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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to do the Anthem Third Quarter Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to the company's management.

Chris Rigg *- Anthem, Inc. - VP, IR*

Good morning, and welcome to Anthem's Third Quarter 2018 Earnings Call. This is Chris Rigg, Vice President of Investor Relations. And with us this morning are: Gail Boudreaux, President and CEO; John Gallina, our CFO; Pete Haytaian, President of our Commercial & Specialty Business division; and Felicia Norwood, President of our Government Business division. Gail will begin the call by giving an overview of our third quarter financial results, followed by commentary around our focus on execution and our enterprise-wide growth priorities. John will then discuss our key financial metrics in greater detail and go over our updated 2018 outlook. We will then be available for Q&A.

During the call, we will reference certain non-GAAP measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are available on our website at antheminc.com.

We will also be making some forward-looking statements on this call. Listeners are cautioned that these statements are subject to certain risks and uncertainties, many of which are difficult to predict and generally beyond the control of Anthem. These risks and uncertainties can cause actual results to differ materially from our current expectations. We advise listeners to carefully review the risk factors discussed in today's press release and our quarterly filings with the SEC.

I will now turn the call over to Gail.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Good morning, everyone. Thank you for joining us for Anthem's Third Quarter 2018 Earnings Call. Today, we reported third quarter 2018 GAAP earnings per share of $3.62 and adjusted earnings per share of $3.81, reflecting improved execution across our enterprise and growing momentum within our businesses. Anthem's third quarter operating revenue grew 4% over the prior year quarter to $23 billion. Strong growth in our Government business more than offset the planned reduction in our Individual business. Administrative fees and other revenue increased more than 15% over the prior year quarter, reflecting increased sales of our specialty products, clinical engagement programs and growth of fee-based membership. Third quarter membership met expectations, and we expect growth to accelerate in the fourth quarter. Our third quarter medical cost performance was strong and reflects the impact of our value-based integrated care arrangement.

Anthem's Whole Health Connection, which delivers clinical integration across our medical and specialty products, is closing gaps in care and reducing cost. Over the last year alone, this program has helped identify over 30,000 diabetics through vision exams.

Our 2018 adjusted earnings per share outlook is now greater than $15.60, reflecting a 30% increase from 2017. Our revised 2018 guidance is a direct result of the enterprise-wide changes we made to improve execution, including sales force automation, the introduction of new clinical programs and further scaling of existing assets, like CareMore. We believe the investments and cultural changes we've implemented in 2018 provide a solid foundation for growth in 2019 and beyond.

We're focused on creating innovative, meaningful and cost-effective health care solutions for consumers. Our collaboration with Walmart launching in January of 2019 gives our Medicare Advantage members the flexibility to use their over-the-counter plan allowances to purchase medications and health-related items from Walmart's 4,700 stores and online. Today, more than 90% of Americans live within 10 miles of a Walmart store, and our partnership demonstrates our commitment to driving convenient, affordable access to health care for seniors. Our 2019 Medicare Advantage plan designs feature competitive medical and pharmacy benefits and includes significant enhancement to ancillary benefits designed to address whole person care. Overall, our 2019 Medicare Advantage offerings position us well for both mid-double-digit growth and stable margins.

As we highlighted on the second quarter earnings call, momentum in our group Medicare Advantage business is accelerating and we now expect total membership to exceed 150,000 in the first quarter of 2019. Our success in winning business is a result of our deep penetration in the Commercial market, industry-leading Blue brand and strong consumer relationships. As the trusted brand for many of the largest commercial accounts, we benefit from a captive new business pipeline and are uniquely positioned for multiyear growth in the group Medicare segment.

We're disappointed with the star quality rating scores that were recently announced by CMS, which will impact payments in 2020. As part of our overall Medicare Advantage star strategy, we're deploying incremental capital to improve clinical quality, pharmacy and medication management and the member experience. We believe these steps will lead to an improved stars outcome for the 2021 payment year.

In the Medicaid segment, our partnership with Blue Cross Blue Shield in Minnesota is expected to go live in December and will serve approximately 365,000 Medicaid and dual eligible members. In addition, the Virginia Medicaid expansion remains on track to commence in the first quarter of 2019, and we continue to expect to serve our pro rata share of the estimated 400,000 eligible individuals.

Looking ahead to 2019 and beyond, our CareMore business is an important clinical differentiator as we target growth in more medically complex patients. CareMore's Medicaid care delivery program integrates medical and behavioral with a focus on whole person care leading to significantly improved quality and affordability of care. As a result of the CareMore model, we estimate our members in Tennessee, for example, spend at least 10% fewer days in the hospital, reported 20% fewer ER visits and 25% fewer specialist visits.

In our Commercial business, our pricing strategies remain disciplined, and overall, we believe our markets are rational. Our strategic focus is to improve the consumer experience for our members by delivering end-to-end solutions that address the physical, emotional, spiritual and social and financial dimensions of well-being. We've improved sales effectiveness and strengthened how we work with our distribution partners through investments in our front-end broker portal and CRM technology. We simplified our technology environment and added valuable digital capabilities that make it easier for our broker partners to do business with Anthem. Our new integrated digital platform equips our distribution partners with the necessary tools to seamlessly sell, renew and monitor their medical and specialty business with Anthem.

