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ANTM - Q3 2017 Anthem Inc Earnings Call

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OVERVIEW:

Co. reported 3Q17 operating revenues of $22.1b and GAAP EPS of $2.80. Expects 2017 operating revenues to be $88.5-89.5b, GAAP EPS to be $10.80-10.90 and adjusted EPS to be $11.90-12.00.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Anthem Third Quarter Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Douglas Simpson - *Anthem, Inc. - VP of IR & Finance and National Accounts*

Good morning, and welcome to Anthem's Third Quarter 2017 Earnings Call. This is Doug Simpson, and with us this morning are Joe Swedish, Chairman, President and CEO, and John Gallina, our CFO.

Joe will begin the call by giving an overview of our third quarter financial results, discussing our business unit performance and providing some qualitative remarks around our strategic positioning and high-level headwinds and tailwinds going into 2018.

John will then discuss in more detail our key financial metrics, performance during the quarter and provide some details on our updated 2017 outlook. We will then 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 at antheminc.com.

We will also be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Anthem. These risks and uncertainties can cause actual results to differ materially from our current expectation. We advise listeners to review the risk factors discussed in today's press release and in our quarterly and annual filings with the SEC.

I will now turn the call over to Joe.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Thank you, Doug, and good morning. Before we discuss our third quarter financials, I wanted to take a moment to highlight the acquisition of America's 1st Choice that was announced last night. America's 1st Choice is a Medicare Advantage company that offers HMO products, including Chronic Special Needs Plans and Dual-Eligible Special Needs Plans. America's 1st Choice currently serves approximately 130,000 members through its proprietary technology tools, managerial processes and member engagement programs that helps the company deliver efficient, cost-effective health care services to its members.

Its 2 health plans in Florida received a 5- and 4-star rating for 2018. The acquisition is expected to close in the first quarter of 2018 and be slightly accretive to earnings in year 1.

Turning to discuss our third quarter financials, we announced GAAP earnings per share of $2.80 and adjusted earnings per share of $2.65, reflecting continued strong execution across our businesses.

We ended the third quarter with 40.3 million members, translating to growth of 338,000 lives since the end of 2016. We continue to be pleased with the enrollment trends in our commercial group insured business, which grew again during the quarter.

Our individual enrollment declined by 83,000 lives in the quarter, as expected. As of September 30, 2017, our total individual enrollment was approximately 1.7 million members, consisting of 1.4 million ACA-compliant members and approximately 300,000 non-ACA-compliant members. Of the 1.4 million ACA-compliant members, a little more than 900,000 were from the individual exchanges.

Finally, our employer self-funded business grew by a little more than 100,000 members during the quarter as we continued to win new sales and benefit from an improving labor market.

Our membership results translated into top line growth that continues to be solid, with consolidated third quarter operating revenues of $22.1 billion, an increase of nearly $1 billion or 4.6% versus the third quarter of 2016.

The benefit expense ratio in the third quarter of 87% came in slightly better than expectations, reflecting improved claims trends in individual, continued strong performance in our local group insured business and the impact of a retroactive revenue adjustment in Medicaid.

Our third quarter SG&A expense ratio of 13.6% came in higher than expectations, as we increased spending on our growth initiatives during the quarter and recorded slightly higher than expected incentive compensation expense due to the outperformance in the quarter.

Finally, cash flow remains very strong, and we generated over $2.4 billion in operating cash flow during the quarter, bringing year-to-date operating cash flow to $5.5 billion or 2.1x net income. John will go into more detail in a moment, but our third quarter operating cash flow is impacted by several timing items that are expected to reverse in the fourth quarter.

Moving on to our business unit results, our enterprise earnings reflected contributions from both our Commercial and Government segment. In Commercial, operating revenues grew by 4.1% versus the prior year quarter to $10.1 billion in the third quarter of 2017. The increase was mainly driven by premium rate increases, reflecting overall cost trends in our Individual and Local Group businesses, as well as enrollment growth, primarily in the Local Group business.

These increases were partially offset by the 1-year waiver of a health insurance tax in 2017 as well as lower current year risk adjustment accruals versus the prior year quarter.

Our third quarter 2017 operating margin for Commercial of 5.3% declined by 130 basis points from 6.6% in the third quarter of 2016. The decline was due to the 1-year waiver of the health insurance tax in 2017 and the higher investment spending in the current year quarter.

The decline was partially offset by improved medical costs experienced in our Individual business as well as the impact of continued strong operating performance in our Local Group insured business.

