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ANTM - Q2 2018 Anthem Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Anthem second 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. Please go ahead.

Chris Rigg - *Anthem, Inc. - VP, IR*

Good morning, and welcome to Anthem's Second Quarter 2018 Earnings Call. This is Chris Rigg, Vice President of Investor Relations. And with us this morning are Gail Boudreaux, President and CEO; John Gallina, our CFO; Pete Haytaian, President of our Commercial & Specialty Business division; and Felicia Norwood , President of our Government Business division. Gail will begin the call by giving an overview of our second quarter financial results, followed by commentary around our focus on execution and our enterprise-wide growth priorities. John will then discuss our key financial metrics in greater detail and go over our updated 2018 outlook. We will then be available for Q&A.

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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 expectations. We advise all 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 Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Good morning, everyone. Thank you for joining us for Anthem's Second Quarter 2018 Earnings Call.

Today, we reported second quarter 2018 GAAP earnings per share of $3.98 and adjusted earnings per share of $4.25, which are ahead of expectations. Our second quarter results reflect our ongoing commitment to improve execution across our enterprise. Anthem's second quarter operating revenue grew 2.3% over the prior year quarter to $22.7 billion. The increase in operating revenue was driven by growth in our Government Business that more than offset the headwinds presented by the planned reduction in our Individual business. Service fee revenue was up, a direct result of our efforts to improve sales of our consumer-centric clinical engagement programs within our self-funded book. Membership declined sequentially by 129,000 lives, attributable to declines in both our Commercial and Medicaid businesses. The Commercial membership results in the second quarter remained inconsistent with our expectations and do not yet reflect the initiatives that are expected to drive improvement. The decrease in Medicaid was due to a reduction in TANF members due to an improving economy and continued redetermination of eligibility efforts by state. Our focus on managing the overall health of our members results in another quarter of solid medical cost performance. Anthem's medical cost ratio in the second quarter was 83.4%, better than expectation and down slightly year-to-year when normalized for the health insurer fee. Our SG&A ratio was in line with expectations at 15.1%, leading to a favorable second quarter operating margin of 6.9%.

Turning to our outlook. We expect the positive momentum exhibited in the first half of 2018 to carry forward to the balance of the year. Further, we remain focused on accelerating revenue growth while continuously providing our members with trusted caring solutions. Based on our strong first half financial performance, we are raising our full year 2018 adjusted earnings per share outlook to greater than $15.40, a 28% increase from 2017.

In our Commercial business, we continue to build our segment strategy and increase our focus on sales execution. As we have previously noted, the reinstitution of the health insurer fee was a catalyst for our employer partners to shop for flexible plan designs and we did not move quickly enough to pivot to their needs. Our new strategy enables more consistent and effective product deployment, sales training and broker service across our 14 states while allowing for flexibility and choice in the local market. Leadership and structure is now in place, and we are intensely focused on building momentum for growth in 2019 and beyond by increasing our agility and speed to market. An example of this is our recently announced partnership with Samsung and American Well. Through this partnership, consumers with an Anthem-affiliated health plan can use the Samsung health app to access the LiveHealth Online, which connects consumers with U.S.-based, board-certified health care providers for a wide variety of nonemergency medical care 24 hours a day, 7 days a week. We expect to see growing momentum in membership retention and growth as we move into 2019. Although the 2019 National account selling season is still under way, we are seeing signs that Anthem's integrated clinical capabilities are resonating. Our pricing strategies in the Commercial segment remain disciplined and our pretax segment margin targets are unchanged. Overall, we believe the pricing environment is rational.

Turning to our Government Business. We recently announced that Felicia Norwood has been appointed President. Felicia has over 25 years of commercial and government health care experience and was most recently serving as the Director of the Illinois Department of Healthcare and Family Services. In this role, Felicia will be able to apply her valuable insight and experience to drive persistent growth in our Government division.

We have significantly scaled our Medicare platform over the last seven months with the acquisition of HealthFund and America's 1st Choice. As we look ahead, we will see good balance between both membership growth and margin retention. We recently submitted our planned bids for

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2019 with this in mind and we continue to believe that mid-double-digit organic membership growth remains in reach over the near term. Approximately 70% of our membership is in plans rated 4 stars or higher, and we have 5, 5-star plans, the most in our industry.

Acquisitions have been a key element of our Medicare Advantage growth strategy. But given our star profile, market share gains in adjacent county expansion presents the most capital efficient means to increase profitability. We are targeting growth in both the dual and non-dual Medicare population. However, we believe Anthem is uniquely positioned to serve the needs of the medically complex dual-eligible population because of our industry-leading Medicaid platform and our provider collaboration initiative like Enhanced Prsonal Health Care. We expect to increase our county footprint meaningfully in 2019, but in aggregate, the largest source of near-term growth resides in our ability to go deeper and get stronger in the regions where we currently operate.

