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ANTM - Q3 2019 Anthem Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 operating revenue of $26.4b, adjusted net income of $1.3b and GAAP EPS of $4.55. Expects full-year 2019 adjusted EPS to be greater than $19.40.

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PRESENTATION

Operator

Good morning. I would like to apologize for the technical difficulties that we are experiencing with our phone carriers. This is not an issue related to Anthem. If you are joining via webcast, please submit your questions to Chris Rigg, Vice President of Investor Relations. His e-mail address is chris.rigg@anthem.com, which also can be found on Page 6 of the company's press release. We will be monitoring e-mails accordingly.

Ladies and gentlemen, thank you for standing by, and welcome to 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 2019 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 comments on our key business initiatives and enterprise-wide growth priorities. John will then discuss our key financial metrics in greater detail and go over our updated 2019 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, 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 & Director*

Thank you, Chris, and good morning. Today, we reported third quarter 2019 GAAP earnings per share of $4.55 and adjusted earnings per share of $4.87, reflecting strong revenue and earnings growth across our businesses. Operating margin was 5.8% for the quarter, a substantial improvement, both sequentially and year-over-year. Over the last several quarters, our enterprise-wide financial results have been strong. And in 2019, we will exceed our long-term revenue and earnings growth targets.

Anthem's third quarter operating revenue increased a robust 15% over the prior year quarter to $26.4 billion. Medical membership trumped all of our businesses, increasing by 1.1 million consumers served, with our risk businesses accounting for nearly 90% of total growth.

Anthem's specialty businesses also delivered solid growth, adding nearly 150,000 new consumers in the quarter and nearly 800,000 to the first month of this year -- first 9 months.

Anthem Whole Health Connection has been a key enabler of our strategy to increase specialty product sales by integrating information across our package, medical and specialty offerings, driving more effective innovations to close gaps in care and reduce costs.

As part of Anthem Whole Health Connection, we identified that dentists account for nearly 10% of opioid prescriptions. By leveraging this insight and mobilizing our local provider network and clinical teams, we initiated a multiyear effort to broadly educate Anthem dentists on effective nonnarcotic alternatives.

As a result, opioids prescribed by our dental providers decreased by more than 50% and the number of opioid prescriptions exceeding a 7-day supply were cut by more than 90%. Our clinical focus is designed to support care providers by giving them data, tools and capabilities to effectively manage performance.

This example illustrates the power of our focus on whole person health to deliver improved outcomes and reduced costs while impacting one of the most pressing health care issues facing society today.

The migration of our pharmacy business to IngenioRx continues to go extremely well, and we remain on track to have all of our members on the IngenioRx platform by January 1, 2020.

We're confident in our ability to execute on the remaining aspects of the transition and now expect to be in a position to provide value-added services at much more competitive pricing. IngenioRx is a key example of the strategic end-to-end execution that we're driving across all aspects of our business.

With each successful wave of our migration, we've implemented a command center model, bringing together hundreds of associates, representing critical operational areas to work side-by-side 24/7. Through this model, we've been able to monitor performance in real time and deploy cross-functional SWAT teams to quickly and effectively resolve any issues or concerns.

Medicaid results improved this quarter, but at a slower rate than previously anticipated as we had better alignment of revenue relative to the risk profile of the population served. We added nearly 200,000 members and see continued strong growth through 2020.

We remain confident we'll continue to improve our performance while delivering even greater value for our state partners and the individuals that we serve in our Medicaid program.

Our previously announced acquisition of Beacon Health remains on track to close late in the fourth quarter. This strategic addition to the Anthem portfolio will strengthen our market position in behavioral health and help further our efforts around whole person care.

Improving performance execution around Anthem remains a key priority and focus. We made progress in many areas, but there is still more work needed in order to unlock the full potential of our enterprise. We're very disappointed with the recently announced star rating scores for payment year 2021, which have not improved at the rate we had targeted.

Unfortunately, these ratings were largely impacted by our clinical pharmacy results. However, with the successful transition to IngenioRx, we have refocused our organization with clearer accountability and line of sight to deliver dramatically improved results going forward. We are absolutely committed to improving the percentage of our members in 4-star plans.

Across Anthem, we remain intensely focused on creating innovative, meaningful and affordable products and services for our customers, consumers and care provider partners. We continue to invest in digital capabilities and AI in order to create the kind of health care experience our consumers demand today.

Our recently launched electronic personal health record is gaining traction. This unique tool is empowering consumers to be more engaged in health care decisions by supporting greater alignment and communication with their own care providers.

We're excited about the launch of Sydney, our next-generation consumer engagement platform. Sydney is delivering on our promise of a simpler, more personalized experience, giving consumers have control over where and how they engage with us regarding their care, benefits coverage, their health and wellness goals and more.

By leveraging data and AI, Sydney is providing a personalized health care experience tailored to each individual's unique needs, resulting in improved engagement and ultimately a lower total cost.

Turning to 2020. In Commercial, we anticipate another solid year of both risk and fee-based membership growth. In addition of the benefit of IngenioRx, we've deployed a broad portfolio of innovative products to meet our customers where they are. This include Anthem's recently announced chamber-based association products, along with the newly launched HealthSync high-performing provider network, giving employers more affordable choices.

We anticipate another strong year of national account growth. National account customers represent our most sophisticated buyers, and our success is determined by our ability to deliver better quality at the lowest net cost with improved member satisfaction.

Clinical programs such as Total Health, Total You, our integrated end-to-end, digital first clinical model, are exceeding expectations on this front. Since launching in January of this year, we've added 1 million members and expect to have approximately 2 million consumers in 2020.

