	**6/11**	**7/9**	**5/9**	**7/11**	**4/8**
4Q14 Number of Beats/Up	**7/11**	**2/11**	**6/11**	**7/9**	**4/9**	**7/11**	**4/8**
3Q14 Number of Beats/Up	**7/11**	**6/11**	**5/11**	**7/9**	**5/9**	**8/11**	**7/8**
2Q14 Number of Beats/Up	**5/11**	**6/11**	**10/11**	**8/9**	**3/9**	**3/11**	**7/8**
1Q14 Number of Beats/Up	**10/11**	**7/11**	**5/11**	**5/9**	**7/9**	**8/11**	**6/8**
4Q13 Number of Beats/Up	**5/11**	**1/11**	**7/11**	**5/9**	**3/9**	**5/11**	**3/8**
3Q13 Number of Beats/Up	**8/11**	**5/11**	**10/11**	**4/9**	**5/9**	**10/11**	**4/8**
2Q13 Number of Beats/Up	**11/11**	**7/11**	**4/11**	**4/9**	**8/9**	**2/11**	**3/8**
1Q13 Number of Beats/Up	**10/11**	**7/11**	**5/11**	**7/9**	**6/9**	**4/11**	**4/8**
4Q12 Number of Beats/Up	**9/12**	**-**	**8/12**	**6/10**	**7/10**	**10/12**	**1/10**
3Q12 Number of Beats/Up	**10/11**	**6/10**	**2/11**	**7/9**	**4/9**	**3/11**	**8/8**
2Q12 Number of Beats/Up	**7/11**	**4/10**	**8/11**	**7/9**	**5/9**	**6/11**	**5/8**
1Q12 Number of Beats/Up	**9/13**	**6/12**	**6/13**	**8/11**	**8/11**	**11/13**	**2/10**
4Q11 Number of Beats/Up	**10/13**	**1/7**	**10/13**	**10/11**	**6/11**	**6/13**	**6/10**
3Q11 Number of Beats/Up	**13/14**	**12/13**	**11/14**	**11/12**	**11/12**	**12/14**	**3/11**
2Q11 Number of Beats/Up	**11/14**	**11/13**	**10/14**	**6/12**	**10/12**	**7/14**	**6/11**
1Q11 Number of Beats/Up	**13/14**	**11/13**	**10/14**	**7/12**	**12/12**	**8/14**	**5/11**
4Q10 Number of Beats/Up	**12/14**	**5/13**	**7/14**	**7/12**	**10/12**	**9/14**	**3/11**
3Q10 Number of Beats/Up	**14/15**	**12/14**	**8/15**	**11/13**	**10/13**	**11/15**	**2/11**
2Q10 Number of Beats/Up	**14/15**	**13/13**	**7/15**	**7/13**	**11/13**	**8/15**	**6/11**

Source: Company documents, Barclays Research

13) In the second quarter, eight of ten companies beat our EPS estimates by an average of 10.7%. Broadly speaking the government plans beat our estimates by a wider margin with improvements in core business. The group showed an average increase over the prior year quarter that averaged 16.5%

FIGURE 29

2Q16 Actual Earnings versus Estimates

	Reported	Barclays Estimate			Prior Year Quarter	
Earnings Per Share (EPS)	2Q16A	2Q16E	+/-	%	2Q15A	% Y/Y
Aetna	$2.00	$2.21	($0.21)	-9.5%	$2.05	-2.2%
Anthem	$3.33	$3.25	$0.08	2.5%	$3.10	7.3%
Centene	$1.29	$1.05	$0.24	22.6%	$0.76	70.2%
Cigna	$1.98	$2.30	($0.32)	-13.7%	$2.55	-22.3%
Healthways	$0.54	$0.05	$0.49	N/A	$0.29	N/A
Humana Inc.	$2.30	$2.15	$0.15	6.9%	$1.75	31.8%
Magellan Health Services	$0.16	$0.42	($0.26)	-62.0%	$0.17	-7.0%
Molina Healthcare	$0.59	$0.31	$0.28	91.2%	$0.72	-17.7%
UnitedHealth Group	$1.96	$1.85	$0.11	5.9%	$1.73	13.5%
WellCare Health Plans	$2.04	$1.34	$0.70	52.0%	$1.17	74.9%
2Q16 Average	**$1.62**	**$1.49**	**$0.13**	**10.7%**	**$1.43**	**16.5%**
1Q16 Average	**$1.44**	**$1.37**	**$0.07**	**7.7%**	**$1.34**	**26.2%**
4Q15 Average	**$1.62**	**$1.49**	**$0.13**	**10.7%**	**$1.43**	**16.5%**
3Q15 Average	**$1.20**	**$1.22**	**-$0.02**	**9.1%**	**$1.17**	**30.1%**
2Q15 Average	**$1.32**	**$1.15**	**$0.17**	**13.0%**	**$0.99**	**219.1%**
1Q15 Average	**$1.24**	**$1.06**	**$0.17**	**25.3%**	**$1.05**	**65.2%**
4Q14 Average	**$1.06**	**$1.03**	**$0.03**	**9.7%**	**$0.77**	**31.6%**
3Q14 Average	**$1.24**	**$1.14**	**$0.10**	**13.5%**	**$1.32**	**-11.4%**
2Q14 Average ex-WCG	**$1.14**	**$1.12**	**$0.03**	**2.4%**	**$1.26**	**-9.2%**
1Q14 Average	**$1.06**	**$0.88**	**$0.18**	**20.8%**	**$1.21**	**-12.8%**
4Q13 Average	**$0.79**	**$0.78**	**$0.00**	**0.2%**	**$0.90**	**-12.5%**
3Q13 Average	**$1.32**	**$1.15**	**$0.17**	**9.3%**	**$1.27**	**25.8%**
2Q13 Average	**$1.27**	**$1.06**	**$0.21**	**26.4%**	**$0.92**	**41.6%**
1Q13 Average	**$1.21**	**$0.89**	**$0.32**	**51.3%**	**$0.97**	**43.8%**
4Q12 Average	**$0.90**	**$0.78**	**$0.11**	**20.5%**	**$0.96**	**-7.9%**
3Q12 Average	**$1.22**	**$0.93**	**$0.29**	**14.3%**	**$1.25**	**-3.6%**
2Q12 Average	**$1.04**	**$0.94**	**$0.10**	**9.1%**	**$1.24**	**-22.5%**
1Q12 Average	**$0.92**	**$0.81**	**$0.11**	**7.8%**	**$1.04**	**-12.1%**
4Q11 Average	**$0.94**	**$0.80**	**$0.13**	**14.3%**	**$0.85**	**20.9%**
3Q11 Average	**$1.17**	**$0.96**	**$0.21**	**18.8%**	**$1.09**	**11.8%**
2Q11 Average	**$1.15**	**$0.91**	**$0.24**	**23.5%**	**$1.01**	**14.3%**
1Q11 Average	**$1.04**	**$0.68**	**$0.36**	**45.7%**	**$0.79**	**43.0%**
4Q10 Average	**$0.87**	**$0.73**	**$0.14**	**17.5%**	**$0.72**	**41.3%**
3Q10 Average	**$1.08**	**$0.79**	**$0.28**	**24.0%**	**$0.81**	**44.2%**
2Q10 Average	**$0.97**	**$0.69**	**$0.28**	**32.1%**	**$0.72**	**41.2%**

Source: Company documents, Barclays Research

Excluding outliers, our coverage universe posted roughly 5.8% upside to our estimates. In 2015, the sector has exceeded our estimates by an average of 10.5%.

FIGURE 30

EPS Results vs. Estimates

COMPANY	2Q16E	2Q16A	2Q16 % Chg.	1Q16 % Chg.	4Q15 % Chg.	3Q15 % Chg.	2Q15 % Chg.
Aetna	$2.00	$2.21	10.7%	9.7%	17.7%	12.5%	15.3%
Anthem	$3.25	$3.33	2.5%	3.2%	-2.5%	16.9%	17.2%
Centene	$1.05	$1.29	22.6%	5.3%	13.3%	11.1%	17.2%
Cigna	$2.30	$1.98	-13.7%	10.1%	9.1%	1.1%	17.2%
Humana	$2.15	$2.30	6.9%	0.3%	0.1%	2.8%	3.2%
Magellan	$0.73	$0.58	-20.0%	15.2%	-9.1%	-152.0%	-21.1%
Molina	$0.40	$0.68	70.8%	-43.7%	35.4%	40.3%	20.3%
UnitedHealth	$1.85	$1.96	5.9%	6.5%	1.1%	2.2%	4.5%
WellCare	$1.40	$2.23	59.9%	62.6%	-2.2%	-11.8%	49.9%
Average-Ex Outliers			**5.8%**	**7.2%**	**3.7%**	**-12.4%**	**7.4%**

Note: 1Q16 outliers excludes Cigna, Molina and WellCare
Source: Company Documents, Barclays Research

14a) Reserve quality in days-in-claims payable increased slightly in the quarter on a sequential basis and on a year over year basis. On a year-over-year basis, the quarter total was up 1.1 days, and on a quarter-over-quarter based DCP was up 0.4 days sequentially to 47.2 days. Only three companies, Aetna, Anthem and Humana showed a decline in their DCP on **a sequential basis**. On a y/y basis, Centene had the largest decrease down 2.5 days y/y. **The most notable y/y increase was at WellCare up 6.3 days y/y.**

FIGURE 31

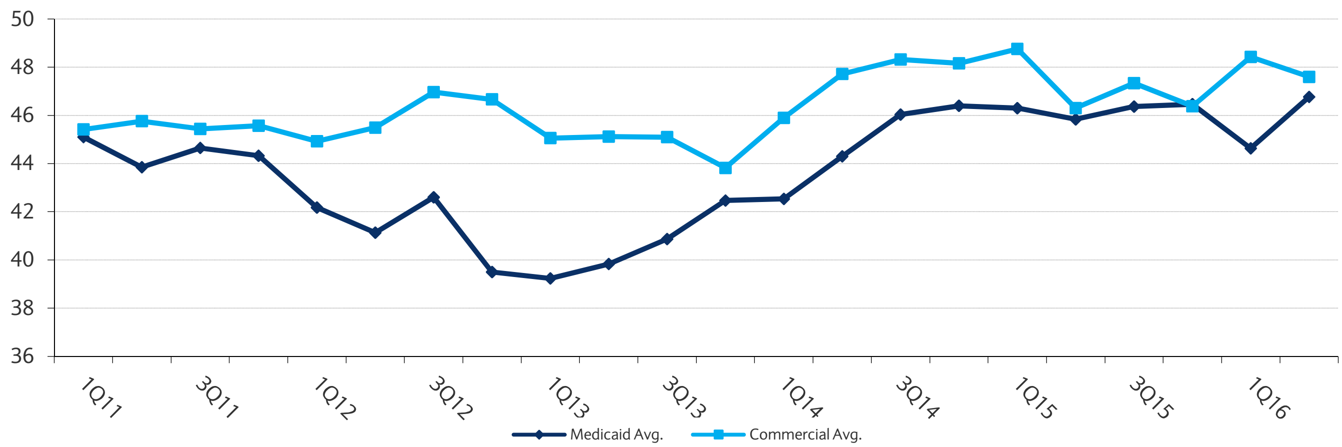
Managed Care Days in Claims Payable

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	Average	Y/Y	Q/Q
Aetna	45.1	45.3	45.5	45.0	47.1	47.4	49.7	49.2	53.5	51.8	54.3	54.9	57.3	56.2	**51.7**	4.4	(1.1)
Anthem	40.7	40.5	40.0	38.7	44.2	44.8	44.0	42.5	45.7	43.0	42.3	42.7	43.4	40.6	**47.1**	(2.4)	(2.8)
Centene	39.7	41.5	40.6	42.4	42.6	42.9	43.1	44.2	45.5	45.5	44.5	44.3	42.0	43.0	**47.7**	(2.5)	1.0
Humana	49.0	50.7	49.5	47.8	48.0	49.4	47.5	44.7	42.8	41.1	43.4	41.6	43.0	42.6	**51.3**	1.5	(0.4)
Molina	38.0	38.0	41.0	43.0	46.0	46.0	50.0	49.0	50.5	49.0	49.0	48.0	46.0	48.0	**48.2**	(1.0)	2.0
UnitedHealth	47.0	47.0	49.0	47.0	47.0	48.0	49.0	47.0	47.0	48.0	50.0	50.0	50.0	51.0	**55.2**	3.0	1.0
WellCare	40.0	40.0	41.0	42.0	39.0	44.0	45.0	46.0	42.9	43.0	45.6	47.1	45.9	49.3	**49.6**	6.3	3.4
Average	**42.9**	**43.1**	**43.5**	**43.3**	**44.6**	**46.4**	**47.5**	**47.5**	**47.8**	**46.1**	**47.0**	**46.4**	**46.8**	**47.2**	**49.6**	**1.1**	**0.4**

Source: Company Documents and Barclays Research

FIGURE 32

Managed Care Days in Claims Payable



Source: Company Documents and Barclays Research

14b) We stress the importance of cash flow trends because it is impossible to manipulate the reserve balances without seeing deteriorating cash flow trends in the long run, in our opinion. As the chart below shows, the group this quarter generated cash flow from operations that represented 56% of net income on a GAAP basis compared to 77% in the same quarter last year. This compares to last quarter that generated cash flow of 171% of net income.

FIGURE 33

Unadjusted Cash Flow from Operations versus Net Income (in thousands)

	CFFO			Net Income			CFFO/NI		
	2Q16	2Q15	Change	2Q16	2Q15	Change	2Q16	2Q15	Change
Aetna	$428,900	$255,700	67.7%	$790,800	$732,600	7.9%	0.54x	0.3x	55.4%
Anthem	$661,800	$1,172,900	(43.6)%	$861,417	$811,400	6.2%	0.77x	1.4x	(46.9)%
Centene	($420,000)	$350,000	(220.0)%	$168,000	$88,000	90.9%	-2.50x	4.0x	(162.9)%
Cigna	$302,000	$584,000	(48.3)%	$503,000	$445,000	13.0%	0.60x	1.3x	(54.3)%
Humana	($296,000)	($543,300)	45.5%	$311,000	$252,700	23.1%	-0.95x	-2.1x	55.7%
Molina	$139,000	$94,077	47.8%	$33,000	$38,943	(15.3)%	4.21x	2.4x	74.4%
UnitedHealth	$1,683,000	$1,163,000	44.7%	$1,760,000	$1,585,000	11.0%	0.96x	0.7x	30.3%
WellCare	$51,900	$25,200	106.0%	$91,500	$51,700	77.0%	0.57x	0.5x	16.4%
Total	**$2,550,600**	**$3,101,577**	**(17.8)%**	**$4,518,717**	**$4,005,343**	**12.8%**	**0.56x**	**0.77x**	**(27.1)%**

Source: Company Documents and Barclays Research

Figure 34 depicts adjusted cash flow from operations. We believe this shows a better representation of cash flows after adjusting for one-time charges. The adjustments are basically a series of timing issues that are corrected within one quarter. That said, there were no adjustments this quarter, **the group generated adjusted cash flow from operations that represented 56% of net income, below adjusted cash flow from operations that represented 171% of net income in the same quarter last year. Overall,** Adjusted CFFO was $4.5 billion.

FIGURE 34

Adjusted Cash Flow from Operations versus Net Income ($ in thousands)

ADJUSTED	CFFO			Net Income			CFFO/NI		
	2Q16	2Q15	Change	2Q16	2Q15	Change	2Q16	2Q15	Change
Aetna	$428,900	$255,700	67.7%	$790,800	$732,600	7.9%	0.54x	0.3x	55.4%
Anthem	$661,800	$1,172,900	(43.6)%	$861,417	$811,400	6.2%	0.77x	1.4x	(46.9)%
Centene	($420,000)	$350,000	(220.0)%	$168,000	$88,000	90.9%	-2.50x	4.0x	(162.9)%
Cigna	$302,000	$584,000	(48.3)%	$503,000	$445,000	13.0%	0.60x	1.3x	(54.3)%
Humana	($296,000)	($543,300)	45.5%	$311,000	$252,700	23.1%	-0.95x	-2.1x	55.7%
Molina	$139,000	$94,077	47.8%	$33,000	$38,943	(15.3)%	4.21x	2.4x	74.4%
UnitedHealth	$1,683,000	$1,163,000	44.7%	$1,760,000	$1,585,000	11.0%	0.96x	0.7x	30.3%
WellCare	$51,900	$25,200	106.0%	$91,500	$51,700	77.0%	0.57x	0.5x	16.4%
Total	**$2,550,600**	**$3,101,577**	**(17.8)%**	**$4,518,717**	**$4,005,343**	**12.8%**	**0.56x**	**0.77x**	**(27.1)%**

Source: Company Documents and Barclays Research

For a historical perspective, we include the following history of CFFO to Net Income ratios. We note that the total unadjusted cash flow to net income ratio of 0.6x is below the five-year average of 1.4x.