We are focused on integrating products and services with solutions that enable ease of use and greater engagement. The recent launch of Anthem Act Wise is expected to accelerate growth on our consumer-directed segments. The Act Wise tool simplifies health care by allowing members to manage medical and well-being benefits through a single interface. We anticipate greater than 800,000 subscribers and 9,000 employer groups will utilize Act Wise by early 2019.

We've also standardized our clinical and value-based programs with predefined combinations of offerings. These packages make it easier for employers to purchase the suite of products most relevant to their employee population. The packages will be priced lower than if purchased separately and will generate a strong return for employers with superior medical cost savings.

And all of this will be integrated and available on our digital consumer engagement platform, Anthem Engage. Since its launch in the first quarter of this year, we've doubled the number of members using Anthem Engage. By leveraging Engage, we are able to deliver a fully integrated suite of products, including Anthem Health Guide, well-being coach and other health care solutions.

LiveHealth Online, our telehealth solution, saves consumer's time and drives affordability by redirecting care to the appropriate setting. Our data shows 86% of LiveHealth Online users chose lower-cost health care setting, generating an average saving of $200 per health episode.

The steps we've taken to improve sales execution and enhance the competitiveness of our product designs and consumer engagement tools are resonating and will drive growth in our Commercial group business in 2019. Our recently launched digital lifestyle management program and Total Health, Total You clinical package are distinctive offerings powered by AI and deep analytics that enable real-time referrals to disease and complex case management resources.

Our new PBM, IngenioRx, remains on track to launch January 1, 2020. The launch of our PBM remains a key initiative with an experienced dedicate transition team fully focused on delivering not just the stand-up of IngenioRx, but also a seamless execution for our customers and members. To date, we've built and tested thousands of our benefit plans and set up our required technology environments. The build out of our customer service center is ongoing and will be up and running by mid-2019. Overall, I am very pleased with our progress to date. We continue to expect IngenioRx to deliver at least $4 billion of gross pharmacy savings annually once our transition has been completed. The vast majority of these savings will flow through to our customers in the form of more affordable health care, and at least 20% of this value will accrue to our shareholders.

I will now pass the call over to John for a more detailed review of our third quarter financial performance before concluding our prepared remarks with an initial assessment of 2019.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Thank you, Gail, and good morning. As Gail stated, we reported strong third quarter financial results with adjusted earnings per share increasing 44% year-over-year to $3.81. Adjusted net income was $1 billion in the quarter, up 43% over the prior year.

Operating revenue in the third quarter of 2018 was $23 billion, an increase of 4% versus the prior year quarter. The growth in operating revenue reflects strong organic growth in our Medicare and fee-based businesses as well as the acquisitions of HealthSun and America's 1st Choice, among other factors. The revenue growth in the quarter comes despite our voluntary decision to reduce our individual ACA footprint, which has resulted in a 56% decline in our individual membership since the end of 2017.

Medical memberships was stable at 39.5 million members, and we have maintained our year-end guidance range of 39.9 million to 40.1 million members.

Our medical cost ratio in the third quarter was 84.8%, lower than expected and down 220 basis points from the prior year quarter and 60 basis points year-to-year when normalized for the health insurer fee. We are reaffirming our 5.5% to 6.5% Local Group medical cost trend, with an expectation of being slightly below the midpoint. Further, we have reduced our medical loss ratio guidance range by 20 basis points at the midpoint to 84.2%.

Our SG&A ratio was 15.4%, striking a strategic balance between cost discipline and investments we are making in systems modernization, digital and clinical product capabilities. Our SG&A guidance range for 2018 is unchanged at 15.4%, plus or minus 30 basis points.

Our balance sheet remained strong, with our debt-to-cap ratio at 40% at the end of the quarter, in line with our targeted range. During the third quarter, we repurchased 1.5 million shares of common stock at a weighted average price of $259 per share, totaling approximately $397 million.

Operating cash flow, which is in line with our expectations, was $607 million in the quarter, resulting in operating cash flow of $3.4 billion or 1x net income for the first 9 months of the year. We continue to expect operating cash flow to exceed $4 billion for all of 2018.

Our adjusted tax rate in the quarter was 22.9%. As anticipated, our effective tax rate decreased in the third quarter, and full year 2018 guidance range is unchanged at 26.5% to 27.5%. As a reminder, due to the nondeductible nature of the health insurer fee, higher-than-expected operating gains skews our tax rate lower.

Our third quarter results reflect stronger-than-anticipated growth in operating gain, and we expect to maintain our momentum for the balance of the year. As a result, we now expect our 2018 adjusted earnings per share to be greater than $15.60.

I will now pass the call back over to Gail

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks, John. We're entering 2019 in a position of strength. As an organization, we have made significant improvements over the last year and we expect to sustain our enterprise-wide momentum in 2019 as a result of recent and ongoing investments. We intend to offer a much more detailed 2019 outlook on our fourth quarter earnings call, but I do want to highlight several factors which will impact our financial performance next year.