The group Medicare Advantage market is a significant untapped opportunity and we feel that our existing Commercial business and trusted brand give us an unmatched competitive advantage. Combined with improved star scores and Anthem's innovative community-based program and integrated clinical arrangement, we are poised for growth in the group MA segment. Anthem has historically been uncompetitive in this area, but as we look ahead, we are certain we can increase our market share. As one of the most trusted consumer brands, we are confident that we bring an improved value proposition to the Group Retiree segment, a value proposition that will only improve with IngenioRx beginning in 2020.

Several recent group Medicare wins support our optimism. We expect our group MA business will more than double in the back half of 2018, albeit off a base of 26,000 members at the end of the second quarter. Early indicators suggest this enrollment's success can be sustained into next year.

In the Medicaid segment, we continue to see a growth pipeline of $80 billion over the next 5 years, largely by serving the needs of higher acuity and specialty populations. Of note, during the second quarter, we rewarded a statewide contract to serve Florida's HIV population. We're also proud to announce that we recently received 2 Case-In-Point Platinum awards, which recognize the most successful and innovative case management program. Our health care solutions, behavioral Health Homeless Case Management program and Diabetic Clinic Days program each won their respective category.

Our partnership with Blue Cross Blue Shield in Minnesota is expected to go live in the fourth quarter of 2018 and serve 375,000 Medicaid and dual-eligible members. Looking ahead to the first quarter of 2019, we are also encouraged by the opportunity to serve a portion of the 400,000 Virginia Medicaid expansion population.

During the second quarter, we completed the acquisition of Aspire health, furthering our clinical capabilities through a network of interdisciplinary skilled medical professionals that provide comprehensive care in the home for patients facing a serious illness. Aspire currently serves more than 20 health plans across 25 states. Additionally, we are pleased with the progress in our integration planning ahead of the launch of IngenioRx on January 1, 2020. We feel our growth savings target of $4 billion annually is prudent and expect at least 20% of the savings to flow through to our bottom line.

Before passing the call over to John, I would like to offer some high-level thoughts about our future. As I look across the competitive landscape, I am confident that Anthem is well positioned to gain market share in our key business segment. I am often asked what has surprised me most since joining Anthem and my answer is that I'm extremely impressed by the depth and breadth of our clinical and network capabilities and our ability to drive affordable solutions despite our significant pharmacy disadvantage. This is a testament to the strength of our company and the power of our deep local market engagement. Looking ahead, we're excited about the opportunities to better manage the burden of health care inflation for both our current and potential customers. The rollout of IngenioRx in 2020 is of paramount importance to our objective. The foundation of our PBM strategy is built on bringing the most clinically effective and financially efficient pharmacy solution to our members, an approach that is predicated on the overall cost of care and not rebate maximization.

To conclude, we're excited about the growth opportunities we see in the balance of 2018 and 2019 as we bridge the GAAP to 2020. The inflection point for Anthem as we align our best-in-class medical cost position and consumer response solutions with a greatly improved pharmacy offering.

With that, I'll pass the call over to John for a more detailed review of our second quarter financial performance and updated 2018 guidance.

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John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Thank you, Gail, and good morning. As Gail stated, we reported strong second quarter financial results with GAAP earnings per share of $3.98 and adjusted earnings per share of $4.25. Operating revenue in the second quarter was $22.7 billion, an increase of 2.3% versus the prior year quarter. The growth in operating revenue is resolved in the acquisitions of HealthSun and America's 1st Choice, in addition to a premium rate increases to cover the return of the health insurance tax in 2018. The government growth in the quarter comes despite our voluntary decision to reduce our individual ACA footprint, which has resulted in a 55% decline in our individual membership since the end of 2017.

Enrollment declined by 129,000 members during the quarter of 0.3%, bringing total enrollment to 39.5 million members. Fully insured membership decreased by 103,000 members sequentially driven largely by declines in Medicaid and continued attrition in our Individual business. Fully insured declines were partially offset by our organic growth in Medicare, which grew by approximately 25,000 lives.

Our Medical Loss Ratio is 83.4% in the second quarter, a decrease of 270 basis points from the prior year quarter. The decline was primarily driven by the reinstitution of the health insurer tax in 2018. However, our Medical Loss Ratio further improved as a result of the strong medical cost performance in both our Commercial and Government businesses. This improvement is seen in our strong gross margin results across multiple lines of businesses. Our results in the quarter reflect our commitment to improve the total cost of care through various programs such as our innovative clinical and value-based care arrangements.

Based on the success of our care management initiatives and our overall performance debate, we continue to expect our Local Group insured medical cost trend to be in the range of 6% plus or minus 50 basis points.

As Gail mentioned, our SG&A expense ratio was 15.1% in the second quarter, an increase of 130 basis points relative to the second quarter of 2017. The increase is driven by the return of the health insurer tax in 2018, in addition to increased investments spend to fund future growth, partially offset by the settlement related to a 2015 cyber attack, which was recorded in the second quarter of 2017. Looking ahead, we will continue to prioritize investment spending and growth initiatives across the enterprise.