FIGURE 35

Non-Adjusted CFFO to NI Ratio

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	5 Yr Avg
Aetna	2.1x	0.2x	0.4x	1.8x	1.1x	0.1x	1.9x	1.3x	2.1x	1.2x	1.6x	0.7x	1.8x	0.3x	1.8x	2.5x	2.3x	0.5x	1.3x
Anthem	1.5x	0.7x	0.4x	2.4x	1.1x	0.5x	2.2x	1.0x	2.1x	1.5x	0.9x	0.6x	1.9x	1.4x	0.5x	3.6x	1.5x	0.8x	1.3x
Centene	-1.3x	0.9x	16.1x	-1.5x	1.9x	1.0x	2.6x	3.6x	7.5x	3.4x	5.4x	3.5x	0.7x	4.0x	0.7x	1.8x	-12.2x	-2.5x	2.0x
Cigna	2.5x	2.5x	-0.9x	1.8x	-1.4x	0.2x	1.5x	1.7x	0.9x	1.0x	0.9x	1.1x	1.3x	1.3x	1.1x	2.1x	1.7x	0.6x	1.1x
Humana	9.5x	2.8x	-5.4x	1.1x	0.9x	0.4x	3.1x	0.5x	1.8x	-0.6x	3.3x	1.1x	0.1x	-2.1x	3.3x	1.5x	1.9x	-1.0x	1.0x
Molina	2.8x	10.2x	1.5x	3.1x	0.7x	-8.2x	29.6x	-8.8x	43.6x	3.1x	37.6x	6.5x	19.7x	2.4x	5.6x	5.9x	5.8x	4.2x	8.1x
UnitedHealth	2.6x	1.6x	-0.2x	1.4x	0.8x	1.0x	2.2x	0.7x	1.3x	0.7x	2.0x	1.6x	2.1x	0.7x	1.7x	2.9x	1.4x	1.0x	1.4x
WellCare	0.2x	-3.9x	1.2x	2.1x	0.1x	-1.4x	4.3x	-1.2x	-0.9x	31.0x	15.7x	15.6x	-5.7x	0.5x	8.6x	37.0x	-3.0x	0.6x	5.0x
Average	2.4x	3.0x	-0.5x	1.5x	0.6x	-0.7x	5.8x	-0.5x	7.6x	4.6x	8.6x	3.2x	4.1x	0.6x	2.5x	6.1x	-0.1x	0.5x	2.4x
Total CFFO/NI	**2.7x**	**1.3x**	**-0.3x**	**1.6x**	**0.6x**	**0.5x**	**2.3x**	**1.0x**	**1.8x**	**0.8x**	**2.1x**	**1.3x**	**2.0x**	**0.7x**	**1.6x**	**2.7x**	**1.7x**	**0.6x**	**1.4x**
5-Year Average	*1.2x*	*1.2x*	*1.2x*	*1.2x*	*1.2x*	*1.2x*	*1.3x*	*1.2x*	*1.2x*	*1.2x*	*1.3x*	*1.3x*	*1.3x*	*1.3x*	*1.3x*	*1.4x*	*1.4x*	*1.4x*	

Source: Company Documents and Barclays Research

15) In 2Q16, companies spent roughly $482 million for share repurchases (down from $618 million in 1Q16) and another $861 million on dividends to shareholders. Of that total, United bought back the largest amount, at roughly $480 million of its own stock in 2Q16 with another $594 million in dividends. **In 2Q16, share buybacks and dividends have amounted to roughly 20% of total CFFO generated**, which is below levels seen in recent years. We remind investors that the primary reason for the decline in share repurchases in the quarter was the pending managed care M&A transactions - AET-HUM and ANTM-CI.

As a reminder, in 2015 repurchases totaled $5.6 billion, with another $3.0 billion in dividends. For reference, in 2014 repurchases totaled $11.1 billion, with another $2.3 billion in dividends. In 2013 repurchases totaled $7.7 billion with another $2.0 billion in dividends. In 2012, the group repurchased $8.2 billion in shares or 53% of CFFO. In 2011, the group repurchased $10 billion in shares, or 59% of CFFO. In 2010, the group repurchased $9.39 billion in shares, or 63% of CFFO. In 2009 the group bought back $5.5 billion of its shares, while in 2008 the group spent $9.2 billion on repurchases. These buybacks amounted to 67% and 35% of CFFO generated in 2008 and 2009, respectively.

FIGURE 36

Share Repurchase Activity: 2009-2016YTD ($ in millions)

	($ in millions)	2011	2012	2013	2014	2015	2016YTD	TOTAL	'01 - '15 Avg	07-'15 Avg
Aetna	Share Repurchases	$1,849	$1,418	$1,258	$1,218	$296	$0	$18,071	$1,205	$1,320
	Dividends	$167	$230	$279	$321	$349	$141	$1,486	$269	$269
	CFFO	$2,508	$1,822	$2,279	$3,373	$3,866	$2,210	$28,962	$1,783	$2,447
	% CFFO	80%	90%	67%	46%	17%	6%	68%	**64%**	**54%**
Anthem	Share Repurchases	$3,040	$2,497	$1,620	$2,999	$2,684	$0	$34,520	$2,655	$3,260
	Dividends	$93	$367	$448	$481	$657	$342	$2,387	$409	$409
	CFFO	$3,374	$2,745	$3,052	$3,369	$4,116	$1,966	$41,660	$2,646	$3,112
	% CFFO	93%	104%	68%	103%	81%	17%	89%	**97%**	**105%**
Centene	Share Repurchases	$8	$13	$20	$29	$64	$0	$184	$18	$20
	CFFO	$262	$279	$382	$1,223	$658	($225)	$4,016	$283	$405
	% CFFO	3%	5%	5%	2%	10%	0%	5%	**5%**	**5%**
Cigna	Share Repurchases	$225	$208	$1,001	$1,630	$685	$110	$13,685	$1,044	$691
	Dividends		$12	$11	$11	$0	$0	$34	$8	$8
	CFFO	$1,491	$2,350	$2,915	$1,994	$2,717	$1,196	$25,579	$1,626	$1,871
	% CFFO	15%	9%	35%	82%	25%	9%	54%	**105%**	**33%**
Healthways	Share Repurchases	$24	$0	$0	$0	$0	$0	$129	$14	$14
	CFFO	$76	$41	$19	$52	$61	$2	$940	$63	$72
	% CFFO	31%	0%	0%	0%	0%	0%	14%	**15%**	**20%**
Humana	Share Repurchases	$541	$518	$531	$872	$369	$0	$3,059	$340	$490
	Dividends	$82	$165	$168	$172	$172	$90	$849	$127	$127
	CFFO	$2,079	$1,923	$1,716	$1,618	$933	$186	$18,054	$1,191	$1,571
	% CFFO	30%	36%	41%	65%	58%	48%	22%	**30%**	**21%**
Magellan	Share Repurchases	$408	$22	$61	$198	$206	$10	$1,279	$159	$159
	CFFO	$112	$181	$183	$211	$239	($65)	$2,593	$190	$213
	% CFFO	364%	12%	33%	94%	86%	-15%	49%	**91%**	**66%**
Molina	Share Repurchases	$7	$0	$0	$0	$0	$0	$60	$7	$5
	CFFO	$154	$344	$194	$1,060	$1,134	$278	$4,122	$256	$378
	% CFFO	5%	0%	0%	0%	0%	0%	1%	**12%**	**1%**
UnitedHealth	Share Repurchases	$2,994	$3,084	$3,170	$4,008	$1,200	$980	$41,885	$2,727	$3,122
	Dividends	$651	$820	$1,056	$1,362	$1,786	$1,071	$6,746	$1,135	$1,135
	CFFO	$6,968	$7,155	$6,991	$8,051	$9,740	$3,983	$86,727	$5,516	$6,770
	% CFFO	52%	55%	60%	67%	31%	51%	56%	**59%**	**46%**
WellCare	Share Repurchases	$4	$6	$0	$0	$0	$0	$24	$2	$3
	CFFO	$151	($31)	$179	$299	$719	($60)	$2,834	$193	$228
	% CFFO	2%	-21%	0%	0%	0%	0%	1%	**-1%**	**1%**
TOTALS	Share Repurchases	$10,001	$8,175	$7,739	$10,953	$5,504	$1,100	$117,659	$7,771	$9,196
	Dividends	$993	$1,645	$1,962	$2,346	$2,963	$1,643	$11,553	$1,982	$1,982
	CFFO	$18,598	$18,396	$19,047	$21,251	$24,182	$9,470	$232,150	$14,845	$18,192
	% CFFO	59%	53%	51%	63%	35%	29%	56%	**55%**	**51%**

Source: Company Documents and Barclays Research

Medicare Observations

16) The average Medicare MLR was 83.2%, down 169bps year over year. However, 2Q16 excludes Humana, as the company longer provides Medicare-specific MLRs. Those that still report a Medicare MLR include Aetna, Cigna (although this is technically all government) and WellCare. Aetna and WellCare showed a decline in their Medicare MLR while Cigna showed an increased in their Medicare MLR.

As a reminder, in 2012, we saw a moderate increase in cost trends and continued pressure from a challenging reimbursement environment, which caused MLRs to increase roughly 113 bps annually to 85.2%. In 2013, MLR's increased 272bps to 86.6%, following continued rate pressures, a continued challenging reimbursement environment. In 2014, Medicare MLR's increased by just 2bps y/y despite reimbursement pressure. **In 2015, Medicare MLR's decreased by 54bps y/y.** In the second quarter of 2016, MLRs decreased by 169 bps year over year and decreased by 70 bps quarter over quarter. Notably WellCare saw a strong improvement in its MLR, with a decrease of 216bps y/y.

FIGURE 37

Medicare Managed Care Medical Loss Ratios

	2014	2015	2016E	2017E	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	Q/Q (bps)	Y/Y (bps)
Aetna	84.6%	80.6%	81.3%	82.4%	87.8%	89.1%	87.8%	87.9%	84.5%	86.8%	84.3%	84.4%	79.5%	79.0%	82.5%	81.2%	80.8%	78.8%	*(193)*	*(22)*
Cigna	84.3%	NA	NA	NA	84.3%	82.9%	85.5%	86.4%	86.5%	85.5%	84.3%	80.9%	89.4%	84.4%	83.6%	83.1%	86.2%	86.4%	*20*	*200*
Health Net	91.6%	91.2%	NA	NA	91.9%	89.9%	89.9%	90.5%	91.8%	90.9%	90.8%	92.8%	92.9%	89.5%	90.1%	92.1%	NA	NA	*NA*	*NA*
Humana	82.3%	82.4%	NA	NA	81.5%	82.3%	84.4%	84.3%	80.5%	82.5%	83.5%	82.9%	NA	NA	NA	NA	NA	NA	*NA*	*NA*
WellCare	89.5%	85.7%	85.6%	86.8%	90.9%	87.3%	82.7%	85.6%	92.8%	88.3%	90.7%	86.5%	87.1%	86.4%	86.9%	88.7%	84.6%	84.2%	*(36)*	*(216)*
Average	**86.4%**	**84.9%**	**83.5%**	**84.6%**	**86.8%**	**85.9%**	**86.1%**	**86.9%**	**87.2%**	**86.8%**	**86.7%**	**85.5%**	**87.2%**	**84.8%**	**85.8%**	**86.3%**	**83.9%**	**83.2%**	***(70)***	***(169)***

Source: Company Documents

On the membership front, the pace of enrollment has continued its strong pace in 2016 (although the rate of growth is slower than in 2015). As of the latest CMS data, our covered companies have grown MA enrollment 5.4%, versus the 3% growth we saw for 2011, 16.6% growth in 2012, 11.8% growth exhibited in 2013, 10.0% growth in 2014 and 7.0% growth in 2015.

FIGURE 38

MA Enrollment

MA Membership	Dec-13	Dec-14	Dec-15	Mar-16	Jun-16	Jul-16	Aug-16	M/M %	M/M	Y/Y %	Y/Y
Aetna	967,834	1,153,143	1,278,512	1,358,383	1,371,401	1,376,744	1,386,147	0.7%	9,403	9.2%	117,102
Centene	6,335	10,334	32,000	33,231	298,257	299,338	299,235	(0.0)%	(103)	778.3%	265,164
Cigna	456,815	464,084	505,819	562,161	541,445	536,931	532,641	(0.8)%	(4,290)	6.4%	32,258
Health Net	242,946	292,795	291,897	268,156	0	0	0		0	(100.0)%	(296,411)
Humana	2,493,547	2,933,614	3,253,528	3,176,688	3,185,031	3,193,099	3,198,438	0.2%	5,339	(0.8)%	(24,769)
Universal American	133,103	120,294	113,093	120,858	120,966	121,250	121,463	0.2%	213	8.2%	9,172
UnitedHealth	3,200,958	3,224,585	3,505,925	3,818,301	3,859,746	3,875,390	3,903,455	0.7%	28,065	12.4%	429,166
WellCare	289,059	374,685	355,144	326,848	333,095	336,573	336,374	(0.1)%	(199)	(4.6)%	(16,261)
Anthem	634,157	693,675	603,047	601,983	610,943	614,154	616,790	0.4%	2,636	2.8%	16,690
TOTAL	**8,424,754**	**9,267,209**	**9,938,965**	**10,266,609**	**10,320,884**	**10,353,479**	**10,394,543**	**0.4%**	**41,064**	**5.4%**	**5,521,737**

Source: CMS

Medicaid Observations

17) Medicaid managed care medical loss ratios were down 136bps annually to 87.5%. After struggling to rein in Medicaid costs in new markets, MLRs stabilized from 2Q13 through 1Q14, **before accelerating throughout the back half of 2014 and the first quarter of 2015 as cost issues were reported in several new and existing markets, along with a more severe Flu season**. Now in the second quarter, the performance was mixed with Centene and WellCare reporting y/y improvements.

FIGURE 39

Medicaid Managed Care Medical Loss Ratios

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Centene	85.0%	84.8%	84.9%	85.9%	88.2%	92.9%	90.4%	90.9%	90.4%	88.8%	87.7%	88.1%	89.3%	88.9%	89.7%	89.3%	89.8%	89.1%	89.0%	88.0%	88.7%	86.6%
Molina	84.5%	84.1%	84.1%	83.8%	85.2%	92.3%	88.3%	86.1%	86.1%	86.2%	87.3%	88.7%	88.7%	89.3%	90.6%	89.4%	88.7%	88.7%	89.3%	88.9%	89.8%	89.2%
WellCare	84.1%	78.5%	79.0%	82.1%	85.7%	89.2%	91.1%	88.7%	87.7%	87.5%	89.1%	87.4%	86.9%	93.5%	89.3%	91.7%	90.1%	88.8%	90.7%	89.6%	89.9%	86.7%
Averages	**83.9%**	**82.9%**	**83.0%**	**84.1%**	**86.1%**	**90.3%**	**89.2%**	**88.6%**	**88.0%**	**87.5%**	**88.0%**	**88.1%**	**88.3%**	**90.5%**	**89.8%**	**90.1%**	**89.5%**	**88.9%**	**89.7%**	**88.8%**	**89.5%**	**87.5%**
Y/Y Change +/-	*(101)*	*(163)*	*(98)*	*47*	*224*	*745*	*626*	*442*	*194*	*(285)*	*(121)*	*(50)*	*27*	*305*	*182*	*207*	*123*	*(168)*	*(19)*	*(127)*	*(7)*	*(136)*

Source: Company Documents, Barclays Research

In 2014 Medicaid MLRs averaged 89.8%, up 190bps y/y with an increase reported for all three Medicaid focused health plans. For some perspective, Medicaid MLRs averaged 83.4% in 2011, down 152 bps annually, driven mainly by a ~550 bps improvement at WellCare, offset by increases at Centene. For 2012, Medicaid MLRs increased 579 bps to 89.2%. This was driven by tighter reimbursement, the rapid rate of new implementations (booked at higher costs), moderately higher cost trends and the lack of any future favorable development. MLR's improved 125bps in 2013, as medical management and rate adjustments reigned in costs on several programs that caused issues in 2012. **In 2015**

MLRs averaged 89.18%, 64bps lower than 2014. Looking ahead to 2016, we estimate **2016 MLRs will average 88.6 %, 69bps lower than 2015.**

FIGURE 40

Medicaid Managed Care Medical Loss Ratios: 2000-2017E

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017E
Centene		82.82%	82.31%	82.44%	80.72%	81.94%	82.74%	86.10%	82.71%	83.55%	83.83%	85.18%	90.73%	88.71%	89.29%	88.93%	87.12%	87.49%
Molina	81.04%	81.77%	82.91%	83.33%	84.39%	87.09%	84.81%	84.47%	84.80%	86.78%	84.48%	84.15%	88.05%	87.08%	89.51%	89.00%	89.31%	88.99%
WellCare				82.10%	80.70%	81.16%	81.37%	80.85%	84.83%	86.31%	86.53%	80.95%	88.69%	87.94%	90.64%	89.80%	89.22%	89.36%
Averages	**81.04%**	**82.30%**	**82.61%**	**82.62%**	**81.94%**	**83.40%**	**82.97%**	**83.81%**	**84.11%**	**85.54%**	**84.95%**	**83.43%**	**89.16%**	**87.91%**	**89.81%**	**89.24%**	**88.55%**	**88.61%**
Y/Y Change +/-	*(175)*	*126*	*31*	*1*	*(69)*	*146*	*(43)*	*83*	*31*	*143*	*(59)*	*(152)*	*573*	*(125)*	*190*	*(57)*	*(69)*	*6*

Source: Company Documents, Barclays Research

2Q16 RISQE Review

For a full version of the introduction, please see our note, "Raskin Index of Sustainable Quality Earnings (RISQE): A Systematic Approach to Earnings Quality Quantification" *from December 7th, 2010*

The Raskin Index of Sustainable Quality Earnings (RISQE) is an analytical tool to objectively evaluate the quality of our coverage universe's quarterly earnings. The model uses quantitative metrics to produce a ratings score for each company, with high scores indicating a lower level of risk to future results. RISQE scores range from 1 to 100, with 100 reflecting the highest level of sustainable quality earnings.

In certain cases, trends in the RISQE score components can meaningfully predict the following quarter's excess outperformance versus the S&P 500. When the RISQE score trends up or down by a significant amount, there is an 84% possibility that the stock will have positive or negative excess returns in the following quarter, respectively. In addition, there is a 66% possibility that the stock price will have significant excess over performance (over 10%) or underperformance versus the S&P 500 in the following quarter, respectively.

