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OVERVIEW:

Company Summary



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to our second quarter Elevance Health Inc earnings conference call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would now like to turn the conference over to the company's management. Please go ahead.



Stephen Tanal - *Elevance Health Inc - Vice President - Investor Relations*

Good morning, and welcome to Elevance Health's second quarter 2024 earnings call. This is Steve Tanal, Vice President of Investor Relations. And with us this morning on the earnings call are Gail Boudreaux, President and CEO; Mark Kaye, our CFO; Pete Haytaian, President of Carelon; Morgan Kendrick, President of our Commercial Health Benefits business; and Felicia Norwood, President of our government health benefits business.

Gail will begin the call with a brief discussion of the quarter and recent progress against our strategic initiatives. Mark will then discuss our financial results and outlook in greater detail. After our prepared remarks, the team will be available for Q&A.

During the call, we will reference certain non-GAAP measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are available on our website elevancehealth.com.

We will also be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Elevance Health. These risks and uncertainties can cause actual results to differ materially from our current expectations.

We advise listeners to carefully review the risk factors discussed in today's press release and in our quarterly filings with the SEC.

I will now turn the call over to Gail.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you, Steve, and good morning, everyone. We appreciate you joining today's earnings call. This morning, we reported second quarter results, including adjusted diluted earnings per share of \$10.12, reflecting 12% growth year on year.

These results reflect thoughtful execution in a dynamic operating environment as well as the unique strengths of our enterprise, including the power of our diverse set of businesses. We have reaffirmed our full year adjusted diluted earnings per share guidance of at least \$37.20, which represents 12% growth year over year.

We have prudently maintained our full year outlook given industry wide dynamics we are navigating in our Medicaid business and the investments we're making to support business transformation and deepen capabilities within CarelonRx.

Our health benefits segment demonstrated balance and resilience in the quarter. In commercial we continue to make progress on our margin recovery initiative and are delivering solid membership growth, notably in our individual ACA business, which has grown substantially year over year.

We've also extended our momentum in national accounts where the business is tracking to historically high retention levels and new customer acquisition remains strong. Year to date, we've consolidated business with additional existing employer group clients who previously only worked with us on a slice of their business, a testament to the unique value we deliver to the market.

In Medicaid we are pleased with our recent new business wins and re-procurements success positioning us for future growth. We launched the Indiana pathways for aging program just weeks ago and are proud to be the largest payer in this important program in our home state, serving nearly 40% of all eligible Hoosiers.

Indiana pathways plays directly to our strengths, serving populations with chronic and complex needs. We were also privileged to be awarded to KanCare Kansas Medicaid RFP this quarter, working in partnership alongside two Blue partners as Healthy Blue.

Turning to Medicaid redeterminations. While nearly all of our members have had their eligibility redetermined since the process resumed last year, our work is not done. With approximately 70% of coverage losses attributable to administrative challenges, we continue our proactive outreach

to members to maximize access to care and minimize barriers to Whole Health. We expect disenrolled members to re-enroll throughout the year, albeit on a longer lag than expected when redeterminations resumed last year. We are seeing the percentage of return are steadily increase, especially in our Blue states where we offer both commercial and Medicaid health plans.

As a result of redeterminations our Medicaid membership mix has shifted resulting in increased acuity, and we are working actively with our state partners to ensure rates remain actuarially sound. In Medicare, we were pleased with the recent ruling regarding our challenge of the initial 2024 star ratings.

As a result, our enterprise weighted average rating has increased to four star, and we now expect approximately 56% of our members will be in plans rated at least four star or in contracts to new to be rated that will be reimbursed similarly in payment year 2025.

This outcome will help offset funding cuts to the Medicare Advantage program for the second consecutive year, which we believe will result in increased premiums and/or reduce benefits for seniors and people with disabilities who rely on Medicare Advantage for their health and well-being.

For our part, we maintained our disciplined approach to 2025 bids. We will be offering highly valued and competitive benefits as we seek to balance growth and margins and remain focused on building an attractive and sustainable Medicare Advantage business for the long term.

In our Health Services businesses, we are making progress on our key strategic priority to scale our enterprise flywheel for growth. Carelon services delivered robust growth in operating revenue and earnings in the quarter as we gain traction with external clients, both through new business wins and the expansion of risk-based services to existing customers.

For example, we recently secured a significant win with an existing Blue Cross Blue Shield partner and deploy new behavioral and medical benefit management services to state and third party payer clients. These awards are a testament to the value we deliver and an affirmation of our strategy of proving value internally before driving growth externally.

Turning to CarelonRx, we are integrating recent acquisitions and scaling key value drivers as we invest to control the levers that matter to deliver greater value and enhance consumer experiences for our members.

Our margin performance in the second quarter reflects elevated investment, specifically around infrastructure and service levels as we remain committed to providing best in class home delivery and specialty Rx services. We see significant opportunity to grow and scale these assets and remain excited about the growth potential of CarelonRx.

We are making progress on our enterprise strategy in 2024 to accelerate capabilities and services, invest in high-growth opportunities and optimize our health benefits business and have robust long-term growth potential embedded in each of these imperatives. We are delivering strong and accelerating growth and Carelon services with a long runway ahead.

Meanwhile, our guidance for 2024 embeds significant investment in growth, notably in CarelonRx and government health plan operating margins below the long-term average with meaningful upside to our targets.

Our focused execution reflects our confidence in Carelon as our flywheel for enterprise growth and the embedded earnings power of our businesses, which together will enable us to deliver strong growth in adjusted diluted earnings per share over the long term.