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. We experienced favorable prior year result development of approximately $800 million for the first 6 months of 2018, slightly ahead of our expectations. Our reserves continue to include a provision for average deviation in the mid- to high-single-digit range, and we believe our reserve balances remain consistent and strong as of June 30, 2018.

Days in Claims Payable was 38.7 days in the second quarter, decreasing by 1.6 days sequentially and in line with our high 30s target. The decrease was driven by our focus on improving our claims processing systems, ultimately leading to faster claims payment cycle times and the impact of the timing of the acquisition of America's 1st Choice on the first quarter Days in Claims Payable metric.

Our debt-to-cap ratio is 40.2% as of June 30, 2018, a decrease of 220 basis points compared to the first quarter. The decrease is primarily driven by the conversion of our $1.25 billion of equity loans, which were originally issued in 2012 and matured in early May as well as a modest reduction of our short-term borrowings. Our debt-to-cap ratio is in line with our targeted range and is at a sustainable level.

During the second quarter, we repurchased 1.7 million shares of common stock at a weighted average price of $229.75 per share, totaling approximately $400 million. In addition, we distributed $196 million during the quarter for our cash dividend. As of yesterday, our audit committee approved a third quarter dividend of $0.75 per share. Taken together, we ended the second quarter with approximately $2.2 billion in cash and investments at the parent company.

Operating cash flow was $542 million in the quarter, up versus $393 million in the prior year quarter. For the first 6 months of 2018, operating cash flow is approximately $2.8 billion or 1.2x net income and is in line with our expectations.

Looking ahead to our outlook for the remainder of the year, we now expect fully insured enrollment to be in the range of 14.6 million to 14.7 million members by the end of the year. Our revised outlook takes into consideration the greater-than-projected membership decline in the second quarter

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and a more modest growth outlook for the remainder of 2018. In the second half of 2018, our membership outlook continues to include growth of approximately 375,000 Medicaid members in Minnesota, organic Medicare Advantage gains and recent wins in the Group Retiree business. Self-funded membership is expected to be in the range of 25.3 million to 25.4 million members, unchanged from prior guidance. In total, we now expect medical membership to end the year within the range of 39.9 million to 40.1 million lives, down 200,000 at the midpoint due to the previously noted trends in our fully insured business.

As Gail mentioned, heading into 2019, we remain focused on improving our sales execution to the segment strategy and building positive momentum in the Commercial business. Our medical cost ratio and SG&A guidance is unchanged as the first half results track largely in line with our expectations. Below the line, we estimate our diluted share count will be in the range of 263 million to 265 million shares, up from the 260 million shares to 264 million shares due to conversion of our equity units in May, which increased the share count by 6 million shares. We narrowed our effective tax rate in the range of 26.5% to 27.5% from the 25.5% to 27.5% previously. Finally, we increased our investment income guidance by $75 million to the higher short-term interest rate yields, partially offsetting the share count and the tax rate adjustments. Taken together and reflecting our strong year-to-date medical cost performance, we now expect full year 2018 adjusted earnings per share to be greater than $15.40.

And with that, I'll turn the call over to the operator for questions and answers.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Lance Wilkes with Sanford Bernstein.

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

I wanted to ask a little bit on the cross-selling progress you're having and just overall getting the earnings up and kind of the self-insured block. You've noted self -- or service fee revenues being up. But could you talk a little bit about kind of the progress you're making thus far, but really your strategies for driving up kind of cross selling and overall earnings per member?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Good morning, Lance. Thank you for the question. In terms -- we are pleased with some of the progress that we're making as you saw in terms of our self-funded revenue, a couple of the areas, in particular, we have had a focus around adding some of our clinical programs as well as our specialty, vision, dental and life. Part of what you're not seeing is in the penetration rate because a lot of our specialty products were tied to our individual business so that, overall, is down, but we actually have seen a nice progress in sales of those specialties. Again, in terms of strategies, I'm going to ask Pete Haytaian who leads that division -- that business -- to give you a little bit of insight, but it's been an area of focus in the couple of areas Structure, we put some very specific structures in place around our segment. We've added additional leadership and talent to that area. And as part of that, we're seeing that come through in the first quarter as well as the second and we would expect to see ongoing momentum. But let me ask Pete to give you a little bit more color on that as well.

Peter David Haytaian - *Anthem, Inc. - Executive VP & President Commercial and Specialty Business Division*

Yes. Thanks for the question. I agree with everything that Gail said. I think we have a tremendous opportunity with respect to improving our specialty penetration rates. As we have said before relative to the competition, we are not performing as well and there's tremendous opportunity to improve that. I think what Gail says -- really the most important points -- and that is our focus on building out the infrastructure for this. So we've hired talent, we're making investment in the specialty organization. We feel very confident that we have the products and the services and the pricing in place where it makes a lot of sense right now and it's how that then connects with our segment strategy and making sure we're driving sales down into the market. In addition to that, we're very focused on improvements from a broker perspective in providing tools and engagements for

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the brokers to be able to more effectively upsell. So we think there's a tremendous opportunity to continue to sell clinical programs and our specialty products into our existing book and we are seeing really good progress in that regard.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Next question, please.