In the second quarter, RISQE scores for the nine health plans decreased 350bps, on average. We calculate RISQE scores for all nine membership-based companies that report. RISQE returns were mixed, with four companies posting increases versus five decreases. **There were no significant reports in 2Q16 after no significant reports in the first quarter.**

FIGURE 41

Quarterly RISQE Scores through 2Q16

Raskin's Index of Sustainable Quality Earnings - RISQE	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Aetna	64.7%	61.6%	53.7%	67.2%	52.0%	57.8%	62.0%	73.0%	72.2%	81.8%	71.1%	80.5%	71.1%	70.6%	75.6%	69.5%	73.1%
Anthem	57.7%	59.7%	66.8%	56.3%	61.9%	66.7%	49.8%	76.8%	81.0%	75.9%	73.7%	77.8%	61.1%	62.9%	68.5%	68.8%	61.1%
Cigna	54.7%	48.0%	59.8%	45.7%	55.3%	58.8%	52.9%	81.9%	72.5%	72.4%	66.7%	61.8%	74.7%	67.9%	70.4%	76.4%	61.4%
Centene	40.0%	49.6%	48.2%	58.6%	68.3%	65.2%	65.4%	59.5%	54.0%	57.9%	65.5%	63.2%	67.4%	63.1%	64.5%	66.5%	39.3%
Humana	59.9%	47.3%	52.3%	55.0%	56.7%	68.9%	53.0%	67.5%	64.9%	60.6%	48.9%	41.3%	46.3%	59.2%	50.8%	58.7%	69.6%
Molina Healthcare	51.3%	62.7%	71.2%	55.1%	52.5%	71.9%	70.2%	57.0%	63.3%	68.7%	62.3%	68.8%	64.2%	71.5%	57.5%	56.3%	59.9%
UnitedHealth	72.2%	70.6%	61.8%	54.5%	60.6%	70.2%	63.1%	72.0%	72.4%	75.1%	71.9%	69.7%	73.4%	59.0%	60.4%	67.8%	60.2%
WellCare Group	34.8%	40.3%	39.8%	39.2%	55.0%	51.0%	50.5%	42.3%	30.7%	53.0%	60.1%	58.9%	70.8%	73.2%	77.5%	65.7%	77.6%
Average	**54.8%**	**52.8%**	**56.4%**	**54.6%**	**56.2%**	**64.5%**	**58.4%**	**66.9%**	**62.9%**	**67.9%**	**65.5%**	**65.4%**	**65.6%**	**65.2%**	**64.3%**	**66.2%**	**62.7%**

Source: Company documents, Barclays Research

We evaluate RISQE returns against managed care stock returns from the day before the first company reports earnings.

This quarter, UnitedHealth led off earnings on July 19, 2016. From the previous close through August 4, 2016, the managed care group has had positive stock returns of 1.3%, versus the S&P 500 which was down 0.1%. **There was one significant event this quarter as WCG reported significant improvement in the cash flow, balance sheet and income statement metrics.**

FIGURE 42

RISQE Scores versus Stock Returns since 7/18/2016 (Day Before UnitedHealth Reported 4Q15 Earnings)

Historical Prices	7/18/2016 Closing Price	8/4/2016 Closing Price	Stock Returns	Q/Q RISQE Score Change
Aetna	$118.36	$116.61	-1.5%	**3.6%**
Anthem	$135.00	$126.82	-6.1%	**-7.8%**
Cigna	$133.13	$128.28	-3.6%	**-15.1%**
Centene	$72.11	$71.27	-1.2%	**-27.3%**
Humana	$159.64	$173.83	8.9%	**10.8%**
Molina Healthcare	$52.51	$58.00	10.5%	**3.6%**
UnitedHealth	$140.75	$142.71	1.4%	**-7.6%**
WellCare	$109.07	$111.24	2.0%	**11.9%**
Managed Care Average			**1.3%**	
S&P500	**$2,166.89**	**$2,164.25**	**-0.1%**	

Source: Company Documents, Thomson, Barclays Research

Looking back at last quarter, UnitedHealth led off earnings on April 19, 2016. From the previous close through May 13, 2016, the managed care group has had negative stock returns of 4.9%, versus the S&P 500 which was down 2.3%. **There was no significant report in 1Q16**.

FIGURE 43

RISQE Scores versus Stock Returns since 4/18/2016 (Day Before UnitedHealth Reported 4Q15 Earnings)

Historical Prices	4/18/2016 Closing Price	5/13/2016 Closing Price	Stock Returns	Q/Q RISQE Score Change
Aetna	$110.47	$107.90	-2.3%	**-6.1%**
Anthem	$142.59	$135.51	-5.0%	**0.3%**
Cigna	$137.12	$128.36	-6.4%	**6.1%**
Centene	$59.39	$56.64	-4.6%	**2.0%**
Humana	$171.72	$165.23	-3.8%	**7.9%**
Molina Healthcare	$61.72	$46.74	-24.3%	**-1.3%**
UnitedHealth	$127.81	$129.00	0.9%	**7.4%**
WellCare	$91.62	$93.14	1.7%	**-11.8%**
Managed Care Average			**-4.9%**	
S&P500	**$2,094.34**	**$2,046.61**	**-2.3%**	

Source: Company Documents, Thomson, Barclays Research

COMPANY 2Q16 EARNINGS SUMMARIES

Aetna Summary: For a full copy of the report, please see "*Aetna Inc.: 2Q16 Review: Core Strong Enough to Offset Exchanges*" published on August 3, 2016.

Similar to peers, Aetna is experiencing higher-than-anticipated pressure from the public exchanges in 2016. However, the biggest differentiator this quarter was that Aetna's other operating segments were able to more than absorb a significant PDR (and other costs in the quarter) and still lead to quarterly results that were well above our estimates. The company previously expected this business to operate at break-even levels in 2016, but **the morbidity of this population has significantly deteriorated this year. This is leading Aetna to cease all exchange expansion plans in 2017 and even consider exiting some of its current 15 state exchange footprint.** While the company did not comment further on specific states for potential exits, we expect we will hear more on this prior to the September 23 2016 deadline regardless of the outcome of the Humana merger. We note that Aetna operates exchange plans in 15 states, and as of 2Q16 had total exchange membership of 838K lives. **Looking at the on-exchange ACA impact, we estimate Aetna is operating at (7.5)% losses in 2016.** Its off-exchange business is operating at similar losses but the chart below only highlights on-exchange losses. **This (7.5)% loss compares to the peer average on-exchange operating loss of ~8.0% in 2016.** We estimate Humana and UnitedHealth have experienced the greatest loss on exchanges with negative (24)% and (19)% operating margins, respectively.

FIGURE 44

2016 On-Exchange ACA Impact ($ in thousands, except EPS)

2016	AET	ANTM	CI	CNC	HUM	MOH	UNH
Membership (Avg 1H16)	874,500	949,000	100,000	650,500	554,300	613,500	807,500
Revenues	$3,250,000	$6,500,000	400,000	$1,951,500	$1,662,900	$1,840,500	$3,802,632
% Total Revenues	*5.2%*	*7.9%*	*1.0%*	*4.9%*	*3.1%*	*10.6%*	*2.1%*
Operating Income	($243,750)	($325,000)	($20,000)	$78,060	($400,000)	$55,215	($722,500)
% EBIT Margin	*-7.5%*	*-5.0%*	*-5.0%*	*4.0%*	*-24%*	*3.0%*	*-19.0%*
Net Income	($139,044)	($180,537)	($12,512)	$34,574	($200,156)	$20,485	($434,043)
EPS Impact	($0.39)	($0.67)	($0.05)	$0.21	($1.33)	$0.36	($0.45)
% Total EPS	*-4.9%*	*-6.2%*	*-0.6%*	*4.8%*	*-15.0%*	*14.9%*	*-5.7%*

Source: Company Documents, Barclays Research

In the current quarter, Aetna booked a $65 million PDR for future losses related to their exchange operations. This was part of the total loss of $200 million related to exchanges booked in 2Q16 and likely includes some negative catch up from 1Q16. In total, Aetna expects to lose at least $300 million related to exchanges which implies an incremental $100 million in losses in the back half of 2016 (the $100mm is still a drag on the income statement this year). **The $300 million incremental full-year 2016 exchange losses were driven primarily by higher specialty pharmacy costs associated with members with higher morbidities. Importantly, the 3Rs do not adjust for pharmacy costs which represent a structural issue with risk adjustment on the exchanges.** Again, it was no surprise that Aetna is facing pressure on the individual book of business following earnings announcements from United, Anthem, and Cigna and Humana's recent guidance update. **We believe Aetna's decision to exit exchange expansion markets exchanges in 2017 is based on numerous factors, but this should help create a more stable operating environment, especially if they choose to exit any existing state exchanges.**

We recognize that there are several moving parts to the Aetna exchange story, and have attempted to simplify the math. **Based on our understanding, exchanges are now**

expected to be a $0.51 per share headwind to EPS in 2016 (i.e. the amount that actually runs through the P&L as losses this year). On the call the company noted that all-in, exchanges losses in 2016 are expected to total $300 million. We note that $200 million of this amount was accounted for this quarter (including the PDR). Given that the company previously expected the exchanges to operate at break-even margins, **exchange losses that will flow through the P&L in 2016 are expected to total $300 million.** Again, this is all incremental from the company's previous 1Q16 commentary and the exchange lives are running much worse than expectations. After taking into account taxes, this amounts to $0.51 on a per share basis. **Looking at the reaffirmed 2016 guidance of $7.90 - $8.10 and taking into account this $0.51 headwind, we estimate the core business (excluding exchanges) would generate $8.41 to $8.61 earnings per share for the year.**

FIGURE 45

Exchange Losses and Implied Core EPS Growth

Losses from Exchanges in 2016	
As of 2Q16	**$ in millions**
2Q16 Exchange Losses	($135)
Plus: 2Q16 PDR related to future 2016 exchange losses (existing lives)	*($65)*
Total 2Q16 Exchange Losses	**($200)**
Incremental 2H16 Exchange Losses (not included in PDR)	**($100)**
Total 2016 Exchange Losses	**($300)**
2016E Projected Tax Rate	*40%*
Tax-Effected Impact of Exchanges	($180)
2016E Diluted Shares Outstanding	*354.225*
Per Share Losses from Exchanges in 2016	**($0.51)**
2016E Cash EPS Guidance	$7.90 - $8.10
Adjusted 2016 EPS Guidance Range (Excluding Exchange Losses)	**$8.41 - $8.61**

Source: Company Documents and Barclays Research

U.S. Health Care-Managed Care | **Industry View: POSITIVE**

Aetna Inc. (AET)

Stock Rating: OVERWEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	60,401,000	63,308,350	65,363,457	N/A	N/A
EBITDA (adj)	4,964,700	5,424,401	5,249,827	N/A	N/A
EBIT (adj)	4,709,300	5,174,789	5,063,501	N/A	N/A
Pre-tax income (adj)	4,345,700	4,682,311	4,668,081	N/A	N/A
Net income (adj)	2,541,900	2,725,961	3,010,912	N/A	N/A
EPS (adj) ($)	7.71	8.00	8.90	N/A	N/A
Diluted shares (k)	352,575.0	354,225.0	351,600.0	N/A	N/A
DPS ($)	0.00	0.00	0.00	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	8.2	8.6	8.0	N/A	8.3
EBIT (adj) margin (%)	7.8	8.2	7.7	N/A	7.9
Pre-tax (adj) margin (%)	7.2	7.4	7.1	N/A	7.2
Net (adj) margin (%)	4.2	4.3	4.6	N/A	4.4
ROIC (%)	11.7	8.6	11.7	N/A	10.7
ROA (%)	4.8	4.4	4.7	N/A	4.6
ROE (%)	16.5	15.5	14.7	N/A	15.6

Balance sheet and cash flow ($mn)					CAGR
Tangible fixed assets	28,361	29,276	29,276	N/A	N/A
Intangible fixed assets	12,325	11,853	11,176	N/A	N/A
Cash and equivalents	5,539	20,307	9,445	N/A	N/A
Total assets	53,382	70,461	58,921	N/A	N/A
Short and long-term debt	7,828	20,019	7,019	N/A	N/A
Other long-term liabilities	13,894	13,197	11,247	N/A	N/A
Total liabilities	37,204	51,520	36,970	N/A	N/A
Net debt/(funds)	2,289	-288	-2,426	N/A	N/A
Shareholders' equity	16,179	18,940	21,951	N/A	N/A
Change in working capital	808	13,812	-11,262	N/A	N/A
Cash flow from operations	3,866	3,516	4,288	N/A	N/A
Capital expenditure	-363	-329	-350	N/A	N/A
Free cash flow	3,503	3,187	3,938	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	15.1	14.5	13.1	N/A	14.2
Equity FCF yield (%)	8.5	7.7	9.6	N/A	8.6
P/BV (x)	2.5	2.2	1.9	N/A	2.2
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Total debt/capital (%)	32.6	51.4	24.2	N/A	36.1

Selected operating metrics				
Medical loss ratio (%)	80.8	82.1	82.7	N/A
SG&A/sales (%)	19.6	18.2	18.1	N/A
Total membership (k)	24,953.0	24,956.4	25,150.0	N/A
Premium revenues PMPM ($)	484	509	538	N/A

Price (06-Sep-2016)	**USD 116.37**
Price Target	**USD 152.00**

Why Overweight? Three main factors support our price target. First, we see the combination of Aetna and Humana adding 180bps to the long-term top-line growth rate of Aetna. Second, the blended multiple implies a target that is about 1x higher than standalone Aetna. Third, we see short-term earnings acceleration through synergies and other merger benefits.

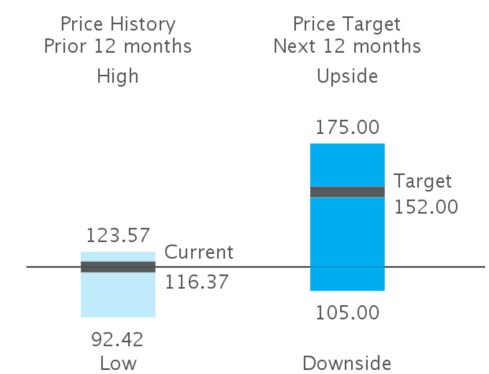
Upside case **USD 175.00**

The Humana transaction is successful, the headwind from Reform dissipates, Aetna accretively deploys capital and attains outsized synergies from the merger. A forward P/E multiple of 17.9x cash EPS of $8.90 implies an upside case of $175.00.

Downside case **USD 105.00**

The merger fails, cost trends increase above projections, integration costs are incurred and push cash EPS to $7.20. With a forward P/E multiple of 14.6x, we arrive at a downside case of $105.00.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Anthem Summary: for a full copy of the report, please see "*Anthem, Inc.: 2Q16 Review: Low Expectations Neither Met Nor Missed*" published on July 28, 2016.

We believe the results of the quarter bring out some frustration for most involved. Expectations were relatively low coming into the quarter, and much of the buyside was looking for some revision to guidance. **Unfortunately, the quarter was reported as slightly above consensus with a confirmation of guidance, but obfuscated by what we view as certain red flags**. The results were backed by weak quality and disclosure around pressures in public exchanges. Remember, no one is surprised by exchange related pressures at this point, but the exchanges are more important to Anthem than other industry participants. Were the company to have shown solid results with good quality, that would have been a sign that an investment was clearly safe. Conversely, if results were poor and guidance was formally reduced, that too could have served as a clearing event. Instead, it appears that investors will have to wait longer for more definitive proof on operations trends.

With that, we see the changes in underlying metrics within the guidance as most important in determining the outlook for 2017 and beyond. There were several moving parts to guidance, the gist of it being incremental losses on Medicaid (particularly the newly implemented Iowa contract) and ACA-compliant plans is which is being offset by significant cuts to SG&A spending. More specifically:

First, as it relates to the Iowa Medicaid contract: the contract began implementation on April 1, 2016 and was expected to boost revenues by $1 billion on a run-rate basis or by roughly $750 million in 2016. Additionally Anthem previously assumed they would be losing money on the contract in year one (but would be profitable over the life of the contract). Based on comments from 4Q15 "*margin pressure in the back half of 2016 from states, as well as expansion, there's about a few hundred million dollar headwind baked in. But I would tell you that Iowa is less than 25% of that*" we estimate Anthem expected to lose roughly $100 million. Now in the second quarter, the company noted the company enrolled an additional 25K members and the contract MLR is running 25-30% higher than initial expectations. Remember, this is in just the first quarter of operations as the contract began on April 1, 2016. **We estimate this now represents an incremental headwind of $269 million in operating losses or $0.55 EPS**. Lastly, we were a little surprised that Anthem did not take a premium deficiency reserve when they won the contract as was seen by the other two operators of that contract. We are more surprised that this wasn't raised with the starting results.

Second, there are incremental pressures in ACA compliant plans. Previously Anthem expected to break-even in 2016, and we have suggested in the past that this was optimistic. Now, the company is expecting to incur mid-single-digit operating margin losses. We would guess that is roughly a -5% margin. Anthem stated that ACA-compliant plans generated "closer to $7" billion in revenues, **which translates to an incremental headwind of $338 million or $0.70 in EPS**.

Lastly, offsetting the above mentioned pressures is lower SG&A spend. The company revised its operating expense guidance for the year from 15.5% +/- 30bps to 14.5% +/- 30bps on a higher revenue base, which presents a tailwind of $598 million or $1.23 in EPS. Candidly, this is area where we have the least understanding. It sounded like a large component of this was variable compensation for employees. However, if the company is confirming guidance (and thus on plan), we are not sure why bonuses would be cut. Additionally, we worry that some of this spending cut is a deferral of investments that are needed for future growth.

