By revenue, UnitedHealth Group is the nation's largest publicly traded managed care company. It operates through two business segments, UnitedHealthcare and Optum. UnitedHealthcare provides healthcare benefits through four membership groups: Employers & Individual, Medicare & Retirement, Community & State, and International. Optum is a health services business that serves payers, care providers, employers, governments, life science companies and consumers. Optum uses advanced data analytics and technology to help optimize the performance of clients. Optum includes OptumRx, which operates a pharmacy benefit management service (PBM).

## Analyst's Notes

*Analysis by David Toung and Katelyn Bayone, July 21, 2016*

**ARGUS RATING: BUY**

- Upgrading to BUY with $170 target
- We think that UnitedHealth's decision to exit most of the ACA public exchange markets in 2017 will limit its exposure to unprofitable business and lead to stronger EPS growth in 2017.
- We also have a favorable view of the company's Optum businesses, which are growing faster and generating higher margins than its insurance division.
- Based on the company's updated guidance and strong 2Q results, we are raising our adjusted EPS estimates to $7.85 from $7.80 for 2016 and to $9.00 from $8.70 for 2017.
- UNH trades at 15.8-times our 2017 EPS estimate, slightly below the average of 16.2 for our coverage universe of healthcare services stocks. Given the company's strong growth drivers, we view this as an attractive valuation.

**INVESTMENT THESIS**

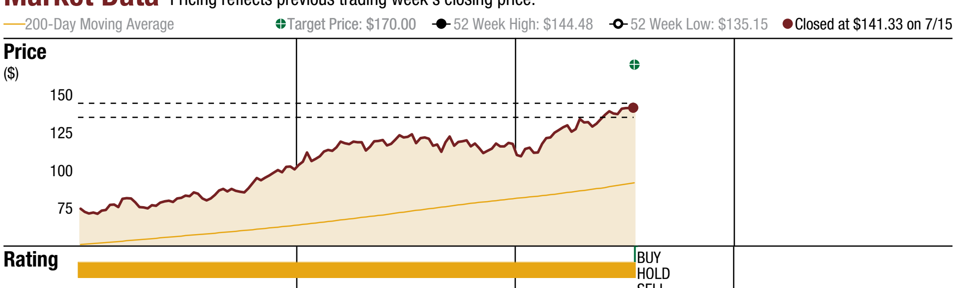
We are upgrading UnitedHealth Group Inc. (NYSE: UNH) to BUY from HOLD and setting a price target of $170. We think that UnitedHealth's decision to exit most of the ACA public exchange markets in 2017 will limit its exposure to unprofitable business and lead to stronger EPS growth in 2017. We also have a favorable view of the company's Optum businesses, which are growing faster and generating higher margins than its insurance division. In our view, Optum also has greater flexibility to expand organically and through acquisitions as it is not subject to insurance industry regulations. We note that OptumRx, the company's pharmacy benefit management business, saw revenue rise 69% year-over-year in 2Q16.

**RECENT DEVELOPMENTS**

UNH delivered strong 2Q16 results on July 19. Although the company faces rising utilization and higher costs for its ACA-compliant plans, we expect these pressures to abate

## Market Data

Pricing reflects previous trading week's closing price.




**EPS ($)**

| | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 | 2016 Q3 | 2016 Q4 | 2017 Q1 | 2017 Q2 | 2017 Q3 | 2017 Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Quarterly | 1.10 | 1.42 | 1.63 | 1.55 | 1.55 | 1.73 | 1.77 | 1.40 | 1.81 | 1.96 | 2.15 | 1.93 | 2.25 | 2.30 | 2.30 | 2.15 |
| Annual | 5.70 | | | | 6.45 | | | | 7.85 (Estimate) | | | | 9.00 (Estimate) | | | |

**Revenue ($ in Bil.)**

| | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 | 2015 Q1 | 2015 Q2 | 2015 Q3 | 2015 Q4 | 2016 Q1 | 2016 Q2 | 2016 Q3 | 2016 Q4 | 2017 Q1 | 2017 Q2 | 2017 Q3 | 2017 Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Quarterly | 31.7 | 32.6 | 32.8 | 33.4 | 35.8 | 36.3 | 41.5 | 43.6 | 44.5 | 46.5 | 44.4 | 46.7 | 47.6 | 49.7 | 47.5 | 49.9 |
| Annual | 130.5 | | | | 157.1 | | | | 182.1 (Estimate) | | | | 194.8 (Estimate) | | | |

FY ends Dec 31

## Argus Recommendations

| | | | |
|---|---|---|---|
| **Twelve Month Rating** | SELL | HOLD | **BUY** |
| **Five Year Rating** | SELL | HOLD | **BUY** |
| **Sector Rating** | Under Weight | **Market Weight** | Over Weight |