Operator

This line of age arise with A. J. Rice with Crédit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

Maybe now having 2 quarters under our belt we can start to look at first half versus second half. And I'm particularly focused on the MLR outlook. Where you're maintaining that, that implies a pickup in the back half versus first half MLR by about 320 at the low end of the range and 400 basis points at the high end of the range. We went back and looked at last year, you were, first half to second half, about 290 basis points. I guess with the decline in the Individual business, which has a seasonal ramp in the back half of the year, we would have probably thought the ramp might be less. Is there -- is it -- are we just being conservative? Or are there is some things to point to why that pickup in MLR in the back half of the year would look that significant?

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Hi. Good morning, A. J., and thank you for the question. As you indicated in your question, you essentially answered the question associated with the seasonality issues and the fact that our Individual business is, as everyone knows, reduced our footprint in the ACA-compliant marketplace by over 55% year-over-year. And that clearly is changing the trajectory of MLR on a quarter-by-quarter basis. At any rate, just look at the overall mix of our fully insured business. We acquired America's 1st Choice in February, we acquired HealthSun back in December and those have a slightly different seasonality pattern from what we had 1 year ago in terms of adding all these Medicare Advantage lives, along with all the double-digit organic Medicare Advantage growth that we had. So it's all those things combined, but the single biggest factor, as you pointed out, is the Individual Marketplace.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Next question, please.

Operator

The line of Anagha Gupte with Leerink Partners.

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

The question is on the Commercial fully insured turnaround that Gail, you and Peter are leading. And you talked about growth in the fully insured market. Was curious where the market share is likely to come from. Is it -- it will come from players like Cigna, which have been taking share from fully insured? Or is it more from the large nationals like Aetna and United or smaller players? And then also, will the margins -- and they've expanded really nicely on your Commercial book, and I'm not sure if it's the core underwriting or it's mix of business -- will the margins stay where they are in your Commercial book overall?

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Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question, Ana. There's a number of questions in there. Let me start and again I'll ask Pete to share a little bit more color. First in terms of growth, as I shared, we have made a number of changes inside of our commercial organization and we expect those to start taking hold, as I would say, over the next few quarters, those take a little bit time to implement. But each of our markets is very different. Our commercial market, as you know, we operate in 14 markets. And I would tell you that we expect to see improvement because of the improved focus on sales execution, our value story across the board in small and large group. In terms of which specific competitors, they are all different in each of our markets. So I'm not going to point to a specific one. Because we compete differentially, for example, in small group and individual versus different competitors in each market. We are very disciplined to pricing so let me start with that, in terms of your margin question. Overall, our margins, we have had all-out focus on buyout inside of our fully insured as well as self-funded. So some of the things that I shared with you on the very first question have also helped drive our margins. But overall pricing, we've stayed disciplined. I think we've always had a very consistent underwriting function and we continue to have that. But with that, let me ask Pete maybe to share some additional insight into some of the strategies that are going into the marketplace and some of the different product offerings. So that is one of the areas that we focus on and expect to see some improvement.

Peter David Haytaian - *Anthem, Inc. - Executive VP & President Commercial and Specialty Business Division*

Thanks for the question. To be more specific about -- I think your first question was on progress and how we're doing against our strategy. So I put it in the following categories. First, with respect to the segment strategy. I think we're down a really good path, and we're very much focused on ensuring that we have the right leadership in each one of those segments and we completed that over the last 60 days. In addition to that, like I call them centers of excellence. Very much focused on building the infrastructure for sales execution, having the appropriate reporting and the execution downstream both in the markets but also coordinated with our centralized organization. We've hired strong leadership in that regard that has been there and done that in other large organizations. We've also made a lot of progress with respect to products and product options. And then with respect to underwriting, building an infrastructure that's more agile. Back to the point that Gail made, the point here is that we need to be more agile, we need to be able to offer product services and connect those with the right networks in a more expeditious and agile way. And so we're seeing really good progress in building that out. I'd also say with respect to the way we're manufacturing products -- we call it product modularization -- but this is really the concept of how we build products internally. So being able to do that more effectively and efficiently. And then how products are chosen in the marketplace through digital capabilities and allowing brokers and employers to make choices on products and networks more effectively. And then finally, I mentioned it before, but how we are engaging with brokers. We're seeing really good progress on how we're servicing brokers so we've taken that and really focused on centrally -- centralizing that to a greater degree for better execution. And then the tools and services that they're utilizing out in the marketplace and enabling them to a better degree. So all that, we're seeing really good progress. I think we'll see momentum in the back half of the year. I think a reasonable proof point when you sort of look at all that is what we've done with the Group Retiree business. I mean, that is a segment where we started this a little bit earlier. And as you've seen, we had some nice sales in July and I think we're going to continue to see momentum in that segment. So hopefully, that's representative of what we'll see in the other segments in the near term.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you. And Anna, I think you can see from Pete's comments, it's a pretty comprehensive focus on execution around each of the levers. And so obviously, we think we're going to see some momentum. Next question, please.

