UnitedHealth (UNH)

Updated May 18th, 2018 by Josh Arnold

Key Metrics

Current Price:	$243	**5 Year CAGR Estimate:**	7.8%	**Quality Percentile:**	N/A
Fair Value Price:	$215	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	N/A
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.4%	**Total Return Percentile:**	N/A
Dividend Yield:	1.2%	**5 Year Price Target**	$331	**Valuation Percentile:**	N/A

Overview & Current Events

UnitedHealth traces its roots back to 1974 when Charter Med was founded by a group of health care professionals looking for ways to expand healthcare options for consumers. UNH has certainly done that in the decades since and now offers global healthcare services to tens of millions of people via a wide array of products. The company's market cap is $233B and it produces $225B in revenue annually, making it one of the largest companies in the US.

UNH's recently reported Q1 was outstanding as revenue grew 13% and EPS was up 29%, fueled by the top line gain and operating leverage resulting in higher margins. Lower operating costs as well as a lower medical care ratio helped improve profitability. In addition, a favorable tax rate based upon tax reform helped fuel the rise in EPS. This year's earnings guidance was raised as a result of higher revenue, improved operating leverage and a much lower tax rate as Q1 set the tone for yet another strong year for UNH.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$2.95	$3.24	$4.10	$4.73	$5.28	$5.50	$5.70	$6.01	$8.05	$10.07	***$12.45***	***$19.15***
DPS	$0.03	$0.03	$0.41	$0.61	$0.80	$1.05	$1.41	$1.88	$2.38	$2.88	***$3.20***	***$6.45***

UNH has a long track record of outstanding EPS growth as it continues to capitalize on the lucrative consumer health and wellness sector. The company's EPS forecast for this year is roughly 4X that of 2008 and impressively, UNH has grown EPS very single year in the past decade. We foresee forward EPS growth of 9% annually as UNH continues to buy back stock, see strong revenue growth and squeeze additional costs from its model via better operating leverage. We see growth slowing somewhat from more recent rates as the buyback loses some of its effectiveness due to a higher stock price and as sheer size makes it more difficult to grow. We don't believe UNH's very impressive run of EPS growth is ending by any means, but a slight reduction in growth expectations over the next five years seems prudent.

We do see a lot of growth potential left in the dividend as UNH began seriously returning cash to shareholders a number of years ago. Its dividend growth, as strong as it has been, hasn't been able to keep pace with the rapid rate at which EPS has grown, and the result is a payout ratio that is still very low. We see the dividend roughly doubling in the next five years as UNH capitalizes on its EPS growth and continues its streak of sizable dividend increases.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	10.9	8.1	8.0	9.8	10.4	11.9	14.7	19.4	16.8	18.4	***19.5***	***17.3***
Avg. Yld.	0.1%	0.1%	1.2%	1.3%	1.5%	1.6%	1.7%	1.6%	1.8%	1.5%	***1.2%***	***1.9%***

UNH's P/E multiple has moved substantially higher in recent years and today, stands about 2.5X where it was in 2010. The business has posted continuously strong earnings growth rates and as such, investors have assigned it ever-higher multiples. However, the multiple today is at 19.5, which is as high as it has been in the past decade. We therefore see it drifting lower to 17.3 over time as we see slightly lower EPS growth rates as well as a multiple that has ample room to move down, but not as much room to move up. The combination of a lower multiple but rapidly increasing dividend payment should see the yield much higher in five years, closer to 2% against the 1.2% yield of today. UNH is an outstanding dividend growth story in the making and we see growth in the payout as a significant draw for investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	22.9%	22.4%	24.6%	24.7%	25.2%	24.4%	25.3%	23.6%	23.5%	23.4%	***23.8%***	***24.2%***
Debt/A	61%	63%	60%	59%	58%	61%	61%	62%	70%	69%	***70%***	***70%***
Int. Cov.	8.2	11.5	16.3	16.8	14.6	13.6	16.6	14.0	12.1	12.8	***13.5***	***15.0***
Payout	1%	1%	10%	13%	15%	19%	24%	31%	29%	28%	***26%***	***34%***
Std. Dev.	62.0%	49.3%	19.1%	27.3%	18.6%	19.2%	17.7%	14.2%	16.1%	10.1%	***18.0%***	***25.3%***

Given the growth in EPS, one might expect UNH's quality metrics to have improved substantially over the past decade, but that simply hasn't been the case. Gross margins are right where they've been in past years, although recent reductions in the medical care ratio should drive them slightly higher over the near term. Leverage has creeped higher over time but not significantly, and UNH's interest coverage is terrific in the mid-teens. The payout ratio is still very low, although we do see it moving higher as a result of growth in the payout outpacing earnings growth. UNH could triple its current dividend payout without undue stress on its financials, so the payout ratio is not an issue.

UNH's competitive advantage is in its gargantuan scale as well as its deeply entrenched customers with high switching costs. Like a utility, health and wellness providers have high switching costs, accruing significant benefits to incumbents like UNH. It is also quite resistant to recession as its services are a necessity and not a want. Indeed, EPS grew during the Great Recession and we expect similar behavior during the next downturn.

Final Thoughts & Recommendation

We see UNH as a premier growth stock that is trading modestly above its fair value. Its strong growth forecast makes it attractive to growth stock investors while its high rate of dividend growth makes it attractive for those seeking longer term income. We forecast total annual returns of 7.8%, consisting of the current 1.2% yield, 9% EPS growth and a 2.8% headwind from the valuation drifting lower over time. UNH is an attractive long-term story offering high rates of earnings and dividend growth, but investors may get a better entry point in the future after years of huge returns in the stock. We rate UNH as a hold at current prices.

Total Return Breakdown by Year