Our initial view of 2019 contemplates both manageable challenges and growth opportunities. Key headwinds from this distance include: Ongoing regulatory uncertainty related to the health insurer fee, the expected dilution from new contracts in Medicaid and group Medicare and ongoing investments to drive and accelerate future revenue growth. Tailwinds include: Growth in our Medicare Advantage, Commercial and fee-based businesses; increased accretion from 2018 capital deployment; and the timing benefit of the Health Insurance Fee.

Taken together and in the context of our revised 2018 adjusted earnings per share guidance, the current 2019 consensus is slightly below our core long-term high-single to low-double digit EPS growth target.

And with that, operator, we'll open it up to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Lance Wilkes from Sanford Bernstein.

Lance Arthur Wilkes - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

So first question is going to be on outlook. And I'm interested in both 2019 and then as we're thinking about the PBM impacts for 2020. Could you just give a little color as to what sort of -- the magnitude of any sort of headwind associated with the PBM in 2019? Are you pricing in PBM savings in advance of achieving them in 2020? And then as you're thinking of the PBM in 2020 and beyond, should we be thinking about the 2020 being a partial year of benefit, and then 2021, being a full year? Or will we get all that benefit in 2020?

(technical difficulty)

Operator

Ladies and gentlemen, please stand by.

All right, sir, you're back on. Please go ahead.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Welcome back. And this is Gail Boudreaux, sorry. We had some technical difficulties with our call.

Lance, let me address your question. I wanted to -- there are a number of components in there, and I will first address the 2019 consensus and how we're exiting 2018, and then I'll ask John Gallina to share with you his commentary around the PBM. First, in terms of 2018, overall, we feel very positive about our business and we see a lot of momentum. As we exit 2018, we've increased our guidance by $0.20 to $15.60, and we see growth strengthening based on the initiatives that we put in place across our businesses. For 2019, we will provide much more detailed guidance at our fourth quarter call. And I think it's a bit premature at this stage to go into some of the other details. But again, looking at the guidance from 2018, we do -- have given you long-term EPS growth guidance of high single to low double-digit, and we do see that the consensus for 2019 does appear light, given that. We certainly aspire always to do more, as I've shared on other calls, but overall, we feel that the components within our business are strong and we see moments growing. I'm going to ask John specifically to address your question around the PBM and how that impacts 2019.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Thank you, Gail. Lance, I appreciate the question. Related to the PBM, we're under contract with ESI through 12/31/'19. We'll obviously fulfill our contractual commitments as we expect ESI to fulfill their contractual commitments, and then we'll convert over in 2020. We've talked about $4 billion of savings related to improved pricing, and that more than 20% of that being delivered to shareholders, and almost 80% going back into more affordable health care premiums to our members and our customers. Related to the 2020 savings, the $4 billion is a run rate number, and so we will convert our membership throughout 2020. 2020 should be viewed as a partial year, the way that you asked the question, and we expect to have the conversion fully completed and be 100% migrated onto the new platform no later than January 1, 2021. So partial year for 2020. Now the other part of your question was related to our 2019 pricing strategies and what headwinds we might have associated with that or other implementation or integration cost. I'll just say that, as Gail has reaffirmed, the consensus outlook out there is a little bit light right now, and it certainly includes all aspects of that. We've stated previously that the impact on Anthem's financial statements associated with the migration would be minimal in 2018 and '19. There was not a significant onetime headwind that we had baked in, and continue to believe that. And then in terms of future pricing, very minimally in 2019. But anything that has happened is already fully reflected in Gail's commentary associated with our 2019 expectations.

Operator

Your next question comes from the line of Steven Valiquette from Barclays.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

So just on the Government business, you said in the press release there is some rising medical cost in Medicaid. Just curious if there's more color around what's going on there, whether you could talk about that either categorically. And also, do you view that as kind of more temporary? Just wanted to get your thoughts around that disclosure in the press release.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well, thank you very much for the question. Overall, we're very pleased. Let me start with where I answered my last question. So overall, we're very pleased with the portfolio of businesses. If you look at our performance year-to-date, particularly in our Government business in Medicaid, we feel very good about our business, and it's in line with our expectations for the full year. In Medicaid, as is typical with this business, there's always out-of-period adjustments, so I wouldn't read too much into the quarter-over-quarter comparisons for our Government business. On a year-to-date again, overall, Medicare and Medicaid are performing solidly within our target margins. And keep in mind, too, that we improved our MLR guidance by 20 basis points, which encompasses all of our businesses. So overall, we feel these businesses are performing within expectations and feel good about the full year outlook, and certainly, the year-to-date performance.

Operator

Your next question comes from the line of A.J. Rice from Crédit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