Operator

The line of Justin Lake with Wolfe Research.

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

Was hoping you can give us some color on how the company is looking at 2019 from the perspective of its footprint in the exchanges and Medicare Advantage. And then if I could sneak in one more, John, you increased the tax rate at the midpoint by 50 bps which is curious given the earnings upside in the core business should be driving a lower tax rate all things being equal given -- with [IPA] deductibility accounting? So hoping you can give us some more color there on what's driving it and whether the tax ratio will revert back in 2019 to the original guidance? Or is this the new run rate?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks, Justin. And let me begin, and then I'll turn it over to John. I think a couple of questions around footprint. I know you asked about Medicare Advantage. And I think you slipped in individual exchanges too so I'll try to address both. First, on the individual exchanges. We are not looking to rescale the business, first and foremost, but we do -- we are very pleased with the participation we've had this year and the results of that. I think our team has done an excellent job of identifying the market where it makes sense where we think that we've got a stable presence and offering. As we go into 2019, while no decisions are final yet, we are assessing that. I think you'll see some county expansions, but I think more focused on the areas that we've been this year. So not a major rescaling, but we are pleased with the performance and, again, it is all about stability and more certainty around that marketplace. But again, this year was solid. In terms of the Medicare Advantage marketplace, as I shared in my opening comments, we have really reconstructed our MA book of business and feel going into 2019 that we have taken a very balanced approach. We think the market is strong. We feel that we can grow deeper in the markets that we're in. We do have some geographic expansion and won't go into the numbers on that because we think that's competitive. However, we do think we will grow above industry rates and we do feel that growth will come from deeper penetration with the strong quality assets that we have in our markets. We feel very good about our positioning and the stability of our benefits and the flexibility that this year's guidance gave us. With that, I'll ask John to comment on your second question.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Yes. Thank you, Gail. And Justin, good morning. In terms of the tax rate, we did raise the guidance at midpoint basically by taking up the lower end of the range. Our tax rate for the quarter is still within the range that we provided guidance we provided at the end of the year, although closer to the higher end. We certainly are very proactive in terms of our approach to tax planning, our tax rate is still low relative to our peer group. But in terms of where we are -- and there's multiple factors that go into the rate in terms of where do we make our money. Some municipalities are premium tax, some are income tax. So based on where the money is earned can change the tax rate. We have things that are fine tuning the HIF in terms of the adjustments on that impacts the permanent differences and impacts the tax rate. So we've refined all these things. We think the tax rate that we have laid out there is a very appropriate for 2018. And then in regards to 2019. In 2019, the health insurer fee goes away. As we all know, that is a nondeductible fee, which increases the effective tax rate significantly. So in 2019, our effective tax rate will be much closer to the statutory tax rate than it is now.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Next question, please.

Operator

From the line of Matt Borsch with BMO Capital Markets.

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Matthew Richard Borsch - *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

I was hoping maybe you could just talk about the group retiree traction that you pointed to along with the -- if it relates together, the group Medicare Advantage untapped opportunity or lightly tapped opportunity that you're pursuing and how those 2 might come together, if they do come together.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well, thank you for the question. As I shared a few minutes ago, group Medicare is really a market that we identified early that we had historically under-invested in both at Anthem and I think quite frankly across the Blue system. As we have improved our individual MA book of business, particularly improving our stars performance, our operational performance, putting in a team that really understands that business over the last few years and have begun to gain traction in the individual MA business, we turned our attention to the group MA business. We obviously feel we have a very strong pipeline of commercial customers who want to stay Blue. We think that, that brand resonates very well in this community. Plus having 4-plus star plan that we're able to put our Group Retiree segment into. And then we recruited an experienced leadership team to lead that over the last year. So as you think about those elements -- a scaled infrastructure, a really strong brand, our ability to use our CareMore assets to support and service that business, our ability -- we found that now were able to convert some of those memberships we've seen -- some of those groups rather -- we've seen some of that traction already in 2018 and we feel very good about the pipeline in our opportunities that we'll be able to continue that growth into 2019 and beyond. So we're very bullish about group MA. And again, it's because we have known many of these customers throughout their life and we've had them for 20, 30 years. And that's a wonderful pipeline that we just have under-invested in the past. So it's an area of focus and talent for us right now, so we would expect to see some significant traction. Next question, please.

Operator

The line of Sarah James from Piper Jaffray.