Our Specialty business continues to perform well in 2017. Our dental membership has now increased by 317,000 or 5.8% this year, and vision membership has increased by 517,000 or 8.1% this year.

As a company, we continue to make the necessary investments to capitalize on our opportunity to improve the speciality penetration rate of our medical book of business.

In the Individual ACA-compliant business, our third quarter financial performance was slightly better than our most recent expectations. As a result, our updated claims projections for 2017 have improved, as the morbidity of our population is slightly better than we previously estimated, and our medical management efforts are positively impacting our results.

These improvements are partially offset by a reduction to our current year risk-adjuster receivable estimate. Overall, our updated 2017 guidance now assumes that this business will be relatively breakeven.

It is important to note that our outlook currently assumes that the CSR subsidy cuts do not have a material impact on our results. However, additional regulatory clarity is required for us to fully understand the financial impact of ending the CSR subsidy.

For 2018, our individual ACA-compliant market participation will look materially different than it does today. As a company, our strategy has been and will continue to be to only participate in rating regions where we have an appropriate level of confidence that the financial performance in these markets is predictable. We will offer Individual ACA-compliant products in 56 of the 143 rating regions across our 14 states in 2018.

To put our 2018 market footprint into perspective, the rating regions where we are no longer participating represent a little more than 1/2 of our expected 2017 Individual ACA-compliant membership.

In addition, we were selective in the plan offerings we put into the remaining markets. In total, we believe these actions will cause our Individual ACA-compliant membership to decline by approximately 70%.

There were multiple factors that were considered in each market to determine whether or not continued participation was appropriate. Unfortunately, marketplace instability created a variety of uncertainties, including cost sharing reduction subsidy funding.

The uncertainty around CSR subsidy funding was an important factor as we engaged in constructive dialogue with the state regulators and evaluated the appropriate levels of participation.

Based on the information we know to date, we are expecting our 2018 Individual ACA-compliant membership to be slightly profitable in 2018, albeit below our long-term target operating margins of 3% to 5%.

We are continuing to closely monitor state and federal legislative and regulatory developments, and if the level of uncertainty in the marketplace is reduced, we would have increased confidence to reenter certain rating regions in 2019.

Shifting to the Government Business. Operating revenues of $12 billion in the third quarter grew by 5% compared to the prior year. Operating margin for the Government Business was 3.8% during the third quarter 2017, a decline of 40 basis points compared to the prior year. The decline was primarily due to the impact of higher investment spending in the current year quarter and the 1-year waiver of the health insurance tax in 2017, partially offset by the impact of retroactive revenue adjustments in the Medicaid business.

Our margin performance was in line with expectations in the Medicaid business, excluding the impact of a retro revenue adjustment, which had previously been expected to be realized in the fourth quarter. We continue to work with the state of Iowa and CMS on approving final 2017 rate increases, and we are hopeful that this process will be completed by the end of the year.

We continue to see a significant RFP pipeline of opportunity in the Medicaid business over the next 5 years, largely within the specialized services populations. In addition, we're looking to continue our momentum in forming strategic alliances with other health plans that allows them to utilize our best-in-class Medicaid operating platform and enables us to further augment growth.

In the Medicare business, our core gross margin performance continues to be in line with expectations. We're pleased to have grown membership again this quarter in our Medicare Advantage business. During the quarter, we announced the acquisition of HealthSun, a South Florida Medicare health plan and a provider system, which is expected to close in the fourth quarter. The HealthSun acquisition is an example of our commitment to expanding our footprint in an attractive geography with a well-run asset.

We're also pleased with the CMS Star Ratings that were recently released. More than 60% of our 2018 Medicare Advantage membership will reside in 4-star or higher plans, a meaningful increase from the 22% we had in 2016.

Additionally, 3 of our plans received a 5-star rating, and the HealthSun and America's 1st Choice assets each have a plan that received 5-star rating as well. We feel very well positioned to continue to capitalize on our growth opportunities in the Medicare Advantage business going into 2018.

Before I turn the call over to John, I wanted to provide a few high-level thoughts on our financial outlook. For 2017, we increased our adjusted EPS outlook to a range of $11.90 to $12. As it relates to next year, we're currently developing our 2018 plan.

There are a few high-level headwinds and tailwinds that we've identified, which will impact our financial performance next year relative to 2017.

The primary headwinds to earnings that we are managing through are: The return of the health insurance tax and the timing impact of midyear contract renewals, which we expect will impact 2018 by a little more than $0.40 per share, and the impact of fixed cost deleveraging from the Individual ACA-compliant market exits.