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

**The distribution of ratings across Argus' entire company universe is: 47% Buy, 47% Hold, 6% Sell.**

## Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

**Market Overview**

| | |
|---|---|
| Price | $142.87 |
| Target Price | $170.00 |
| 52 Week Price Range | $95.00 to $144.48 |
| Shares Outstanding | 950.80 Million |
| Dividend | $2.50 |

**Sector Overview**

| | |
|---|---|
| Sector | Healthcare |
| Sector Rating | MARKET WEIGHT |
| Total % of S&P 500 Market Cap. | 14.00% |

**Financial Strength**

| | |
|---|---|
| Financial Strength Rating | MEDIUM-HIGH |
| Debt/Capital Ratio | 47.5% |
| Return on Equity | 20.4% |
| Net Margin | 3.5% |
| Payout Ratio | 0.30 |
| Current Ratio | 0.74 |
| Revenue | $176.10 Billion |
| After-Tax Income | $6.18 Billion |

**Valuation**

| | |
|---|---|
| Current FY P/E | 15.87 |
| Prior FY P/E | 18.20 |
| Price/Sales | 0.77 |
| Price/Book | 3.74 |
| Book Value/Share | $38.16 |
| Market Capitalization | $135.84 Billion |

**Forecasted Growth**

| | |
|---|---|
| 1 Year EPS Growth Forecast | 21.71% |
| 5 Year EPS Growth Forecast | 15.00% |
| 1 Year Dividend Growth Forecast | 26.74% |

**Risk**

| | |
|---|---|
| Beta | 0.91 |
| Institutional Ownership | 87.85% |

**Please see important information about this report on page 4**

## Analyst's Notes...Continued

as it exits the public exchange markets in all but three states in 2017.

Second-quarter adjusted EPS came to $1.96, up from $1.73 a year earlier and above the consensus forecast of $1.89. GAAP net income rose to $1.75 billion or $1.81 per share from $1.58 billion or $1.73 per share in 2Q15. Revenue grew 28% to $46.5 billion. Both UnitedHealthcare (insurance) and Optum (services, health IT, and pharmacy benefit management) recorded strong revenue growth.

Revenue in the insurance business rose 14% to $37.6 billion, though the segment margin fell 90 basis points to 5.2%. This was largely due to wider losses from ACA-compliant plans underwritten by UNH. The consolidated medical loss ratio was 82.0%, up 30 basis points. With the exchange plans accounting for $200 million in losses over and above previous projections, the MLR rose a net 50 basis points. Excluding the exchange plan losses, however, the MLR declined (improved). Management noted that hospital admissions of members continue to trend lower, though the utilization of specialty pharma, and ER and outpatient services has been trending higher. Overall, the company said that its commercial medical trend remains consistent with its original projection of 6.0%, plus/minus 50 basis points.

In the Optum segment, which includes three separate businesses (OptumHealth, OptumInsight and OptumRx), revenue grew 52% to $20.6 billion, though the segment margin declined 30 basis points to 6.1%. This reflected strong membership growth at OptumRx pharmacy services, which has lower margins than the other Optum businesses. On the positive side, OptumRx revenue rose 69% to $15.1 billion, driven by acquisitions and organic growth.

### EARNINGS & GROWTH ANALYSIS

UNH has raised its earnings guidance for 2016, and now expects adjusted EPS of $7.80-$7.95, up from a prior $7.75-$7.90. It reaffirmed its revenue forecast of $182 billion.

Based on the updated guidance and strong 2Q results, we are raising our adjusted EPS estimates to $7.85 from $7.80 for 2016 and to $9.00 from $8.70 for 2017. We expect that UNH's exit from most of the public exchange markets will end the losses experienced in 2016 and lead to stronger earnings growth in 2017.

### RISKS

UnitedHealth and other insurers face higher costs related to compliance with the Affordable Care Act. In response, UNH is raising prices and has decided to withdraw from the public exchanges in all but three states.