Maybe -- I know, Gail, earlier in the year, in some of the calls, you've laid out some of the long-term initiatives that you were pursuing, and you mentioned some of it a little bit in the prepared remarks, but I'll see if there's any further update on cross-selling opportunities in the self-funded business and what you're seeing there. Any further discussions with new collaborations with Blues? And then I think there was also a discussion about investments in things like consumer-facing and general data analytics capabilities. So if there's any update on those or the other initiatives you laid out, would love to hear them.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Great. Thank you, A.J. Covered a number of things. As I think I've shared on each of these quarterly calls, focus on a couple of key areas. One, improving performance execution across our enterprise, and I think that the changes we've made in sort of structure as well as performance and discipline across our culture, we're starting to see some of the early results of that across our businesses, so I feel very positive about that. The second major area of emphasis has been around growth. Coming to Anthem, I felt that we have some very strong assets across all of our businesses, and growth has been a particular focus. And I'm going to start on some of the places that we've invested, and then I'm going to ask Pete Haytaian, who leads our Commercial business, to share with you some of the more specific details. I'll start first on sort of the investments. We have been investing, and you probably saw a recent announcement around digital capabilities, consolidation and migration of our systems, which we think will, over the next several years, improve our operating environment. Artificial intelligence capabilities, we're building a team there that allows us to actually work both in the clinical predictive place, and we've been embedding those in some of the products that I shared with you earlier that help our clients sooner identify individuals with complex conditions. We think that there's a lot of potential in that space because of the population we serve, both in Commercial and the Government business, and that's an area of long-term growth. And again, we've been investing in making sure that our product capabilities are strong. We came into this year a little bit disappointed about the positioning of products. We spend a lot of time focused on those products in our Commercial business and the cross-sell opportunities inside of our specialty business. You saw on our uptick in revenue in the quarter, that we had some nice pull-through of specialty penetration as well as clinical buy-ups. And that's an area of focus where we think we've got additional growth opportunity. With that, I'm going to ask Pete to just share some of the initiatives that he's in put place in the Commercial business and some of the impact that, that's already having.

Peter David Haytaian - *Anthem, Inc. - EVP & President Commercial & Specialty Business Division*

Yes, thank you, Gail, and thanks, A.J., for the question. I think I'll just sort of tick through some of the things that I've mentioned over the last couple of quarters, that I -- and talk to you about progress. But I -- generally speaking, I think we're very encouraged by the progress we're making in the Commercial business. First, I'll start with talent. Really encouraged by the talent that we're attracting into the company, both with respect to my team as well as out in the field. Number two, we've talked a lot about our segment strategy structure, so deploying standardization across all 14 states as well as building in best practices, and we continue to see that build out and we continue to see great progress in that regard. I've also talked about Centers of Excellence and making investments in things like sales force effectiveness, centralizing underwriting so we could be a lot smarter and quicker with respect to our decision-making on our underwriting; and then product development, and making sure that we have the right products in the marketplace and we're being as agile as we can and with respect to selling those. I've also talked about our network development -- provider network development strategies and making sure that we have high-performing networks. We're launching across the company, strategies like cooperative care, in which, we're focused on the highest-quality providers at the best cost, and we're looking to match those networks with the most effective products. And we're seeing progress with regard to that. And then as Gail talked about, how we package our products, making sure that we have clinical packages and other consumer engagement tools that are really effective in the marketplace. And then finally, as we faced the market in terms of how we engage with our distribution channel, our brokers, I am really encouraged by the progress we're making. We are now, with respect to quotes, doing things on a digital basis as well as with respect to enrollment. So we're seeing electronic enrollment occur in the marketplace. And that all is happening in a much more streamlined fashion as we move forward. That is translating, as Gail said, into growth. We're encouraged by what's happening quarter-over-quarter from a membership perspective. We've seen nice improvement in our local market growth. And we are cautiously optimistic with respect to the momentum that's creating going into the -- into 2019 and the first quarter of 2019.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks, Pete. And as you can see, we've got a lot of initiatives underway, and we think that they're going to begin to build momentum, and certainly, are opportunistic for 2019, really seeing the impact to that.

Operator

Your next question comes the line of Ana Gupte from Leerink Partners.

Anagha A. Gupte - *Leerink Partners LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

So if I could just follow up on Commercial as far as National Accounts goes and some of the trends we're seeing, like direct-to-provider contracting, where GM is doing something directly with Henry Ford and the Blue Cross is more a TPA here. You talked about the Castlight platform with member engagement on 800,000 members, Samsung, Am Well and the like. What exactly can Anthem do here, Anthem is doing in partnership with the Blues more broadly to create a Blue platform, a BlueCard and beyond, that can satisfy self-insured employers and away from -- moving away from health plans at this point?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question. Very comprehensive question, Ana. I will try to hit on each of the components. Let me start first with the National Account marketplace, which you began your question with. Overall, we feel actually quite positive about the initiatives in place in that marketplace. Pete touched on a couple of those. One, the networks that we're putting in place around more value-based care. As you know, we have a cost advantage across our Blue Cross and Blue Shield system and we are moving strongly to make sure that we also have integrated value-based arrangements that we can share with our National Accounts. And so that's an initiative that we've been working on across the system and is beginning to resonate. Our overall performance for National Accounts, we're coming to the close of the season for 2019, and this year was an interesting year in that it was more about incumbency, but overall, we do expect to grow in that marketplace. And we did see a number of accounts waiting for 2020 in terms of some of the larger accounts on their bid process. We will expect and we do believe that our launch of IngenioRx there is a huge positive for us in that market. But your broader question around the Blue Cross Blue Shield partnerships and opportunities, that has been a priority of mine. We have over 107 million people across the Blue Cross and Blue Shield system that we serve, 1 in 3 Americans. One of the strongest brands. And we, I think, have an opportunity to work collaboratively across the system to improve the affordability and access to health care. The Engage platform, for us, is somewhat unique in that we have fully integrated that platform into our consumer experience and our digital capabilities as well as our clinical program. So it's not just a platform, it's a stand-alone. And I think what that offers an opportunity to others who want to join us in partnership is being able to share that kind of deep integration is truly an opportunity. We have worked with several Blue partners on our service model and engaging some of our clinical programs through our CareMore subsidiary as well as through some of the other work we do, so we're already doing that. We're doing it in Medicaid, for example, in our partnerships. But back to your question, we do see a lot of opportunity. And we want -- we are very focused on being a good partner in the system. And we think that the good capabilities that we bring are very differentiating because of our local market share depth plus our partnership. And let me maybe ask Pete to give a couple more comments maybe about how the National Account is playing out and specifically about the direct contracting.