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

Should we think about the analytics, PBM and other products that you're selling externally to other insurers as off-the-shelf Anthem solutions? Or is it more of a partnership approach to product development? And if it is a partnership, how important is Anthem's flexibility in the conversations that you've had so far? And do you lose anything in synergies or benefits of scale if you're running a portfolio of customized products?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Good morning, Sarah. I think there's, again, a couple of questions embedded. First and foremost, as you know, we're standing up IngenioRx for effective 1/1/20. And as part of that, while we are in the market now, so I guess I would say it's not -- we're not completely converted of our own business yet. But as you think about -- we've talked about some of the things that we're selling in the industry to other Blues like our Medicaid partnerships. And we've been able to do that very well by customizing but still leveraging our scale. And in the PBM business, with IngenioRx, our early conversations I think demonstrate that we can do the same thing. That we are pretty confident in -- that we're standing up a PBM with very, very strong economics that were also standing it up and we don't basically have the old model PBM. We can integrate pharmacy behavioral. Some of the social determinant issues as well as medical. And as we've looked at some of the things that are out in the marketplace right now, we're pretty confident that we have an ability to meet -- at least meet or beat many of the numbers that have been put out there because again, we see it as a part of our continued strategy of whole health management. And to your specific question around scale and customization, given the flexibility of what we've been able to build we feel pretty confident that we have the right amount of flexibility for the clients that we're talking to and be able to serve their needs. But again, this is a deep integration story as well. And we already have products that do some of that for Anthem itself and we are looking to be able to scale those to others. Next question, please.

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Operator

The line of Ralph Giacobbe with Citi.

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

Just wanted to go back to Commercial risk. Looks like you lowered enrollment guidance for fully insured. And I know that includes Medicaid and Medicare, but sounded like there were some gross adds in the Medicaid and obviously, group commentary that you had. So maybe you just flush out the Commercial risk, sort of ex-exchange, and kind of what's going on there? And then when you talk about sort of the flexibility and the strategy as we think about next year in growth, is that just the Commercial market in general or is that specific to seeing growth in the Commercial risk segment that is obviously seeing a little bit of the slowdown?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question, Ralph. In terms of our overall guidance, we did lower it by 200,000 in the fully -- in the risk membership, but that still implies a growth of 375,000 to 475,000 in the back half of the year. As John shared with you, and I did in my remarks, we know that we're bringing on Minnesota in our Medicaid alliance later this year. We do expect some growth in our group Medicare. We also know that our Individual business will still have some attrition as a typical in that business in the back half of the year. As we think of the overall rest of our Commercial group business, we would expect that to be flat to fairly modest growth. So that's how are thinking about all of those pieces. In terms of the marketplace, maybe Pete can make -- give you some color and commentary on the market place where we kind of expect to see opportunities.

Peter David Haytaian - *Anthem, Inc. - Executive VP & President Commercial and Specialty Business Division*

Yes. I mean, without speaking about particular markets, I think what Gail touched upon before, every market is different. We have different competitors and markets. We believe with the strategy that we're deploying and the higher level of execution, the product options that we're talking about, we can take share. And we're beginning, like I said, to see that momentum and we feel confident that going into '19, we can do that, Ralph. So I wouldn't talk about a particular geography or product, but feel confident that we're going to see the momentum going into 2019.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Next question, please.

Operator

It's from the line of Peter Costa with Wells Fargo Securities.

Peter Heinz Costa - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

Could you tell us more about the Medicare group lives that you're picking up? You talked about increasing that going into the back half of the year. We can see already in July, you picked -- from the government data, you picked up 36,000 Medicare group lives. So can you tell us, are these conversions from your Commercial retirees? And how many Commercial retirees do you have on the books right now?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question. In terms of where most of those are, many of them are Blue Cross Blue Shield Commercial customers so yes, that is the majority of them although we start quoting on some customers that are not currently. Some of those we are picking up from our competitors as well. But I think it's a bit of a mix. But our opportunity is clearly inside of our own Commercial book. Thank you. Next question, please.

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Operator

The line of Kevin Fischbeck with Bank of America Merrill Lynch.

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

You mentioned that you're looking for, I think, you said mid-double-digit organic MA growth. And I just wanted to -- when balancing margins versus membership. So can you just provide a little more color on that, where are you I guess in the MA margin cycle versus where your targets are? How long does it take to get your target margin? As I'm thinking about that double-digit MA membership growth, how long of an opportunity is that? Is that a couple of year opportunity, multiyear opportunity? How do we think about these 2 things?

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Hi, Kevin. Thank you for the question. In terms of our Medicare Advantage margin profile, we continue to be within our target margin range. And quite honestly, we even have some 5-star plans in the marketplace that we're deploying that really is helping and allowing us to market year round. In terms of how long it takes, a lot of it depends on if it's a new member or an existing member from another carrier. In terms of the management opportunities, the medical management and various other cost of care type things that we might do to ensure that the quality scores are there. If it's a new member, it's certainly is going to take into the second year in order to achieve target margins. But if it's an existing member, we can get there much more quickly.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you. Next question.

Operator

The line of Steven Valiquette with Barclays.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Just a quick question here. I know you do not like to provide specific numbers around ACA-related risk adjusters. But last year, you did provide some helpful color whether you're in a net-receivable position or not. And you also talked about the claims experience, relative to your expectations. So I guess I was curious if you're able to provide some of that same color this year?