In Medicare Advantage, we're pleased to have grown enrollment by nearly 20% in 2019 and remain confident that we will continue to outpace the market for the fourth consecutive year based on the value we deliver seniors through our highly attractive plan designs and supplemental benefits.

We also anticipate continued growth in our group retiree business. For 2020, we're enhancing our supplemental benefit choices, which are highly valued by seniors and include areas such as transportation, caregiver support and nutritional education, to name just a few.

These services are an addition to our already successful over-the-counter benefit in partnership with Walmart. Our efforts in this area are proving that Anthem's unique focus on whole person care is truly resonating with this important population.

As you know, our Medicaid business is well positioned for robust membership and revenue growth in the year ahead. Our partnership in North Carolina is expected to go live in the first quarter and will add approximately 400,000 members. Supplementing our strong organic growth, we look forward to working with our state partners to serve members in Missouri and Nebraska upon completion of the Centene WellCare transaction.

Our commitment to sustainability also remains a key focus for our organization. With that, I'm pleased to share that Anthem was named to the Dow Jones Sustainability Index for the second year in a row during this quarter.

This recognition acknowledges our commitment to responsibly address the challenges facing today's dynamic and ever evolving health care environment.

At Anthem, our focus on culture and talent continues to serve as our foundation for success. We are enhancing talents across the organization to support our focus on growth and improve our performance execution. We're not satisfied and know we can and will do more to improve Anthem's impact across the health care system for those we serve.

I will now pass the call over to John for a more a detailed review of our third quarter financial performance before concluding our prepared remarks with our initial assessment of 2020. John?

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

Thank you, Gail, and good morning.

As Gail stated, we reported solid third quarter financial results with adjusted earnings per share increasing 28% year-over-year to $4.87. Adjusted net income was $1.3 billion in the quarter, up 25% over the prior year.

In total, our consolidated operating gain grew by more than 22% over the prior year quarter.

During the second quarter, we shared with you our outlook for improved segment performance in the second half of the year. The Government Business grew operating gain by 35% in the quarter, while the Commercial Business grew by more than 11% compared to the third quarter of 2018. As you can see, not only did we deliver on our commitments, we generated substantial double-digit growth in doing so.

Operating revenue in the third quarter of 2019 was $26.4 billion, an increase of 15% versus the prior year quarter and 17% on a HIF-adjusted basis.

With our updated outlook, we now expect full year operating revenue of approximately $103 billion, with premium revenue now in the range of $94 billion to $95 billion. We are firmly on track to deliver our strongest year of organic operating revenue growth in over a decade.

The increase in operating revenue during the quarter reflects strong enrollment growth in our risk-based businesses as well as premium increases to cover overall cost trends. In addition, our results benefited from revenue related to the launch of IngenioRx and the growth in our specialty and integrated clinical offerings.

The medical loss ratio in the third quarter was 87.2%, representing an increase of 240 basis points over the prior year quarter. The increase was predominantly driven by the 1-year waiver of the health insurer fee.

In the quarter, reserves developed somewhat unfavorably, including favorable prior year development and unfavorable current year development. The unfavorable development totaled $50 million and was isolated to the Commercial segment. This included a few large groups that will be terminating later this year. The magnitude of the impact is immaterial, representing only 0.05% of our full year benefit expense, but it did impact the medical loss ratio in the quarter.

Overall, third quarter medical costs were well contained, and our Local Group medical cost trend is reaffirmed at our 6% plus or minus 50 basis points range.

It is important to note that the Medicaid MLR improved on a sequential and year-over-year HIF-adjusted basis despite ongoing disenrollment. We continue to expect further margin stabilization, but, given the magnitude of the Medicaid reverification challenge we faced in 2019, our full year MLR is trending in the range of 86.5% to 86.8%.

Our SG&A ratio was 12.9%, a decrease of 250 basis points compared to the prior year quarter. The decrease reflects our historically strong top line growth, coupled with a 1-year waiver of the health insurer fee. For the full year, we now expect our SG&A ratio to be in the range of 13% to 13.3%.

Turning to the balance sheet. Our debt-to-cap ratio was 40% at the end of the third quarter, which is consistent with our target range. During the third quarter, we successfully completed a debt offering for $2.5 billion at a weighted average coupon of 2.98% and a weighted average life of 15 years. I am especially pleased that our 10- and 30-year notes were issued at all-time record lows.

Efficient capital deployment and cost discipline remained top priorities. Earlier this year at our Investor Day conference, we committed to an opportunistic capital deployment strategy focused on sustainable, long-term total shareholder return. So far this year, we have announced plans for 2 strategic acquisitions, one of which expands our footprint in Medicaid, while the other deepens our clinical expertise in managing specialized populations.

Simply put, we are building our business and investing strategically.

We also committed to a capital deployment plan that would be both flexible and balanced. After careful consideration of the market environment, we made the decision to accelerate our pace of share repurchases in the quarter and take advantage of the broader market conditions.

As a result, we repurchased 2.4 million shares during the third quarter at a weighted average price of $266.52, and we now expect our 2019 share account to be in the range of 260 million to 261 million shares. Total share buyback for the year is expected to be between $1.6 billion and $1.8 billion, subject to market conditions.

Operating cash flow was $1.7 billion in the quarter or 1.4x net income, signifying high earnings quality for the quarter and representing an increase of $1.1 billion compared to the third quarter of 2018. The increase was primarily driven by membership growth in our Medicaid and Medicare businesses.