In closing, I want to thank our community partners who share our purpose and dedication as well as our associates who work hard every day to make Elevance Health a lifetime trusted health partner for the members we are privileged to serve.

Their collective passion is reflected in recent external recognition, including as one of "America's Greatest Workplaces" in 2024 by Newsweek where Elevance Health earned five out of five stars, as well as our inclusion among the "Best Companies to Work for 2024" by US News & World Report.

With that, I'd like to turn the call over to our CFO, Mark Kaye, to discuss our financial results and outlook in greater detail. Mark?

Mark Kaye - Elevance Health Inc - Chief Financial Officer, Executive Vice President

Thank you, Gail, and good morning to everyone on the line. As Gail shared, we reported second quarter results, including GAAP diluted earnings per share of \$9.85 and adjusted diluted earnings per share of \$10.12, representing growth of 12% year over year.

We ended the second quarter with 45.8 million members, principally reflecting attrition in our Medicaid membership. Our commercial fee-based business grew by 354,000 lives year over year, reflecting the distinctive value we provide to self-insured employers and the strength of the Blue Cross Blue Shield brand. Additionally, the thoughtful positioning of our individual ACA products has proven effective in ensuring robust and profitable growth.

Total operating revenue for the quarter was \$43.2 billion, approximately flat year over year. As we approach the tail end of Medicaid redeterminations we anticipate growing operating revenue in the second half of the year, driven by growth in premiums and CarelonRx product revenue related to higher external membership and the acquisition of Paragon Healthcare.

Carelon services momentum accelerated in the quarter. Operating revenue grew by over 26% and operating earnings increased by more than 30% due to growth in risk based services provided to internal and external clients, prudent pricing and strong execution.

The consolidated benefit expense ratio was 86.3% for the second quarter, an improvement of 10 basis points year over year. This improvement was driven by several factors, including premium rate adjustments in recognition of medical cost trends, disciplined medical management, and a shift in our mix of business towards commercial.

This was partially offset by our Medicaid business where acuity has increased due to attrition of healthier members. Elevance health adjusted operating expense ratio was 11.5% in the second quarter, an increase of 50 basis points relative to the second quarter of 2023.

We absorbed elevated investment costs, notably in CarelonRx and this, along with other strategic initiatives, will position our Company for long-term sustainable growth. We anticipate significant improvement in our operating expense ratio in the second half of this year.

Adjusted Operating gain for the enterprise grew approximately 6% year over year, led by Carelon services. We have maintained a prudent posture with respect to reserves. Days in claims payable at the end of the second quarter stood at 45.3 days above our long-term target range in the low 40s.

As a reminder, days in claims payable in the first quarter included approximately 1.7 days related to the industry wide delays in claims receipts.

With respect to our outlook, we are closely monitoring acuity and cost trends, notably in Medicaid and are working collaboratively with states to ensure rates remain actuarially sound. We are, however, expecting second half utilization to increase in Medicaid, and as a result, anticipate our full year benefit expense ratio will end the year in the upper half of our initial guidance range. Nonetheless, we expect to achieve our full year adjusted diluted earnings per share guidance of at least \$37.20.

Before I close, I'd like to briefly talk through our enterprise growth algorithm, which we have included in the supplemental earnings presentation provided this morning.

Our commitment to growing adjusted diluted earnings per share by at least 12% annually on average incorporates upper single digit growth in operating revenue, underpinned by membership growth, geographic expansion and momentum in Carelon as we scale our enterprise flywheel. Our commitment to disciplined underwriting and operating expense management across all lines of business will drive the improvement inherent in our enterprise operating margin target of 6.5% to 7% by 2027.

Taken together, we are targeting growing operating earnings in the upper single digit to low double digit percent range annually, on average, over time.

Finally, we expect capital deployment to consistently deliver one-third of our targeted adjusted diluted earnings per share growth rate.

Overall, our results in the first half of the year are consistent with our initial guidance, and we will maintain a steadfast focus on execution and operating efficiency over the balance of the year.

And with that, operator, please open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

A.J. Rice, UBS.

Albert J. William Rice - UBS Investment Bank - Analyst

Hi, everybody. Maybe just to kick it off here. I know you laid out your long term growth objectives, but all I wonder if at this early date, you're prepared to comment a little more on any plans you have to accelerate growth in '25. I know the top line has had redeterminations and other things this year, what's your thought about ability to get back to that growth trajectory that you're seeking long term in '25?

Gail Boudreaux - Elevance Health Inc - President, Chief Executive Officer, Director

Great. Thanks, A.J. Thanks very much for the question this morning. You know, I think let me start with what Mark outlined as our enterprise growth algorithm because I think that really frames for everyone how we are thinking about our business.

And also, as you think about 2024 in our results, the balance and resilience of our complementary businesses that has allowed us to grow in multiple ways and many type of different macroeconomic environments.

While it is early for '25, I'd like to at least frame sort of how we're thinking about 2025. We do expect to accelerate revenue growth across all of our businesses.

Specifically in our health business, we see a lot of really strong momentum in commercial, and that's been ongoing part of that, through the targeted expansion of our individual ACA footprint, in some cases, adding new geographies that helps support what's happening in the Medicaid redeterminations. Medicare Advantage, as we said in our opening comments, we feel that we've positioned ourselves for sustainable growth and margins and look at that as a very good long-term business and then Medicaid we're nearing the end of the redetermination cycle and we do anticipate a return to growth and you've heard about some of our early wins this year, which we are very pleased with.