FIGURE 46

2016E Guidance Bridge

	EPS Impact
2016E Earnings	$10.80
(+) G&A Reduction	$1.23
(-) Incremental Iowa Medicaid Losses	($0.55)
(-) Incremental Pressure on ACA Compliant	($0.70)
(-) Other	$0.02
2016E Earnings	**$10.80**

Source: Company Documents and Barclays Research

U.S. Health Care-Managed Care — **Industry View: POSITIVE**

Anthem, Inc. (ANTM)

Stock Rating: EQUAL WEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	79,082,400	84,651,246	86,119,607	N/A	N/A
EBITDA (adj)	5,430,700	5,755,431	5,527,400	N/A	N/A
EBIT (adj)	5,200,600	5,562,320	5,348,427	N/A	N/A
Pre-tax income (adj)	4,661,600	5,019,449	4,636,286	N/A	N/A
Net income (adj)	2,637,500	2,773,867	3,013,586	N/A	N/A
EPS (adj) ($)	10.13	10.80	11.70	N/A	N/A
Diluted shares (k)	274,325.0	268,250.0	266,300.0	N/A	N/A
DPS ($)	2.50	2.50	2.50	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	6.9	6.9	6.5	N/A	6.8
EBIT (adj) margin (%)	6.6	6.6	6.3	N/A	6.5
Pre-tax (adj) margin (%)	5.9	6.0	5.4	N/A	5.8
Net (adj) margin (%)	3.4	3.3	3.5	N/A	3.4
ROIC (%)	4.4	4.6	4.9	N/A	4.7
ROA (%)	3.3	3.3	3.6	N/A	3.4
ROE (%)	9.6	8.9	8.6	N/A	9.0

Balance sheet and cash flow ($mn)					CAGR
Tangible fixed assets	5,136	5,536	5,645	N/A	N/A
Intangible fixed assets	25,720	25,527	25,348	N/A	N/A
Cash and equivalents	40,134	42,870	42,743	N/A	N/A
Total assets	81,186	84,924	84,726	N/A	N/A
Short and long-term debt	15,325	14,835	12,067	N/A	N/A
Other long-term liabilities	22,454	22,094	21,551	N/A	N/A
Total liabilities	52,347	51,535	48,324	N/A	N/A
Net debt/(funds)	-24,809	-28,035	-30,675	N/A	N/A
Shareholders' equity	28,839	33,389	36,403	N/A	N/A
Change in working capital	671	2,565	-227	N/A	N/A
Cash flow from operations ($k)	4,116,000	3,006,260	3,292,560	N/A	N/A
Capital expenditure ($k)	-602,900	-571,200	-620,000	N/A	N/A
Free cash flow ($k)	3,513,100	2,435,060	2,672,560	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	12.3	11.5	10.6	N/A	11.5
Equity FCF yield (%)	N/A	N/A	N/A	N/A	N/A
P/BV (x)	1.2	1.0	0.9	N/A	1.0
Dividend yield (%)	2.0	2.0	2.0	N/A	2.0
Total debt/capital (%)	34.7	29.4	23.4	N/A	29.2

Selected operating metrics				
Medical loss ratio (%)	83.3	84.9	85.4	N/A
SG&A/sales (%)	16.0	14.6	14.7	N/A
Total membership (k)	39,592.0	40,722.9	41,249.7	N/A
Premium revenues PMPM ($)	403	428	432	N/A

Price (06-Sep-2016)	USD 124.29
Price Target	USD 151.00

Why Equal Weight? Anthem has a broad set of products allowing for growth. As a Blues licensee, the company maintains one of the only strong brand advantages in the business. Anthem maintains leading local market share, which will be increasingly important under health reform.

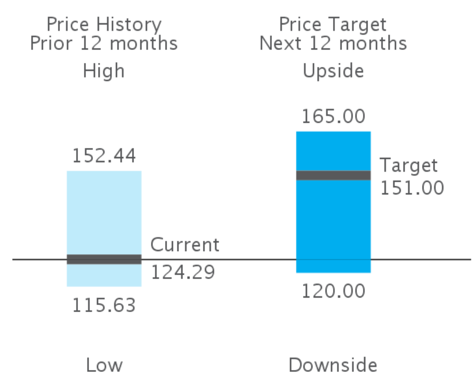
Upside case — **USD 165.00**

The Cigna transaction is successful, reform is less onerous, membership growth is stronger than projected, ANTM earns a positive pricing spread and fixes its Senior segment. A forward P/E multiple of 12.8, along with 10% upside to estimates, brings the upside case to $165.00.

Downside case — **USD 120.00**

The Cigna transaction is unsuccessful, cost trends increase above projections, rate increases are subject to strict regulatory review and another execution misstep occurs. 10% downside to estimates along with a forward P/E multiple of 11.4x equates to a downside case of $120.00.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Centene Summary: For a full copy of the report, please see "*Centene Corp.: Health Net Misses Results Posthumously*" published on July 27, 2016.

Centene reported another strong quarter with just one minor issue. We term it "minor" as there was just a small sentence buried about 80% of the way through the press release, with the issue not quantified. Unfortunately, the issue was quantified on both the conference call and in the 10-Q filing and then further explained in an 8K that was filed after the close of the market. With the quarter, Centene announced it was taking a premium deficiency reserve of approximately $300 million to represent the fair value of underperforming contracts for the period from March 24 through December 31, 2016. **The basic gist is that certain segments in the legacy Health Net book are performing much worse than expected.**

In the chart below, we go through the source segment for the issues, the corrective actions from Centene and most importantly, what we believe the potential drag on 2017 earnings will be. As a reminder, Centene believes that these issues are completely behind them and the actions being taken will address 100% of the $300 million. We are simply choosing to take a more conservative stance on a few areas.

a) **California commercial business ($125 million)** – Of the total, $50 million was associated with substance abuse treatment facilities. The company aims to remedy this issue through a combination of price increases and benefit design changes including reductions in reimbursement for out of network services. **The company reported it was in final stages of approval with the California Department of Insurance, which will be concluded by the end of 3Q16**.

    Barclays 2017 Estimate: We think that the actions taken should be adequate to address the shortfall. That said, we continue to worry more about overall selection issues and assign a savings of 50% to be conservative.

b) **Arizona individual commercial business ($70 million)** – Centene has decided to exit the entire individual PPO business, effective January 1, 2017. Furthermore, the company is reducing its participation in the health insurance marketplace business to one county for 2017 and has taken significant rate actions.

    Barclays 2017 Estimate: A full exit of the PPO and remaining in just 1 county for exchanges seems pretty straight forward. We expect this issue to be fully resolved.

c) **Medicare business ($70 million)** – Centene reported the 2017 bids have been submitted and should return the business to profitability in 2017.

    Barclays 2017 Estimate: Centene has been very good with respect to underwriting and product design, but simply doesn't have a lot of experience in MA. We assume conservatively that they address 50% of the cost issue though it is certainly possible that they resolve more.

d) **Arizona Medicaid business ($15 million)** – This business has been fully transitioned to Centene's operating platform as of July 1, 2016. The company believes it has taken appropriate actions to improve performance in this business.

    Barclays 2017 Estimate: Centene has been very strong at operating in the Medicaid segment across more than 20 states for more than two decades. If the company has one core competency it is running a Medicaid plan efficiently. Health Net did not have that core competency. Additionally, with just $15 million to solve for, we believe this gets entirely addressed.

e) **Small Items ($20 million) -** Small items that include the Arizona small group and Oregon individual business. Primarily, Centene is taking rate increases to remedy the situation and has taken other appropriate actions to address these issues for 2017.

Barclays 2017 Estimate: Candidly, we are not sure what exactly the issues are, so we discount these savings by 50% as well.

FIGURE 47

PDR Breakdown and Estimated 2017 Impact

Issue	Amount	Reaction	2017 Impact Estimate	EPS Impact
CA Comm General	$75	Rate Inc, Benefit Changes	$38	$0.12
CA Comm Substance Abuse	$50	Rate Inc, Benefit Changes	$25	$0.08
AZ Individual Comm	$70	Market Exits, Rate Increase	$0	$0.00
Medicare Advantage	$70	Bid Adjustments	$15	$0.05
AZ Medicaid	$15	Transition to CNC platform	$0	$0.00
Other Small Items	$20	Rate Inc, other actions	$10	$0.03
Total	$300		$88	$0.28

Source: Company Documents

As Figure 47 shows, we conservatively estimate that $88 million, or about $0.28 per share, could continue to impact 2017 earnings. Again, it is possible that Centene truly did capture the impact in its actions and there is no impact in 2017. As discussed in the actions below, we are maintaining our estimates for 2017 at $4.80 per share. We have previously stated that our estimate was a conservative starting point, and perhaps it is slightly less conservative now. That said, the guidance for 2016 is up $0.20 per share and we view the ACA reconciliation as sustainable. With that, the $0.28 per share drag, which we think is conservative, is mostly offset by the higher run rate in the core earnings.

Clearly, the revelation that Health Net is under-earning is disappointing, and even more so in light of the company's investor day a month ago where investors were led to believe that Health Net was operating full on target. While we would like to recommend selling HNT posthumously, **we still believe that Centene represents a good value. With yesterday's price performance and no change to our estimates, the stock is simply 8.5% cheaper on a 2017 P/E basis.**

U.S. Health Care-Managed Care — **Industry View: POSITIVE**

Centene Corp. (CNC)

Stock Rating: OVERWEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	22,795,000	39,707,553	44,695,253	N/A	N/A
EBITDA (adj)	851,000	1,517,002	1,829,779	N/A	N/A
EBIT (adj)	740,000	1,254,332	1,552,669	N/A	N/A
Pre-tax income (adj)	697,000	1,065,558	1,349,329	N/A	N/A
Net income (adj)	N/A	N/A	N/A	N/A	N/A
EPS (adj) ($)	3.15	4.40	4.80	N/A	N/A
Diluted shares (k)	119,098.8	159,754.9	172,708.8	N/A	N/A
DPS ($)	0.00	0.00	0.00	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	N/A	N/A	N/A	N/A	N/A
EBIT (adj) margin (%)	N/A	N/A	N/A	N/A	N/A
Pre-tax (adj) margin (%)	N/A	N/A	N/A	N/A	N/A
Net (adj) margin (%)	N/A	N/A	N/A	N/A	N/A
ROIC (%)	11.4	3.1	8.8	N/A	7.7
ROA (%)	5.4	3.4	3.8	N/A	4.2
ROE (%)	16.9	11.2	12.0	N/A	13.4

Balance sheet and cash flow					CAGR
Tangible fixed assets	N/A	N/A	N/A	N/A	N/A
Intangible fixed assets	N/A	N/A	N/A	N/A	N/A
Cash and equivalents	N/A	N/A	N/A	N/A	N/A
Total assets ($k)	7,339,000	19,971,897	20,356,536	N/A	N/A
Short and long-term debt	N/A	N/A	N/A	N/A	N/A
Other long-term liabilities	N/A	N/A	N/A	N/A	N/A
Total liabilities ($k)	5,015,000	13,968,946	13,588,467	N/A	N/A
Net debt/(funds)	N/A	N/A	N/A	N/A	N/A
Shareholders' equity ($k)	2,324,000	6,002,951	6,768,069	N/A	N/A
Change in working capital	N/A	N/A	N/A	N/A	N/A
Cash flow from operations ($k)	658,000	803,482	1,212,905	N/A	N/A
Capital expenditure ($k)	-150,000	-199,000	-230,000	N/A	N/A
Free cash flow ($k)	508,000	604,482	982,905	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	20.7	14.8	13.6	N/A	16.4
Equity FCF yield (%)	6.3	5.7	8.5	N/A	6.8
P/BV (x)	3.5	1.8	1.7	N/A	2.3
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Total debt/capital (%)	34.4	37.8	35.0	N/A	35.7

Selected operating metrics				
Medical loss ratio (%)	88.9	87.1	87.5	N/A
SG&A/sales (%)	N/A	N/A	N/A	N/A
Total membership	4,941,600.0	8,601,587.7	8,553,047.3	N/A
Premium revenues PMPM ($)	353	339	389	N/A

Price (06-Sep-2016)	USD 65.30
Price Target	USD 82.00

Why Overweight? Centene is well positioned in Medicaid specialty products to win significant RFP opportunities, with an overall revenue opportunity of $138 billion in 2016. The company should also gain membership from the conversion of Medicaid FFS to managed care, including dual eligibles.

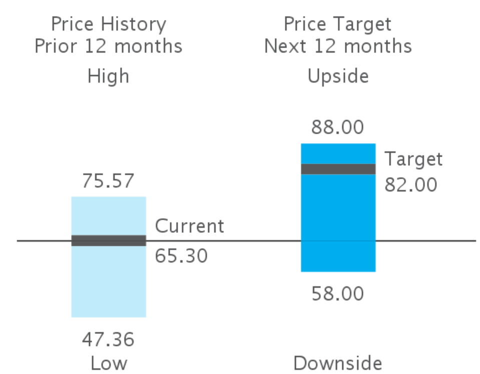
Upside case — **USD 88.00**

The integration of Health Net is successful, the company earns significant RFP wins, membership growth is stronger than projected, and utilization remains low. The forward P/E multiple expands to 16.8x, and 10% upside to estimates brings upside value to $88.

Downside case — **USD 58.00**

The integration of Health Net is not successful, Medicaid RFP expansion is delayed, and utilization trends increase. 10% downside to estimates along with a forward P/E multiple of 13.6x equates to a downside value of $58.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Cigna Summary: For a full copy of the report, please see "*CIGNA Corp.: Significant Shortfall Leads to Plan A*" published on August 1, 2016

For the past year, we have contended that Cigna was disinterested in a merger with Anthem. After being rebuffed by Cigna in the late spring of 2015, Anthem went public with their offer in late July 2015 forcing Cigna's hand (at the behest of shareholders). With few options, Cigna ultimately relented on its Plan B and agreed to sell to Anthem. Fast forward a year and the DOJ has sued to block the deal. While Cigna stated they would fulfil their contractual obligations for Anthem, as Anthem pursues remedies, it is clear, in our view, that Cigna will not go out of its way to assist in that process. Instead, Cigna can again focus on its Plan A, which was to operate as a standalone company and perhaps aggregate more scale itself. Unfortunately, as the Anthem transaction is ending, the standalone future of Cigna took a step back, as the company disclosed significant operating pressures. **While the company suggested that this is contained to two distinct areas that can easily be remedied, we see the weakness as likely more broad based and we have less confidence that 2017 immediately snaps back**. We would expect above average growth in 2017, especially with 2016 expected to be down 6%-10%, but we see the current consensus of $10.07 as simply unrealistic (and obviously that will reset down quickly). There is some support from significant financial flexibility but that will be a secondary consideration for investors until operations are back on track.

Cigna reported second quarter 2016 results that were below our estimate as well as consensus, driven primarily by pressure in the group disability and life segment, though we also saw pressure in the individual business and increased costs associated with the CMS sanction audits. As a result, **Cigna significantly cut guidance with EPS coming down by $1.20 at the midpoint (or 13.4%), lowering its 2016 cash EPS to a range of $7.75 to $8.10.** Approximately $0.90 of the EPS cut was driven by issues in the group disability and life segment, with 2/3 of the problem ($0.60) caused by group disability and 1/3 coming from the life segment ($0.30). **On the group disability issues, the company is going through a period of operational disruption caused by internal process changes in the claims review process, which take longer to remedy**. Cigna overhauled its claims review process but this disruption to the work flow triggered the temporary issue of slower claims review and a higher inventory backlog of claims. **Basically, Cigna is paying out more days of disability as it works through the higher inventory of claims.** The company expects the group disability business to improve in 2016 but these improvements are materializing at the slower pace than originally anticipated. Remember, the company suggested last quarter that this was a very short term issue and wouldn't impact the second half of 2016. **For the life segment, Cigna believes 2Q was a temporary dislocation and does not expect this issue to persist.** Unfavourable life claims spiked in April but moderated by June. According to the company, the life segment tends to be choppy and Cigna noted that they have experienced periods of volatility in the past. Given the reversion in the latter part of the second quarter, the company expects life claims to run closer to historical levels for the balance of the year.

Looking ahead at 2016 and 2017, we expect life and disability to be a lower contributor to earnings. Specifically, we expect life and disability to contribute just 2% to cash EPS and we expect this to improve to 11% in 2017. However, this is still below the historical average of ~15% contribution to earnings.