As I stated earlier, we currently expect our Individual ACA-compliant footprint to decline by approximately 70%, which covered fixed costs that otherwise would have been allocated elsewhere in 2017.

For tailwinds to earnings in 2018, we expect continued enrollment growth in Medicare, Medicaid, Specialty and employer self-funded product offerings. Next, improved profitability in the Individual ACA-compliant business from relatively breakeven in 2017 to slightly profitable in 2018.

Normalization of incentive compensation expense is another category which is expected to be higher than target based on 2017 financial performance. And finally, capital deployment during 2017, including M&A activity and share repurchases, which were more weighted to the back half of 2017 as well as all of 2018.

Taken together, we're targeting a growth rate in 2018 that is consistent with our long-term growth expectations in the high single to low double-digit range when you exclude the impact of the health insurance tax. We expect to provide more details around our 2018 outlook on our fourth quarter conference call.

With that, I'll turn the call over to John to discuss our third quarter financial performance and updated 2017 outlook in more detail. John?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Thank you, Joe, and good morning. I'll begin by discussing the consolidated financial highlights during the third quarter.

On a GAAP basis, we reported earnings per share of $2.80. These results included net positive adjustment items of $0.15 per share. Excluding these items, our adjusted earnings per share was $2.65 for the quarter. These results reflect our continued strong underlying financial performance.

Operating revenues in the third quarter totaled $22.1 billion, an increase of $972 million or 4.6% versus the third quarter of 2016.

The growth was primarily driven by premium rate increases across all lines of business to cover overall cost trends as well as enrollment growth in our Large Group, Medicare Advantage and Medicaid businesses.

These increases were partially offset by the impact of the 1-year waiver of the non-tax-deductible health insurance tax in 2017 as well as lower current year risk adjustment accruals compared to the prior year quarter.

Our benefit expense ratio of 87% in the third quarter increased by 150 basis points from the prior year quarter. This increase, which was slightly better than expectations, was largely driven by the impact of the 1-year waiver of the health insurance tax, partially offset by improved medical cost performance in the Individual business.

Additionally, we benefited from a retroactive revenue adjustment in the Medicaid business, which was expected to be received in the fourth quarter.

Our third quarter 2017 SG&A expense ratio of 13.6% declined by 120 basis points from the 14.8% in the third quarter of 2016. The decrease, as expected, was primarily driven by the impact of the 1-year waiver of the health insurance tax in 2017 and the impact of fixed cost leverage on operating revenue growth. These items were partially offset by the impact of the increased spend to support growth initiatives during the current year quarter.

Now turning to the balance sheet. As has been our practice, we have included a roll forward of our medical claims payable balance in this morning's press release. For the first 9 months of 2017, we experienced favorable prior year reserve development of $1.1 billion, which continues to be better than our expectations.

Our reserves continue to include a provision for adverse deviation in the mid- to high single-digit range, and we believe our reserve balance has remained consistent and strong as of September 30, 2017.

Our Days in Claims Payable was 40.5 days as of September 30, unchanged from the 40.5 days we reported at the end of the second quarter.

Our debt-to-cap ratio was 38.5% as of September 30, 2017, unchanged from the end of 2016 and an increase of 40 basis points from the 38.1% at the end of the second quarter, and it reflects the impact of share repurchase activity during the quarter.

We repurchased approximately 5.9 million shares of common stock for $1.1 billion at a weighted average share price of $189.85, bringing our total year-to-date share repurchases to 8.8 million shares at a weighted average share price of $186.80.

As of September 30, 2017, the company had approximately $2.5 billion of board-approved share repurchase authorization remaining, which we intend to utilize over a multiyear period, subject to market conditions.

We ended the third quarter with approximately $2 billion of cash and investments at the parent company, and our investment portfolio was in an unrealized gain position of approximately $861 million as of the end of the quarter.

We used $181 million during the quarter for our cash dividend, and this week, our audit committee declared a fourth quarter dividend of $0.70 per share to our shareholders.

For the 3Rs, our balance sheet continues to reflect a net receivable for risk adjusters, although our current year risk adjuster estimate is not as high as we were previously anticipating as the claims experienced in the Individual business is coming in slightly ahead of our expectations.

Now moving to cash flow. For the third quarter 2017, we generated operating cash flow of $2.4 billion or 3.2x net income. And on a year-to-date basis, operating cash flow was $5.5 billion or 2.1x net income.