We also do believe that some of those that were redetermined, based on administrative reasons will be coming back, albeit it's taken a little bit longer than we originally thought.

Then I'd like to close these comments about our excitement around Caelon and the growth that we're seeing and how we've progressed, you saw some of that comes through in the second quarter. And Caelon services we are seeing some very strong external growth in the quarter, and we see expanded opportunities as we continue to build our capabilities, particularly in the risk market.

And what we're seeing here is our ability to prove it on our own businesses first and then take it to the market commercially has been a really strong selling point for us, and we're very excited about that.



And then finally, CarelonRx is our ability to scale, especially on the specialty side, including the integration of some of our recent capabilities such as Paragon Healthcare, BioPlus specialty pharmacy and we're looking forward to adding the Kroger specialty pharmacy business as well as we continue to diversify.

So overall, as we think about acceleration of revenue growth and '25, we do expect that across all of our business and are extremely positive about what we're seeing in our business.

So thank you for the question, and next question please.

Operator

Nathan Rich, Goldman Sachs.

Nathan Allen Rich - *Goldman Sachs Group, Inc - Analyst*

Thanks for the questions. I wanted to ask on Medicaid. I think about a quarter of your book is due to set rates in the back half of the year. Could you maybe just talk about what your guidance assumes for these rate updates on and maybe anything you've seen the kind of so far you think about on the updates for July or October to the extent you have visibility. And I guess, Mark, on your comment on Medicaid utilization, have you seen in the level of care on a same member basis increase? Or is the issue really just the timing dynamic between where the rates are and the level of acuity that you're seeing in your population?

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Well, thanks. Thanks for the questions. There's a lot in there. So let me ask Felicia Norwood who leads government first and then have Mark, respond to the second part of the question. Felicia?

Felicia Norwood - *Elevance Health Inc - Executive Vice President, President*

So good morning, Nathan. You are absolutely right. The way our rate timing works, we have about half of our states where we have rates in the first half of the year in this the other half in the back half of the year with a core group certainly in Q4.

At this point, we have visibility into nearly all of our Medicaid premium for 2024 and the rate conversations with our states are very constructive.

With that said, not all of our rates are final. We are in constant conversations with our states and providing them with information, updated information that we see in terms of the experience almost weekly to make sure that they are saying -- what we are saying from an overall change perspective as we wind down redeterminations, which certainly has been a lot of the largest transformative things that have happened in Medicaid for some period of time.

I will say that the conversations are ongoing. We fully expect our rates to remain actuarially sound. So we acknowledge the potential for a short term, disconnect between the timing of our rates in the emerging acuity in our populations and that's certainly been reflected in our updates for the year.

I will say that we continue to make sure that states and their actuaries have the most recent data that we have, and we will continue to have that engagement as we go through the fourth quarter rate process with the few very large states that remain in negotiations with us.

And with that, I will turn it over to Mark to talk about the rest of the issues around utilization.



Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thanks so much, Felicia and good morning. Medicaid utilization in the quarter, as you heard from Felicia, reflected higher acuity as expected, we are also seeing signs of increased utilization across the broader Medicaid population, including in outpatient home health, radiology, durable medical equipment as well as some elective procedures.

I just wanted to add here, just as we noted in our prepared remarks, the full year outlook does allow for both this shift in acuity and increased utilization in the second half of the year, including the rate timing mismatch that Felicia spoke to.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you. Next question, please.

Operator

Lance Wilkes, Bernstein.

Lance Arthur Wilkes - *Sanford C. Bernstein & Co., LLC - Analyst*

Yes. Could you talk a little bit about CarelonRx in particularly interested in contracting approach, for the CVS contract that underlies parts to that as you're insourcing things? And then just a quick update on the status of the integration rollout to the Anthem members and other members of BioPlus and Paragon and the status of Kroger. Thanks.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Great. Well, thanks, Lance, I'm going to ask Pete Haytaian who leads Carelon to address your question.

Peter Haytaian - *Elevance Health Inc - Executive Vice President and President, Carelon and CarelonRx*

Yes, thanks. Thanks a lot for the question, Lance. We feel very good about the overall strategy as it relates to pharmacy. I'll start with how we're performing on the core and growth in the core of our strategy is resonating in the marketplace there continues to be a lot of interest in what we're doing as it relates to the strategic levers that matter and how we're in-sourcing and diversifying our business.

I think our value story is really resonating integrated value story, and that's really playing through with highly competitive pricing and again, we continue to perform very well on the core PBM, downmarket and middle market. So we feel very good about that.

As it relates to our diversification and your question on our assets, things are going very well. As we talked about with regard to specialty, we spent the last year building out our infrastructure to be able to handle the capacity -- to have the capacity to handle the Elevance Scripts.

And we feel very good about that. We began to migrate Scripts at the beginning of this year as it relates to specialty and we continue to move forward in that regard.

And importantly, we are preparing right now and continue to make investments around the Kroger close. And I'm assuming those Scripts as well. Right now, we're projecting that to close Q3, Q4 this year and again, a lot of preparation and investment to make sure that we will do that really well.



And then finally, as it relates to on Paragon, again, just to reiterate the opportunity there because we feel very, very good about that.

We're talking about \$16 billion of infusion spend as it relates to Elevance Health and with about 50% of that being in the hospital setting. So again, a great opportunity for us to have care be provided in a more appropriate setting being a bit in an ambulatory site or on the home.