FIGURE 48

Segment EPS Contribution 2014-2017E

	2014	2015	2016E	2017E
Global Healthcare	$5.58	$6.57	$6.81	$7.24
% total EPS	*75%*	*76%*	*86%*	*78%*
Global Supplemental	$0.68	$0.93	$0.96	$1.02
% total EPS	*9%*	*11%*	*12%*	*11%*
Life & Disability	$1.17	$1.15	$0.18	$0.99
% total EPS	*16%*	*13%*	*2%*	*11%*
CASH EPS	$7.43	$8.66	$7.95	$9.25

* Note: 2014 EPS represents diluted EPS

Source: Company Documents, Barclays Research

U.S. Health Care-Managed Care **Industry View: POSITIVE**

CIGNA Corp. (CI)

Stock Rating: EQUAL WEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	37,876,000	39,599,124	39,588,103	N/A	N/A
EBITDA (adj)	4,330,000	4,075,569	4,318,626	N/A	N/A
EBIT (adj)	3,745,000	3,464,085	3,724,804	N/A	N/A
Pre-tax income (adj)	3,327,000	3,089,111	3,418,166	N/A	N/A
Net income (adj)	2,176,000	1,969,509	2,255,990	N/A	N/A
EPS (adj) ($)	8.66	7.95	9.25	N/A	N/A
Diluted shares (k)	260,595.0	259,636.8	253,900.0	N/A	N/A
DPS ($)	0.04	0.04	0.04	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	11.4	10.3	10.9	N/A	10.9
EBIT (adj) margin (%)	9.9	8.7	9.4	N/A	9.3
Pre-tax (adj) margin (%)	8.8	7.8	8.6	N/A	8.4
Net (adj) margin (%)	5.5	4.8	5.7	N/A	5.3
ROIC (%)	6.7	5.9	6.4	N/A	6.4
ROA (%)	3.8	3.2	3.6	N/A	3.5
ROE (%)	18.0	13.7	13.6	N/A	15.1

Balance sheet and cash flow ($mn)					CAGR
Tangible fixed assets	36,554	38,257	39,309	N/A	N/A
Intangible fixed assets	6,019	5,715	4,660	N/A	N/A
Cash and equivalents	2,349	3,946	6,436	N/A	N/A
Total assets	57,088	60,737	63,224	N/A	N/A
Short and long-term debt	5,169	5,089	5,089	N/A	N/A
Other long-term liabilities	17,312	17,901	17,418	N/A	N/A
Total liabilities	44,975	46,401	46,631	N/A	N/A
Net debt/(funds)	2,820	1,143	-1,347	N/A	N/A
Shareholders' equity	12,113	14,337	16,592	N/A	N/A
Change in working capital ($k)	992	1,183	1,776	N/A	N/A
Cash flow from operations ($k)	2,717,000	2,448,993	2,969,811	N/A	N/A
Capital expenditure ($k)	-510,000	-457,000	-480,000	N/A	N/A
Free cash flow ($k)	2,207,000	1,991,993	2,489,811	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	14.7	16.1	13.8	N/A	14.9
Equity FCF yield (%)	6.6	6.0	7.7	N/A	6.8
P/BV (x)	2.7	2.3	2.0	N/A	2.3
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Total debt/capital (%)	29.3	25.0	22.4	N/A	25.6

Selected operating metrics				
Medical loss ratio (%)	80.9	81.4	81.5	N/A
SG&A/sales (%)	N/A	N/A	N/A	N/A
Total membership (k)	16,475.0	16,193.3	15,958.5	N/A
Premium revenues PMPM ($)	632	642	649	N/A

Price (06-Sep-2016) **USD 127.58**

Price Target **USD 139.00**

Why Equal Weight? Cigna has a broad set of products allowing for growth. The company's limited exposure to individual and small group markets leave it relatively less exposed to the minimum MLR rule. Cigna is also expanding into international markets, a future area of less regulated growth.

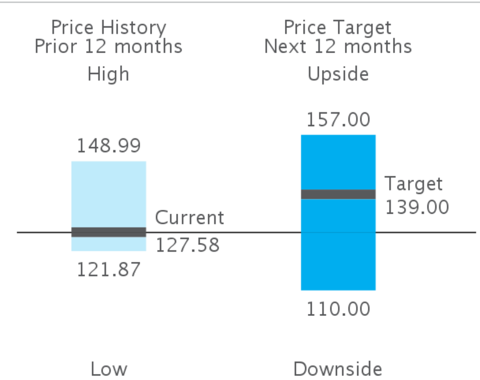
Upside case **USD 157.00**

Aspects of health reform are less onerous than expected, membership growth is stronger than projected, and the company can reduce its administrative cost ratio. Fwd P/E multiples expand to 15.4x, along with 10% upside to estimates brings valuation to $157.

Downside case **USD 110.00**

The transaction with Anthem is unsuccessful, utilization and cost trends accelerate, and Cigna is unable to improve its relative cost structure. 10% downside to estimates along with a forward P/E multiple of 13.2x equates to a valuation of $110.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Healthways Summary: For a full copy of the report, please see "*Healthways Inc.: Transformation to Significantly Improved Returns: Upgrade to EW*" published on August 22, 2016.

We have watched Healthways through many iterations over the past decade and a half. The company has seen periods of significant growth, periods of significant contraction and even a (very) few periods of stability. That said, the last several years were clearly not showing progress in any of the financial metrics. After a year-long strategic review, in part catalyzed by activist investors, the company changed leadership and now the entire operating focus. Healthways used to maintain a portfolio of various health and wellness services attempting to cater to every constituent in healthcare. **Going forward, the services offered and customers targeted are much more focused.** The company will shed approximately 40% of its revenues in this transformation. Most importantly, the company was able to find a "buyer" that took operating losses at what we estimate to be about 1x those losses (thought of another way – selling losses at 1x is similar to buying earnings at 1x). While we see many "transformations" across healthcare, we can say that the process for Healthways truly epitomizes that spirit. **Going forward, we see new entity as significantly more focused, maintaining a better growth trajectory, selling services with clear value to customers, and maintaining higher margins and return. Conversely, the market's reaction (which we view as correct) has led to significant appreciation that reflects some of this upside, and we still work to understand the sustainability of a business model that is a derivative of Medicare Advantage, especially in a period of share consolidation. All of that leads to our Equal Weight rating and increased price target**.

U.S. Health Care-Managed Care | **Industry View: POSITIVE**

Healthways Inc. (HWAY)

Stock Rating: EQUAL WEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	451,074	502,316	549,382	N/A	N/A
EBITDA (adj)	273,574	103,321	117,469	N/A	N/A
EBIT (adj)	269,845	95,798	110,327	N/A	N/A
Pre-tax income (adj)	261,473	79,311	94,583	N/A	N/A
Net income (adj)	247,436	-149,703	94,583	N/A	N/A
EPS (adj) ($)	0.58	2.13	2.50	N/A	N/A
Diluted shares (k)	37,002	37,173	37,865	N/A	N/A
DPS ($)	0.00	0.00	0.00	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	60.6	20.6	21.4	N/A	34.2
EBIT (adj) margin (%)	59.8	19.1	20.1	N/A	33.0
Pre-tax (adj) margin (%)	58.0	15.8	17.2	N/A	30.3
Net (adj) margin (%)	54.9	-29.8	17.2	N/A	14.1
ROIC (%)	4.4	22.9	28.3	N/A	18.5
ROA (%)	36.4	-29.7	18.7	N/A	8.5
ROE (%)	81.3	-109.7	40.9	N/A	4.2

Balance sheet and cash flow ($k)					CAGR
Tangible fixed assets	183,919	29,764	32,217	N/A	N/A
Intangible fixed assets	358,514	360,173	353,031	N/A	N/A
Cash and equivalents	3,752	4,635	4,635	N/A	N/A
Total assets	679,102	504,678	504,460	N/A	N/A
Short and long-term debt	235,670	189,244	95,518	N/A	N/A
Other long-term liabilities	-11,722	55,755	65,680	N/A	N/A
Total liabilities	374,625	368,240	273,439	N/A	N/A
Net debt/(funds)	231,918	184,609	90,883	N/A	N/A
Shareholders' equity	304,477	136,438	231,021	N/A	N/A
Change in working capital	-29,687	-14,409	15,471	N/A	N/A
Cash flow from operations	89,785	72,562	102,725	N/A	N/A
Capital expenditure	-34,730	-14,830	-9,000	N/A	N/A
Free cash flow	55,055	57,732	93,725	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	43.8	11.9	10.1	N/A	21.9
Equity FCF yield (%)	N/A	N/A	N/A	N/A	N/A
P/BV (x)	3.1	6.9	4.2	N/A	4.7
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Total debt/capital (%)	41.1	51.7	18.5	N/A	37.1

Selected operating metrics					
Medical loss ratio (%)	34.9	71.5	70.5	N/A	
SG&A/sales (%)	4.5	8.0	8.2	N/A	
Total membership	48,324,873.6	28,028,426.7	29,850,274.4	N/A	
Premium revenues PMPM ($)	0.72	1.36	1.37	N/A	

Price (06-Sep-2016)	USD 25.34
Price Target	USD 27.00

Why Equal Weight? Healthways Inc. has a new focuseed strategy selling services with clear value to customers, and maintaining higher margins and return. Conversely, the market's reaction has led to significant appreciation that reflects some of this upside, and we still work to understand the sustainability of a business model that is derivative of Medicare Advantage.

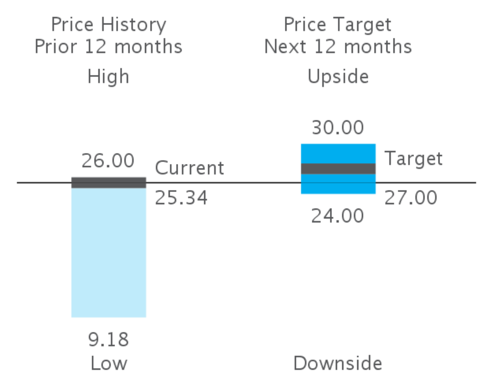
Upside case USD 30.00

2017 P/E expands to 20.0x our '17 adjusted fully taxed eps estimate, which brings upside case to $30.

Downside case USD 24.00

2017 P/E contracts to 16.0x our '17 adjusted fully taxed eps estimate, which brings downside case to $24.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Humana Summary: For a full copy of the report, please see "*Humana Inc.: Strong 2Q16; Setting the Table for a Higher 2017*" published on August 4, 2016.

The clear take-away from the second quarter was that earnings in 2016 are back on track and running favorable to prior expectations. More importantly, the extra strength seen in the Medicare book is being partially offset by higher losses in the individual segment. While we discuss the drivers of the upside below, we think it is important to set expectations for 2017, as investors should be prepared for Humana to operate as a standalone entity should the merger with Aetna fail.

In order to arrive at the right 2017 run rate, it is important to understand 2016 and there are quite a few moving parts to Humana's 2016 EPS. Overall we would categorize the unusual items in three buckets: a) Individual segment (especially ACA compliant) losses, b) prior period reserve development, and c) a small tax benefit. Within the individual segment, there are two sub-parts, the PDR and the 3R True-Ups**. We estimate the impact for the individual segment in total to be $1.08 per share, with $0.86 related to the PDR and $0.22 for the 3R True-Up.**

Next, we have to adjust 2016 for the favorable development Humana benefited from this year. Year to date, Humana has recorded a total of $435 million in favorable development. This is not the real impact to the income statement. The $435 million simply represents the total amount of reserves from 2015 that developed favorably (this is the redundancies on the reserve rollforward). If Humana is conservative every year, and accrues for modestly adverse conditions, then we would expect to see favorable development every year. That has been the case in recent years. What we are concerned with, is any excess development above normal levels that won't recur next year. As the chart below shows, last year PPRD in the first half of 2015 was 0.47% of prior year expenses. This was down from previous years, so the three year average is closer to 91%. Now, in 2016 the first half PPRD is 0.98% of prior year expense. That is elevated relative to the three year average and more so compared to last year. **We would guess that amount that will not recur is closer to the three-year average, and that implies that Humana is seeing a $34mm benefit to its income statement in 2016.**

FIGURE 49

PPRD Analysis ($ millions)

	PPRD	Prior Year Med Expense	as a %
1H16	$435	$44,269	0.98%
1H15	$178	$38,166	0.47%
1H14	$346	$32,321	1.07%
1H13	$366	$30,985	1.18%
3 Year Average	$297		0.91%
1H16 vs Average			0.08%
Excess to 3 years			$34
1H16 vs 1H15			0.52%
Excess to last year			$229

Source: Company Documents and Barclays Estimates

Beyond the PPRD, there was also a one-time tax benefit of $0.12 per share in the second quarter of 2016. With that, in the chart below we arrive at an adjusted EPS run rate for 2016 of $10.32 per share.

FIGURE 50

2016 Run Rate EPS Estimate

$ MM except for per share values	$ Pretax	EPS
2016 GAAP Guidance (at least)		**$8.56**
Aetna integration costs		$0.37
Amrotization Expense		$0.32
2016 Adjsuted EPS Guidance (At Least)		**$9.25**
2Q16 addition to PDR	$208	$0.86
2Q16 Three R's True Up	$52	$0.22
Total Individual Segment		**$1.08**
Favorable PPRD YTD	($32)	($0.13)
Tax Benefit		$0.12
2016 Run Rate EPS		**$10.32**

Source: Company Documents, Barclays Estimates

Moving to 2017 it is unreasonable to start with the $10.32 per share as a base. While that is the 2016 runrate, it really represents Humana's earnings excluding the impact of the individual business and that will not be the case next year. In addition to the $1.08 in losses this year, the company had already booked a PDR$0.74 per share in 4Q15 for losses to be incurred in 2016 (and that was too low as we know now). Also, in addition to the PDR amounts, there are actual losses for continuing operations in the individual segment that were not eligible for the PDR running through the 2016 income statement. **We estimate**

that total losses related to the individual segment, when including the 3 Rs impact, is close to $700 million, or just under $3 per share. As discussed below, Humana is making significant changes to its individual segment in 2017 including market exits, the cessation of off-exchange offerings, rate increases and other actions. It is way too early to know the impact of these actions, but we believe that based on the expected reduction in premiums (about 71%-79% lower in 2017), **we think that continuing losses in the individual segment in 2017 could run about $150-$200, or $0.65-$0.85 per shar**e. Over time, we would expect those losses to move to zero but that will not be the case in 2017. **With that, 2017 is probably starting at a run rate closer to $9.60 per share. For some perspective our $10.60 per share estimate in 2017 implies a growth rate of just over 10% on what we view to be the starting run rate.**

U.S. Health Care-Managed Care — **Industry View: POSITIVE**

Humana Inc. (HUM)

Stock Rating: EQUAL WEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	54,289,000	54,782,375	55,404,395	N/A	N/A
EBITDA (adj)	2,702,000	3,231,793	3,074,676	N/A	N/A
EBIT (adj)	2,347,000	2,880,695	2,750,560	N/A	N/A
Pre-tax income (adj)	2,161,000	2,692,281	2,573,266	N/A	N/A
Net income (adj)	1,172,808	1,350,541	1,556,826	N/A	N/A
EPS (adj) ($)	8.12	9.30	10.60	N/A	N/A
Diluted shares (k)	151,142.3	150,780.5	150,918.3	N/A	N/A
DPS ($)	1.15	N/A	N/A	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	5.0	5.9	5.5	N/A	5.5
EBIT (adj) margin (%)	4.3	5.3	5.0	N/A	4.8
Pre-tax (adj) margin (%)	4.0	4.9	4.6	N/A	4.5
Net (adj) margin (%)	2.2	2.5	2.8	N/A	2.5
ROIC (%)	7.7	8.3	9.0	N/A	8.3
ROA (%)	4.7	5.0	5.5	N/A	5.1
ROE (%)	11.3	11.6	11.8	N/A	11.6

Balance sheet and cash flow ($mn)					CAGR
Tangible fixed assets	5,729	5,867	5,926	N/A	N/A
Intangible fixed assets	3,265	2,976	2,652	N/A	N/A
Cash and equivalents	9,838	11,122	12,593	N/A	N/A
Total assets	24,705	27,270	28,476	N/A	N/A
Short and long-term debt	4,120	4,093	4,093	N/A	N/A
Other long-term liabilities	2,386	2,105	1,634	N/A	N/A
Total liabilities	14,359	15,663	15,312	N/A	N/A
Net debt/(funds)	-5,718	-7,029	-8,500	N/A	N/A
Shareholders' equity	10,346	11,608	13,164	N/A	N/A
Change in working capital	202	1,103	1,351	N/A	N/A
Cash flow from operations ($k)	879,000	1,492,239	2,000,942	N/A	N/A
Capital expenditure ($k)	523,000	518,000	530,000	N/A	N/A
Free cash flow ($k)	356,000	974,239	1,470,942	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	21.8	19.0	16.7	N/A	19.2
Equity FCF yield (%)	N/A	N/A	N/A	N/A	N/A
P/BV (x)	N/A	N/A	N/A	N/A	N/A
Dividend yield (%)	0.7	N/A	N/A	N/A	0.7
Total debt/capital (%)	28.5	26.1	23.7	N/A	26.1

Selected operating metrics				
Medical loss ratio (%)	84.5	83.7	84.6	N/A
SG&A/sales (%)	N/A	N/A	N/A	N/A
Total membership (k)	14,222.8	14,246.5	14,124.6	N/A
Premium revenues PMPM ($)	210	215	221	N/A

Price (06-Sep-2016)	**USD 176.78**
Price Target	**USD 191.00**

Why Equal Weight? Humana has a broad set of products allowing for growth. The company's strong Medicare presence provides a stable membership base. Humana's strong leadership team allows it to adapt quickly under health reform.

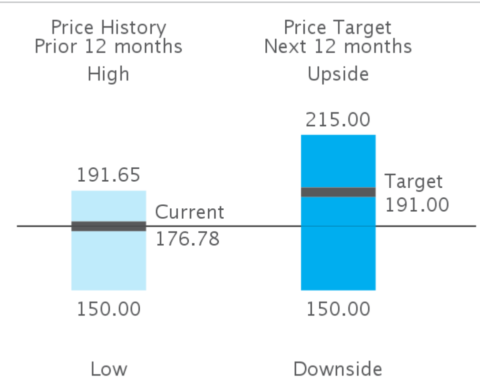
Upside case — **USD 215.00**

Reform is less onerous than expected, membership growth is stronger than projected, and the company continues to outperform its long term 4.5% target margin in Medicare. Forward P/E multiple expands to 21.0x, along with 10% upside to estimates brings value to $215.

Downside case — **USD 150.00**

The transaction with Aetna is unsuccessful, minimum MLRs have a larger impact, cost trends increase above projections and reimbursement pressures in MA lead to membership declines. 10% downside to estimates along with a forward P/E multiple of 17.9x equates to a value of $150.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

Magellan Summary: For a full copy of the report, please see "*Magellan Health Inc.: Soft Quarter Offset by Acquisition Allows for Higher Profit Guidance*" published on August 1, 2016.