### COMPANY DESCRIPTION

By revenue, UnitedHealth Group is the nation's largest publicly traded managed care company. It operates through two business segments, UnitedHealthcare and Optum. UnitedHealthcare provides healthcare benefits through four membership groups: Employers & Individual, Medicare & Retirement, Community &

## Growth & Valuation Analysis

### GROWTH ANALYSIS

| ($ in Millions, except per share data) | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Revenue | 103,712 | 113,676 | 123,857 | 134,522 | 165,878 |
| COGS | 77,966 | 85,427 | 92,978 | 99,730 | 127,484 |
| Gross Profit | 25,746 | 28,249 | 30,879 | 34,792 | 38,394 |
| SG&A | 16,036 | 17,824 | 19,942 | 22,436 | 25,236 |
| R&D | — | — | — | — | — |
| Operating Income | 8,560 | 9,076 | 9,538 | 10,860 | 11,341 |
| Interest Expense | 535 | 662 | 690 | 608 | 899 |
| Pretax Income | 8,025 | 8,414 | 8,848 | 10,252 | 10,442 |
| Income Taxes | 2,841 | 3,036 | 3,316 | 4,319 | 4,360 |
| Tax Rate (%) | 36 | 36 | 42 | 43 | — |
| Net Income | 5,184 | 5,330 | 5,532 | 5,933 | 6,011 |
| Diluted Shares Outstanding | 1,077 | 1,038 | 1,015 | 979 | 967 |
| EPS | 4.82 | 5.13 | 5.44 | 6.06 | 6.22 |
| Dividend | 0.65 | 0.85 | 1.12 | 1.50 | 2.00 |

### GROWTH RATES (%)

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Revenue | 8.6 | 10.7 | 6.5 | 20.6 | — |
| Operating Income | 9.3 | 4.0 | 6.8 | 7.3 | — |
| Net Income | 7.5 | 1.8 | -0.1 | 3.5 | — |
| EPS | 11.6 | 4.2 | 3.6 | 5.4 | — |
| Dividend | 30.6 | 31.6 | 33.5 | 33.5 | — |
| Sustainable Growth Rate | 15.8 | 14.2 | 13.1 | 13.4 | 12.2 |

### VALUATION ANALYSIS

| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| Price: High | $60.75 | $75.88 | $104.00 | $126.21 | — |
| Price: Low | $49.82 | $51.36 | $69.57 | $95.00 | — |
| Price/Sales: High-Low | 0.6 - 0.5 | 0.7 - 0.5 | 0.9 - 0.6 | 0.9 - 0.7 | — - — |
| P/E: High-Low | 12.6 - 10.3 | 14.8 - 10.0 | 19.1 - 12.8 | 20.8 - 15.7 | — - — |
| Price/Cash Flow: High-Low | 8.9 - 7.3 | 10.3 - 6.9 | 15.5 - 10.4 | 14.1 - 10.6 | — - — |

## Financial & Risk Analysis

| FINANCIAL STRENGTH | 2014 | 2015 | 2016 |
|---|---|---|---|
| Cash ($ in Millions) | — | — | — |
| Working Capital ($ in Millions) | — | — | — |
| Current Ratio | 0.77 | 0.74 | — |
| LT Debt/Equity Ratio (%) | 49.3 | 75.3 | — |
| Total Debt/Equity Ratio (%) | 53.6 | 94.9 | — |
| **RATIOS (%)** | | | |
| Gross Profit Margin | 25.3 | 23.6 | — |
| Operating Margin | 7.9 | 7.0 | — |
| Net Margin | 4.3 | 3.7 | — |
| Return On Assets | 6.7 | 5.9 | — |
| Return On Equity | 17.4 | 17.5 | — |
| **RISK ANALYSIS** | | | |
| Cash Cycle (days) | — | — | — |
| Cash Flow/Cap Ex | — | — | — |
| Oper. Income/Int. Exp. (ratio) | 16.6 | 14.0 | — |
| Payout Ratio | — | — | |



**Please see important information about this report on page 4**

## Analyst's Notes...Continued

State, and International. Optum is a health services business that serves payers, care providers, employers, governments, life science companies and consumers. Optum uses advanced data analytics and technology to help optimize the performance of clients. Optum includes OptumRx, which operates a pharmacy benefit management service (PBM).

### INDUSTRY

Our recommended weighting on the Healthcare sector is Market-Weight. We lowered our weighting from Over-Weight amid signs that a new Democratic president would attempt to impose drug price caps, and that a Republican president would continue attempts to dismantle the Affordable Care Act. The Healthcare sector accounts for 14.7% of the S&P 500, and includes companies in the pharmaceuticals, hospital, medical devices, and insurance industries.

The Healthcare sector has benefited from its perceived insulation from economic turbulence. In addition, many Healthcare stocks have benefited as the pool of people with insurance expands under the ACA.

The sector outperformed in 2015, with a gain of 5.2%, and in 2014, with a gain of 23.3%. It is underperforming thus far in 2016, with a gain of 3.3%.

Fundamentals for Healthcare stocks appear reasonable. According to our model, the projected P/E ratio on 2017 EPS is 14.5, below the market multiple of 15.4. The sector's debt ratios are low, with an average debt-to-cap ratio of 35%, below the market average. Yields of about 1.7% are below the average for the S&P 500, but still attractive for some Big Pharma companies.