For the first 9 months of the year, operating cash flow was $4.7 billion or a solid 1.2x net income. As a result of our strong growth year-to-date and proactive efforts to better manage our cash and the timing of collections, we now expect operating cash flow for the full year to be greater than $5.5 billion.

2019 has been a productive year at Anthem. Despite the challenges we faced early on, we have made substantial progress, including the launch of IngenioRx, which is now expected to contribute at least $1 to full year adjusted earnings per share. As a result, we are raising our full year guidance and now expect our 2019 adjusted earnings per share to be greater than $19.40. We are wholly committed to driving the lowest net cost of care for our members while achieving greater diversification across our businesses, both of which are reflected in our double digit top and bottom line growth targets.

There is still one quarter left in 2019, and our focus is on driving sustainable long-term value in completing 2019 on our growth trajectory, enabling us to enter 2020 with positive momentum.

And with that, I will now pass the call back over to Gail.

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

Thanks, John.

As you've heard throughout this morning, we are growing on all fronts. Our revenue growth is strong, and we have made substantial progress in advancing our mission of driving higher quality care at the lowest net cost.

As we begin to shift our focus to 2020, the headwinds that we face are manageable, with tailwinds that lay the foundation for compelling long-term growth and far outweigh the impact from short-term challenges.

Our growth heading into 2020 is fueled by our commitment to precision and execution with an emphasis on sustainable value for our stakeholders.

As is customary, we will provide more detailed outlook for 2020 on our fourth quarter earnings call, but our initial view of 2020 contemplates the following tailwinds: the full year impact from IngenioRx; margin improvement in Medicaid; overall 2019 and 2020 membership growth; increased penetration of specialty and clinical programs in our fee-based businesses; and accretion from capital deployment.

These would be partially offset by margin normalization in the individual business, dilution from government contracts and Medicaid and growth in our group Medicare and the return of the health insurer fee.

At this early stage, our view on 2020 would point to core adjusted earnings per share growth through the low end of our 12% to 15% target growth rate relative to our original 2019 guidance. We continue to expect IngenioRx will produce total operating gain of at least $800 million or roughly $2.30 per share in 2020.

We're on track for another year of historically strong revenue and earnings growth, and we look forward to building on our momentum in the year ahead.

As I approach my second anniversary here at Anthem, I remain incredibly proud of the more than 60,000 associates, who are living our mission, vision and value every day in service to those who trust us with their care.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Ralph Giacobbe from Citi.

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

Just hoping you could start with providing a little more details on the unfavorable reserve development with -- within Commercial. And I know you quantified the impact in the quarter. How much of that sort of reflects the higher MLR outlook for the year as well? And then any details around that?

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

Thanks, Ralph. I'm going to ask Pete Haytaian to talk about our Commercial business, which we feel very strongly about, and then maybe John to tie up the overall MLR question.

Peter David Haytaian - *Anthem, Inc. - Executive VP and President of Commercial & Specialty Business Division*

Yes. Thanks for the question, Ralph. As it relates to our Commercial fully-insured business, earlier this year, we set up to do a couple of things. One, we wanted to grow our membership, and we wanted to improve our year-over-year operating performance. And I'd say with confidence that we've done both. Our year-over-year operating margins and performance has shown strong improvement, and you can see that through the release.

In addition to that, we've seen solid membership growth. In fact, in our large group fully-insured business, we've seen, in 9 of the last 12 months, net sequential growth. So we feel really good about that.

The in-year unfavorable development is really immaterial. We had a few large groups in being a Blue. We have some large fully insured groups. Well, we didn't have a meeting of the minds with, quite frankly, and so those groups are going to be moving on. And as it relates to our outlook, Q4 and into 2020, we feel very comfortable with our fully insured business.

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

And, Ralph, this is John. Thank you for the question, and I really appreciate the opportunity to provide a little bit of clarity. To be clear, Medicaid, and more specifically the Medicaid reverification process, is driving the entire increase in increasing MLR guidance. And I'll just give you a couple of proof points, if you'd like them, for your modeling and your information.

In some states, reverification efforts have minimal impact, but in others, we've seen disenrollment on the average of 2%, with states going as high as 4% disenrollment. In those same states, if you review the statutory filings from the first 6 months of the year for us and our peers, you'll see that the MLRs associated with those remaining populations are up on average 3% year-over-year, with some states being up as high as 5% year-over-year.

And as we have told you in the prior quarter call, reverification has impacted a little over half of our states at this point in time. And if you just take that 3% times half of our Medicaid block and apply it to our consolidated medical loss ratio, you'll see that the consolidated medical loss ratio would go up 50 basis points.

And then just another quick proof point, for your modeling purposes, is we've made commentary that we're at the low end of our target margin ranges associated with Medicaid for the year, associated with the lack of revenue on the reverification, the timely lack of revenue on reverification. And the difference between the midpoint of our operating margin and the low end of our operating margin, if you apply those dollars again to the medical loss ratio, you'll see that it would drive the consolidated medical loss ratio by about 50 basis points. So both of these things are just proof points to show that the entire increases associated with Medicaid. And that the commercial issue, which was only 0.05% of annual benefit expense, really didn't drive that guidance change. So thank you for the question.

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 one numbers question here, and then I'll ask my actual. The -- obviously, a lot of focus on 2020, so I just want to make sure I got the math right here. We start with around $18.20 of core EPS, right? That's the guide of $19 minus Ingenio coming into the year, and then add 12% to that or grow that by 12% gets us in the low 20s. And then we add back the entire Ingenio of $2.30, and you get somewhere between $22.50 and $22.60. I know that range is going to be wider than that, but is that about the right math?