And we feel very good about our positioning in the density that we have in our markets as it relates to that. And importantly, as part of that strategy, we are targeting at a ZIP code level on the standup of ambulatory sites to be able to provide that care.

We're launching one imminently, and then we are preparing and building out strategies to launch others into 2025. So overall, we feel very good about our strategy of in-sourcing this strategic levers that matter in the growth opportunity that exists.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thanks, Pete, and thanks again, Lance for the question. And just I think that's a great example of our flywheel for growth in our ability to scale these assets, which were very excited about. And again, I'm thinking about this is the opportunity to drive a differentiated cost of care for our health plans within Elevance Health, but also better experience for members and support our partners across the ecosystem. So again, a really important part of our flywheel.

Next question, please.

Operator

Kevin Fischbeck, Bank of America.

Kevin Mark Fischbeck - *BofA Securities - Analyst*

Okay, great. Thanks. I guess in your prepared remarks, you mentioned that some of the results here were somewhat burdened by, I guess three things. One; your investments in Carelon for growth and then you had a below average margins and Medicaid and below-average margins in Medicare Advantage.

Can you help size those things? How should we think about where those margins are today relative to kind of, where they should be from a target perspective? Thanks.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thanks very much for the question. We're not going to comment on in detail where our single lines in our business operating margin may land, given our combined health benefits reporting segment. But however to your question, let me give you a little bit of color.

We do expect the Medicaid margins to compress year over year. There are key factors driving this, including or beyond the industry wide dynamics that we're navigating. And those include what we spoke to a moment to go around the timing mismatch rates relative to acuity and the higher acuity itself associated with the Medicaid membership mix.

As you heard us talk just a moment ago, we are holding very constructive conversations with the states to ensure those rates remained actuarially sound.

In Medicare we do continue to expect margins are going to improve in 2024 compared to 2023. They will still remain below our long-term target margin range. And then finally, we are very pleased with the progress of our 2024 commercial pricing initiatives and our disciplined pricing practices.

And we've spoken about this before, but it's worth emphasizing 2023 really marked at first the end of that first full year of our efforts to recover margins. And you're seeing some of that benefit together with the actions that we're taking in 2024 come through our numbers.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you. Next question, please.

Operator

Josh Raskin, Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Analyst*

Hi, thanks. Good morning. What are your expectations for market level growth in MA for 2025? And I know it's early, but maybe any headwinds, tailwinds and how we should expect Elevance to grow market share relative to the overall market in MA for 2025?

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

I'll ask Felicia to comment on that, Josh. Thank you.

Felicia Norwood - *Elevance Health Inc - Executive Vice President, President*

Good morning, Josh, and thank you. you know it's an incredibly dynamic time in Medicare Advantage and now more than ever, we think it's important to be very thoughtful and rational as we planned for 2025.

Despite this environment, Medicare Advantage enrollment is at an all-time high and over 50% of individuals are still choosing MA. And that means there's still a clear value for what MA offers. And we're committed in the long term to having and operating a profitable and sustainable MA business.

You know, it's a little early to talk about 2025 in terms of growth expectations as bids were recently submitted to CMS and frankly, we are still getting feedback on that.

In addition to that, the industry wide submissions aren't known yet. We feel encouraged by commentary from peers that everybody is going to kind of price rationally and have benefit rationalization as we head into 2025.

But we still have to wait and see what emerges once we have greater information from our competitors. So at this point, there's a lot of unknowns.

I will tell you we maintained a very disciplined approach offering competitive benefits while we are balancing growth and margins, I think we were very thoughtful in the plan designs that we put out there to make sure that we were focusing on profitable growth in the sustainability of that this program for the long term, we are very focused on our DNSP business, which is where we believe that we have a strong advantage, but we think about our Medicaid and Medicare positioning.

And we also did prioritization around our products in terms of our local market dynamics. So it's still early to determine what growth it's going to look like for 2025. We feel very good about how we position our business on the heels of our strategy in 2024 to make sure that we have a sustainable long-term business and Medicare Advantage. Thank you.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please.

Operator

Lisa Gill, JP Morgan.

Lisa Christine Gill - *JPMorgan Chase & Co - Analyst*

Thanks very much and good morning. I wanted to stick with Medicare Advantage for a minute. Can you talk about what you saw specifically in the quarter around trend? And then Felicia maybe you can comment on what you included around trend assumption in your MA bids as we think about 2025.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Great. I'll ask Mark to comment on your question.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thanks very much for the additional question here on Medicaid. First, we are seeing a larger than typical pull forward effect, and that's really driven by the increased numbers of Medicaid members who are losing coverage because think about this is beneficiaries who are facing an imminent loss of coverage in the month or so proceeding that coverage lost picking up additional benefits.

Second; member characterization among the core expansion and specialized population has caused some localized revenue pressure. Some members expect to regain coverage after previously being determined ineligible and the third on the topic of Medicaid elevated to outpatient trends of elective procedures.

Steve just flagged me to talk about Medicare, so I apologize for that. On the Medicare the answer is very short trends developed in line with expectations.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you Mark next question, please.

Operator

Justin Lake, Wolfe Research.

Justin Lake - *Wolfe Research, LLC - Analyst*

Thanks. Appreciate the question. First, can you size the Medicaid trend increase that you're seeing here? And then second, I just wanted to follow up on Kevin's question on government margins.

Understand you don't want to give a specific margin levels, but was wondering if you could share your expectation of the trajectory of margins in Medicare Advantage Medicaid for 2025 versus 2024. Thanks.

