UnitedHealth Group Inc. (UNH)

Updated July 18th, 2018 by Josh Arnold

Key Metrics

Current Price:	$250	**5 Year CAGR Estimate:**	7.7%	**Volatility Percentile:**	9.4%
Fair Value Price:	$220	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	84.2%
% Fair Value:	114%	**5 Year Valuation Multiple Estimate:**	-2.7%	**Valuation Percentile:**	36.0%
Dividend Yield:	1.4%	**5 Year Price Target**	$336	**Total Return Percentile:**	47.1%

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. UnitedHealth 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. Its market cap is $233 billion, and it produces $225 billion in revenue annually, making it one of the largest companies in the US.

UnitedHealth's Q2 report was released on 7/17/2018 and results were nothing short of stellar. Revenue rose 12% on broad-based strength in all of its segments. Operating leverage was once again a factor in higher margins, and adjusted earnings-per-share were up 28%. In addition, operating cash flow rose 44% during Q2. Overall, the company continued to produce torrid growth as it takes advantage of consumer healthcare trends in the US, and 2018 guidance was raised.

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	***$12.65***	***$19.45***
DPS	$0.03	$0.03	$0.41	$0.61	$0.80	$1.05	$1.41	$1.88	$2.38	$2.88	***$3.60***	***$6.45***

UnitedHealth has a long track record of outstanding earnings growth as it continues to capitalize on the lucrative consumer health and wellness sector. The company's earnings forecast for this year is more than 4X that of 2008 and, impressively, it has grown earnings-per-share every year in the past decade. We see forward earnings-per-share growth of 9% annually as UnitedHealth continues to buy back stock, generate 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 the company's very impressive run of earnings-per-share growth is ending by any means, but a slight reduction in growth expectations over the next five years seems prudent. We've also raised estimates for this year and 2023 as a result of the company's strong guidance during the Q2 report.

We see a lot of growth potential left in the dividend as UnitedHealth 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 earnings have grown, and the result is a payout ratio that is still very low. We see the dividend nearly doubling in the next five years as UnitedHealth capitalizes on its 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	***19.8***	***17.3***
Avg. Yld.	0.1%	0.1%	1.2%	1.3%	1.5%	1.6%	1.7%	1.6%	1.8%	1.5%	***1.4%***	***1.9%***

UnitedHealth's price-to-earnings 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 19.8, 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 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 1.4% yield of today.

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%	***28%***	***33%***
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%***

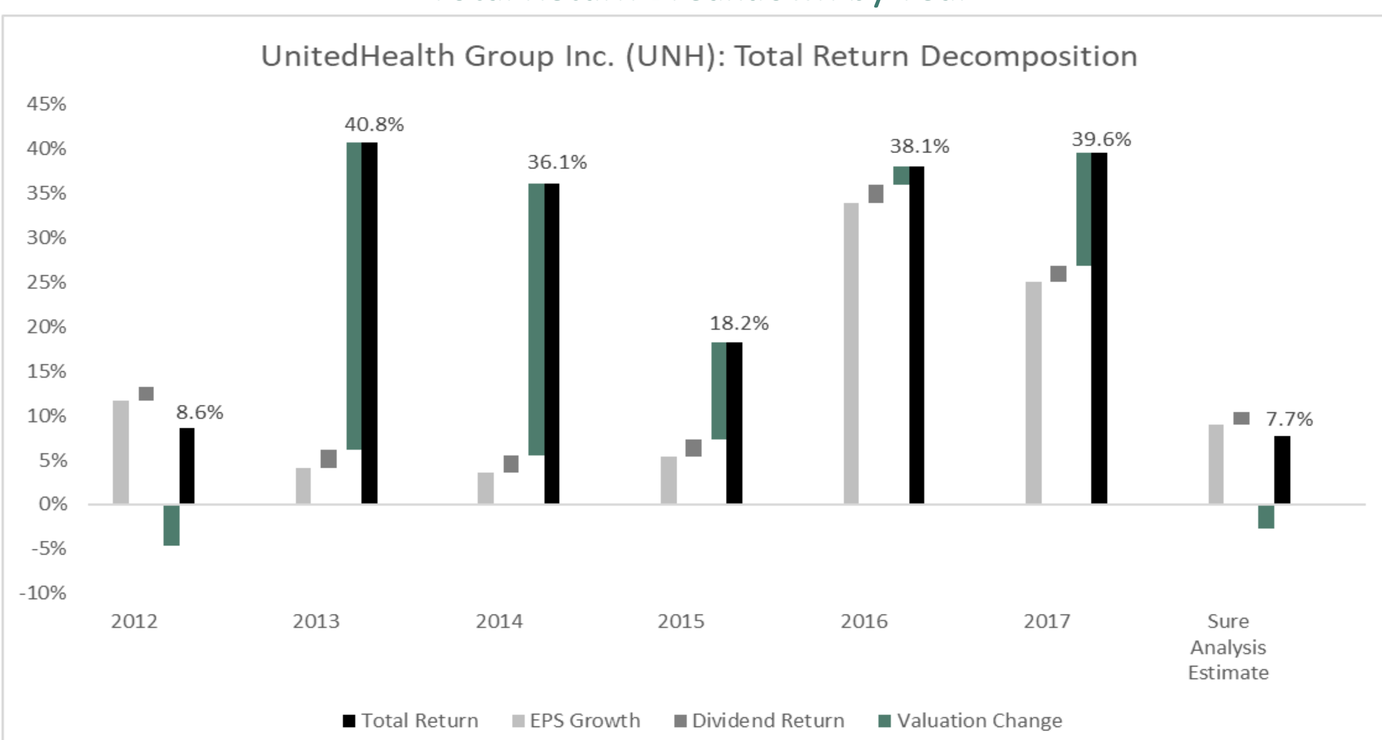
Given the growth in earnings, one might expect UnitedHealth's quality metrics to have improved substantially over the past decade, but that simply hasn't been the case. Gross margins are right where they've been in past years, although recent reductions in the medical care ratio should drive them slightly higher over the near term. Leverage has creeped higher over time but not significantly, and UnitedHealth'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.

UnitedHealth'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 UnitedHealth. It is also quite resistant to recessions as its services are necessities. Indeed, earnings-per-share actually grew during the Great Recession and we expect similar behavior during the next downturn.

Final Thoughts & Recommendation

We see UnitedHealth as a premier growth stock that is trading above its fair value. Its strong growth forecast makes it attractive to growth investors, while its high rate of dividend growth makes it attractive for those seeking longer term income. We forecast total annual returns of 7.7%, consisting of the current 1.4% yield, 9% EPS growth and a 2.7% headwind from the valuation drifting lower over time. UnitedHealth 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 UnitedHealth as a hold at current prices.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.