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

Thank you, Justin. Thanks for the question. In terms of -- we're not giving exact guidance. As you know, we're giving headwinds and tailwinds. But as you think about your math, I'd say you're in the ballpark clearly to what we articulated at our Investor Day this past spring. So, yes.

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

That's helpful. And then my question was just a follow-up on Medicaid. Specifically, I know, as you said, things got better. So in the first half, you were running at the low end of your range, so let's say 2%. Can you give us an idea of what you're expecting to do in the back half of the year in Medicaid, back half of this year, and then how we should think about Medicaid into next year? What's in that 2020 number for a Medicaid margin, just so we can kind of have a starting point?

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

Yes, sure, Justin. Thank you. The low end of the target margin range for Medicaid is where we actually expect to be relatively close to for the entire year. But the second half is definitely going to be better than the first half in terms of 2019.

And then in terms of 2020, we do expect ultimately to be in the target margin range associated with Medicaid. Unfortunately, the timing doesn't always work out perfectly. And sometimes, it can take 12 to 18 months to get the appropriate rates associated with our negotiations and sharing of information with our state partners. And so we clearly have an expectation of improvement associated with Medicaid in 2020, but it's really premature to provide an exact percentage or where we are exactly in the range at this point until we get to the point that we'll provide a lot more guidance metrics on the fourth quarter call.

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

Yes. And let me just add to John's comment. I think, overall, in terms of Medicaid, we felt quite good about the conversations we're having, as he shared with you, in terms of the reverification and the data that we have.

We're working very proactively with our states. And again, this -- a lot of this comes down to timing and their cycle, but we feel quite good about what we've been able to achieve to date and also what we feel for 2020. So we're very positive about the overall Medicaid environment business going forward.

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*

Just maybe continuing to try to think about 2020 and what's in and what's not. It sounds like you guys were assuming again the public exchange, hix business normalizes margin. I know you had an assumption of a declining margin for 3 years in a row and continue to outperform it. Is that just conservatism? Or do you know something that would suggest that that's going to moderate?

And then in Ingenio, it sounds like you're assuming that you've got the same upside that you had originally forecast in terms of gain. It sounds like things have gone at least as well, if not a little better. Is there any chance of upside there?

And then finally, the Medicaid, just a follow-on to that question. Are you -- when you talk about what the margin for next year and what's assumed in that number, is that only what you have realized so far in terms of true-ups? Or are there more true-ups that are potentially on the table that you haven't yet realized that would be a potential upside?

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

So thanks for the multitude and multifaceted question, A.J,. I think you hit most of our businesses. So let me start with John and have him address the first part of it, and we'll see if we can go through it. Thank you.

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

Yes. No, thank you, A.J. So, yes, we do expect normalization of individual margins in 2020. And just as a frame of reference, in 2016 and 2017, we performed essentially at a breakeven basis in that line of business. We never really lost money on the exchanges, but it was essentially breakeven. And then we reduced our footprint quite dramatically in 2018 by some 65% and walked away from almost 1 million members and had an extremely successful 2018, and are having a very good 2019. We expect the margins to moderate in 2019, and they have, but not quite as quickly as we have assumed. Then you get into 2020, while the way that the MLR rebate rules work are based on a 3-year rolling average. And so the 2017 and '18, '19 rebates where they had the prior information in them with -- when we were much larger. And then you get to 2020, and with that 3 fairly good years, assuming that we hit our margin range is for 2020 and so that's going to actually limit the ability to have incremental upside.

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

Yes. In terms of IngenioRx, first of all, we're really pleased with the way the transition has gone and the migration of our members. As you saw, we upped our guidance, and that's really a result of both strong operational execution, but also greater certainty. And now, when we first gave it, we didn't know exactly when our state approvals would occur in Medicaid and Commercial and now, obviously, that we have certainty on. And again, as I shared in my opening remarks, really strong execution of the migration, probably one of the most complex migrations that has happened in the space. So we're really pleased about that. And we feel very good going into 2020 that all of our business will now be on that platform, and we can use our integrated capabilities and the digital things that we've advanced over the last years. So thank you very much for the question.

Operator

Your next question comes from the line of Ricky Goldwasser from Morgan Stanley.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

A couple of questions here. So just, first, a follow-up on what -- the unfavorable reserve development that you saw in the Commercial business. I understand that it's immaterial to the bottom line and not going to have an impact on the fourth quarter, but could you talk a little bit about what you're seeing in terms of the competitive marketplace, and how competitors are kind of like responding to the fact that you now have just better economics and ability to provide more affordable offerings? So that is question one.

And second of all, if you can give us any early read, now that the Medicare for 2020 plans are out there, how do you see the landscape and opportunities compare to before? And anything that surprised you?

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

Thank you very much, and we are going to try to limit to one question. I know we're getting multiple in, but we've asked that we just limit to one question. And let me ask Pete first to comment on the commercial marketplace competitiveness.

Peter David Haytaian - *Anthem, Inc. - Executive VP and President of Commercial & Specialty Business Division*

Yes. I think as it relates to our fully insured business, it remains a competitive marketplace and remains a rational marketplace. We're really excited about our positioning. We've talked before about our segment positioning and our product portfolio and the options that we're creating in the marketplace, and we are seeing an uptick there in terms of performance. And we continue to see growth, as I mentioned before. 9 out of the last 12 months, we've seen net positive growth.

The one thing that we are seeing in the marketplace today, and that is with the addition of Ingenio and other capabilities that we have, we are seeing the market have a bit of inertia, both of them more than we expected. And what I mean by that is retention rates are really, really strong for us and for our competitors.