Mark Kaye - Elevance Health Inc - Chief Financial Officer, Executive Vice President

Thanks very much for the question. Segment, margins in the quarter improved by 20 basis points year over year. And I'd argue that the first half results here are consistent with our initial guidance range, and we expect full year margins to end within our initial outlook, up 25 basis points to 50 basis points, primarily driven by the ongoing recovery of our commercial business.

From a seasonality perspective, there are two key comments, I wanted to draw out -- draw out here. For modeling purposes second quarter revenue growth is going to mark the low point for the year, and we expect third and fourth quarter operating revenue and premium revenue growth rates to improve.

And secondly just on the MLR, the ties directly to your question. We now expect the third quarter MLR out to be near the high end of our full year guidance range. And I note the specifically, Justin, the current third quarter consensus estimate does not appear to capture the calendar day shift associated with the leap year.

And that's going to have approximately a 70 basis point impact on the third quarter MLR.

Gail Boudreaux - Elevance Health Inc - President, Chief Executive Officer, Director

Thank you. Next question, please.

Operator

Erin Wright, Morgan Stanley.

Erin Wright - Morgan Stanley - Analyst

Hey, thanks for taking my question. Can you talk a little bit about the investments you're making around CarelonRx and how you're thinking about the trend line in terms of scaling specialty? And are there are ample opportunities out there for you to like Kroger and Paragon out there?

Gail Boudreaux - Elevance Health Inc - President, Chief Executive Officer, Director

Well, thanks. Thanks, Erin, and welcome to our call. I think that's the first time you've been on our call. So it's great to hear from you. I'll ask Pete to comment.

Peter Haytaian - Elevance Health Inc - Executive Vice President and President, Carelon and CarelonRx

Yes, no, thank you. We feel very good about our specialty strategy, and I appreciate the question. I'll try not to repeat what I said before and give you a little bit more context. But as I noted as it related to our specialty strategy we acquire BioPlus last year in 2023.

And again, we spent a lot of time on last year and building out the infrastructure and the capacity to be able to assume Elevance Scripts. And as it relates to the near term, is being able to migrate Elevance Scripts, which will occur through this year and into 2025.

As you as you noted, we're going to be opportunistic and we have been as it relates to things like Kroger, that provides additional scale for us to give you a little bit of color on Kroger, it's about 500,000 incremental Scripts.



They also give us access to additional LDDs as well as having a presence in places like Puerto Rico, which could help us as well. And so we'll continue to be opportunistic as it relates to our specialty strategy and really our focus to deliver our Whole Health.

We are anticipating, as I noted earlier, that Kroger, will close Q3, Q4 of this year, and we're preparing for that and continuing to make investments around that.

But I'd say as we move forward more broadly, and Gail touched upon this as it relates to our specialty strategy. There's a real focus on patient differentiation and on whole health. We have a wonderful opportunity as we move forward to really drive Whole Health and capture on all the value of Carelton, including things like integrating behavioral health and other services.

And so that's going to be our volume of our goals and focus moving forward. We feel very bullish about it. We feel very bullish about our growth. We feel very bullish about delivering on the Carelton strategy and Whole Health as we move forward.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please. Thank you, Pete.

Operator

Michael Hall, Baird.

Michael Halloran - *Robert W. Baird & Co., Inc. - Analyst*

Thank you. Just wanted to ask about your long-term growth target in your deck. You now have a slight decline in health benefits, long-term growth CAGR. Apologies if I missed your comments, but could you provide what color what's driving that MA, Medicaid presume its not commercial? And then I also think you reaffirmed our long-term targets on Carelton.

But over the past year since your Investor Day, CD&R partnership, BioPlus the acquisition of Paragon pending Kroger, the business seemingly has taken a very positive step forward.

Would it be fair to say your prior targets at Investor Day, most of those assumptions within your guide or long-term targets did not contemplate all these new developments, and specifically Carelton Services revenue per consumer serve a 50% growth target by '27 now appears like there's much, much higher runway. So just overall even though you are reaffirming your target, it's just true that now today, there's many greater attentional embedded power with Carelton verses out last two years that could be unlock your future years. Thank you.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

This quarter, we are pleased to introduce our growth algorithm, which underpins our adjusted diluted earnings per share target of average annual growth of at least 12% over time.

You asked a little bit about the revision. And we have revised our enterprise revenue growth target from the high single to low double digits to high single digits percent range and that's primarily to reflect Medicaid related attrition that has occurred to date and the impact of the prudent actions that we're taking in our 2024 and 2025 Medicare Advantage bids in response to the risk model decisions.

Accordingly, Health Benefits segment revenue, CAGR should now be in the will now be in the mid to upper single digit percent range.

But the key point here is our path is much the same and that really mean that we're expecting high single digit to low double digit percent growth in operating earnings in the key point here to the second half of your question, with approximately one-third contribution from capital deployment and at capital deployment can come through in the form of inorganic activity to support our Carelon businesses.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you. Next question, please.

Operator

Andrew Mok, Barclays.

Andrew Mok - *Barclays - Analyst*

Hi, good morning. I wanted to follow up on some of the Medicaid comments. It sounds like you're optimistic about rates get better in the back half, but also acknowledge a temporary disconnect that persists and expect higher Medicaid utilization in the back half. So if we translate that into MLR expectations. Does guidance assume that Medicaid MLR peaks into 2Q, it gets better from here with potentially better rates?