Our year-to-date cash flow through September 30 continues to be impacted by several timing items that are expected to reverse, including collecting 10 CMS Medicare payments during the first 9 months of the year, while only expecting to collect 2 payments in the fourth quarter; receiving provider capitation pass-through payment funding at the end of the third quarter, which we will paying to various providers in the fourth quarter; and finally, our original cash flow expectations assumed we would make certain Medicaid collar payments in the fourth quarter of 2017 which are now expected to be made in 2018.

After adjusting for these timing items, operating cash flow was still strong. We now expect full year 2017 operating cash flows to be greater than $4 billion, reflecting the high quality of our earnings so far this year.

Turning to our updated 2017 financial outlook. Our 2017 GAAP earnings per share is now expected to be in the range of $10.80 to $10.90, and we have increased our adjusted earnings per share outlook by $0.25 per share at the midpoint to a range of $11.90 to $12. Operating revenues are expected to be in the range of $88.5 billion to $89.5 billion.

Fully insured membership is now expected to be in the range of 15.1 million to 15.2 million and our self-funded membership in the range of 24.9 million to 25 million as our Medicaid and BlueCard enrollment is coming in lighter than we previously expected.

Taken together, we expect our total membership to now be in the range of 40 million to 40.2 million members.

Our 2017 medical loss ratio is now projected to be 86.8% plus or minus 30 basis points, reflecting better-than-expected performance in our Individual ACA-compliant and Local Group insured businesses. We now expect our SG&A ratio to be at 13.8% plus or minus 30 basis points on a GAAP basis, which includes the impact of the Penn Treaty assessments, the 2015 cyberattack litigation settlement and transaction costs related to the terminated Cigna transaction incurred in the first 9 months of 2017.

The increase versus our previous expectations now reflects the impact of higher spending on our growth initiatives as well as higher incentive compensation due to our better-than-expected performance in 2017.

We continue to expect our 2017 Local Group insured medical cost trends to be in the range of 6.5% to 7%, with a bias towards the low end of the range.

Regarding capital deployment, our 2017 outlook includes some additional share repurchase during the beginning of the fourth quarter, bringing us to the higher end of the $1.5 billion to $2 billion range communicated previously.

It is important to note that our outlook does not include any additional transaction or legal costs associated with the terminated Cigna acquisition beyond those incurred in the first 9 months of 2017.

Additionally, our outlook also does not include any benefit from lower pharmaceutical pricing, which we continue to believe we are entitled to under our current contract with ESI.

With that, operator, please open up the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ana Gupte with Leerink Partners.

Anagha A. Gupte - *Leerink Partners LLC, Research Division - MD, Healthcare Services and Senior Research Analyst*

Appreciate the commentary directionally on 2018. I had a couple of follow-ups. The first one is on the HIF headwind, $0.20 each, I think, roughly on Commercial and Medicare. Do you see any offsets from utilization into 2018? You have a very good loss ratio in the third quarter, possibly even ex hurricane, it looks really good, given your presence in Texas and Florida. So how should we think about that for '18?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Ana, this is John. Thank you for your question. Yes, the HIF headwind, make sure I've got your question correct. We've actually got a tailwind here in 2017 associated with HIF of about $0.20, that then turns into a little bit more than a $0.40 headwind in 2018. But specifically related to the hurricane, it really didn't impact us that much. We do not have the Blue properties in either Florida or Texas. And the Medicaid business that we had was fairly well controlled. So the hurricane -- neither of the hurricanes really had a significant financial impact to our results or our outlook.

Operator

And we do have a question from the line of Ralph Giacobbe with Citigroup.

Ralph Giacobbe - *Citigroup Inc, Research Division - Director*

I just want to go to the exchanges and your exchange expectations into next year. I guess, how do you approach it in terms of just an overall enrollment? I mean, is it just the expectation that things are stable? Do you expect there to be a lot of churn? How committed are you, I guess, to the marketplace, in general? I mean, if you expect membership to be down 70%, kind of what's the benefit of sticking it out? And then just a follow up around that was just the Executive Order, how you see that potentially impacting you, any thoughts on how the short-term plans -- or, how you think association health plans will sort of impact the small group for you? Just trying to get a sense of your position and how disruptive that may or may not be.