Our sales close ratios are improving, and it has to do with our sales effectiveness. So we feel really good about all that. But we are seeing a little bit less movement in the marketplace, a little bit more stickiness with the membership. And so a little bit slower rates of uptick. But other than that, we feel really good about our positioning in the fully insured marketplace going to 2020.

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

Yes. And I guess what I would just add to Pete's comments, I mean, we've had really solid growth. We think it's a disciplined market. It's always been competitive. We are very happy with the solid retention rates we're seeing. And we've invested quite heavily in that business, both in product offerings. So we feel well positioned for 2020 with a variety of affordable options, particularly in our small business area.

And as I shared, we're seeing great traction in our largest clients, who are really our most sophisticated, and are really valuing the innovation that we've brought to the market.

So overall, as Pete said, a very, very -- we feel very strongly about the Commercial business right now. And maybe, Felicia Norwood can address the Medicare question you had as well.

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

Sure, Gail, thank you. And, Ricky, thank you for the question. We feel very good about our positioning in terms of our portfolio on the Medicare side as we head into AEP. As you know, we're about, what, day 9 into this, but the feedback has been incredibly positive from our distribution channel and our brokers.

In 2019, as you know, we were one of the first plans carriers to really make a strong investment in supplemental benefits. We believe that these are differentiating characteristics in the market with respect to our seniors. And we've seen great receptivity to the benefits that we have out there. This is particularly true with respect to our over-the-counter benefit with Walmart, which has brought great cost advantage and affordability to seniors. So as we head out into AEP, the competitive positioning is strong. We've enhanced our supplemental benefit offerings this year as well, so we are very bullish about our expectations with respect to the 2020 selling season in Medicare.

Operator

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

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

Maybe just following up on that, Ingenio and the Commercial market, but maybe a broader question across all of the products. With the savings that you got for 2020, how much of that benefit could you flow through immediately into 2020? Just trying to get a sense of what has 2020 -- your fully updated view on pharmacy costs and the growth that you got or will get in 2020 kind of reflective of what that new base is? Or did you -- because of the transition, for whatever reason, kind of slowly build that into the pricing, so that we should expect the multiyear benefit from membership? And did you treat Medicare or Commercial any differently as you thought about pricing that benefit through to the customers and the pace of that timing?

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

Yes, sure. Thanks, Kevin. This is John. And if I understand your question properly, the benefit in 2020, as we know that the value that we're obtaining from Ingenio is approximately $4 billion, actually slightly greater than $4 billion versus what we would have paid with our prior carrier, and that we're going to take 20% of that and drop to the bottom line, which is the $800 million that was part of Gail's prepared comments, which is the $2.30 of EPS. And then the $3.2 billion is being baked into either benefit design or more affordable pricing or other options that flow straight through the customer.

In terms of the timing of all that, we really did not let any of that of substance go through in 2019. 2019, for the majority of the year, we are still under the ESI contract. And the pricing that we have with our book really did represent the pricing of the pharmacy costs that we are employing.

So don't overread into or overanalyze the 2019 versus the 2020. The Ingenio is providing about a $1 of benefit in '19 and is going to provide about $2.30 in benefit in 2020. And that $2.30 is now run rate.

Operator

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

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

I think the unfavorable development sort of situation seems like an isolated issue, but it sounds like you wouldn't have had a favorable development on the Commercial business, excluding the large group you mentioned. I don't want to put words in your mouth, but that's sort of the message that I felt like we're hearing. And so, I guess, typically, we'd expect some favorable developments. So just looking for any color you could provide in the balance of the business. And as your view sort of Local Group trend at this point that have sort of accelerated through the first 9 months of the year, we're realizing you reiterated your outlook, but any color maybe in the -- on where you might land in the range? That could be helpful as well.

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

Yes, sure. Thanks. And in terms of the development, we did have favorable prior year development. The development that we referenced was current year or in year. We usually don't talk about that, but since it was a -- did impact the MLR slightly, and it certainly had impacted the Commercial operating game growth. Commercial grew 11% quarter-over-quarter. Commercial expanded their margins by 0.3% quarter-over-quarter, and that was in spite of this negative development. So really, what it points to is the fact that the Commercial business is even stronger that it may appear initially.

So -- but we did have favorable prior development. We certainly have a consistent, conservative reserving methodology that we will expect to employ.

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

I guess I would add to John's comments that our commercial growth is very solid, and we have very healthy margins. And I think as you look at our margins overall, we feel very good about the Commercial business. And again, the amount of reserve development is fairly minor, but we felt that we would point it out, and I think exactly as a Pete addressed that, that's really the driver. So we wanted to give you some clarity on that.

Operator

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

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Research Analyst*

I was hoping you could maybe give us a sense of how things look as you're going into January 1 in terms of -- I'm not looking for guidance for the year, just a sense on the January 1 national account changes and how you think you did in that progress. And whether the very strong retention rates that you referenced earlier, is that playing out in that market as well?

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

Great. I'll have Pete address that question.