Peter David Haytaian - *Anthem, Inc. - EVP & President Commercial & Specialty Business Division*

Yes, Ana. We -- I would agree with everything that Gail said. We're very encouraged by what's happening. I mean, it's nice to see that year-over-year, we will see growth. In a year of incumbency, we will see growth in the National business from '18 to '19. And just to accentuate a point that Gail made around collaboration and cooperation with the Blues, I am really encouraged by the conversations that are going on with the Blues on a national basis with respect to network construction and high-performing networks. We are locking arms and making sure that we're building networks on a unified basis so that consumers can have a real consistent experience across the board. And then in terms of our capabilities, like Gail said, our theme is really around integration and the consumer experience and making sure that there's an ease of use with our customers. So we're really encouraged by that. We're making a lot of investment in that regard. A lot of our peers and competitors are working in a fragmented environment, and so bringing all these tools and capabilities together in an integrated way, I think, is a meaningful difference.

Operator

Your next question comes from the line of Justin Lake from Wolfe Research.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Just have a couple of follow-ups here. First, there's been a lot of focus on your Medicaid comments in the press release on higher medical costs, and you've mentioned out-of-period adjustments, Gail, earlier in the call. So can you give us more detail here on what occurred in the quarter? And then on guidance, appreciate the commentary, but in terms of how we should think about 2019, is it reasonable to think about '19 as a combination of the high single digit to low double-digit growth, coupled with, I think you talked about $0.60 of HIF timing benefit previously. Is that kind of a reasonable framework?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks, Justin. First of all, in terms of Medicaid, I guess, again, what I would say as you think about that, it's pretty typically in the Medicaid business to have out-of-period adjustments. So as you look at our full year, it's really more about the timing. And we expect that timing to normalize. We've got very strong 9-month performance and we expect to see continued ongoing strong performance for the full year. So overall, that was really what I meant in comments around Medicaid. Let me ask John to comment a little bit more, I think, about your 2019 earnings per share guidance because again, we're not getting into detailed guidance at this stage and I'll go back to my prepared comments, but maybe John can add some commentary.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Sure, thanks. And thanks for the question. In terms of 2019, first, I'll address the HIF fee headwind that we're in this year. It's about $0.40 this year associated with our current operations, and the other $0.20 is a bit more fungible. So I would say that the way that you're approaching it from a modeling perspective, I think the $0.40 is a very fair and appropriate adjustment to make on the starting point. And then, yes, we are very much looking at a high single to low double-digit growth rate associated with that starting point.

Operator

Your next question comes from the line of Dave Windley from Jefferies.

David Howard Windley - *Jefferies LLC, Research Division - Equity Analyst*

In Medicaid, wondered if you could talk about the adequacy of the rate increase in August in Iowa. Does that kind of get your plan there in Medicaid Iowa to a more normal margin? And then in Texas, if you could talk about your confidence or comfort with your positioning relative to reprocurement in Texas?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Well, in terms of sort of specific states, we really don't comment on overall specific state situations, and so I won't go into any state-specific situations. Overall though, again, as we think about our guidance in 2018, we feel that our Medicaid position is actually -- we have a very strong Medicaid platform and is performing within our target margins. So overall, we feel comfortable about our portfolio. We have over 22 states, so we think about our business as a complete portfolio. In terms of procurements, maybe I'll ask Felicia Norwood, who leads our Government business, maybe just to comment a little bit about the pipeline and what's happening in our various opportunities.

Felicia Farr Norwood - *Anthem, Inc. - Executive VP & President of Government Business Division*

thank you. Certainly, with respect to Texas, as you know, the state canceled and reissued the Texas Procurement. We are an incumbent today and we certainly would expect to bid on that procurement as we move forward. That's due this month. When we take a look at the overall Medicaid pipeline, it remains very robust. We have had a very strong success rate in terms of winning procurements and we are confident of our ability to continue to maintain that trajectory as we go forward.

Operator

Your next question comes from the line of Matthew Borsch from BMO Capital Markets.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Managed Care and Providers Analyst*

You touched on the health insurer fee as a key uncertainty, I suppose looking beyond 2019. What are -- if you don't mind sharing with us, what are the key milestones that you're looking to in terms of activity that -- when you think that may happen in Congress in terms of further suspension or perhaps permanent elimination of the fee?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question, Matt. I'm not quite sure how to respond, only in the sense that I really don't have a great crystal ball as to the timing of when those types of things are happening. Obviously, we feel very strongly about affordability in the marketplace, and stability is really important. We appreciate the suspension for 2019 and feel that, certainly, it's good for employers good and for the marketplace. And it's something that we are strongly advocating that becomes a permanent reduction in the health insurer fee, that, that goes away. So I don't really have any great insight into timing. It's something that we're constantly sort of sharing our views on and working on The Hill, et cetera and with the administration on. So other than that, not a whole lot of specifics there to provide.