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Sure. I'll just say -- Ralph, this is John. Why don't I start out by addressing a couple of your financial questions, and then I think joe will weigh in on some of the strategic elements to your questions. In terms of the enrollment, as we -- as Joe stated, we're expecting our footprint to decrease by about 70% in 2018 from our current 2017 perspective. And that's about half of the rating regions that we're currently in we're getting out of, and maybe a little bit more than that. And then for the rating regions that we're staying in, really refining our product designs and our offering in the various medal levels. And that all relates to about a 70% decrease in footprint. In terms of being committed, it's really related to providing optionality associated with 2019 and where do we want to head in 2019 based on what happens in 2018, and it's really premature for us to make a decision on 2019 today. So with that, well, obviously, we do have the CSR funding issues need to be resolved as well, and that's part of why we're actually pretty comfortable with the significant drop in membership that we have in '18, given the uncertainty of that area. So a lot needs to be resolved in the next 12 months before there's a final declaration, but we're -- we've been in this business since day 1, and we think it can be a viable business, assuming that the appropriate legislative and regulatory fixes are in place.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Yes, Ralph, let me weigh in based on that background. I think that -- well, let me key in on one phrase you used, which is sticking it out. I think, surgically speaking, I used that term quite often in the last year, I think we've successfully repositioned ourselves in a way that allows us to participate in a more stable environment with respect to the rating regions that we have remained in. Specifically, we will continue to participate in 56 of the 143 rating regions, which, comparatively speaking, we were in virtually all of the rating regions previously. My sense is that where we are sticking it out, we've got, I think, a reasonably good line of sight to the year. And our expectation is that by the end of '18, we'll be making the choices that are necessary, considering the advancement of stability, which still, there is a tremendous amount of lack of clarity in terms of what the future state might look like until further legislation occurs or specificity around certain policy announcements bring clarity. So long story short, I think, again, surgically, we're very well positioned. I think our pricing is appropriate relative to the hand that's been dealt us. And so again, I think we have said that we're targeting a low single-digit margin, albeit certainly not at the 3% to 5% target that we continually hope to achieve. We're not there yet. But as John just pointed out, I think we've got the technical and kind of the strategic insights necessary to effectively perform that then we are well positioned to make the right choices by the end of '18. So hopefully, that gives you some line of sight with respect to the ask about our ability to stick it out.

Operator

And we do have a question from the line of Kevin Fischbeck with Bank of America Merrill Lynch.

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

Can you just quantify how much the Medicaid retroactive payment was in the quarter? And I guess, just to clarify, it sounds like you're saying it was in your guidance, it was just the timing of it that was the issue as far as the guidance goes. It did not contribute to your guidance raise; is that correct?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Yes. You are correct with your assessment there at the end of your question. We really don't go into exactly how much a retroactive adjustment is. There are retroactive adjustments in the Medicaid arena on, really, a regular basis. We only spike it out when it's material enough to move the needle, but we have retroactive adjustments every quarter within that -- our block of business. And we had been expecting it all along, and we expected it to occur in the fourth quarter. So we actually got it early, which is good news. But it did not change our annual guidance at all.

Operator

And we do have a question from the line of Christine Arnold with Cowen.

Christine Mary Arnold - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Two questions. One, prior period development looked pretty significant. Was it heavily weighted towards Government or Commercial? And in looking at Commercial earnings, they were down about 16% year-over-year this quarter versus about 10% in the prior quarter. And I think the prior quarter also had some cybersecurity drain. Is there a comp issue we should be thinking about when looking at this quarter year-over-year on the Commercial operating earnings that I'm maybe forgetting about?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Christine, on the PPIA, I'll say that our reserves have been calculated consistently conservative across all lines of business. And some of the favorable results, I think, reflect the fact that we do have consistently conservative methodologies associated with our reserving pattern. So I really can't say more about a specific line of business after that. But we continue to target a high single-digit margin for adverse deviation, and again, we believe our reserves continue to be consistent and conservative. In terms of the other question of year-over-year -- or quarter-over-quarter, I guess -- again, there are several things that are going on. Obviously, the HIF fee always impacts every analysis. And the fact that we had HIF fee in '16 and then not in '17, and then presumably we'll have it again in '18, profitability by line of business, all the ratios, all the metrics, all are really noncomparable. You're correct in terms of compensation expense. And basically our bonus program had issues in '16, if you'll recall. We reduced our compensation in '16, and we have been fortunate enough that we have not had to do that yet in '17. Hopefully, that helps answer your questions.

Operator

And we do have a question from the line of Justin Lake with Wolfe Research.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Can you talk about what you were assuming now in updated 2017 guidance for Iowa performance, relative to what I think was breakeven expectation in the second half of this year on actuarially sound rates? And then can you tell us why admin fees were down nearly $100 million sequentially in the third quarter?

