

Humana Profit Rises 9.9% on Gains in Medicare Plan (Update1)

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July 31 (Bloomberg) -- Humana Inc.'s second-quarter profit rose 9.9 percent as the health insurer gained customers in the U.S. Medicare insurance program and commercial and military plans. The shares rose as much as 4.8 percent in early trading.

Net income rose to \$89.5 million, or 53 cents a share, from \$81.4 million, or 49 cents, a year earlier, Louisville, Kentucky-based Humana said today in a statement. Revenue jumped 52 percent to \$5.41 billion.

Chief Executive Officer Michael McCallister has centered a campaign to add customers on Medicare's new Part D drug benefit, and Humana today said it will increase marketing spending in the second half of the year to help do that. The company's Medicare Advantage program -- which combines health and drug benefits -- meanwhile grew faster than Humana had estimated, almost doubling its customers in a year, to 959,800 at June 30.

For 2006, Humana's "earnings on a year-over-year basis are going to be up substantially, in my view, because of the seasonality of the Part D business," said Peter Costa, an analyst in the Boston office of FTN Midwest Securities Inc., in a telephone interview on July 28.

Humana shares rose \$1.87, or 3.6 percent, to \$53.50 at 8:47 a.m. in pre-market trading today, after earlier reaching \$54. In the last year, the shares have risen 29 percent in New York Stock Exchange composite trading.

Costa, who has a "buy" rating on the stock, said he was expecting Humana's second-quarter earnings to be 36 cents a share. The reported profit of 53 cents also topped the average estimate of 35 cents by 14 analysts surveyed by Thomson Financial. Thomson doesn't disclose its basis for estimates.

Earnings Forecast

Humana reiterated its forecast that earnings will be \$2.82 to \$2.88 a share this year. The company will boost Medicare marketing costs by 15 cents a share more than it had previously estimated. For 2005, Humana had net income of \$308.5 million, or \$1.79 a share, as restated to reflect stock-related compensation costs, on revenue of \$14.4 billion. In a May forecast, the company projected 2006 revenue of \$21 billion to \$22 billion.

The company is "on track" for a 50 percent revenue gain this year, McCallister said in today's statement.

Humana said medical costs in its government-related insurance consumed 86 percent of premiums received in the second quarter, an increase from 83.8 percent a year earlier, reflecting the timing of expenses for the new Medicare Part D coverage. In commercial plans, the ratio fell to 82.9 percent in the second quarter, from 83.8 percent. Investors often gauge an insurer's performance on whether the health plan raised premiums enough to offset medical cost increases.

Medicare

Medicare, the U.S. health plan for the elderly and disabled, began its new drug plan Jan. 1, allowing the coverage of medicines through commercial providers. Under Part D, patients pay for the first \$250 of medicines used in a year, and the insurer covers the next \$2,000. Then, coverage doesn't kick in again until the patient's pharmaceutical bill for the year has hit at least \$5,100.

The gap, dubbed the "doughnut hole," is the most profitable period for insurers. As Humana's policies under the program all began early in the year, the profitable time comes later, according to the company and analysts.

Government-Sponsored Programs

In May, the company projected second-quarter earnings of 31 cents to 36 cents a share. For the second quarter of 2005, Humana originally reported 51 cents a share, a figure that has been restated to recognize stock-based compensation expense.

The company serves members of government-sponsored programs including Medicare, Medicaid and the Tricare plan for the U.S. military. Humana also sells policies to commercial groups, such as employers, and to individuals.

Medicare on May 10 said 37 million of its beneficiaries had enrolled its various prescription-drug plans. Humana was the second-biggest provider of Medicare drug plans as of April 27, with 2.4 million customers. Minnetonka, Minnesota-based UnitedHealthGroup Inc. was No. 1, with 3.8 million, according to the Medicare agency.

Humana's Medicare-related business hasn't always gone smoothly. On June 5, Medicare said a computer file with personal data on about 17,000 Medicare beneficiaries "was not maintained securely" by Humana.

The agency ordered corrective steps by Humana, according to a statement by Mark McClellan, head of the Centers for Medicare & Medicaid Services, the agency in charge of Medicare. Those actions have been taken, Humana spokesman Dick Brown said in a voicemail message on July 28.

Risk from Medicare

Humana's "increased focus on Medicare, coupled with an inability to improve its commercial business, has worsened the risk profile of the company," analysts Stephen Zaharuk and Robert Riegel of Moody's Investors Service said in statement on May 24, when the agency assigned a Baa3 senior unsecured debt rating to the insurer's new \$500 million issue.

In the case of Medicare, "the chief concern is the possibility of future lower reimbursement levels, which could erode the profitability of the product," the analysts wrote. In addition, Humana may require "capital infusions" to sustain the growth, according to the report.

Humana in May completed the \$65 million acquisition of CHA Health, a Kentucky-based health plan, to add about 92,500 commercial members.

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