UnitedHealth Group, Inc. (UNH)

Updated July 16th, 2020 by Josh Arnold

Key Metrics

Current Price:	$308	**5 Year CAGR Estimate:**	8.5%	**Market Cap:**	$288 B
Fair Value Price:	$264	**5 Year Growth Estimate:**	10.0%	**Ex-Dividend Date:**	09/15/20[1]
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.0%	**Dividend Payment Date:**	09/25/20[2]
Dividend Yield:	1.6%	**5 Year Price Target**	$425	**Years Of Dividend Growth:**	12
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	15.7%

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 $288 billion, and it produces about $255 billion in revenue annually, making it one of the largest companies in America.

UnitedHealth reported second quarter earnings on July 15th, with results coming in better than expected on the bottom line, but with revenue coming up short. Revenue was up 2.5% year-over-year to $62.1 billion, with Premiums revenue rising 4.7%, Products revenue down 1.3% and Services revenue off -7.6%.

The UnitedHealthcare business saw its revenue deviate from its long-term trajectory and gained just 1.1% in Q2, rising to $49.1 billion. The Optum business was up very strongly, adding 16.6% to $32.7 billion year-over-year.

The medical care ratio fell to 70.2% from 83.1% last year as customers temporarily deferred care due to the pandemic. We expect this to begin to unwind and normalize in Q3 and Q4. The company's operating cost ratio was up from 13.9% to 16.1%, offsetting some of the strength from the lower medical care ratio.

Adjusted earnings-per-share nearly doubled to $7.12 in Q2, and cash flow from operations was up 42% to $12.9 billion. The company reiterated its guidance of $16.25 to $16.55 in adjusted earnings-per-share for this year, and we're leaving our estimate at $16.50 as a result.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.10	$4.73	$5.28	$5.50	$5.70	$6.01	$8.05	$10.07	$12.19	$15.11	***$16.50***	***$26.57***
DPS	$0.41	$0.61	$0.80	$1.05	$1.41	$1.88	$2.38	$2.88	$3.45	$4.14	***$5.00***	***$9.63***
Shares[3]	1,086	1,070	1,019	988	954	953	952	969	968	962	***955***	***930***

We see forward earnings-per-share growth of 10% annually as UnitedHealth continues to buy back stock and generate strong revenue growth. However, this would mean that growth is 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. Margin expansion is also playing a meaningful part in the earnings growth story, as evidenced again in 2019. Margins were a tailwind in Q2, but we believe this will be transitory, and that operating leverage will continue to serve UnitedHealth well in the coming years as it relates to margins.

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[1] Estimated date
[2] Estimated date
[3] Share count in millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	8.0	9.8	10.4	11.9	14.7	19.4	16.8	18.4	20.4	16.5	***18.6***	***16.0***
Avg. Yld.	1.2%	1.3%	1.5%	1.6%	1.7%	1.6%	1.8%	1.5%	1.4%	1.7%	***1.6%***	***2.3%***

UnitedHealth's price-to-earnings multiple has moved significantly higher since our last update and today, stands at 18.6. The business has posted continuously strong earnings growth rates and as such, investors have assigned a high-teens multiple in recent years. With shares trading above our fair value estimate of 16 times earnings, this could drive a modest headwind to annual total returns. We see the yield rising over time as UnitedHealth has proven its commitment to increasing the dividend at meaningful rates. With the most recent dividend increase, UnitedHealth boosted its payout by 16% on top of the 20% increase last year.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	10%	13%	15%	19%	24%	31%	29%	28%	28%	27%	***30%***	***36%***