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Yes. In terms of -- you're correct that we really don't provide some of the level of specificity of questions that we get asked. But in terms of the risk adjusters, we got the information from CMS a few weeks ago, as everyone else did. It was exactly in line with our expectations. We clearly understand the marketplace and had projected out what we thought the final true-ups would be. And they were very, very much in line. We're a significant risk adjuster receiver, with approximately $520 million that we're entitled to now, and feel very good that were going to get back cash with what came out of CMS last night. In terms of the -- and of course that's all based on 2017, which is significantly a larger footprint that we have in 2018. In 2018, we still expect to be a risk adjuster receiver, but when the footprints been reduced by over 55% obviously, the magnitude dynamics of that goes down significantly. But we're still very comfortable with our approach and we think our strategy is playing out extremely well.

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Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you. Next question, please.

Operator

It's from the line of Steve Tanal with Goldman Sachs.

Stephen Vartan Tanal - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

We noted -- at least versus our estimates sort of a big [V] in Commercial & Specialty segment revenue and margin rate, but lower enrollment in risk and ASO. So kind of curious to know whether you got better pricing for 2Q renewals? Or is there maybe any other factors you can call out that might -- that drive a dynamic like that?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well, thank you for the question, Steve. I mean, I'll go back to what I said, and we've been a very disciplined pricer so I don't think anything has changed in our approach. And then secondarily, we've been able to successfully bring through a number of buy ups. So those 2 factors have really had an impact on, I think, our overall PMPM rates inside the market. Next question, please.

Operator

Line of Joshua Raskin with Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

Was wondering if you can just give us some more color on the enhanced sort of medical cost performance. It sounds like that's not an industry-wide or trend impact. It seems like that's a lot more Anthem company-specific driven. So what exactly are you doing? Are there new protocols in place? Are you being little bit more restrictive on pre-auth and all that stuff? And if you could just give color on the Medicaid reductions. Are there specific states that are going through reenrollment processes? Or are you seeing bigger attrition in certain markets?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question, Josh. Let me start, and then I'll ask Felicia Norwood to comment on Medicaid a little bit. In terms of your question on what are we doing, we have an intense focus across the company on cost of care. And I would point to pretty much everything that you mentioned. First and foremost, we do lead the industry in integrated care arrangements so we have had a long history of incenting primary care in particular, in our local markets, where we do have significant volume to basically help us manage that cost of care effectively. Secondarily, we do use AIM, in particular, to help us on radiology, oncology all of those management of specialty services and they've done a very nice job helping us mitigate trend. Third, we look across our network. We have had an industry-leading unit cost perspective, but we're also looking to insure things like enhanced Personal Health Care, which I've shared before we've seen some strong results. And that's not just from the programs. We also deploy staff in our local markets to help those practices more effectively manage and integrate. And the last thing that I guess I will point to, actually 2 things. We have an integrated patient record and it ties to the whole health that I answered a question will bit about pharmacy, whereas we have been working on integrating pharmacy, behavioral, dental, vision with an integrated patient record. And I think that has helped. So the combination of our deep market presence, we're able to deploy individuals into the marketplace and then our provider value-based arrangements are more impactful. And that again goes to many of the reason why we don't feel we have to own primary care, that we can actually drive this differential cost of care by putting those programs into the market. With that, I'm going to ask Felicia to comment a little bit on the Medicaid enrollment.

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Felicia Farr Norwood - *Anthem, Inc. - Executive VP & President of Government Business Division*

Thanks, Gail. Good morning, Josh. We are seeing, as Gail mentioned in her opening comments, a decrease in Medicaid enrollment primarily due to a reduction in our TANF members because of an improving economy. And also the continued redetermination efforts that we're seeing in several states, we are also seeing some just general market share contraction in several markets as well. But as we've mentioned, we certainly expect to end our Medicaid membership. ahead at at the end of the year as to where we are with respect to Q2. We've mentioned our partnership certainly with respect to Blue Cross of Minnesota adding about 375,000 lives. And as we look ahead, were certainly very excited about the opportunity and encouraged about the Virginia Medicaid expansion, which will put in play over 400,000 Medicaid expansion lives from 1/1 of '19.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Okay. Thank you. Next question, please.

Operator

It's from the line of Gary Taylor with JPMorgan.

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

Had a question for John. I just wanted to come back to the Days Claims Payable in the quarter. I think the explanation about the ACA footprint and the acquisitions really served -- addressed the sequential decline in the Days Claims Payable, but I'm not sure how much impact on the year-to-year. So I'm just wondering if you look at the year-to-year decline of 1.8 days, is that most of that being operational improvements around claims processing that you attribute to that?

