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Managed Care & Facilities

Did CVS Save the Future of Medicare Advantage?

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A little over a week ago, we wrote about the importance of CVS' message in the context of the long term Medicare Advantage opportunity. We warned that CVS was being painted with a brush of irrationality that was leading to growth at all costs, with a further fear that CVS might be using the totality of its Enterprise benefit to fund that MA growth. **Today, CVS couldn't have been clearer – CVS will be rational with respect to its bid process, something that we think "lifts all boats" for 2025.**

First, it is important to note that CVS was serious in delivering this message. The commentary was included in CEO Karen Lynch's prepared remarks, also included in CFO Tom Cowhey's prepared remarks and the broad management team was prepared with specific bullets for the Q&A. CVS knew the questions were coming, and this was a paragon of preparedness.

Second, each business must stand on its own with respect to margins and returns. This should assuage the speculation that CVS was ok with losing a ton of money in MA because it benefits the totality of the business. CVS stated that the target margin for Medicare Advantage is 4%-5% pretax and CVS intends to bid its products to attain that margin. CVS noted that the MA segment consumes significant amounts of capital, as much as mid-teens percentages of revenues, and that capital has to earn its return. When asked about the impact to the enterprise, CVS was again very clear. CVS noted that the Health Care Benefits segment, which is over 50% MA at this point, needs to earn its target margin AND then the enterprise should be able to benefit from the other services that can be sold into that book.

Third, the path to margin recovery starts in 2025, suggesting cover for the entire industry. Again, there was a perception that CVS was acting irrationally and that had the potential to disrupt the industry in the future as well. Remember, CVS took 62% of the entire MA industry growth in the month of January 2024. Today, CVS noted that the MA segment target margin was 4%-5% and that margin recovery would begin in 2025. The company noted that it intended to take benefit actions in excess of just the STARs revenue recovery. With MA operating at approximately breakeven in 2024, we would guess that CVS is looking to recoup at least 200bps of margin in 2025, and with the pressure seen in the preliminary 2025 rate notice, we think that will lead to meaningful benefit changes. At this point, we think it is certainly possible that CVS cedes some share back in 2025.

Fourth, actions speak louder than words. While there is much rebate over what is going on with utilization trends, the actions/guidance from the group is amazingly consistent.

	2023 MLR	2024 MLR	Total MLR YOY	MA Rev %	If ALL MA Related
Centene *	87.1%	90.0%	288 bp		**288 bp**
Humana	88.0%	90.0%	202 bp	87.9%	**230 bp**
CVS	86.2%	87.7%	150 bp	54.6%	**275 bp**
UnitedHealth	83.2%	84.0%	83 bp	40.5%	**204 bp**
Cigna	81.3%	82.2%	90 bp	19.2%	**469 bp**
Elevance	87.0%	87.0%	(3) bp	21.9%	**(14) bp**
Average (ex ELV)	**85.2%**	**86.8%**	**162 bp**	**50.6%**	**293 bp**

** - note that Centene breaks out an MA specific MLR*

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Observations

Investors seem to be wrestling with the language from some companies suggesting that the uptick in utilization is temporary whereas others are assuming it's more permanent. As the chart above shows, **every company (we are excluding Elevance solely due to its outlier effect) that has reported to date is assuming an increase in their MLR for 2024, with the average increase assumed to be 162bps**. Obviously, these companies are diversified and not all of the revenue is from MA. However, if you assume that the remaining segments (commercial and Medicaid mostly) are seeing flat MLRs, we estimate that industry is implying an average increase in the Medicare MLR of 293bps in 2024. What is really interesting is that the spread between the companies ranges from an implied increase in the MA MLR of ~200bps for UnitedHealth to about ~290bps for Centene. **We focus on Humana, UnitedHealth, and CVS as the largest MA plans with the most exposure and their guidance seems very consistent. Again, while the words used to describe the pressures can vary, the actions in the form of guidance are consistent.**

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