Operator

Your next question comes from the line of Josh Raskin from Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

Still struggling, I guess, to understand why you called out Medicaid. And I guess just looking in context of Government segment operating gain this quarter, 60% or 70% growth sort of through the first half of the year, and then a 3% growth number this year. So it looks like a relative big change or at least a decent number in there. So maybe you could just help us, what exactly was this out of period? Why should we understand that not to be a go-forward issue? If you could -- is this contained to a specific state or a specific program, et cetera? I think that would be helpful.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Josh, this is John. Thank you for the question, and I appreciate the opportunity to try to clarify whatever misunderstanding is out there. The way that the Medicaid business just operates in general is there are always out-of-period adjustments and there are always timing issues that can skew quarter-over-quarter results. Quite honestly, sometimes, it can be misleading to look at just a quarter-over-quarter result without understanding all the issues and you really have to look at out-of-period that occurred in the third quarter of 2017 as well as out-of-period that occurred in 2018. And unfortunately, we're not going to go through the list of the 22 states and which ones may have had an out-of-period or which ones didn't. But what I would ask you to do is to look at the year-to-date performance as well as our annual expectations and know that our Government business, in total, as Gail said, is within our targeted operating gain ranges. We believe that both Medicaid and Medicare are operating very well and within our expectations. And we're very, very satisfied with the performance and think we have some nice momentum heading into 2019.

Operator

Your next question comes from the line of Kevin Fischbeck from Bank of America Merrill Lynch.

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

So just wanted to confirm, I guess, one thing and then a follow-up. So when guys look at your results this quarter, from your perspective, MLR is coming in better and the tax rate looks a little bit lower just because the operating income gain is higher, and that just mathematically brings down the tax rate, so I just want to confirm that. But then to the extent that cost trend is coming in better, do you have some color on what is coming in a little bit better, and by product? Is it Commercial, is it Medicare? How should we think about that?

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Sure. On the tax, you're exactly correct that as we perform better in our core operations, that our tax rate will be lowered mathematically, given the fact that the health insurer fee is a fixed number in the calculation. In addition, there were a couple of small true-ups associated with our 2017 tax return filing that also benefited. But when you look at the outperformance in the quarter, the outperformance in the quarter was driven both by strong operations as well as by the small true-ups from the third quarter -- I'm sorry, from the 2017 tax return we did in the third quarter. So associated with that, we're very bullish. That's one of the reasons we increased our guidance by $0.20 for the year. And then the other part of your question was we lowered our medical loss ratio by 20 basis points. It's really -- it's the continued strength in our clinical programs, continued strong momentum in that area. Our medical cost trend, which is based on our Commercial group, we build a bias to slightly below the midpoint, and all those things combined are giving us the comfort to reduce our medical loss ratio guidance for the rest of the year.

Operator

Your next question comes from the line of Charles Rhyee from Cowen.

Charles Rhyee - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

So Gail, you spent a bit of the time in [commentary over here] talking about your consumer-facing platform. And just as a follow up on some of your comments. You talked earlier about, with Engage, doubling the number of members. Can you talk about sort of the penetration into the client base? You mentioned 800,000 members expected by early next year. What do you think is the realistic target part of your market to have that platform facing? And then as you talk about the investments that you're making in the consumer experience, how far along are you, would you say, in terms of where you want to be ultimately in this regards?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Sure. I'll start and then I'll also ask Pete to give a little bit more color. In terms of our capabilities, I actually -- I think we're pretty far along. We have been investing in those capabilities for the last few years. We accelerated those investments this year and when you think about Anthem Engage, that's just one component of a complete digital platform and an AI platform that we're building. We launched Anthem Engage in January, have seen some very strong uptick, mostly in our large self-insured customers, and we doubled it, which was our goal. So I think that there's a significant penetration opportunity there, but that's just, again, one piece. LiveHealth Online is another really interesting offering, where we have several -- close to several million members in that opportunity. Again, a fairly recent launch. All of those have very strong Net Promoter Scores. But I also like to look at not just our consumer engagement, but our clinical program. Our clinical programs are also powered by digital and we're using AI to help us identify patients sooner in the process, and we think significantly sooner, almost 6 months, in some instances, to get them into our complex case management programs as well as to integrate all of their well-being aspects. The last piece that I wanted to just touch on is Anthem Whole Health Connection. I shared a little bit about that in my prepared remarks, but that's a pretty interesting combination of not just technology but also integration, where we're really taking our vision, our dental, our pharmacy, our medical and our disability and our both clinical and claims information and connecting them with the way we work with our care providers in the community to access and understand gaps in care and coordinate care across the continuum. And we're identifying interrelationships and issues much earlier. And the reason that works for us, again, is because we have the digital capability, but also, we have the deep market penetration and market share, where we have significant number of patients in a physician's office, in a dentist's office in our local markets. So overall, what I would say is we are making significant investments around digital, AI. We've hired a team that's working on that, that we think will help accelerate that. We did a recent press release, I think you saw some information about that. But we also think we need to work in partnerships. So we've got a number of partners that we're also trying things, like doc.ai. We announced our relationship with them because we think that it's this interconnectedness across the system that's going to, not just advance our capabilities, but also leapfrog them. But maybe I'll ask Pete to just share a little bit about how the market -- how this is resonating in the market, because I think that was sort of the core of your question, and the potential it has.

