UnitedHealth Group, Inc. (UNH)

Updated January 16th, 2019 by Josh Arnold

Key Metrics

Current Price:	$257	**5 Year CAGR Estimate:**	10.2%	**Volatility Percentile:**	6.4%
Fair Value Price:	$254	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	87.2%
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.2%	**Growth Percentile:**	83.7%
Dividend Yield:	1.4%	**5 Year Price Target**	$390	**Valuation Percentile:**	41.3%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	50.8%

Overview & Current Events

UnitedHealth dates 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. The company has two major reporting segments: UnitedHealth and Optum. The former provides global healthcare benefits to individuals, employers and Medicare/Medicaid beneficiaries. The Optum segment is a services business that seeks to lower healthcare costs and optimize outcomes for its customers. UnitedHealth's market capitalization is $247 billion and it produces $244 billion in revenue annually, making it one of the largest companies in America.

UnitedHealth reported Q4 earnings on 1/15/19 and results were characteristically strong. Revenue was up 12% as the company enjoyed strength from all of its major revenue streams. Premium revenue rose 11% while products revenue soared 20% and services revenue increased 9%. The Optum business reached the $100 billion mark in annual revenue during the fourth quarter for the first time ever, while the core UnitedHealth business is also performing well.

Despite some operating efficiencies, UnitedHealth's operating cost ratio increased 40bps in 2018 thanks to the return of the health insurance tax. However, the company's medical care ratio decreased 50bps in 2018, so damage to margins was negligible. We expect margins to remain roughly flat in the years to come as UnitedHealth is extremely profitable.

The company is also a significant returner of capital as it paid out $3.3 billion in dividends in 2018 and another $4.5 billion in share repurchases.

Management's fresh guidance for 2019 informed our initial earnings-per-share estimate of $14.50 for this year, another strong year of growth for what has become one of the best large cap growth stocks in the market.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.24	$4.10	$4.73	$5.28	$5.50	$5.70	$6.01	$8.05	$10.07	$12.19	***$14.50***	***$22.30***
DPS	$0.03	$0.41	$0.61	$0.80	$1.05	$1.41	$1.88	$2.38	$2.88	$3.45	***$3.60***	***$6.70***
Shares	1,147	1,086	1,070	1,019	988	954	953	952	969	968	***965***	***940***

UnitedHealth's earnings forecast for this year is more than 4X that of 2009 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 and generate strong revenue growth. 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 do not 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 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, has not 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.

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

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	8.1	8.0	9.8	10.4	11.9	14.7	19.4	16.8	18.4	20.4	***17.7***	***17.5***
Avg. Yld.	0.1%	1.2%	1.3%	1.5%	1.6%	1.7%	1.6%	1.8%	1.5%	1.4%	***1.4%***	***1.7%***

UnitedHealth's price-to-earnings multiple has moved substantially higher in recent years and today, stands at 17.7. The business has posted continuously strong earnings growth rates and as such, investors have assigned it ever-higher multiples. However, recent weakness in the stock, combined with ever-growing earnings, has created a much more favorable value proposition for the shares as they now trade at fair value. We see the yield as rising over time as dividend increases consume a greater proportion of earnings, but the yield should remain comfortably below 2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	1%	10%	13%	15%	19%	24%	31%	29%	28%	28%	***25%***	***30%***

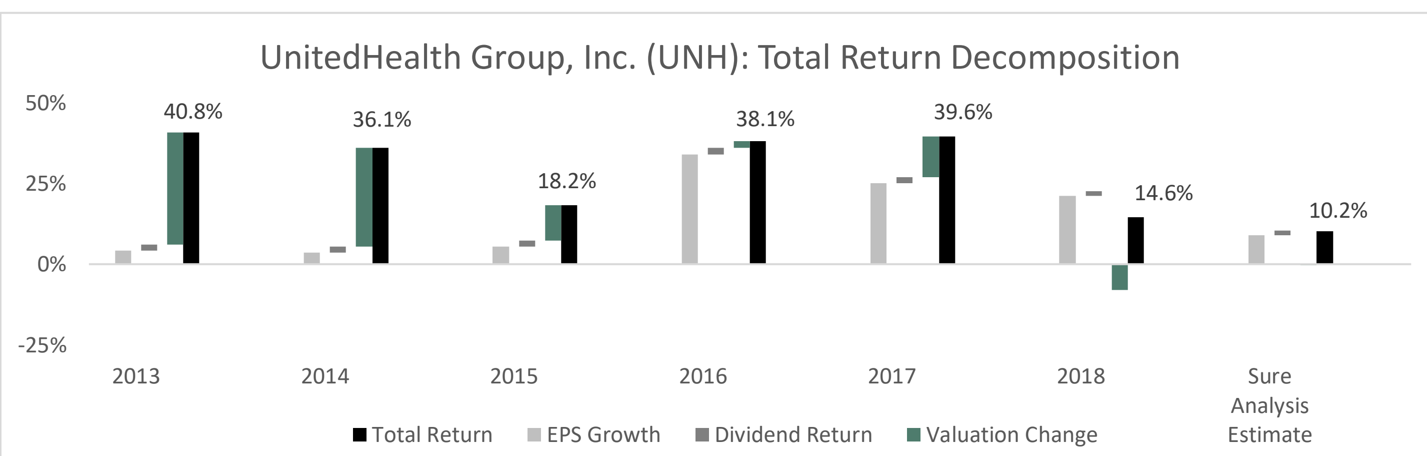
Given the growth in earnings, one might expect UnitedHealth's quality metrics to have improved substantially over the past decade, but that simply has not been the case. Gross margins are right where they've been in past years, although recent reductions in the medical care ratio should drive them slightly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