Magellan reported a somewhat mixed result for the second quarter of 2016. Revenue, segment profit, and EPS were below our estimates, though it appears the results were closer to management's projections. That said, Magellan is increasing guidance for most of these metrics (EPS is coming down) due to the recently completed AFSC acquisition. The company reported what we view to be a slightly lower quarter though "close enough" to broader expectations. Earnings per share came in well below our estimates at $0.16, compared to our estimate of $0.42. Additionally, overall segment profit was reported at $56.9 million and when adjusted for the $2 million of favorable items, this was $5.7 million below our estimate of $60.6 million. Healthcare segment weakness and higher corporate expenses were partially offset by better Pharmacy segment results. Additionally, the company took an impairment charge of $4.8 million in the quarter on acquisition intangibles due to its exit of certain lines in the AlphaCare JV. **Looking at 2016 guidance, Magellan is adding $140 million to revenues at the midpoint and increasing adjusted EPS by $0.26 at the midpoint. However the company is reducing its GAAP EPS guidance as the transaction is dilutive when considering amortization (which we believe should be considered).**

The quarter produced revenues and segment profit that were below our estimates. **As compared to the Street, revenues were above consensus while EPS was below consensus (we do not have a consensus for segment profit).** We note that the results of the quarter were favourably impacted by roughly $2 million of non-recurring items, and as a result segment profit would have been further below our estimate once adjusted for the favorable items. **As noted, segment profit was reported to be 6.1% below our estimate and was still 9.4% below our estimate when we exclude the one time benefits.** Recently, the company consolidated its Commercial, Public and Specialty Solutions segments into the Healthcare segment. From a segment perspective, we saw some upside from the pharmacy segment, partially offset by lower than expected segment profit from the healthcare segment and higher corporate expenses.

Revenues came 0.9% below our expectations and segment profit came in below our estimates by 6.1%. On the top line, upside came from higher Pharmacy segment revenues relative to our estimates and as well as higher Healthcare segment revenues. However, this was more than offset by intersegment eliminations, which came in 1.5% higher than our expectations. Looking at expenses, cost of goods sold was meaningfully higher than our estimate, while cost of care was lower than our estimate, and direct services costs and other expenses came in above our expectations, as well. D&A came in 3.5% higher than our estimates and investment income came in 3.7% higher than our estimates while interest expense was above our estimate. The tax rate in the quarter was above our estimate. Cash flow from operations was an outflow of $(86.5) million came in well below our estimate of $48.5 million.

Magellan reported second quarter 2016 results with GAAP EPS of $0.16, well below our estimate of $0.42 and below the Street consensus of $0.58. On an adjusted cash basis, EPS of $0.58 was below our estimate of $0.62. **Revenues for the quarter came in below our expectations, due to higher than expected eliminations which exceeded our estimates by 1.5%.** Revenues were reported at $1.16 billion, up 0.6% from the prior year, and 0.9% below our estimate. While Magellan reported revenues for its two primary segments that came in above our expectations, the corporate eliminations segment offset this. The biggest deviations from our model was the interest expense and tax rate (52.2% above our estimates), which led to significantly lower than expected EPS. Conversely, we saw a deteriorating in the corporate and healthcare sectors, coming in below our estimates at 6.9% and 8.7% respectively. In aggregate, segment profit was reported at $56.89 million, up 7.0% from the prior year and down 5.1% q/q.

Looking more closely at the operating segments, we would categorize the quarter as showing stronger results in the health care segment and pharmacy segments, offset by weaker results in the corporate segment. Starting with the Healthcare segment, revenues came in $637 million or 1.5% above our estimate, while segment profit was $50.7 million or 6.9% below our estimate. We note that the upside in the healthcare segment revenues was driven primarily by direct service costs. In the **Pharmacy Management** segment, revenues were $557 million or 2.1% above our estimates. We note that Pharmacy segment profit was $50.7 million up 6.9% y/y. Lastly, **Corporate expenses** were $31.0 million an increase of 11.1% y/y**.**

U.S. Health Care-Managed Care | **Industry View: POSITIVE**

Magellan Health Inc. (MGLN)

Stock Rating: UNDERWEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	4,597,400	4,804,858	5,195,919	N/A	N/A
EBITDA (adj)	183,247	254,049	265,456	N/A	N/A
EBIT (adj)	80,403	153,316	155,157	N/A	N/A
Pre-tax income (adj)	73,822	132,102	146,187	N/A	N/A
Net income (adj)	31,413	61,437	86,250	N/A	N/A
EPS (adj) ($)	3.62	3.85	4.30	N/A	N/A
Diluted shares (k)	25,617.3	24,552.0	24,658.5	N/A	N/A
DPS ($)	0.00	0.00	0.00	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	4.0	5.3	5.1	N/A	4.8
EBIT (adj) margin (%)	1.7	3.2	3.0	N/A	2.6
Pre-tax (adj) margin (%)	1.6	2.7	2.8	N/A	2.4
Net (adj) margin (%)	0.7	1.2	1.7	N/A	1.2
ROIC (%)	2.5	4.5	5.9	N/A	4.3
ROA (%)	1.5	2.8	3.9	N/A	2.7
ROE (%)	2.8	5.2	6.8	N/A	4.9

Balance sheet and cash flow ($k)					CAGR
Tangible fixed assets	189,778	230,441	230,756	N/A	N/A
Intangible fixed assets	754,764	609,005	442,981	N/A	N/A
Cash and equivalents	437,771	677,808	969,071	N/A	N/A
Total assets	2,069,060	2,168,314	2,293,868	N/A	N/A
Short and long-term debt	257,309	254,539	254,539	N/A	N/A
Other long-term liabilities	34,410	41,405	22,275	N/A	N/A
Total liabilities	996,940	971,218	952,088	N/A	N/A
Net debt/(funds)	-180,462	-423,269	-714,532	N/A	N/A
Shareholders' equity	1,072,120	1,197,096	1,341,780	N/A	N/A
Change in working capital	-181,390	230,752	291,263	N/A	N/A
Cash flow from operations	239,185	134,933	176,493	N/A	N/A
Capital expenditure	71,584	60,522	78,000	N/A	N/A
Free cash flow	167,601	74,411	98,493	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	15.1	14.2	12.7	N/A	14.0
Equity FCF yield (%)	N/A	N/A	N/A	N/A	N/A
P/BV (x)	N/A	N/A	N/A	N/A	N/A
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Total debt/capital (%)	18.2	16.2	14.7	N/A	16.4

Selected operating metrics				
Medical loss ratio (%)	N/A	N/A	N/A	N/A
SG&A/sales (%)	N/A	N/A	N/A	N/A
Total membership (k)	55,982.0	52,887.3	53,293.1	N/A
Premium revenues PMPM ($)	7	8	8	N/A

Price (06-Sep-2016)	USD 54.68
Price Target	USD 68.00

Why Underweight? Magellan Health Services is a diversified specialty health care management organization, managing behavioral health, radiology and specialty pharmacy services for government agencies, health plans and corporations. We believe the company is well positioned for growth under health reform.

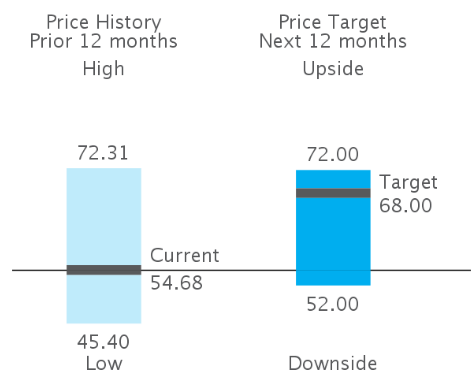
Upside case USD 72.00

Health reform expands market opportunities, and Magellan continues to win new contracts. Company also continues share repurchase and M&A activity. Fwd P/E multiple increased to 17.8x, along with 5% upside to estimates brings upside case to $72.

Downside case USD 52.00

Company loses contracts, implementation of health reform stalls, or physical health plans expand into behavioral services. 5% downside to estimates along with a fwd P/E multiple of 14.2x equates to a downside case of $52.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

UnitedHealth Summary: For a full copy of the report, please see "*UnitedHealth Group: 2Q16 Review: Tangible 2017 Wins with Just Respect for Negatives*" published on July 20, 2016.

In the report below, we speak to the strength of UnitedHealth's second quarter results and continuing momentum on the top line, which is being obfuscated by additional noise around exchanges. **Our focus this quarter is on 2017, as that is where investor focus will be in the very short term. That focus is suggestive of higher earnings and stronger top line gains that we had previously assumed.**

Over the past few months we have heard several tangible sources of stronger growth in 2017. UnitedHealth has spoken about more than $2B of wins for OptumRx in 2017. There was commentary around using the insurance fee holiday next year to augment benefits selectively in MA, a business that is growing the top line more than an estimated 15% this year already. On top of that, more MA lives will be 4 star plans which should further accelerate growth. In Medicaid, the company spoke about its significant pipeline and 20 RFPs that the company expects to bid on. In national accounts we would expect the dissonance caused from M&A among the other plans to lead to a very strong 2017 for UnitedHealth. In the OptumHealth segment, the company pointed to an acceleration in its urgent care operations (think about growth that is 3-6x a typical year. Lastly, and perhaps most importantly, **the company has already lost $605 million, or about $0.38 per share, in public exchanges in 2016 and those losses will disappear as the company exits that market.** The 2016 losses are fully absorbed in guidance for 2016. There were numerous other tangible examples of growth accelerants in 2017.

When asked about potential headwinds for 2017, CEO Hemsley suggested that while there were no tangible negatives, the company must always "be respectful" of government reimbursement (forget the fact that Medicare is about 60% of government revenues and those rates are already set for 2017) as well as changes in medical cost trends. In a similar vein we are respectful of those comments. But realistically, we think that 2017 is setting up for strength that could accelerate the momentum seen in 2017.

With the elimination of exchange losses, and tangible top line wins already known, we are increasing our estimates for 2017 above the consensus. We now see EPS growth of 15%, which is within the company's long term target of 13%-16%, and we believe that this is a conservative starting point.

U.S. Health Care-Managed Care — **Industry View: POSITIVE**

UnitedHealth Group (UNH)

Stock Rating: OVERWEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	157,107,000	183,170,287	195,543,376	N/A	N/A
EBITDA (adj)	12,714,000	14,893,399	16,037,477	N/A	N/A
EBIT (adj)	11,021,000	12,876,556	14,326,473	N/A	N/A
Pre-tax income (adj)	10,231,000	11,827,739	13,366,012	N/A	N/A
Net income (adj)	5,813,000	7,071,534	8,310,587	N/A	N/A
EPS (adj) ($)	6.44	7.90	9.10	N/A	N/A
Diluted shares (k)	966,500.0	966,250.0	960,750.0	N/A	N/A
DPS ($)	1.85	2.33	2.44	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	8.1	8.1	8.2	N/A	8.1
EBIT (adj) margin (%)	7.0	7.0	7.3	N/A	7.1
Pre-tax (adj) margin (%)	6.5	6.5	6.8	N/A	6.6
Net (adj) margin (%)	3.7	3.9	4.3	N/A	4.0
ROIC (%)	9.7	10.1	12.3	N/A	10.7
ROA (%)	5.9	6.2	7.2	N/A	6.4
ROE (%)	16.9	18.4	18.3	N/A	17.9

Balance sheet and cash flow ($mn)					CAGR
Tangible fixed assets	26,900	86,305	86,305	N/A	N/A
Intangible fixed assets	52,844	-3,719	-12,139	N/A	N/A
Cash and equivalents	12,911	14,432	18,794	N/A	N/A
Total assets	111,383	119,342	115,284	N/A	N/A
Short and long-term debt	32,094	33,198	33,198	N/A	N/A
Other long-term liabilities	7,564	1,945	-10,882	N/A	N/A
Total liabilities	75,922	77,593	65,114	N/A	N/A
Net debt/(funds)	19,183	18,766	14,404	N/A	N/A
Shareholders' equity	35,461	41,750	50,170	N/A	N/A
Change in working capital	-4,192	-799	4,014	N/A	N/A
Cash flow from operations ($k)	9,740,000	9,813,851	11,006,222	N/A	N/A
Capital expenditure ($k)	-1,556,000	-1,689,000	-1,800,000	N/A	N/A
Free cash flow ($k)	8,184,000	8,124,851	9,206,222	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	21.1	17.2	14.9	N/A	17.7
Equity FCF yield (%)	6.2	6.2	7.1	N/A	6.5
P/BV (x)	3.7	3.1	2.6	N/A	3.2
Dividend yield (%)	1.4	1.7	1.8	N/A	1.6
Total debt/capital (%)	47.5	44.3	39.8	N/A	43.9

Selected operating metrics					
Medical loss ratio (%)	81.7	82.0	82.5	N/A	
SG&A/sales (%)	N/A	N/A	N/A	N/A	
Total membership (k)	51,455	52,912	53,993	N/A	
Premium revenues PMPM ($)	400	429	438	N/A	

Price (06-Sep-2016)	USD 135.97
Price Target	USD 164.00

Why Overweight? UnitedHealth maintains a leadership position in various health benefit segments, which should lead to share gains. The company also differentiates itself through its faster growing Health Services segment (Optum) which provides a higher margin growth opportunity.

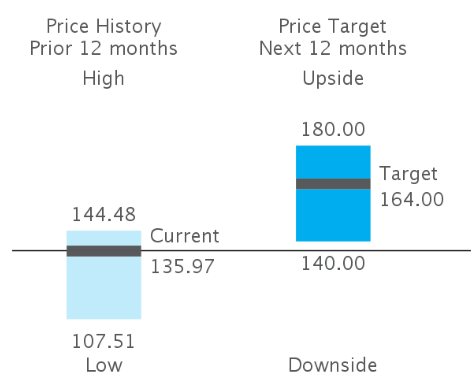
Upside case — USD 180.00

UNH maintains positive pricing spread and investors recognize the premium that should accrue to its services segment. Forward P/E of 20.7x and 10% upside to estimates brings upside case to $180.

Downside case — USD 140.00

Reform more onerous, utilization/cost trends increase above projections and rate increases are subject to strict regulatory review, while UNH is not rewarded for its services segment. 10% downside to estimates with a forward P/E of 19.7x equates to downside case of $140.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

WellCare Summary: For a full copy of the report, please see "*WellCare Health Plans: Strong 2Q16; We Review Longer Term Opportunity*" published on August 3, 2016.

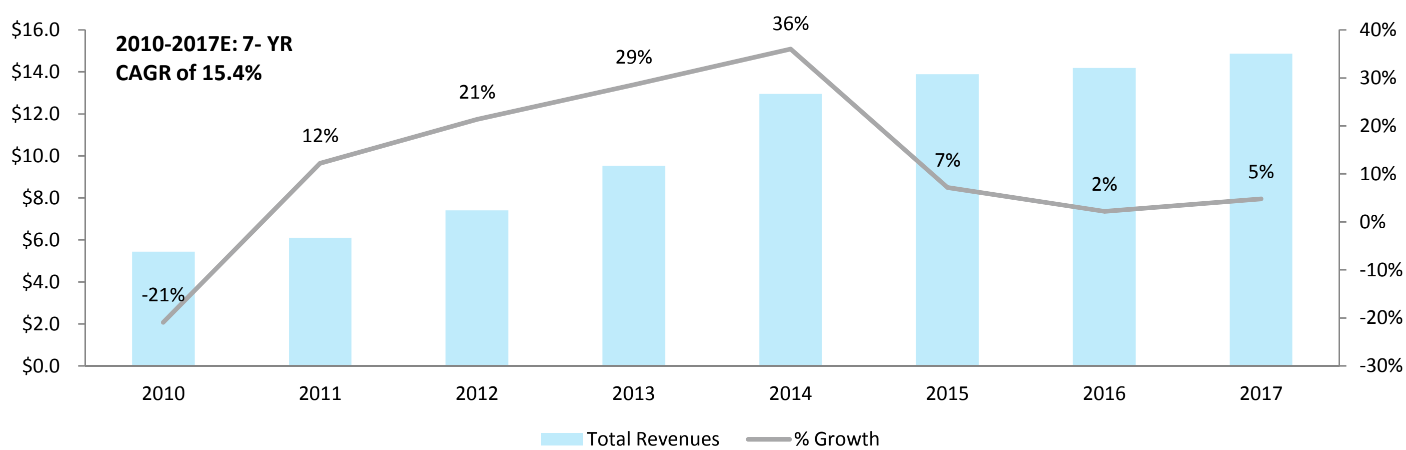
WellCare's results this quarter were certainly strong, as margins expanded noticeably and there was improvement in all three segments for the company. As we have said in the past, **margin expansion is one part of the opportunity for WellCare, with top-line growth being the second part**. We continue to believe it will be challenging for the company to reach its goals of doubling company revenues between 2017 and 2021 without a large scale acquisition. That said, there was certainly progress on the margin front this quarter.

We would have thought the greatest near-term sizeable acquisition opportunity would have come from a plan divested in one of the large HMO transactions but that is not the case for the Aetna-Humana transaction. With that, it is tough to have visibility into how the company reaches its revenue growth goal without sizeable acquisitions. We assume the majority of the growth would accelerate and come at the later end of the 2017-2021 time frame. CFO Asher noted on the call, that even the company expects the growth rate in 2017 to come in at a more modest level as the company ramps up the growth rate in future years. **The company pointed to recent acquisitions (Advicare), the Nebraska contract win and PDP bid progress for 2017 will aid its growth prospects for the end of 2016 and into 2017.**

We note that Wellcare's current 2016 guidance implies revenue growth of just 2.2% (significantly below peer growth rates), and we are starting with a growth rate just above 5% in 2017 (remember the industry fee will be a headwind to the top line).

FIGURE 51

Revenue Growth 2010-2017E



Source: Company Documents and Barclays Estimates

As mentioned above WellCare established a long-term target to achieve net margins of 2.0%+. For 2016 we estimate WellCare's net margin will be 1.4%, which screens favorabaly to peers. After a very tough 2014, WellCare reported a net margin of 0.81% in 2015 up 43bps year-over-year. Over the past three years Wellcare has reported average net margins of 1.02%. This compares to average net margin of 2.45% between 2002-2012, however keep in mind the tax rate since has increased from 36% to 57% (though that should decline with higher operating earnings and the elimination of the industry fee in 2017). All that said, **while margin expansion could lead to meaningful earnings upside we believe that top-line growth will remain modest**.