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Yes. Hi, Gary. Thank you for the question. And some of the same explanations that I provided for the sequential decline are the exact same explanations for the year-over-year. The Days in Claims Payable is an interesting metric. Sometimes, the metric is impacted just by the math of the calculation. Other times, it's impacted by operational and business issues. And clearly, we have both going on in the second quarter here in 2018. So I did just want to spend a moment on the timing of the America's 1st Choice acquisition because how significant that is to the math of the calculation. So we acquired America's 1st Choice in late February. And had, in the first quarter, only just over 30 days of benefit expense, yet had the entire reserves associated with 135,000 Medicare Advantage lives in our quarter-end reserves. And then in the second quarter, it's 90 days of benefit expense with a very consistent reserve level. So that in of itself is a significant driver. It's also impacting year-over-year as well. And then the operational improvements, things like we continue to be very focused on systems consolidation. As people know, we're improving our EDI rates, we're improving our auto adjudication rates. We're being more efficient and effective. We believe that there will be additional SG&A saves in the future associated with this. But all that provides faster throughput and then continues to lower the Days in Claims Payable balance. So it's very operational, very strategic, quite honestly in doing that. But I guess at the end of everything what I will say is that our reserves are calculated very consistent and very strong and very conservatively year-over-year.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you. Next question, please.

Operator

From the line of Frank Morgan with RBC Capital Markets.

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Frank George Morgan - *RBC Capital Markets, LLC, Research Division - MD of Healthcare Services Equity Research*

It sounds like your interest and external growth in Medicare Advantage is slowing so -- after doing these 2 deals -- so I'm just curious, are you seeing any change in the M&A market for Medicare Advantage? Is there anything you're seeing out there? Is this more of just one wanting to kind of assimilate the 2 recent acquisitions you made?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you for the question. Actually, we're quite opportunistic in terms of M&A in the space. And so I think it's more of a focus on where we think the growth can come from most immediately. As things arise, we certainly are interested in those type of opportunities. But we think given what we have right now, our footprint, again, our strong stars rating, our strong quality, our strong medical cost management and I think very, very good benefit offerings, that we can grow and get deeper in those markets so we actually -- we do believe that there is significant growth opportunities in the states where we already have a presence. And then some geographic expansion in counties around there. The other opportunity that we have -- that we haven't quite talked as much about is the opportunity to do eligible population. So we have an opportunity actually to do well in that. We do sell all year, as you heard, across our industry-leading Medicaid platform as well as Medicare. So we see growth coming from that arena as well. And then, I would like to point to our ASPIRE acquisition because I think that's a great example of the capability that helps us support the Medicare Advantage population, a leading capability that we think we can leverage. So as you think about where our interests lie, we're quite opportunistic. And we are looking at capabilities that help support and drive cost of care and quality in those marketplaces. Thank you next. Question, please.

Operator

It's from the line of Dave Windley with Jefferies.

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

Gail, I'm wondering if the potential extension of the health insurer fee moratorium through 2020 would change any strategies? And if so, how soon could we see the impact of that -- how would -- how might that change the benefit design and product design and strategies as early as 2019, if at all?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well certainly, in having stability and certainty understanding kind of what the marketplace -- we're doing renewals for 2020 beginning obviously, in February of 2019. So the sooner we have a good clear picture of the cost structure and where the health insurance tax is going to be, I think helps in terms of our pricing and passing that tax through. In terms of benefit plan and design, affordability is the dominant issue for employers, it's something that we focus on very much. So obviously, not having to pass the health insurance tax provides for greater stability and greater affordability for employers and we think that it's important overall. Thank you. Next question, please.

Operator

It's the line of Zack Sopcak from Morgan Stanley.

Zachary William Sopcak - *Morgan Stanley, Research Division - VP on the Healthcare Services and Distribution Team*

I just wanted to see if the recent drug pricing blueprint [you may have received] from drug manufacturers has changed, how you think about implementing IngenioRx at all? And if you think it improves the value proposition of having the integrated solution?

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Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you for the question. Well, let me begin first and foremost, that we are very focused on reducing net overall drug prices. I think that really is the goal on industry and certainly our goal as we launch IngenioRx. In terms of the value proposition that we've laid out, the $4 billion growth savings with 20% falling to the bottom line, we are very confident in that, feel it's a prudent number and do not see that changing. But again, we're very supportive of anything as we build this new generation, next-generation PBM of really getting to the lowest net cost. And I think that's what's really important. We're not building this based on a rebate model, but we are building it based on a net lowest cost value model. And again, we're very supportive but we want to ensure that everything that gets implemented really does result in lower cost for consumers. And so that really is our focus will IngenioRx. Thank you. Next question, please.

Operator

At this time, we have no other questions. I'll now turn the conference back to company's management for closing comments.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well, great. Thank you very much, and we're pleased that we're able to get through the questions. Thank you for joining us for our second quarter earnings call. As we look ahead, Anthem remains focused on improving the quality and value of the health care solutions we bring to our members while at the same time delivering on the commitments we made to our shareholders. I want to thank all of our Anthem associates for living our values each and every day as we endeavor to deliver on the promises that we make to our stakeholders. Thank you for your interest in Anthem, and I look forward to speaking with you at the future events.

Operator

Ladies and gentlemen, this conference is available for replay after 11:00 a.m. Eastern time today through August 8 at midnight. You may access the replay service at any time by calling 1 (800) 475-6701 and enter the access code of 432035. International participants may dial (320) 365-3844. (Operator Instructions) And that does conclude your conference for today. Thank you for using AT&T Teleconference service. You may now disconnect.

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