Final Thoughts & Recommendation

We see UnitedHealth as a premier growth stock that is trading near 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 10.2%, consisting of the current 1.4% yield, 9% earnings growth and a 0.2% headwind from the valuation. UnitedHealth is an attractive long-term story offering high rates of earnings and dividend growth, and recent weakness in the stock has created a buying opportunity. We have upgraded UnitedHealth to a buy as a result of its more favorable valuation.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	80.42	86.55	93.55	101.21	109.94	121.74	129.70	156.40	184.01	200.14
Gross Profit	18.58	19.49	22.59	24.49	27.19	29.19	32.24	36.32	42.56	45.99
Gross Margin	23.1%	22.5%	24.1%	24.2%	24.7%	24.0%	24.9%	23.2%	23.1%	23.0%
SG&A Exp.	13.10	12.73	14.27	15.56	17.31	18.94	21.26	24.31	28.40	29.56
D&A Exp.	0.98	0.99	1.06	1.12	1.31	1.38	1.48	1.69	2.06	2.25
Operating Profit	4.49	5.77	7.26	7.81	8.57	8.88	9.50	10.31	12.10	14.19
Operating Margin	5.6%	6.7%	7.8%	7.7%	7.8%	7.3%	7.3%	6.6%	6.6%	7.1%
Net Profit	2.98	3.82	4.63	5.14	5.53	5.63	5.62	5.81	7.02	10.56
Net Margin	3.7%	4.4%	5.0%	5.1%	5.0%	4.6%	4.3%	3.7%	3.8%	5.3%
Free Cash Flow	3.45	4.89	5.40	5.90	6.09	5.68	6.53	8.18	8.09	11.57
Income Tax	1.65	1.99	2.75	2.82	3.10	3.24	4.04	4.36	4.79	3.20

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	55.82	59.05	63.06	67.89	80.89	81.88	86.38	111.25	122.81	139.06
Cash & Equivalents	7.43	9.80	9.12	9.43	8.41	7.28	7.50	10.92	10.43	11.98
Accounts Receivable	1.93	1.95	2.06	2.29	2.71	3.05	4.25	6.52	8.15	9.57
Inventories	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Goodwill & Int. Ass.	22.42	23.11	25.66	26.77	35.97	35.45	36.61	52.84	56.13	63.05
Total Liabilities	35.04	35.44	37.24	39.60	49.71	49.73	53.93	77.53	84.63	89.23
Accounts Payable	8.66	9.36	9.22	9.80	11.00	11.58	12.04	14.33	16.39	17.87
Long-Term Debt	12.79	13.50	13.50	11.64	16.75	16.86	17.41	31.97	32.97	31.69
Shareholder's Equity	20.78	23.61	25.83	28.29	31.18	32.15	32.45	33.83	38.27	47.78
D/E Ratio	0.62	0.57	0.52	0.41	0.54	0.52	0.54	0.94	0.86	0.66

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	5.6%	6.7%	7.6%	7.9%	7.4%	6.9%	6.7%	5.9%	6.0%	8.1%
Return on Equity	14.6%	17.2%	18.7%	19.0%	18.6%	17.8%	17.4%	17.5%	19.5%	24.5%
ROIC	9.2%	10.8%	12.1%	13.0%	12.6%	11.6%	11.4%	10.1%	10.3%	13.8%
Shares Out.	1,201	1,147	1,086	1,070	1,019	988	954	953	952	969
Revenue/Share	64.80	73.41	82.71	93.11	105.10	119.01	131.54	161.73	190.10	203.18
FCF/Share	2.78	4.14	4.77	5.43	5.82	5.56	6.62	8.46	8.36	11.75

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.