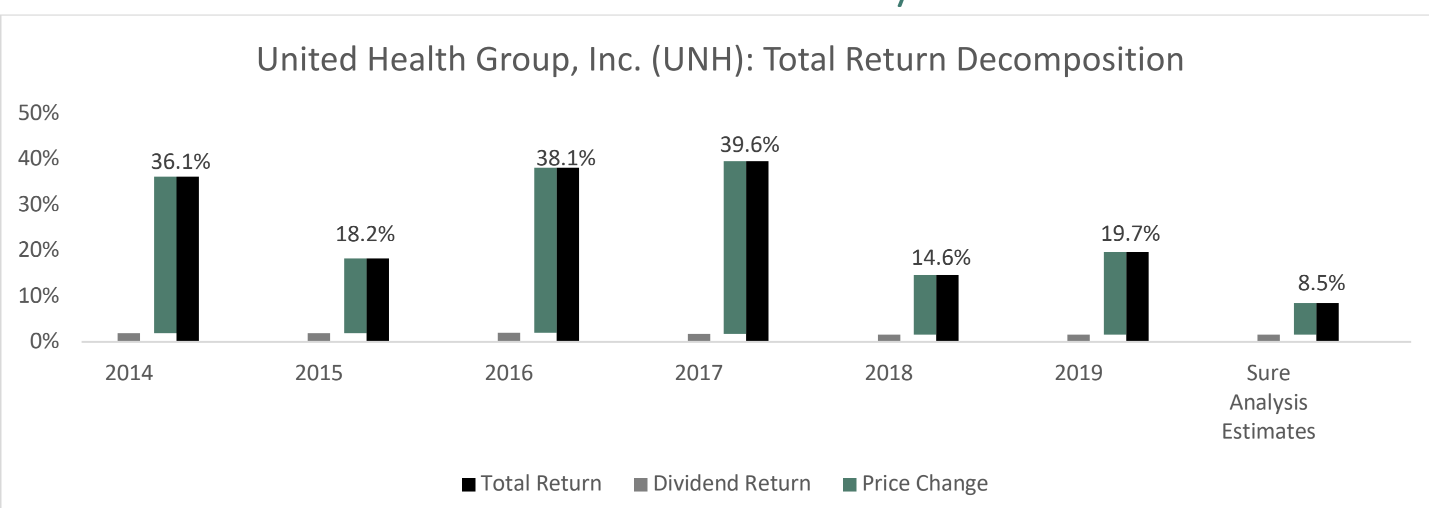
As mentioned, we see the payout ratio rising over time, as UnitedHealth's dividend is ultra-safe today. At less than one-third of earnings, UnitedHealth has tremendous flexibility in terms of returning capital to shareholders. Its outstanding earnings growth should only strengthen this over time.

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 in most cases.

Final Thoughts & Recommendation

We see UnitedHealth as a premier growth stock that is now trading somewhat 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 8.5%, consisting of the current 1.6% yield, 10% earnings growth and a small headwind from the valuation. UnitedHealth is an attractive long-term story offering high rates of earnings and dividend growth. However, the recent rally has pushed the valuation out of our comfort zone, so we are maintaining our rating at hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	93.55	101.21	109.94	121.74	129.70	156.40	184.01	200.14	224.87	240.27
Gross Profit	22589	24491	27189	29194	32236	36316	42558	45988	52470	55712
Gross Margin	24.1%	24.2%	24.7%	24.0%	24.9%	23.2%	23.1%	23.0%	23.3%	23.2%
SG&A Exp.	14270	15557	17306	18941	21263	24312	28401	29557	34074	---
D&A Exp.	1064	1124	1309	1375	1478	1693	2055	2245	2428	2720
Operating Profit	7255	7810	8574	8878	9495	10311	12102	14186	15968	17799
Op. Margin	7.8%	7.7%	7.8%	7.3%	7.3%	6.6%	6.6%	7.1%	7.1%	7.4%
Net Profit	4634	5142	5526	5625	5619	5813	7017	10558	11986	13839
Net Margin	5.0%	5.1%	5.0%	4.6%	4.3%	3.7%	3.8%	5.3%	5.3%	5.8%
Free Cash Flow	5395	5901	6085	5684	6526	8184	8090	11573	13650	16392
Income Tax	2749	2817	3096	3242	4037	4363	4790	3200	3562	3742

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	63.06	67.89	80.89	81.88	86.38	111.25	122.81	139.06	152.22	173.89
Cash & Equivalents	9123	9429	8406	7276	7495	10923	10430	11981	10866	10980
Acc. Receivable	2061	2294	2709	3052	4252	6523	8152	9568	11388	11822
Goodwill & Int.	25655	26770	35968	35448	36609	52844	56125	63045	68235	76010
Total Liabilities	37238	39597	49707	49733	53928	77529	84633	89225	97902	113453
Accounts Payable	9220	16652	17988	19033	21287	26324	29752	33051	36596	21690
Long-Term Debt	13503	11638	16754	16860	17406	31965	32970	31692	36554	40678
Total Equity	25825	28292	31178	32149	32454	33830	38274	47776	51696	60436
D/E Ratio	0.52	0.41	0.54	0.52	0.54	0.94	0.86	0.66	0.71	0.67

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.6%	7.9%	7.4%	6.9%	6.7%	5.9%	6.0%	8.1%	8.2%	8.5%
Return on Equity	18.7%	19.0%	18.6%	17.8%	17.4%	17.5%	19.5%	24.5%	24.1%	24.7%
ROIC	12.1%	13.0%	12.6%	11.6%	11.4%	10.1%	10.3%	13.8%	13.9%	14.4%
Shares Out.	1,086	1,070	1,019	988	954	953	952	969	968	962
Revenue/Share	82.71	93.11	105.10	119.01	131.54	161.73	190.10	203.18	228.76	248.73
FCF/Share	4.77	5.43	5.82	5.56	6.62	8.46	8.36	11.75	13.89	16.97

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