Peter David Haytaian - *Anthem, Inc. - EVP & President Commercial & Specialty Business Division*

Yes, I think it's a great question, Charles. And I think Gail really covered the gamut. I would think of Engage as our consumer engagement platform, and everything, we're doing attempting to integrate ultimately into the user experience through Engage. Just to give you some facts. That's up to over 1.6 million members today in Engage. We're finding that 30% of our users are viewing gaps in care, 60% of our users are accessing benefits and health management programs. So we're seeing really good engagement. Our NPS score associated with Engage is around a 70, so we feel really good about the use there. But let me give you a specific example of how we're trying to differentiate ourselves from an integration perspective. So you had asked the question about consumer-directed health plans and how we're differentiating ourselves, we call that Anthem Act Wise. And so consumer-directed health plans are not new, we know that. We have about 4.5 million customers in that today. But what we're doing that's different is we're bringing together disparate services. So think about all the financial services associated with a consumer-directed health plan, be it your FSA, your HSA, et cetera, specialty products that you may have or medical products, and we're ultimately integrating all of those into one unified consumer experience. And ultimately, they'll engage -- or excuse me, experience that through our Anthem Engage tool. So when we talked about uptake in Act Wise, we talked about expecting over 800,000 subscribers and ultimately over 9,000 employers taking advantage of our new Anthem Act Wise technology, but that's how we're really differentiating ourselves, creating that integrated environment versus a fragmented experience that folks may have today with a consumer-directed health plan.

Operator

Your next question comes the line of Ralph Giacobbe from Citi.

Ralph Giacobbe - *Citigroup Inc, Research Division - Director*

Just want to be clear on guidance. Again, I'm seeing consensus EPS growth of 10.7%, so seems sort of in line with commentary of high single, low double. So maybe just help us on the line item that you're comparing to and what consensus growth is there. And just staying on the guidance, you talked about headwinds and you specifically called out sort of dilution on Medicare and Medicaid. Hoping you can kind of flesh out as we think about the ramp of the margin with so much group MA coming off.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Sure, Ralph, and thank you for the question. Now in terms of guidance in the high single and the low double-digit growth rate that we've -- previously have expressed, I think the real question is off of what starting point? And we raised guidance today from $15.40 to greater than $15.60. And then as a previous question has referred to as how the HIF fee is factoring into that? The fact that we have a HIF fee this year, we have about a $0.40 headwind associated with that in our 2018 results and how to factor that into the 2019 jumpoff point. And then I think, really, the math on that is to take our earnings and add the $0.40 headwind back in. And then think through our long-term growth rate from that perspective. In terms of the other headwinds, tailwinds, yes, I mean, the fact that we have a headwind for growth in group MA and growth in Medicaid is actually a very good thing because it both revolve around the word growth, associated with growing those lines of business, which we believe will be very profitable for us over the long term. We don't specifically size the individual items on a line item by line item basis, but we're very bullish with the membership growth and very bullish with what the long-term aspects of that will provide for the company.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks, John. And also, I'll just add that those things -- those components have been factored into the outlook that we provided.

Operator

Your next question comes from the line of Steve Tanal from Goldman Sachs.

Stephen Vartan Tanal - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I guess I just wanted to follow up on the commentary around the cost trend. So is it also fair to read the change to the Local Group cost trend outlook as suggestive of trend having maybe decelerated more recently? And perhaps maybe you could just give us a flavor for how much of the favorability this year is the initiatives versus sort of the natural patterns you're seeing. And maybe comment on how utilization is trending within that, that would be great.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Yes, sure. Thanks, Steve. Thank you for the question. Yes, we are very bullish on our cost trend. And as I had stated in the prepared comments, that we are going to slightly below the midpoint of the trend. And I think that's very meaningful associated with being able to reduce our medical loss ratio guidance for the fourth quarter by 20 basis points. In terms in-patient -- I'm sorry, in terms of utilization versus pricing, we're pretty much consistent with what most others in the industry are, is that somewhere between 2/3 and 80% of the increase is price and as unit cost, and then the rest is utilization. We continue to work very hard on utilization, ensuring that we have appropriate care and that the experience that our members have, that they're getting the right care in the right place at the right time. We're seeing reductions in inpatient bed days as an example of one of the initiatives. It's going very well in helping direct more care to lower-cost out-patient settings.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Let me also add to John's comment and your specific question about, is this sort of a natural trend, or what's occurring? I mean, we have done a lot in our marketplace around value-based care; clinical program; moving, as John said, to appropriate place of service. So there is a lot of activity that goes on each and every year. And so to parse that out -- but clearly, the biggest driver of trend historically, and continues to be, unit cost pressure in the system. We have seen, obviously, very positive trends over inpatient utilization, continues to go down. And we continue to stay very focused on specialty pharma. That's an area of intense focus, and we're excited about the ability of actually going forward in IngenioRx to continue to manage it. So overall, I don't think you really parse the pieces, but we are doing a lot in our markets around value-based care, moving more -- and we have over 60% today under those arrangements, moving to much stronger forms of risk-share and risk-taking.