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Justin, this is Joe again. With respect to Iowa, we're continuing negotiations with the state, and there are adjustments that have occurred from time to time, and we're in the middle of negotiations as we speak. And there have been some recommendations with respect to those rate adjustments, which we've now -- those adjustments have been put forward to CMS for review and, hopefully, approval. We've not heard back from CMS as yet and expect, at least hopefully, we'll get something by the end of '17. But in any event, Iowa is still a work in process, and, obviously, we're always optimistic that we'll finally be able to work out the situation there. And so I guess we'll just have to ask you to kind of stay tuned with respect to the final resolution that will be given to us by CMS. John, you want to speak to the other matter?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Yes, on the admin fees, there's really nothing within that line item that's problematic or an issue, Justin. It's a good question. The revenues are very much in line with expectations. Our membership is very strong. There is just -- we did exit the Massachusetts Medicaid ASO arrangement, that caused that to drop out, and just some other true-ups, but nothing that's really overwhelming associated with that line item.

Operator

And we do have a question from the line of Dave Windley with Jefferies.

David Howard Windley - *Jefferies LLC, Research Division - Equity Analyst*

Management embarked on some fairly significant SG&A streamlining efficiency initiatives going back, I think, as early as maybe 2015. Some of that SG&A savings continued in 2016, obviously, over and above the comp issues that you've already discussed. And then, in the press release today, you talk about some investments in growth initiatives. I wondered if you could describe where you've been able to take costs out? And then, where you are now putting costs into the business and kind of clarify that those are distinctly different buckets?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Yes, Dave, great question. This is John. So happy to respond to that. In terms of where we're taking costs out, we continue to focus on non-value-added services and things that really don't provide a lot of impact to the [members] and eliminating any duplication of processes and things like that and just being wise stewards of shareholder and member premiums -- shareholder dollars and member premiums. In terms of some growth initiatives, I'll just give you a few examples just to get you a comfort around that. Like, for instance, we're really building out our capabilities to enhance our position with the employer group retiree business for Medicare offerings is an example that we see some significant long-term potential, and we really need to enhance our capabilities. We're focusing on the aging population. What we mean by that is, let's take a look at the 63- and 64-year-olds who are actually buying insurance through Anthem's Commercial marketplace and get them signed up for a Medicare offering when they age into Medicare. In addition, we're building out offerings for specialty, stop loss, integrated health care management for our ASO customers, all very specific items associated with our growth imperatives and our growth strategies that are clearly different than systems consolidation and elimination of duplicate processes.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Yes, let me jump in here. Thanks, John. And maybe I could step up a little bit higher, just to let you know I just, by reminder, back in the first quarter communicated to you that we've embarked upon some really detailed review of our SG&A specific to capturing more efficiencies as we service our customers. I challenged our senior leadership at that time to take a really hard look at our relative performance as well as our cultural characteristics. And we compared ourselves against our competitors and performance variations across our business environment. We are taking that -- those insights and really translating it into strengthening the assets that we do have. And by way of some specific examples, for instance, our service operation center is really getting streamlined tightly now with respect to how well we service each one of our members with respect to their necessity to have a very efficient and effective engagement with us. So we're taking out costs, but translating that level performance in a way that leverages, for instance, digitization by way of mobile technologies, by way of other assets that makes it a lot easier for our customers to use our business model. And so I guess that's just one small example, but we've got a really significant commitment now to digitization that gives the kind of leverage we think is necessary to optimize the spend that we've historically placed with respect to eliminating customer abrasion. Again, one small example that's producing very meaningful large results for us. In addition, what John said with respect to capital deployment that really is supporting our growth imperatives, which we've mentioned to you. I think there are 7 key areas. I won't get back into it because we've made that clear to you with respect to where we're putting our commitment going forward with respect to growth, but it's literally just reallocating our cost structure in a way that optimizes our commitment to our customers as well as our growth imperatives.

Operator

And we do have a question from the line of Chris Rigg with Deutsche Bank.

Christian Douglas Rigg - *Deutsche Bank AG, Research Division - Research Analyst*

Just one quick clarifying. Can you remind us, of the 1.7 million Individual, how many are ACA compliant? And then, my real question relates to Medicare Advantage. How do you guys think you'll grow organically next year? When you think about how your plans stack up against the competition, do you think you're positioned to take market share or grow more in line with the market? I'm just wondering how you're thinking about that.