Peter David Haytaian - *Anthem, Inc. - Executive VP and President of Commercial & Specialty Business Division*

Yes, thanks, Matt. Great question. We're obviously in the late innings. We're sort of the ninth inning of the selling season at work. As it relates to 2020, there are some minor puts and takes, but it's almost complete. And we feel very good about our positioning in our results. We had a good year this year. And going into 2020, we think we're going to have a very strong year as well as from a growth perspective and a retention perspective. Most importantly, and as Gail pointed out in her prepared remarks, we feel really good about our value proposition and how that's playing out in the marketplace. But things like our total value story and clinical programs and advocacy programs like Total Health, Total You, which we've just recently launched with differentiated AI capabilities and care management capabilities, we already have over 1.2 million members in that program. We feel really good about our consumer engagement platform and the work that we've done historically through Engage, and now we've launched rolled out the new Sydney digital platform and ecosystem. And our Anthem Health Guide, from an advocacy perspective, really, really performing well and resonating in the marketplace with over 8 million members in that, with MPS scores that continue to improve. So our value proposition's playing out in the market. We will have a strong Q1 with respect to growth in our national business.

Operator

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

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

I'd like to drill down a little bit more on the commercial development, unfavorable development. What exactly caused the unfavorable development? Was it a provider specifically that was higher cost? Was it a product type that was higher cost? Was it some geography? How -- I'd love to drill down and understand what exactly caused that. I know you said it's a couple of accounts, but I want to understand more.

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

Yes. Pete, this is John. That's not the type of information, for competitive reasons, that we're really going to go into on this call, especially given the fact that those accounts have terminated once we determine what actuarially justified rate increases would be. Let's just say that we understand what the causes were. We price the forward trend. We feel very comfortable that this issue has been taken care of. And we feel very bullish about our aspects, but we really can't get into the level of granularity for competitive reasons that you're talking about.

Operator

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

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

I just want to go back to the really strong government operating income growth, which was up 35% year-over-year. And when we initially saw that number this morning, we presumed some of the retro price increases or the acuity mix really had come through and driven that. But it's not what you cited in the release. You said still cost -- primarily it's been by cost performance. And on the call, you have said still what you're getting from states in terms of rates was not quite as good or as you had anticipated. So I just wanted to understand that was there not material benefit from some of those acuity true-ups happening in the quarter? And if not, what was really the source of the cost performance?

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

Well, thank you very much for the question. I think there are certainly a couple of things embedded in that question. The first is that 2018 was well. As you think about the comparative from 2018 to '19, and as you go back to our call in that quarter, so you're comparing, I think, quite frankly, a below baseline 2018.

So there isn't anything unusual in this quarter for 2019 in our Government business. We have made a lot of progress on getting the rates that match the population, so we feel really good about that. But as you know, this is a complex business with geographies and a population mix. And so we still feel that there's a lot of runway. And we're having those conversations in our states, and we are making progress. And we are seeing it flow through, but we didn't have a giant retro payment or anything of that sort to point to in this quarter. But we did see improvement in rates, and we are seeing improvement in the overall management of the business.

So I guess the summary answer to the question is the comparison, we like where we're heading, but we also believe we have a lot more runway. And the conversations are quite productive with our states, and we do feel confident, but, again, we can't absolutely predict timing.

Operator

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

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

So just on the topic of Medicaid membership, over and above the shifting of Medicaid enrollees in the Commercial plan, that's been talked about previously, I guess I'm just curious if you can comment on the public charge rule that could create some extra volatility around Medicaid enrollment. I know in light of some federal courts turning the rule, do you think just the notion of this could still be material for Anthem either in late '19 and into 2020?

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

I'll ask Felicia to comment.

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

Thank you for the question, Steve, and good morning. In terms of the public charge rule, we haven't seen a material impact on our business year-to-date. However, the rule is still pending. We will continue to monitor this with our state partners. And certainly, because of the unknowns, we are cautiously optimistic that we're going to be able to work closely with our partners as individuals are going through this process.

This, in some respects, is akin to some of the things you see with respect to reverification. And one of the things that we've been able to do with our state partners is to try to understand early on individuals who have been impacted or maybe impacted and have an opportunity to work with individuals to maintain their eligibility. So thus far, we haven't seen a material impact on our business. But as I said, it's still early, so we will continue to monitor this and work closely with our state partners throughout this process.

Operator

You next question comes from the line of Lance Wilkes from Bernstein.

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

Could you talk a little bit about the partnership strategy with the other Blues that are out there and what you're seeing as far as progress in Medicaid joint ventures, Medicare Advantage, cross-sales especially? And do the other Blues have any sort of change perspective or greater sense of urgency in any of this, given the political dialogue and concepts like public option, et cetera?

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

Well, thank you for the question, Lance. As you know, we shared that we are working quite closely with our Blue partners across a variety of opportunities. And we're very pleased with the partnerships that we have in Medicaid. We have 8 alliances today. 5 are with our fellow Blue Cross Blue Shield partners. We're also adding additional partnerships. We're adding a Medicare partnership in Louisiana, and we're adding a partnership in Maine with the Maine Health system. So it's broader than just the Blues. I know your question was more specific to the Blues.

As you saw, we announced that Blue Cross of Idaho will be an IngenioRx customer. So there's another great example. So more broadly, I think we are having a broad array of capabilities both through Medicaid, but also through our diversified business group. Our AIM business and our CareMore businesses work across the spectrum. North Carolina is a great example, where we are doing a partnership with Blue Cross Blue Shield in North Carolina for Medicaid. Our CareMore business will be building clinics in that environment as well, and then IngenioRx will be the PBM. So to me, that offers a really great glimpse of the ability to package things across the Blues.

In terms of overall, I think, as a system, we're intensely focused on affordability and costs and access for the 1 in 3 Americans that we serve across Blue Cross Blue Shield plans. And I think you saw hopefully many of the Medicare focus in advertising about the Blue Cross Blue shield brand this past year. So I think what you're seeing is that we recognize that rule we have in the American health care system. And by working together, we can do a lot more to have an impact on the system. So thanks very much for the question, but we're very, quite frankly, bullish and excited about the opportunities that -- as a Blue system, the impact that we can have across America.