Operator

Your next question comes from the line of Gary Taylor from JPMorgan.

Gary Paul Taylor - *JP Morgan Chase & Co, Research Division - Analyst*

Two-part question. One on group MA, you talked about 150,000 enrollment for the first quarter. I think that's up from just a little under 60,000 currently. And my question was, is that being driven by one large contract win, or several? And is the catalyst for that the multi-state Blue platform? And then second part of the question is just a cash flow question for John. Cash flow has been weaker. I understand some of the timing issues on CMS payments, et cetera and the exit of the exchanges having an impact, but the one line that I'm a little confused by is, I think, premium receivables has been $700 million bad guy year-to-date on cash flow. And just wanted to understand the source of that growth a little bit.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Gary, let me take the first part of your question around group MA, and then I'll have John address the cash flow questions that you raised. First, thanks for the question on group MA. As you've heard, we're very bullish about the opportunity of group Medicare Advantage. And it's a business that we've gotten very serious about and brought in a dedicated team and resources. Specifically to your question, though, we have broad-based growth, so we're not looking at any single client driving this into 2018. But what is unique, I think, about our opportunity is we have a very attractive commercial book that is an inherently captive pipeline of members that are Medicare eligible, both through our members that are receiving benefit today through rep products, existing commercial accounts that are using the MA products from our competitors as well as agents. And we have a very robust pipeline. So we feel confident, obviously, in the numbers that we shared with you this morning, and we see a pretty significant pipeline going forward. The Blue Cross Blue Shield partnerships, absolutely, are an opportunity for us as well going forward. I think the overall system recognizes the value. These are Commercial members that we have had through their lifetime, and it's important that we keep them. So I think you hit on another really important part of our strategy and why we're very bullish about group Medicare Advantage going forward. So with that, I'll ask John to address your cash flow question.

John Edward Gallina - *Anthem, Inc. - Executive VP & CFO*

Yes, thank you. On the cash flow, there are several different moving pieces, as you've identified. And I think you called out one of the -- a significant factors already. And that is, with our strategic decision to reduce our footprint in the individual ACA marketplace. We have obviously had payments the run out of claims and the reserves that existed on that business at 12/31/17. And so that would have lowered our cash flow expectations for the year. That was obviously all part of our guidance and we knew that was coming, but it does actually reduce the cash flow. Even with that, we have a very strong cash flow expectations of 1x net income. The piece on the premium receivables is really focused primarily on a lot of Medicaid and Medicaid states paying us 1 month in arrears, and that's driving the receivable balance a little bit higher. And yes, we think it's still obviously very collectible. They're good receivables, it's just a bit of a slowdown of the cash flow associated with having some states having us 1 month in arrears versus getting paid on a more timely basis.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

We have time for one more question, so next question, please.

Operator

Okay. Your final question comes from the line of Peter Costa from Wells Fargo.

Peter Heinz Costa - *Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst*

My question, you covered the rest of this year and 2019 pretty well, but I'd like to talk about 2020 and a couple of big changes there. First, the PBM, have you decided whether you're going to migrate the Medicare business or the Commercial business first? Because that matters in terms of when you get the cost savings. And then President Trump's HRA changes, how do you feel that's going to impact your Commercial business?

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thanks for the question, Peter. First, as I shared on the call -- or in my prepared remarks, rather, we have a very detailed schedule. We are going through benefit testing, et cetera. We're not going to go into the specifics of which business migrates at which period of time, but I guess, suffice it to say that we have kind of worked through a whole number of scenarios and want to make sure that, first and foremost, it's an absolutely seamless transition. And as you know, we have to go through series of approval processes, et cetera, from states and other things like that. So we're going to work through that. In terms of your second question about the HRA, I'll ask Pete Haytaian to answer that for you.

Peter David Haytaian - *Anthem, Inc. - EVP & President Commercial & Specialty Business Division*

Yes. Thanks, Pete. There's obviously a lot of proposals over the last couple of weeks. But I'd say that we're obviously very focused on affordability and sustainability in the marketplace. And as it relates to the HRA specifically, I think that you've probably read that there were appropriate safeguards put in place to sort of address that. So while it is addressing the affordability concept, it also has safeguards in there to ensure that employers don't inappropriately take that risk and push it into an individual marketplace. So we feel very good about that. That's generally how we look at these things, being supportive of affordability in the marketplace, but also being very keenly focused on sustainability in the marketplace.

Gail Koziara Boudreaux - *Anthem, Inc. - President & CEO*

Thank you. And thank you for all of your questions and for joining us this morning on Anthem's Third Quarter Conference Call. As you can see, we are well-positioned for 2019, and I'm excited about the opportunities that lie ahead of us.

I want to thank each of our associates for their commitment to Anthem and all of those individuals we serve. Thank you for your interest in Anthem, and I look forward to speaking with you at future events.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.