FIGURE 52

Revenues & Net Margins 2002-2017E

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017E
Total Revenues ($ in MM)	$921	$1,045	$1,384	$1,872	$3,753	$5,391	$6,522	$6,878	$5,440	$6,107	$7,409	$9,528	$12,960	$13,890	$14,195	$14,872
% growth (Y/Y)		*13.5%*	*32.4%*	*35.2%*	*100.5%*	*43.6%*	*21.0%*	*5.5%*	*(20.9)%*	*12.3%*	*21.3%*	*28.6%*	*36.0%*	*7.2%*	*2.2%*	*4.8%*
Net Margin	**3.49%**	**2.20%**	**3.07%**	**2.52%**	**3.39%**	**4.89%**	**1.12%**	**0.58%**	**-0.98%**	**4.15%**	**2.49%**	**1.87%**	**0.38%**	**0.81%**	**1.40%**	**1.63%**
YOY Change (bps)		(129)bps	87bps	(55)bps	87bps	150bps	(377)bps	(54)bps	(156)bps	513bps	(166)bps	(62)bps	(149)bps	43bps	59bps	22bps

Source: Company Documents and Barclays Estimates

As we look at the opportunity going forward, we revisit the earnings power story for WellCare. If WellCare is correct and it can double the company's revenues between 2017-2021 and earn a margin of 2.0%, **the adjusted EPS power would be a range of approximately $11.35-$14.54 per share** in 2021 and that is predicated on doubling our 2016 revenue estimates. Based on WellCare's share price at market close (8/2) of $111.91 **that would imply a multiple of about 8.6x the midpoint of that earnings power range, which again is predicated on the top line doubling!** We believe that there is meaningful upside to that multiple if the company can achieve those targeted margins. However, in order to see appreciation from these levels, we believe that WellCare needs to show higher revenues. **Said another way, even with a 2% net margin on 2016 revenues, the company would earn an estimated $6.37 per share, implying a current valuation of 17.6x that peak margin estimate.**

U.S. Health Care-Managed Care — **Industry View: POSITIVE**

WellCare Health Plans (WCG)

Stock Rating: EQUAL WEIGHT

Income statement ($k)	2015A	2016E	2017E	2018E	CAGR
Revenue	13,890,200	14,194,867	14,872,045	N/A	N/A
EBITDA (adj)	456,700	602,601	546,837	N/A	N/A
EBIT (adj)	384,100	515,360	457,605	N/A	N/A
Pre-tax income (adj)	330,000	455,930	402,953	N/A	N/A
Net income (adj)	112,500	199,176	241,772	N/A	N/A
EPS (adj) ($)	3.43	5.00	5.60	N/A	N/A
Diluted shares (k)	44,391.0	44,573.4	44,825.0	N/A	N/A
DPS	N/A	N/A	N/A	N/A	N/A

Margin and return data					Average
EBITDA (adj) margin (%)	3.2	4.1	3.6	N/A	3.6
EBIT (adj) margin (%)	2.7	3.5	3.0	N/A	3.0
Pre-tax (adj) margin (%)	2.4	3.2	2.7	N/A	2.8
Net (adj) margin (%)	0.8	1.4	1.6	N/A	1.3
ROIC (%)	4.8	7.2	8.2	N/A	6.7
ROA (%)	2.3	3.6	4.1	N/A	3.4
ROE (%)	6.8	10.9	11.7	N/A	9.8

Balance sheet and cash flow ($k)					CAGR
Tangible fixed assets	581,900	555,500	555,500	N/A	N/A
Intangible fixed assets	343,200	327,359	254,578	N/A	N/A
Cash and equivalents	2,611,400	3,004,012	3,153,847	N/A	N/A
Total assets	5,193,600	5,808,771	5,885,825	N/A	N/A
Short and long-term debt	912,100	1,097,200	1,097,200	N/A	N/A
Other long-term liabilities	111,600	257,795	93,078	N/A	N/A
Total liabilities	3,465,300	3,871,095	3,706,378	N/A	N/A
Net debt/(funds)	-1,699,300	-1,906,812	-2,056,647	N/A	N/A
Shareholders' equity	1,722,200	1,937,676	2,179,447	N/A	N/A
Change in working capital	236,300	582,912	149,835	N/A	N/A
Cash flow from operations	712,700	231,812	316,286	N/A	N/A
Capital expenditure	-137,000	-79,200	-150,000	N/A	N/A
Free cash flow	575,700	152,612	166,286	N/A	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	32.9	22.6	20.2	N/A	25.2
Equity FCF yield (%)	N/A	N/A	N/A	N/A	N/A
P/BV (x)	2.9	2.6	2.3	N/A	2.6
Dividend yield (%)	N/A	N/A	N/A	N/A	N/A
Total debt/capital (%)	34.6	36.2	33.5	N/A	34.8

Selected operating metrics				
Medical loss ratio (%)	88.3	87.6	88.0	N/A
SG&A/sales (%)	N/A	N/A	N/A	N/A
Total membership	3,767,000.0	3,809,721.4	4,280,385.8	N/A
Premium revenues PMPM ($)	297	305	289	N/A

Price (06-Sep-2016)	USD 112.98
Price Target	USD 118.00

Why Equal Weight? Wellcare operates in both Medicare and Medicaid, though with concentrated Medicaid enrollment in a few states. The company is well positioned for Medicaid expansion. Additionally, its MA and PDP exposure provides a nice diversification.

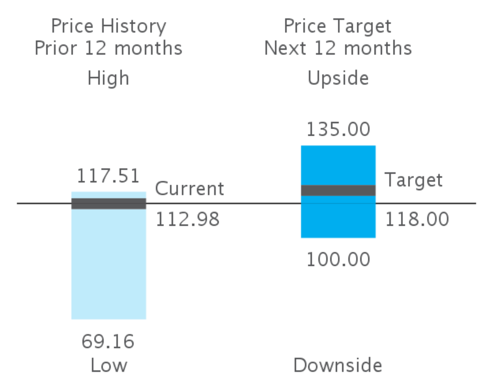
Upside case — **USD 135.00**

Company significantly expands through RFP wins, membership growth is stronger than projected, and margins revert to industry norms. Fwd P/E multiples expand to 21.9x, bringing upside value to $135.

Downside case — **USD 100.00**

Medicaid RFPs are delayed, government regulation slows enrollment in MA, litigation overhang continues, and flu season is stronger than expected. 10% downside to estimates along with a forward P/E multiple of 19.8x equates to a downside value of $100.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

STOCK PERFORMANCE

FIGURE 53

Managed Care Performance

Managed Care	Closing Stock Price 9/6/2016	2013	1Q14	2Q14	3Q14	4Q14	2014	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16
Aetna	$116.37	49.8%	9.6%	8.5%	0.2%	9.9%	30.8%	20.2%	19.9%	(14.0%)	(1.0%)	22.8%	4.1%	8.9%
Anthem	$124.29	53.4%	8.2%	8.5%	11.6%	5.4%	37.9%	23.4%	6.7%	(14.3%)	0.0%	12.9%	0.1%	(5.1%)
Centene	$65.30	43.8%	(42.3%)	22.1%	11.0%	12.6%	76.2%	36.1%	13.7%	(32.5%)	21.4%	26.7%	(6.4%)	15.9%
Cigna	$127.58	63.7%	(4.2%)	9.8%	(1.4%)	13.5%	17.7%	25.8%	25.2%	(16.7%)	8.4%	42.2%	(6.2%)	(6.7%)
Healthways	$25.34	43.5%	11.7%	2.3%	(8.7%)	24.1%	29.5%	(0.9%)	(39.2%)	(7.2%)	15.7%	(35.3%)	(21.6%)	14.5%
Humana	$176.78	52.0%	9.5%	13.6%	2.2%	10.5%	40.2%	24.1%	7.6%	(6.3%)	(0.1%)	25.1%	2.6%	(1.5%)
Magellan Health	$54.68	22.3%	(0.9%)	4.9%	(12.1%)	9.7%	0.2%	18.0%	(1.1%)	(20.9%)	11.2%	2.7%	10.2%	(3.2%)
Molina Healthcare	$55.00	28.4%	8.1%	18.8%	(5.2%)	26.5%	54.0%	25.7%	4.5%	(2.1%)	(12.7%)	12.3%	7.3%	(22.6%)
UnitedHealth	$135.97	40.8%	9.3%	0.2%	6.0%	17.6%	36.1%	17.5%	3.6%	(4.5%)	1.8%	18.2%	10.0%	9.9%
Universal American	$6.91	3.6%	(3.2%)	17.8%	(3.5%)	18.2%	27.1%	15.1%	(5.2%)	(32.4%)	2.3%	(16.5%)	2.0%	6.2%
WellCare	$112.98	44.6%	(9.8%)	17.5%	(19.2%)	36.4%	16.5%	11.5%	(7.2%)	1.6%	(9.2%)	(4.7%)	18.6%	15.7%
Average		**39.0%**	**0.9%**	**12.2%**	**(0.7%)**	**16.7%**	**37.2%**	**19.1%**	**2.9%**	**(12.9%)**	**4.3%**	**9.7%**	**1.9%**	**2.9%**
National (AET,ANTM,CI,UNH)		51.9%	5.7%	6.7%	4.1%	11.6%	30.6%	21.7%	13.8%	(12.4%)	2.3%	24.1%	2.0%	1.8%
Regional (CVH,HNT,HUM)		37.0%	12.0%	12.7%	1.5%	16.9%	60.3%	18.6%	(8.5%)	(6.5%)	9.8%	25.1%	2.6%	6.5%
Medicaid (AGP,CNC,MOH,WCG)		38.9%	(14.7%)	19.5%	(4.5%)	25.2%	44.4%	24.4%	3.7%	(11.0%)	(0.2%)	11.5%	6.5%	3.0%
Medicare (HS, HUM,UAM)		27.8%	3.2%	15.7%	(0.6%)	14.3%	33.7%	19.6%	1.2%	(19.3%)	1.1%	4.3%	2.3%	2.3%
Ancillary (HWAY, MGLN)		32.9%	5.4%	3.6%	(10.4%)	16.9%	14.9%	8.5%	(20.1%)	(14.0%)	13.5%	(16.3%)	(5.7%)	5.6%
S&P500 Index	$2,179.98	29.6%	1.3%	4.7%	0.6%	4.4%	11.4%	0.4%	(0.2%)	(6.9%)	6.5%	N/A	0.8%	1.9%
Russell 2000 Index	$1,251.83	37.0%	0.8%	1.7%	(6.6%)	8.1%	3.5%	4.0%	0.1%	(12.2%)	3.2%	N/A	(1.9%)	3.4%
NASDAQ Composite	$5,007.41	38.3%	0.5%	5.0%	1.9%	5.4%	13.4%	3.5%	1.8%	(7.4%)	8.4%	5.7%	(2.7%)	(0.6%)

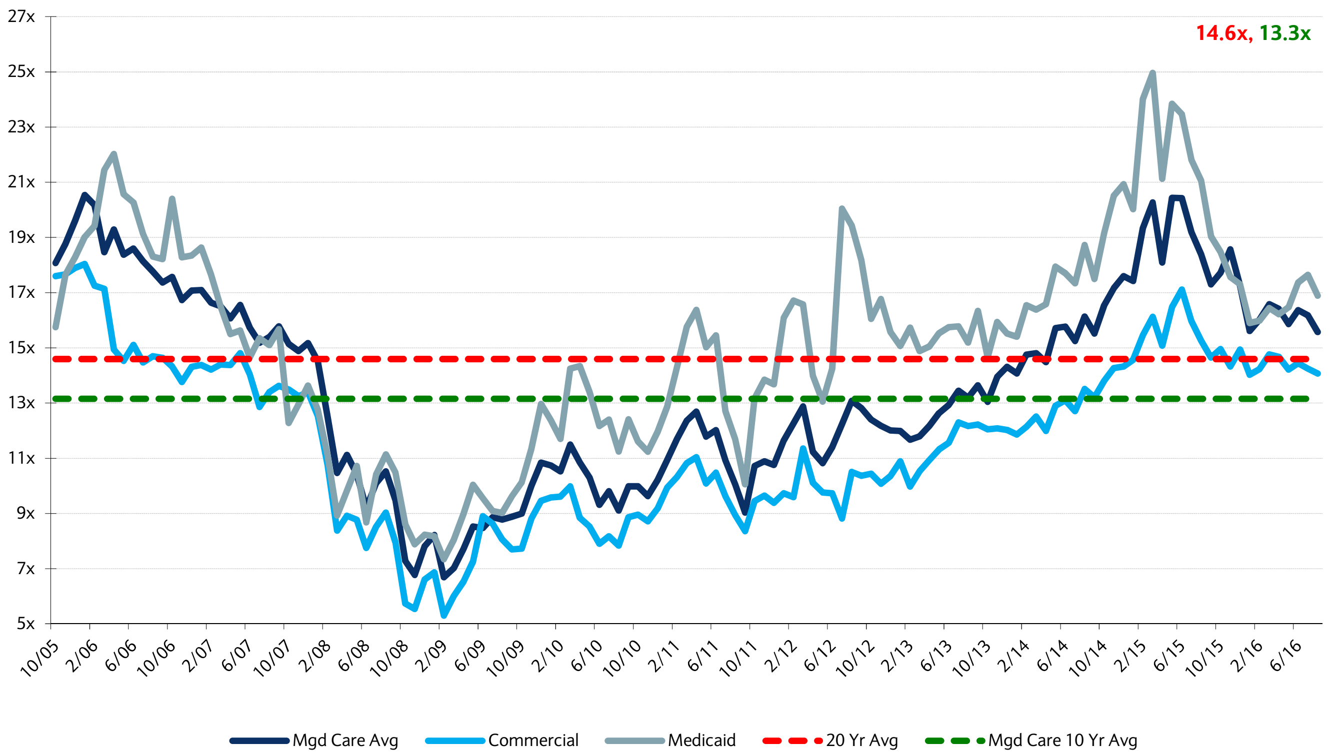
Source: Thomson ONE

VALUATION UPDATE AND METHODOLOGY

The managed care group currently trades at 15.6x forward twelve month (FTM) estimates. This compares to the S&P 500, which is at 17.5x forward twelve month estimates. On a relative basis, the managed care group multiple is currently trading at a discount to the market multiple. The average absolute FTM multiple for the managed care group over the past five years is 14.6x, with an average relative discount of 2% to the average market multiple of 14.8x. **We note that the current commercial average of 14.0x forward earnings represents a 25% discount to the market multiple, compared to a 16% discount over the past five years**.