Operator

Your next question comes from the line of George Hill from Deutsche Bank.

George Robert Hill - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

Just to piggyback on the one that Gary asked earlier. If we think about the expected Medicaid margin improvements in 2020, how much of that is dependent upon the risk or acuity adjustments coming through? And, John, I think you talked a little bit about the timing of those tending normally 12 to 18 months, so that would kind of coincide with it kind of seeing the issue in Q2 of next year and it's starting to wall through into 2020. And I'd say, just am I thinking about that right?

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

Yes, sure. George, it's a very good question. And in terms of exactly how much is related to the reverification, well, it's certainly a piece of it. But just to be clear, every year, we go through with actuarially justified rates and have rate renewal -- site rate renewals and negotiations with our states. And so, obviously, hitting our target margins requires getting from our portfolio of states that we have of getting the right rates on an overall basis.

Clearly, part of that conversation is around reverification. But that's not the entirety of the conversation. The conversation is really about actuarially justified rates based on the acuity of the population regardless what the starting point is. So in one regard, getting the right rates is the entire issue, but it's not just reverification.

Operator

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

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

Question around the Medicare Advantage stars. I know you mentioned in your prepared remarks that there's a focus on improvement, et cetera. And as we kind of look through the metrics, it looked like drug experience, drug safety, categories like that were the ones that showed the biggest declines. So I know there's a huge delay. And so as Ingenio kind of ramps up in '19 and in into '20, is there an opportunity, you think, to improve things for next year? Or is this going to be a multiyear sort of fix? And as you guys dug in, there are certain metrics that you think you can control shorter term around the MA stars?

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

Thanks for the question, Josh. As you can -- you clearly identified some of the areas that we've focused on as well. In terms of your question, as I said, we are disappointed in the results, and we dug in very deeply to figure out where we can have an impact. Last year, we did make an impact in moving one of our largest contracts, a 4-star with that intention of focus. But we know, this year, part of the issue was just the timeliness of data and our ability to have an impact on some of the members in those clinical pharmacy plans. Now that we will move -- we will be moving our entire Medicare Advantage business on 1/1, we're already very engaged in having an impact. So, yes, we do believe we can have an impact, not only on clinical, but we also believe in some of the other metrics where we did make improvements on HEDIS, for example. In many of our markets, we still have opportunities there with better data and integration of the data that I shared with you earlier. And then certainly in some of the consumer metrics, we feel that as part of our end-to-end focus on execution across our businesses that there's opportunity there. So, yes, we absolutely believe we can have an impact on pharmacy. Now owning pharmacy, 100% under our own control, we really do believe that would be a multiyear opportunity for us to dramatically expand that. So you hit the core, but as we look at our results this year, the biggest disappointment was in those clinical pharmacy results, which declined. So thank you very much for the question.

Operator

Your next question comes from the line of Scott Fidel from Stephens.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

A question just is on group Medicare Advantage, and instead if you could just update us on margins on the class of 2019 business of progressing relative to plan. And then relative to 2020, I know that you talked about expect a continued growth in group MA. Just interested if you could maybe help sort of size of that or just sort of how that's trending relative to the long-term trajectory that you provided for us at Investor Day.

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

All right, sure. Thanks. Pete -- I'll have Pete share some perspective on the group Medicare market.

Peter David Haytaian - *Anthem, Inc. - Executive VP and President of Commercial & Specialty Business Division*

Yes. Thanks, Scott. Appreciate the question. As you know, we saw some really nice growth in 2019 in the group retiree business, and we do expect growth to continue into 2020.

As we've said before, and we're seeing this come through, our greatest opportunity continues to be with respect to our inherent pipeline of existing commercial clients that have Medicare-wrapped product. And so we're seeing really strong sales there.

As it relates to new store sales and RFPs, the market continues to be really competitive. And we do win some business there as well, but we're also looking at creating new opportunities. The question was asked before about Blue partnerships, and we see this as another wonderful opportunity for Blue partnerships, and we're actually exploring those. And then, finally, I'd say having a competitive pharmacy benefit will certainly help in 2020 and beyond as it relates to upcoming bids in group retirees. Overall, we feel good that we continue to see growth in that space.

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

Right. And that business is dilutive. More for insight, it takes 12 to 18 months of dilution. And so it continues to be a headwind until we get the block of business to an appropriate level.

Operator

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

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

Josh asked my earlier question. I'm going to ask a follow-on to that. On -- I'm thinking about those MA stars and improving that investments in quality. As you think about the $3.2 billion that you have to essentially reinvest in the business, how would you -- if you'd be so kind as to tell us, how would you think about allocating that between the benefit design and price point references that I think John gave earlier? And then how much would quality investments like stars consume of the $3.2 billion?

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

Well, we haven't broken it down in that way. And I guess, as we think about this, we're investing heavily in pharmacy, just so you know. I mean, it's not just the benefit of the impact of the earnings that we get because of the lower cost of goods sold, which is really driving that $4 billion. That is fundamentally a lower cost of goods sold. But as part of bringing IngenioRx up to speed and the migration, we've built a new integrated specialty clinical service center, which has areas of excellence around these areas that I think will absolutely help our clinical performance in pharmacy.