### VALUATION

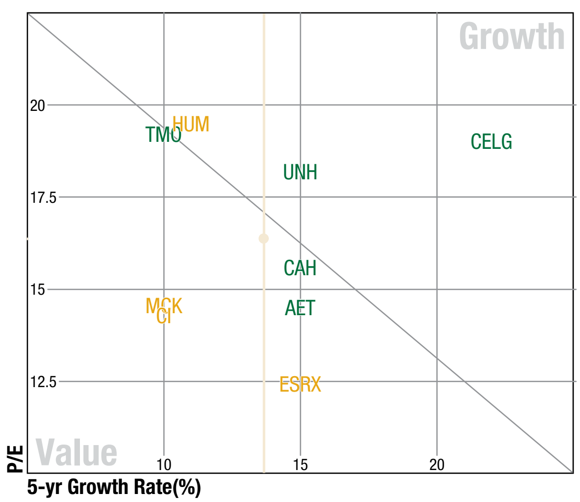
UNH trades at 15.8-times our 2017 EPS estimate, slightly below the average of 16.2 for our coverage universe of healthcare services stocks. Given the company's strong growth drivers, we think this is an attractive valuation. We are raising our rating to BUY with a price target of $170.

On July 21, BUY-rated UNH closed at $142.87, down $0.15.

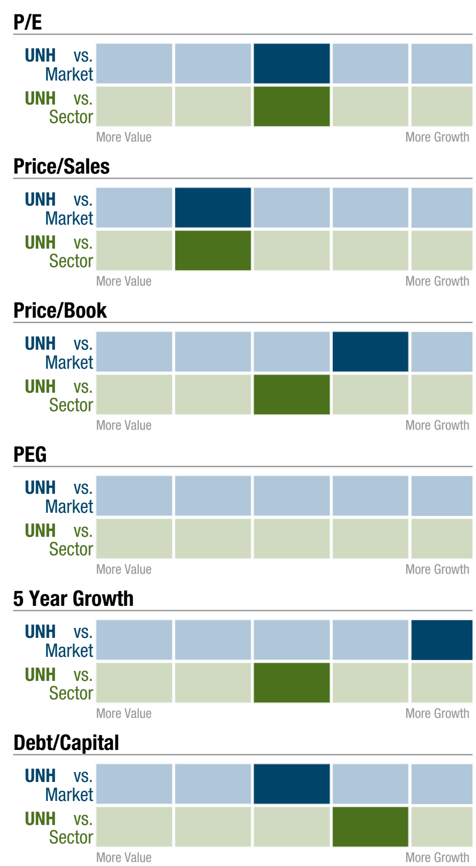
## Peer & Industry Analysis

**The graphics in this section are designed to allow investors to compare UNH versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.**

- **The scatterplot shows how UNH stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.**
- **The table builds on the scatterplot by displaying more financial information.**
- **The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how UNH might fit into or modify a diversified portfolio.**




| Ticker | Company | Market Cap ($ in Millions) | 5-yr Growth Rate (%) | Current FY P/E | Net Margin (%) | 1-yr EPS Growth (%) | Argus Rating |
|---|---|---|---|---|---|---|---|
| UNH | Unitedhealth Group Inc | 135,841 | 15.0 | 18.2 | 3.5 | 14.6 | BUY |
| CELG | Celgene Corp | 83,231 | 22.0 | 19.0 | 17.4 | 24.8 | BUY |
| TMO | Thermo Fisher Scientific Inc | 61,467 | 10.0 | 19.2 | 11.5 | 8.2 | BUY |
| ESRX | Express Scripts Holding Co | 49,711 | 15.0 | 12.4 | 2.5 | 6.0 | HOLD |
| MCK | McKesson Corp | 44,349 | 10.0 | 14.6 | 1.2 | 5.9 | HOLD |
| AET | Aetna Inc | 41,476 | 15.0 | 14.5 | 3.8 | 11.0 | BUY |
| CI | Cigna Corp | 28,242 | 10.0 | 14.3 | 5.9 | — | HOLD |
| CAH | Cardinal Health Inc | 26,916 | 15.0 | 15.6 | 1.2 | 12.3 | BUY |
| HUM | Humana Inc | 25,564 | 11.0 | 19.5 | 2.0 | 9.1 | HOLD |
| **Peer Average** | | **55,200** | **13.7** | **16.4** | **5.4** | **11.5** | |




Please see important information about this report on page 4

## About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

**THE ARGUS RESEARCH RATING SYSTEM**

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

## Argus Research Disclaimer



## Morningstar Disclaimer