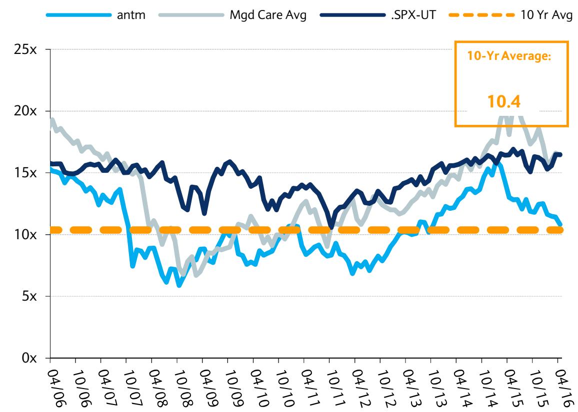
FIGURE 54

Managed Care 10-Year Absolute FTM P/E Multiples



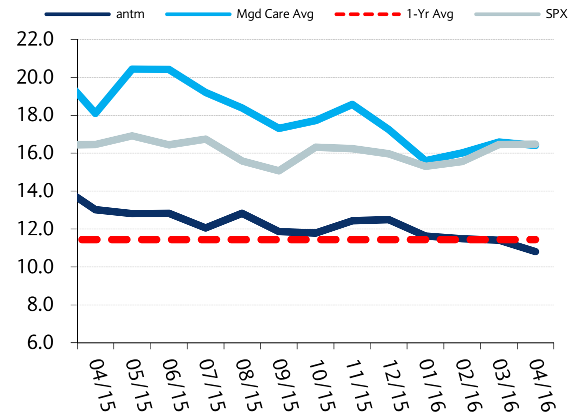
Source: Thomson ONE

FIGURE 55
ANTM 10-Year FTM P/E Multiple



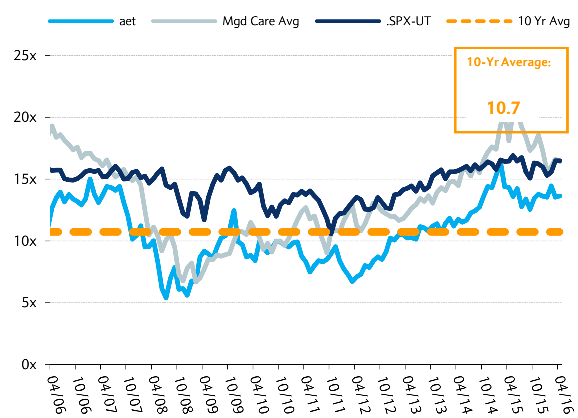
Source: Thomson ONE

FIGURE 56
ANTM 1-Year FTM P/E Multiple



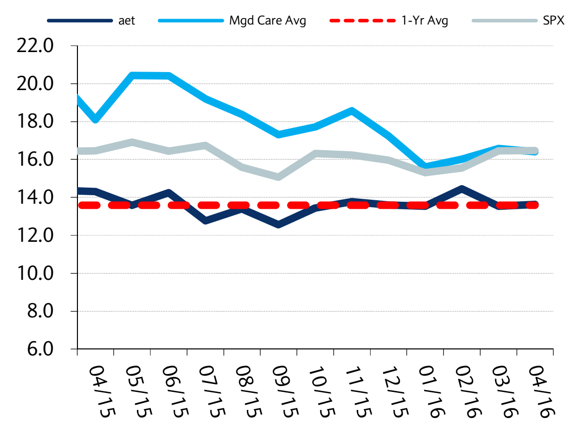
Source: Thomson ONE

FIGURE 57
AET 10-Year FTM P/E Multiple



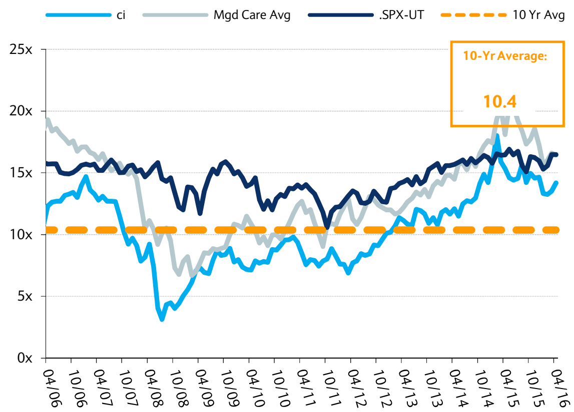
Source: Thomson ONE

FIGURE 58
AET 1-Year FTM P/E Multiple



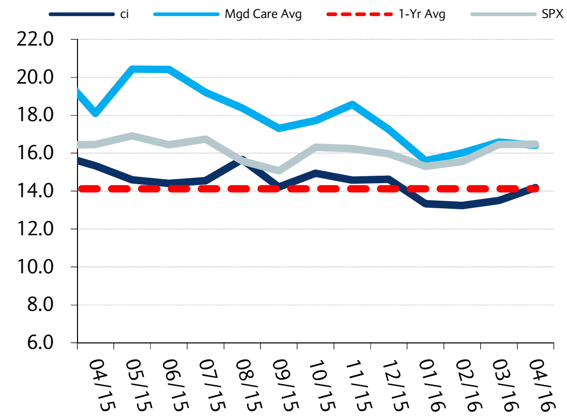
Source: Thomson ONE

FIGURE 59
CI 10-Year FTM P/E Multiple



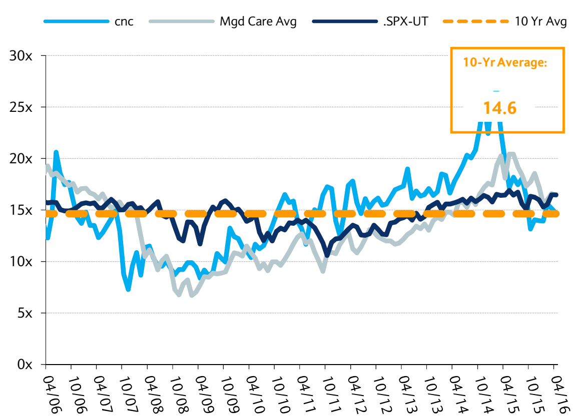
Source: Thomson ONE

FIGURE 60
CI 1-Year FTM P/E Multiple



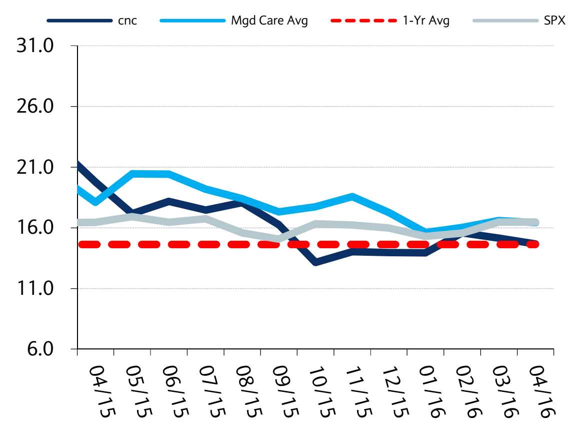
Source: Thomson ONE

FIGURE 61
CNC 10-Year FTM P/E Multiple



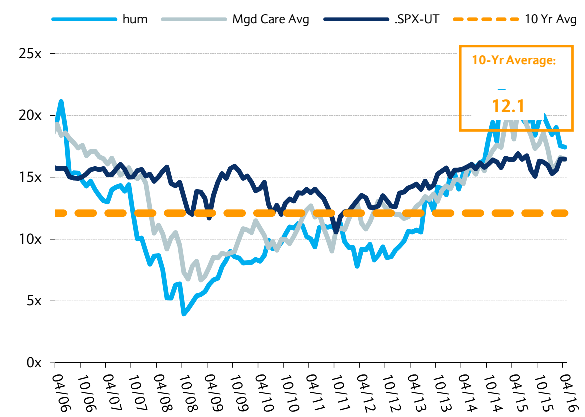
Source: Thomson ONE

FIGURE 62
CNC 1-Year FTM P/E Multiple



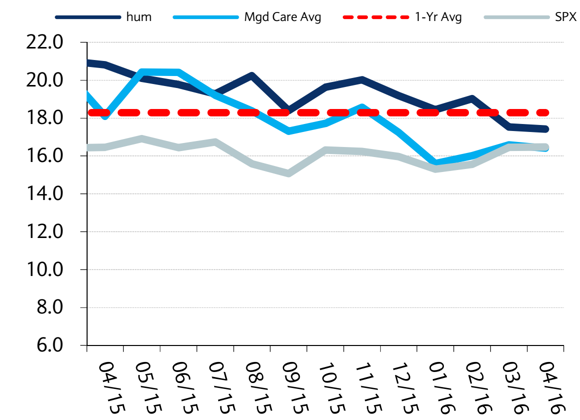
Source: Thomson ONE

FIGURE 63
HUM 10-Year FTM P/E Multiple



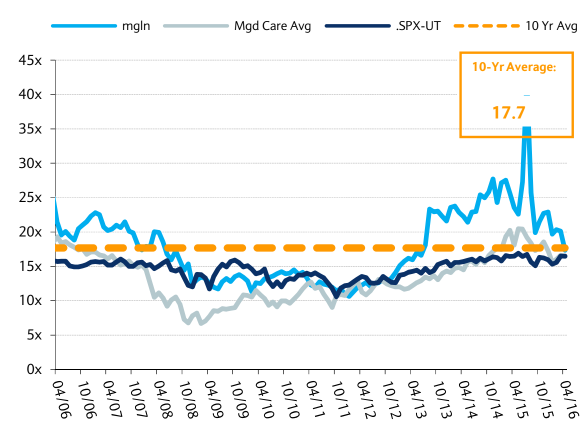
Source: Thomson ONE

FIGURE 64
HUM 1-Year FTM P/E Multiple



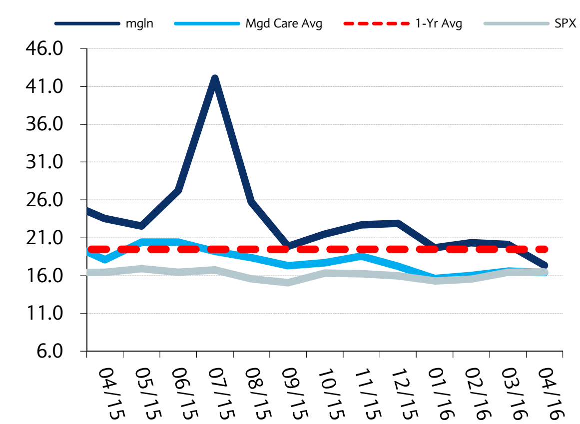
Source: Thomson ONE

FIGURE 65
MGLN 10-Year FTM P/E Multiple



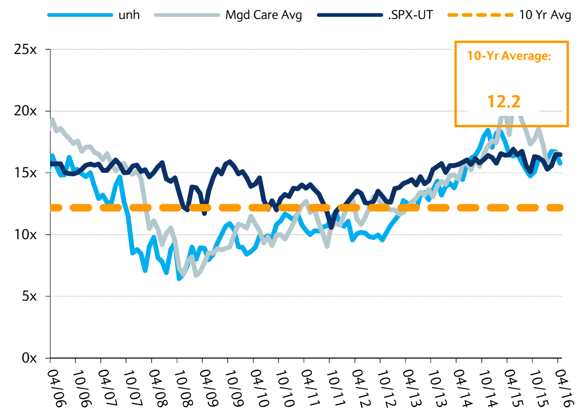
Source: Thomson ONE

FIGURE 66
MGLN 1-Year FTM P/E Multiple



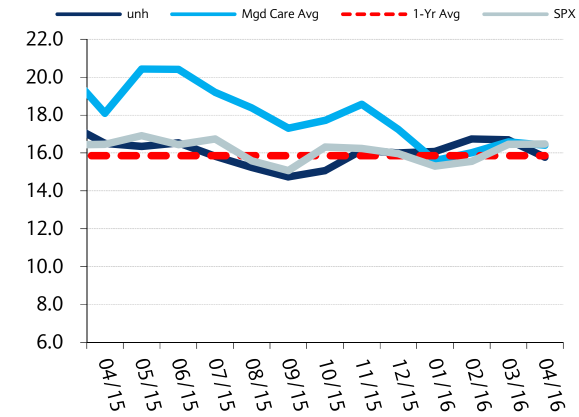
Source: Thomson ONE

FIGURE 67
UNH 10-Year FTM P/E Multiple



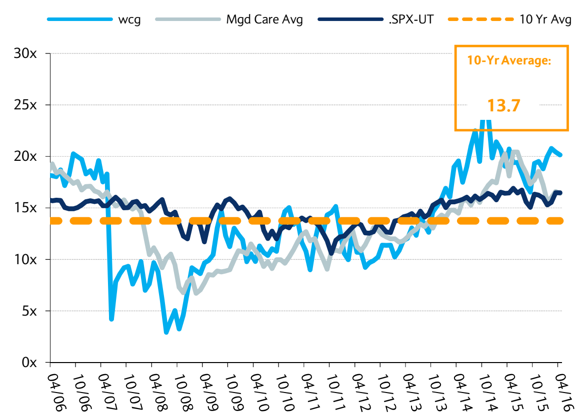
Source: Thomson ONE

FIGURE 68
UNH 1-Year FTM P/E Multiple



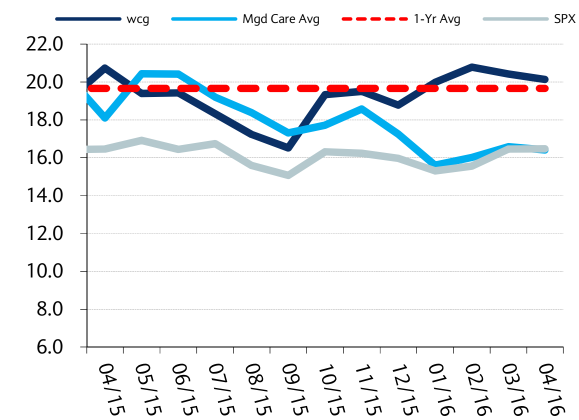
Source: Thomson ONE

FIGURE 69
WCG 10-Year FTM P/E Multiple



Source: Thomson ONE

FIGURE 70
WCG 1-Year FTM P/E Multiple



Source: Thomson ONE

FIGURE 71
Valuation Methodology

Rating	TICKER	Price Target	'17 Target Multiple	2017 EPS Est	Prem/Disc to Group Mult	Group Multiple	Prem/Disc to Current Mult.	Current Multiple
OW	AET	$ 152.00	17.1x	$8.90	18%	14.5x	31%	13.1x
EW	ANTM	$ 151.00	12.9x	$11.70	-11%	14.5x	21%	10.6x
OW	CNC	$ 82.00	17.1x	$4.80	18%	14.5x	26%	13.6x
EW	CI	$ 139.00	15.0x	$9.25	4%	14.5x	9%	13.8x
EW	HWAY	$ 27.00	10.8x	$2.50	-25%	14.5x	N/A	10.1x
EW	HUM	$ 191.00	18.0x	$10.60	24%	14.5x	8%	16.7x
UW	MGLN	$ 68.00	15.8x	$4.30	9%	14.5x	24%	12.7x
RS	MOH		N/A	$3.73	N/A	14.5x	N/A	14.7x
RS	UAM		N/A	N/A	N/A	14.5x	N/A	N/A
OW	UNH	$ 164.00	18.0x	$9.10	24%	14.5x	21%	14.9x
EW	WCG	$ 118.00	21.1x	$5.60	45%	14.5x	4%	20.2x

Source: Reuters and Barclays Research Estimates. Stock rating: OW = Overweight; EW= Equal Weight; UW = Underweight, RS = Rating Suspended; Price targets are based on a multiple of 2016 EPS estimates. Pricing as of 9/6/2016

ANALYST(S) CERTIFICATION(S):

I, Joshua R. Raskin, CFA, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Materially Mentioned Stocks (Ticker, Date, Price)

Aetna Inc. (AET, 06-Sep-2016, USD 116.37), Overweight/Positive, A/CD/CE/D/E/J/K/L/M

Other Material Conflicts: Barclays Bank and/or its affiliate is acting as exclusive financial advisor and has provided a debt commitment letter to Molina Healthcare, Inc. (NYSE:MOH) in relation to its announcement that it has entered into definitive agreements to acquire certain Medicare Advantage assets from both Aetna Inc. (NYSE:AET) and Humana Inc. (NYSE:HUM). The rating, price target and estimates (as applicable) on Aetna Inc. and Humana Inc., previously-issued by the Firm's Research department, do not incorporate this potential transaction.

AmSurg Corp. (AMSG, 06-Sep-2016, USD 66.31), Rating Suspended/Neutral, CD/CE/J/K/M

Other Material Conflicts: Barclays Bank Plc and/or its affiliate is acting as financial advisor to Envision Healthcare Corporation (NYSE: EVHC) in relation to its potential merger agreement with Amsurg Corporation (NASDAQ:AMSG). The rating, price target, and estimates (as applicable) on Envision Healthcare Corporation and Amsurg Corporation previously issued by the firm's Research department have been temporarily-suspended due to this potential transaction.

Anthem, Inc. (ANTM, 06-Sep-2016, USD 124.29), Equal Weight/Positive, CD/CE/D/E/J/K/L/M/N

Centene Corp. (CNC, 06-Sep-2016, USD 65.30), Overweight/Positive, A/CD/CE/D/E/J/K/L/M

CIGNA Corp. (CI, 06-Sep-2016, USD 127.58), Equal Weight/Positive, CD/CE/J/K/M/N

Healthways Inc. (HWAY, 06-Sep-2016, USD 25.34), Equal Weight/Positive, CD/CE/J

Humana Inc. (HUM, 06-Sep-2016, USD 176.78), Equal Weight/Positive, CD/CE/J/K/M

Other Material Conflicts: Barclays Bank and/or its affiliate is acting as exclusive financial advisor and has provided a debt commitment letter to Molina Healthcare, Inc. (NYSE:MOH) in relation to its announcement that it has entered into definitive agreements to acquire certain Medicare Advantage assets from both Aetna Inc. (NYSE:AET) and Humana Inc. (NYSE:HUM). The rating, price target and estimates (as applicable) on Aetna Inc. and Humana Inc., previously-issued by the Firm's Research department, do not incorporate this potential transaction.

Magellan Health Inc. (MGLN, 06-Sep-2016, USD 54.68), Underweight/Positive, CE/J

Molina Healthcare (MOH, 06-Sep-2016, USD 55.00), Rating Suspended/Positive, A/CD/CE/D/J/L

Other Material Conflicts: Barclays Bank and/or its affiliate is acting as exclusive financial advisor and has provided a debt commitment letter to Molina Healthcare, Inc. (NYSE:MOH) in relation to its announcement that it has entered into definitive agreements to acquire certain Medicare Advantage assets from both Aetna Inc. (NYSE:AET) and Humana Inc. (NYSE:HUM). The rating, price target and estimates (as applicable) on Molina Healthcare Inc., previously-issued by the Firm's Research department, have been temporarily-suspended due to this potential transaction.

UnitedHealth Group (UNH, 06-Sep-2016, USD 135.97), Overweight/Positive, A/CD/CE/D/J/K/L/M

WellCare Health Plans (WCG, 06-Sep-2016, USD 112.98), Equal Weight/Positive, CD/CE/J/K/M

Prices are sourced from Thomson Reuters as of the last available closing price in the relevant trading market.

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P: A partner, director or officer of Barclays Capital Canada Inc. has, during the preceding 12 months, provided services to the subject company for remuneration, other than normal course investment advisory or trade execution services.

Q: Barclays Bank PLC and/or an affiliate is a Corporate Broker to this issuer.

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Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-

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month investment horizon.

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Rating Suspended - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

Industry View

Positive - industry coverage universe fundamentals/valuations are improving.

Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

Negative - industry coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "industry coverage universe":

U.S. Health Care Facilities		
American Renal Associates Holdings Inc. (ARA)	AmSurg Corp. (AMSG)	Brookdale Senior Living (BKD)
CareTrust REIT, Inc. (CTRE)	Civitas Solutions, Inc. (CIVI)	Community Health Systems (CYH)
Envision Healthcare (EVHC)	HCA Holdings Inc. (HCA)	HCP, Inc. (HCP)
HealthSouth Corp. (HLS)	Kindred Healthcare (KND)	LifePoint Health, Inc. (LPNT)
Sabra Healthcare REIT (SBRA)	Surgery Partners, Inc. (SGRY.O)	Surgical Care Affiliates Inc. (SCAI)
Team Health Holdings Inc. (TMH)	Tenet Healthcare Corp. (THC)	Universal Health Services (UHS)
Ventas, Inc. (VTR)	Welltower Inc. (HCN)	

U.S. Health Care-Managed Care		
Aetna Inc. (AET)	Anthem, Inc. (ANTM)	Centene Corp. (CNC)
CIGNA Corp. (CI)	Healthways Inc. (HWAY)	Humana Inc. (HUM)
Magellan Health Inc. (MGLN)	Molina Healthcare (MOH)	UnitedHealth Group (UNH)
Universal American Corp. (UAM)	WellCare Health Plans (WCG)	

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