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Yes, so Chris, this is John. In terms of the Individual membership, we have about 1.4 million ACA-compliant. And of that 1.4 million ACA-compliant, a little less than 1 million of it, maybe a little bit more than 900,000, actually purchased it via the exchanges. So that's -- that hopefully will help you reconcile that. In terms of where we are in the marketplace, we feel very comfortable with our ability to grow. We're going to grow our self-funded membership. We're going to grow our Medicare membership above and beyond the M&A issues that we have in terms of nice Medicare growth associated with the 2 acquisitions that we've announced here in the last several weeks, continue to grow that. Local Group, we expect the enrollment to be stable in a slightly shrinking marketplace. In terms of the overall market share, we expect our market share to increase, so our enrollment will stay stable on that. So we feel pretty good about where we're positioned. And, of course, the Medicaid pipeline continues to be extremely strong in terms of some of the specialized services, whether it's LTSS populations, aged, blind and disabled, various other areas within Medicaid that are -- have not historically been in a Medicaid managed care arrangement that we can provide a lot of savings to the states by providing our support there.

Operator

And we do have a question from the line of Gary Taylor with JPMorgan.

Gary Paul Taylor - *JP Morgan Chase & Co, Research Division - Analyst*

A two-part question. One, I just wanted to make sure I'm following what you had laid out for '18 correctly. So midpoint of this year would be $11.95. Midpoint of your long-term guidance, 10% growth, takes you to $13.15. Back off $0.40 of HIF, would be about $12.75 for 2018. So is that -- is there anything wrong with that math?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

Gary, your math is very credible and reasonable, without saying that -- we obviously can't comment on specific point estimates, and I really don't want to go into providing guidance in 2018 yet since our planning process is not yet complete. But we're -- your math is credible.

Operator

And we do have a question from the line of Sarah James with Piper Jaffray.

Sarah Elizabeth James - *Piper Jaffray Companies, Research Division - Senior Research Analyst*

I appreciate the comments around the exit in specific exchange counties with lack of clarity, but I wanted to get a little bit more context around the evaluation process and what you perceived as the biggest risk or swing factor. So some of the common characteristics in markets where you decided to stay versus commonalities you saw in markets where you decided to leave.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Yes, thanks. Regarding the levels of specificity, obviously, varied by state, as you would expect. And it's obvious there were multiple factors that we considered when we examined the rating regions. In the main, the instability was a big driver for us, and we tried to map the instability that we could observe and determine how then it would be applied to each one of those rating regions. In some cases, we did feel that exiting was appropriate. Then we began working very carefully with state government to get a better line of sight as to what could occur and then what adjustments would be necessary to create the stability that we needed to stay in the marketplace. So we did look at trend expectations, and we examined various risk profiles that then gave us some line of sight regarding what our position needed to be. We looked at our competitor's factors with respect to how they were performing in the markets. And I think in the main, we were able to target some long-term margin expectations based on what we -- how we could price and then what we would sell. And, quite frankly, at the end of the analytics, we then made decisions to stay in certain rating regions and exit others. So I think that, that probably pretty much sums up kind of our outlook going rating region by rating region. The CSR subsidy certainty was a very serious consideration. And the fact that we priced accordingly, recognizing that, that probably would not -- well, we assumed it would not be in place. And that gave us, quite frankly, a line of sight or a commitment to pricing that we felt put us in a good standing with respect to at least being able to price effectively and position ourselves well in the rating regions that we did decide to stay in.

Operator

And our last question this morning comes from the line of Josh Raskin with Nephron.

Joshua Raskin - *Nephron Research - Analyst*

I wanted to sort of maybe take a step back just from an overall strategy perspective and get your views, Joe, in terms of what's the plan for Anthem's growth, right, as you think about sort of expanding markets? And I guess, I'm curious on a couple of fronts, with the understanding there's timing issues, the cash flow has been really strong, and I think what we're seeing in the last quarter was really a big acceleration in buybacks, the largest we've seen probably in 3 years, 3 years plus, and then a couple of Florida Medicare Advantage deals. And so I'm just curious, is the strategy here to sort of buy back stock but look for selective opportunities to expand beyond the 14 markets? Or do you think more of the growth is going to come from your 14 markets? And maybe within that, how do you play with the other Blues plans?