Or do you expect that to peak at some point in the back half of the year? Thanks.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Great question and the opening comments there are completely consistent with the way that we're thinking about it. You should really think about this as we now expect our full year benefit expense ratio to be in the upper half of that initial guidance range to 87% to 87.5%, principally because of the Medicaid dynamic that we're navigating. We're not looking to provide specific quarter-by-quarter guidance.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please.

Operator

Ryan Langston from Cowen.

Ryan Langston - *TD Cowen - Analyst*

Hi, good morning. Just a quick one for me. Prior year development was a bit more favorable than we expected. Can you maybe give us a sense on if that's just mostly from the fourth quarter? And if so, any kind of a particular pockets of utilization you'd call out as maybe coming in better than expected? Thanks.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thanks very much for the question. Let me put the prior year development in the context of the medical claims payment change this quarter. I think that's more instructive to understand the dynamics here and you saw medical claims payable in the quarter go down by approximately \$1.3 billion versus the first quarter.

They're really several factors that drove this and then ultimately drove PYD development. And they include the reserve runoff due to Medicaid membership decline, the catch-up in claims paid associated with elevated reserves for industry wide claim receipt delays in the first quarter and then the improved operational environment that's reflected through our shorter cycle times. The key point here is that MCP, which is why it's more instructive, remains at historically high levels, both in aggregate and on a fully insured PMPM basis and it indicates the continuity of our historical prudent reserving practices and our strong balance sheet.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you, Mark. And Ryan, welcome to our call for the first time. It's great to have you. Next question, please.

Operator

Stephen Baxter, Wells Fargo.

Stephen C. Baxter - *Wells Fargo Securities LLC - Analyst*

Hi, thanks I just wanted to come back to their Medicaid utilization comments. I think you are making in response to an earlier question of us to expand a little bit on that.

Can you comment perhaps on how much of the pressures geographically isolated and some of your markets versus maybe more broad based? I think you're speaking to you also have some utilization of care from people that were expecting to lose coverage.

Would you be expecting that dynamic to slow a little bit as redeterminations end? or is that potentially offset by rejoined our dynamics are factors like that? Thank you.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thanks for the question and appreciate the opportunity to provide additional clarification here. And certainly we expect to be larger than typical pull-forward effect that we've seen in the second quarter to abate as the year goes on, principally because we're through the tail end of redeterminations at this point that we are obviously working with the states to ensure that the timing and rate mismatches appropriately adjusted.

On the member mis categorization, this is really ensuring that those members who were initially categorised, for example, in TANF and are putting the more appropriate and cohort for purposes of rates to think about ABD, for example.

And then what we are real, we're seeing elevate as the year goes on the outpatient trends in elective procedures, and that's something that we fully accounted for in our MLR guide for the full year.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please.

Operator

Scott Fidel, Stephens.



Scott J. Fidel - *Stephens Inc. - Analyst*

Hi, thanks. Good morning. I was hoping you could drill a bit more into the \$4.3 billion of timing items that impacted operating cash flow on and just wanted to see whether you expect all those to reverse in the back half of the year end and whether you're comfortable reaffirming your full year CFO targeted at least \$8.1 billion and if not, where you expect operating cash flow to land for the year. Thanks.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Appreciate the question this morning. Year-to-date operating cash flow is \$2.4 billion. And to your point, there is a decrease of approximately \$6 billion year over year.

The key point here is that this includes \$4.3 billion of timing related items and approximately \$1.3 billion of net cash outflows that are primarily associated with the runoff of our Medicaid reserves and the improvement in the operational environment, which is reflected by shorter cycle times.

The timing related item reflects a \$3.6 billion impact from an additional month of premiums that we received from CMS in the year ago period. And so not a concern from our perspective. On a full-year basis, we do expect operating cash flow outlook to be slightly north of \$7 billion, and that really reflects the year to date reductions in working capital.

And specifically, as I mentioned a moment ago that decreasing MCP driven by Medicaid membership attrition.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please.

Operator

Sarah James, Cantor Fitzgerald.

Sarah Elizabeth James - *Cantor Fitzgerald & Co. - Analyst*

Thank you. Saw in the prepared remarks, you guys mentioned a significant win with Blue Cross Blue Shield partner. I was wondering if you can help us size your pipeline there and give us any clarity on how penetrated you are into that market. How many of your Blues do you currently have contracts with? And what's the opportunity look like to expand this?

Peter Haytaian - *Elevance Health Inc - Executive Vice President and President, Carelon and CarelonRx*

Great. Thanks Sarah. Thanks a lot for the question. Appreciate it. And yes, we're really pleased with how services growth is going. We mentioned 26% growth in the quarter on a clear path of achieving our long-term objective. So we feel very good about that.

As it relates to your question, again, our focus is as Gail said earlier building capabilities internally and importing them externally, and we're seeing that play through and you referenced the Blues. I would say that we are currently engaged with most of the Blues, and our strategy with regard to that is really from landing and expanding to be quite frank.

And this is a great example of that where we have got an existing relationship with the client, we continue to grow those services with that -- with that particular Blue, they see the value and that we were able to convert some of those capabilities to risk.

And I'll remind you that that is a very big part of our strategy, no assumption of risk, both on a category of service basis as well as a full risk basis and so on, you'll see that continue to move forward. As it relates to the pipeline from this year, we're doing very well. '24 growth year over year is very, very strong. You'll see really nice improvement from that perspective.