And again, we know what we need to do. And we have a very clear line of sight around what the opportunities are in pharmacy, and we feel very confident in our ability to have an impact on those. As you think more broadly about pharmacy, I think has John shared with you how we're approaching the $3.2 billion, and it's very different based on each of our lines of business and where we work competitively and how that aligns with plan designs, et cetera. So it's not a straight-line formula, but, clearly, pharmacy gives us a tailwind as our opportunity in Medicare Advantage and helps us offset some of those impacts from stars.

Operator

Your next question comes from the line of Sarah James from Piper Jaffray.

Sarah Elizabeth James - *Piper Jaffray Companies, Research Division - Senior Research Analyst*

I was hoping you could talk about the DBG selling process beyond Ingenio. Just wondering how long the selling process is to better understand how strong the line of sight is into the near-term sales. And from conversations so far, do you have a sense of what the near-term product mix could look like over the next couple of years?

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

Well, thank you for the question, Sarah. I think, broadly, as you think about any group of services businesses, the selling cycles very much vary. Our AIM business has been in the market for a very long period of time. Aspire has a very mature sales cycle, and CareMore also is working as part of very much not just in the integrations that we mentioned and the partnerships we have, but they've been actively talking to our Blue partners about areas where they can help.

So it isn't a definite, but I'd say, generally, as you think about pharmacy, it's 12 to 18 months at least lead time. As you think about large-scale projects bringing up a new CareMore site, you're usually talking 9 months plus in terms of the procurement and the discussion. AIM is the shorter sale often because we can deal with closer capabilities. And we're really excited about bringing Beacon into the family in the fourth quarter because we also believe that provides some really unique capabilities.

So overall, as we shared, our diversified service business is a growing business. It's something over the next 3 to 4 years you're going to see much more significant traction. But quite frankly, we are seeing progress in sales already. And we feel really good about that, but I would say at least 12 to 18 months is the lead time in terms of the conversations and the procurement, just given these are fairly large sales that we're talking to people about. But thank you very much for the question, and we're very much looking forward to sharing more about DBG as we go forward.

Operator

Your next question comes from the line of Michael Newshel from Evercore ISI.

Michael Anthony Newshel - *Evercore ISI Institutional Equities, Research Division - Associate*

For exchanges in 2020, can you frame the magnitude of any geographic reexpansion you're planning, and whether that kind of revenue growth could be any meaningful offset to the margin normalization you talked about?

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

Pete, please?

Peter David Haytaian - *Anthem, Inc. - Executive VP and President of Commercial & Specialty Business Division*

Yes, sure. Thanks for the question, Michael. We're pleased with our individual performance and progress. And I think our strategy really remains the same with respect to expansion. We're disciplined and we're targeted in terms of where we play. We've talked about this before, but it's been largely based upon geographies, where we can partner with key providers at the right economics and, in partnership on delivering really strong cost of care, partnering with providers and being aligned on risk adjustment. And in many instances, we're focused on, obviously leveraging our value-based care relationships.

And of course, then, importantly, we have to be positioned well with respect to our product and being #1 or #2 as it relates to the right product. And this has translated into good results for us, as we talked about earlier, a bit better than expected. As we continue down this path and in 2020, we're continuing to target expansions. We do see pockets where, competitively, some of our competitors are a little bit better positioned. And if that's the case, we're going to remain disciplined, and we're not going to participate in those markets in which we can't do what I said before, and that is part of what providers and have the most competitive products. So we feel like we're continuing down the path of being very methodical and thoughtful about that business, and we'll continue to grow that business in the right way.

Operator

And your final question today comes from the line of Charles Rhyee from Cowen.

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

Just to clarify earlier some of your comments, John, around -- and, Gail, around the Commercial business, these few accounts. And I know you didn't want to get too much into it, but the reason for termination, it sounds like you're saying, is because when you repriced the business for them, those are rates where it just didn't match up with what, I guess, the clients had wanted. But did that factor in also what expected savings that you would have been able to generate for them through Ingenio? And just to be clear that there shouldn't have any impact on how your Commercial book is pricing for next year?

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

Well, let me start, and then I'll ask John to follow up. First, in terms of the last part of your question, no, we feel really strongly. I mean, we reaffirmed our trend. We feel very strongly about our book of business. And the Commercial business is performing. Our margins are good. They're improving. And honestly, outside of even just risk, we're adding a lot more of specialty products and bringing through revenue and our clinical products. So overall, no, you shouldn't read into anything about our Commercial business.

In terms of your second question, maybe I'll have John answer that one because I don't think that there's much more to add, but...

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

Yes, sure. Thank you, Gail. And in terms of the impact on the overall Commercial book, really, there is not any -- our prior guidance did assume that these members would stay with us for the rest of the year. So it was a difficult decision. So there will be a slight impact on our year-end membership. However, associated with our pricing, with our growth outlooks, with our competitive position in each of our markets, there's really no change. We feel very good about our commercial business strategy and the ability for Pete and the team to execute that, and think that 2020 is going to be another growth year for us. So thank you.

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

Thank you very much for all of your questions. And I'd like to thank everyone for hanging in there this morning while we dealt with the phone issues, but we're happy that we're able to address all of your questions and still get everyone through the lines.

As you can see, we remain committed to delivering a simple, more affordable and personalized experience for those we serve, and I look forward to building on our momentum in 2020. I want to thank our associates for their ongoing commitment to serving our nearly 41 million members, and I look forward to speaking with all of you again soon. Thank you.

Operator

Ladies and gentlemen, this conference will be available for replay after 11:00 a.m. Eastern time today through November 6. You may access the AT&T Teleconference Replay System at any time by dialing 1 (800) 475-6701 and entering the access code 432048. International participants dial (320) 365-3844.

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