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Well, you covered a lot of territory there, and I think it's obvious share buyback is always an element of our capital deployment strategy. And we have targets, we've made it very clear what that is year-over-year. And so I think in that regard, we're very prudent with respect to how we deploy capital in that regard. With respect to growth overall, we have made it clear that we do have numerous strategic growth imperatives that actually are playing out quite nicely. As an example, M&A in the Medicare Advantage space, which obviously, we were just able to make 2 very significant announcements in short order, in the last few weeks, in the Florida marketplace. I think that is going to be a contributor with respect to M&A opportunities. And obviously, we are targeting organic growth in the Medicare space. I think looking out more long view as an example in the Medicare space, our PBM opportunity going forward will give us, albeit it's still couple of years off in terms of 1/1/20, but I think we will be incredibly competitive in the Part D space that we cannot take advantage of today as effectively as we envision after 1/1/20. I think that kind of the big unknown, I've already mentioned it, is the stability of the -- or the hopeful stability in the Individual marketplace. And that's a story that probably is going to unfold in the coming 12 to 18 months. There are a variety of other opportunities when we -- John already mentioned a few, such as our very heavy focus on specialty cross-selling to our medical membership. And overall, our PBM outlook is very strong. Not just Part D, but broadly speaking, it's going to give us a lot of opportunity going forward in terms of capturing share. John, am I missing anything that maybe you can share?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

No. Thank you, Joe. I think just really I think there's no way we can oversell the ability for our new PBM contract to really accelerate growth in 2020 and beyond. Every line of business is going to benefit from it significantly. Certainly in the Med Part D in the Medicare space, where drug spend is a higher percent of total, it will benefit even more, but the large national accounts, not having the carve-outs on ASO, really positioning ourselves better for Local Group fully insured, every line of business benefits from that in 2020 and beyond.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Yes, and I'm just probably remiss not mentioning other strategic imperatives that we've talked about for growth, like solidifying our commercial portfolio so that we stem the historic tide with respect to out-migration of certain parts of the business. And we're hopeful to really make that a very strong part of our portfolio going forward. And Medicaid, obviously, is another great example. We keep talking about that pipeline. So John?

John E. Gallina - *Anthem, Inc. - CFO and EVP*

I was just going to say, just to finalize or address one of Josh's other comments on capital deployment, our share buyback stays consistent with our expectations. We had not done any share buyback for a couple of years while we were going through a large M&A deal that ended up falling through. And so the fact that we just came back to a more normalized level of M&A. But really the capital deployment thought process is that we want to be very opportunistic. We want to be diligent in the effective use of capital. To the extent that there's additional merger and acquisition opportunities, we'll focus the capital on that. To the extent that we think it's a better return of capital to shareholders to do share buyback, we'll do that. And we'll always pay one of the market leading dividends as well. So there's a lot of different places to go with capital deployment. And any one year is literally just any one year. And we'll make the decisions as the market allows us to.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Yes. I guess, in summary, it's an overarching question. I think it's on everybody's mind, but I can assure you that the team here has well thought out our outlook for next year and then beyond. And that's why we can say that our earnings growth rates, certainly, we can hold firm with respect to upper single-digit and low double-digit outlook. And just in summary, I can tell you our Government Business is strong. Our Commercial Business is continually repositioning and strengthening in many, many ways. And then the core element of performance of the company around SG&A controls, our capital deployment strategies, as John just pointed out, and another sort of driver is our PBM outlook in terms of repricing opportunity.

So I think your question really allowed us to give you kind of a summary statement about our -- the entirety of our performance outlook and the commitment that management has made to the growth agenda for this company. I think the proof points are there, and we're very excited about the potential for the company going forward.

Operator

I'd now like to turn the conference back to company management with the company's closing comments.

Joseph R. Swedish - *Anthem, Inc. - Chairman, President & CEO*

Thank you for all of your questions. As always, they're very insightful and very probing, and I'm glad we are able to give you line of sight to our directions going forward. As you know, as a company, we are committed to confronting our health care system's challenges, and we're focused on expanding access to high-quality, affordable health care for our customers.

I have to, again, underscore thanks to all of our associates for their continued commitment to serving over 40 million members every day. Thank you for your interest in Anthem, and we look forward to speaking with you soon at upcoming conferences. Have a great day. Thank you.

Operator

And ladies and gentlemen, this conference will be available for replay after 11 a.m. today through November 9. You may access the AT&T Teleconference Replay System at any time by dialing 1 (800) 475-6701, entering the access code 403160. International participants may dial (320) 365-3844. That does conclude your conference for today. Thank you for your participation and for using the AT&T Executive TeleConference service. You may now disconnect.