And as you would expect, we're already selling into 2025, a real focus in 2025, on our behavioral health capabilities, our post-acute capabilities and then some of our Carelon health businesses. So appreciate the question time.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Yes. Thanks, Pete, and thanks to the question, Sarah, in, as you heard from Pete, it's an idea of exciting opportunities to deepen our penetration because we do work with most of the other Blues today and also some other payers, quite frankly, and state partners has been a great opportunity for Carelon broadly, and you're seeing that come through.

So thanks for the question. We're excited about the opportunity there. Next question, please.

Operator

George Hill, Deutsche Bank.

George Robert Hill - *Deutsche Bank AG - Analyst*

Hey, good morning, guys. I appreciate you taking the question. I guess, Mark, I was just going to ask if you could bridge a little bit when we think about the 2027 OP margin targets in the MCO segments. So like how you think about the sources of the margin expansion there.

And I'd be interested in particular if you would talk about what your expectations are around the exchange subsidies, and the growth of the exchange business.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Thank you very much for the question to George and certainly happy to talk through the algorithm it a little bit of a high-level. Thinking about this is being driven by upper single digit growth in revenue. Enterprise operating margin expansion to 6.5% to 7%, and then the balanced approach to capital deployment, increases of share repurchase, buses and strategic M&A.

On the revenue side, revenue growth is going to be driven by increased membership in the health benefits business, geographic expansion efforts and prudent pricing to cover cost trend.

And then similarly in Carelon key drivers are going to include the expansion of risk-based revenue and Carelon services and the continued growth and CarelonRx membership. On the margin side, expansion is going to reflect the disciplined operating expense management and the transformation of some of our business processes, leveraging new technologies and including AI.

And that coupled together with that, we'll at least the way to think about effective medical management and underwriting disciplines where they can enable us to achieve the enterprise operating margin target.

And then finally, consistent with our 2023 Investor Day guidance, we do expect to achieve approximately a third of our adjusted diluted EPS growth rate through capital deployment.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you, Mark. And to your second part of the question around our exchange business, as you have heard us talk about, we have done, I think, very disciplined in our approach to expanding that business. We have had very strong results individual up 30% -- 35% year over year, with the ACA growing almost 40%.

So as you think about that, our goal is to serve our members throughout their coverage transitions. We see a significant opportunity to continue that expansion, including geographic draft, geographic expansion, particularly to our members that were historically in Medicaid and now need other coverage.

So again, a really nice opportunity. You'll see that same sort of just on approach that we've shown throughout the ACA. Next question, please.

Operator

Whit Mayo, Leerink Partners.

Benjamin Whitman Mayo - *Leerink Partners LLC - Analyst*

Hi, thanks. Just quickly on mid-year renewals, just remind us how much of the commercial risk book renews in the second half of this year, just how you're thinking about retention, membership ability to take the record price action that you need?

And just as a clarification, is it fair that commercial is performing better than our expectations on margin with government worse, at least the first off? I just wanted to make sure are appropriately got this. Thanks.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

All right. Thank you. I'm going to ask Morgan Kendrick who leads our commercial business address your questions.

Morgan Kendrick - *Elevance Health Inc - Executive Vice President, Elevance Health and President, Commercial and Specialty Health Benefits*

Whit thanks for the question. We think about it that cohort of business that we renew in July is about 25% of the risk-based large group business and to camp onto that, it performed as expected. In fact, we're seeing persistency up a bit.

We talked about attrition in the large group risk as with our January cohort on the first quarter call, that's abated, and we're seeing persistency improved and we're seeing the margins coming through. So we feel really good about how we're positioned for continued growth and expansion in that business moving forward.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Next question, please.

Operator

Dave Windley, Jefferies.



David Howard Windley - *Jefferies LLC - Analyst*

Thanks for taking my question. I believe you have a cost savings plan targeting around \$750 million. That's maybe a relatively near term initiative. I'm wondering if you could describe your progress against that. And then also, should we think about the benefits of those savings dropping through? Or are you mostly reinvesting those savings and some of your growth initiatives? Thank you.

Mark Kaye - *Elevance Health Inc - Chief Financial Officer, Executive Vice President*

Dave. Good morning. Thanks very much for the question. In terms of the 2023 business optimization activity, we are on track to realize the gross run rate expense efficiency improvement of approximately \$750 million that we committed to do, and that's going to benefit both our operating performance this year. And it's going to help to establish the strong foundation for growth in 2025 and beyond.

If I step back just for a moment and we covered this a bit in our prepared remarks, we do anticipate significant improvement in our operating expense ratio in the second half of the year.

As we continue to take additional steps to enhance operational efficiency and we'll begin to see and realize those incremental run rate improvements over time. Thank you.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

Thank you, Mark and Dave. I might maybe just spend a moment because I think it's a great opportunity to share a little bit about how we're going about this. We, first of all, have been very disciplined about our expense management.

More importantly, we believe the opportunity around generative AI for our business is expansive, and it's going to materially impact all parts of our organization. We've enhanced experiences while driving costs down but also fueling future expansion.

And I would say over the last few months, we've really accelerated those internal efforts. And again, this has been a journey, so it's not new, but we are going to start seeing that absolute impact of the AI technology and digitization around our significant operational areas.

And just a couple of things maybe to make this real as we transform and there's kind of three areas around the engagement model that we think about members, providers and our own associates who are critical to this journey with us.

On the member side, we look at each interaction of our members, and we're using AI to make those much more unique and personalized integrating and across our member touch points. Oftentimes, there's disconnects in those touch points and that's a huge opportunity for us to take really personalized digital service and enrich that experience.

And what does that do? I mean, the real impact you see it as improved access to care, better claims processing, less error rates, reduction of our calls use of chat. So those are some very tangible ways that we're deploying that and have been over the last year. You're going to start seeing that come through based on what Mark just shared.

The provider side is an area that I'm particularly excited about because we are looking at reimagining and streamlining all of our admin tasks on an end to end basis with the provider lifecycle. That's a lot.

But as you think about the impacts there with touch, not just providers, but also members and some very specific things like automating the onboarding process of how they come into our plans, refining roster management, specifically around data and how that ties downstream to claims, also enhancing contract administration.

And we think those interactions are going to improve our member experiences, but also improve our relationship and our ability to work and value-based care with our care providers and more seamlessly and then I'll end with associates because we know that they need to be part of this journey.

It's also a cultural journey on AI, that's going to drive, I think, greater efficiency. And we rolled out our Spark, which is our internal chat, GPT tool to over 50,000 of our associates so that they can harness the capability, use it and improve their own productivity, and we're seeing really nice results from that.

So again, I wanted to just share that because at the -- I think our expense focus and efficiency is driven a lot by the impact we're going to see from that and while we have a lot of opportunities, we're trying to look at the end to end impact of where we can take friction out of the system and fundamentally improve what we're doing.

So hopefully, that gives you a sense of how we're going about achieving the goals that we said. And we see huge opportunities going forward and embedded into our growth algorithm for the future.

Next question, please.

Operator

Ann Hynes, Mizuho Securities.

Ann Kathleen Hynes - Mizuho Securities USA LLC - Analyst

Hi, good morning. And I just want to focus on specialty. I know that Elevance with the acquisitions are in-sourcing more specialty not only on the dispensing side, but also the distribution side. So I'm just I'm curious about your strategy longer term getting more opportunity for specialty on the distribution side?

And if you think there is any therapeutic area and you're focused on? Thanks.

Peter Haytaian - Elevance Health Inc - Executive Vice President and President, Carelon and CarelonRx

Thanks for the question. And we think there's a tremendous opportunity as it relates to specialty, as I said earlier, our priority in the near term is some of the Elevance Scripts and absorbing the Elevance scripts to effectively.

And then also, as we talked about what we're doing with Kroger, we continue to see opportunities to cover more LDDs. And then in addition to that, as it relates to Whole Health, we are very focused on the patient experience. We are very focused on centers of excellence and how we can care for the members of a differentiated way by wrapping around additional assets.

Longer term, again, we will be opportunistic. But right now, we have a lot in front of us and we want to execute against that effectively as it relates to specialty.

Gail Boudreaux - Elevance Health Inc - President, Chief Executive Officer, Director

Thanks, Pete. And I just want to highlight one point that Pete said, it's really an integration strategy. Specialty has a long runway for us. But the integration to our Carelon services and what we did deliver better value for our health plan members is really critical to our strategy. I think that is unique.

Our ability to take both the specialty pharmacy, but all the specialty services around these disease categories we think is differentiating. So thank you. Last question we're going to take now, please.

Operator

Ben Hendrix, RBC Capital Markets.

Benjamin Hendrix - *RBC Capital Markets - Analyst*

Hi, thank you very much. I just wanted a quick follow-up on for Felicia's comments on MA bids for next year. I realize it's too early to talk about growth, but I think we've I think earlier in the year, you had talked about long-term MA growth focus toward Carelon markets.

And I just wanted to see if you could provide any color on how your bids contemplate your geographic footprint evolving and also your density towards Carelon markets in 2025? Thanks.

Felicia Norwood - *Elevance Health Inc - Executive Vice President, President*

So Ben, thank you for the question. We've always been very strategic around where we want to see our MA growth as we go forward. As you recall this past year, we've made very deliberate decisions around markets that we wanted to exit because we wanted to make sure that we positioned ourselves to long term growth and performance.

Where we think about our strategy today is certainly in those areas where we have Medicare and Medicaid business because the D-SNP business is incredibly important for us. And as you think about where things are going long term, having alignment around Medicare and Medicaid is critical for us.

But ultimately, it's absolutely about being able to deliver for the Carelon flywheel as well, the members that we are focused on, particularly in D-SNP, and other SNP products are very complex populations. And if we think about will help, we've been working very collaboratively with Pete and the team to make sure that we are able to deliver whole health for those that we are very privileged to serve.

So the footprint really is focused on densities, certainly in our Blue markets, but being able to be focused on our Medicaid markets as well in places where we see opportunities to grow strategically with Carelon in the future.

And that's the pathway and framework that we've established when we think about the long-term growth for our Medicare Advantage business, which we continue to be incredibly excited about as we think about being a lot of time trusted partner for those we serve. So thank you for the question.

Gail Boudreaux - *Elevance Health Inc - President, Chief Executive Officer, Director*

So thank you for your questions, everyone, and thank you for all of you for joining us today for your interest in your support. We look forward to sharing more about our progress that we're making on our enterprise strategy with you in the coming quarters and are confident that the balanced and resilience of our diverse set of business dispositions as positions as well.

Thank you for your interest in Elevance Health and have a great rest of your week.

Operator

Ladies and gentlemen, a recording of this conference will be available for replay after 11:00 AM today through August 17 2024.

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This concludes our conference for today. Thank you for your participation and for using Verizon Conferencing. You may now disconnect.

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