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OVERVIEW:

Company Summary

REFINITIV

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Elevance Health Fourth Quarter Earnings Conference Call. (Operator Instructions).

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

Stephen Vartan Tanal - *Elevance Health, Inc. - VP of IR*

Good morning, and welcome to Elevance Health's Fourth Quarter 2023 Earnings Call. This is Steve Tanal, Vice President of Investor Relations. And with us this morning on the earnings call are Gail Boudreaux, President and CEO; and Mark Kaye, our CFO; Peter Haytaian, President of Carelon, Morgan Kendrick, President of our Commercial Health Benefits business; and Felicia Norwood, President of our Government Health Benefits business.

Gail will begin the call with a brief discussion of the quarter and year and recent progress against our strategic initiatives. Mark will then discuss our financial results and outlook in greater detail. After our prepared remarks, the team will 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, elevancehealth.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 Elevance Health. 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 in our quarterly filings with the SEC. I will now turn the call over to Gail.

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

Thanks, Steve, and good morning, everyone. Today, we're pleased to share that Elevance Health delivered a strong end to 2023. Demonstrating our ability to execute with agility and the balance and resilience of our enterprise. In the fourth quarter, Elevance Health delivered GAAP diluted earnings per share of $3.63 and adjusted diluted earnings per share of $5.62.

For the full year, we reported GAAP diluted earnings per share of $25.22 and adjusted diluted earnings per share of $33.14. 2023 marks the sixth consecutive year in which we grew adjusted diluted earnings per share within or above our 12% to 15% long-term target growth rate with a compound annual growth rate exceeding the high end of the range. This reflects the ongoing execution of our strategy to accelerate capabilities and services, invest in high-growth opportunities and optimize our health benefits business.

In 2023, we made significant strides building upon our flywheel for growth. Carelon has and will continue to add attractive capabilities that we can scale rapidly and sustainably over the long term. For example, just a few weeks ago, we announced the acquisition of Paragon Healthcare, a company specializing in infusible and injectable therapies. The acquisition expands our capabilities catering to consumers with complex and chronic needs, who can benefit the most from our approach to whole person health.

Infusion Services will complement our suite of pharmacy services which today include a fast-growing specialty pharmacy business and our advanced home delivery service, which launched at the beginning of this year. Carelon Services is poised for strong growth in 2024 with the onboarding of new clients and continued expansion of services provided to Elevance Health medical members, including the rollout of risk-based oncology products and Carelon Insights as well as the launch of comprehensive Carelon Behavioral Health management services to address the whole health needs of Medicaid beneficiaries living with serious mental illness.

Turning to our health benefits business. 2023 marked another strong year despite a dynamic operating environment. Performance was led by the optimization of our commercial business, where our operating margins continue to recover from pandemic [Aero lows], which will continue into 2025. Commercial customers prioritize affordability, experience and simplicity, and we're delivering on all fronts.

In 2023, we launched a series of initiatives designed to improve and simplify the customer experience, including our associates' ability to better serve our members through the integration of AI support and natural language processing, which has significantly improved first call resolution, in addition to enhancing our claims auto-adjudication rate. We're also broadening the use of AI to automate certain aspects of our provider directory and other administrative processes, which have improved data accuracy in consumer and provider experiences.

Momentum in our national accounts business is a direct result of the unique and differentiated value we offer to large employers. We continue to consolidate business with existing clients, achieving excellent retention and winning over 75% of employers, who ultimately switch carriers despite a smaller pipeline of new accounts for 2024.

In our individual business, we positioned our products thoughtfully to drive profitable and sustainable growth, and we're pleased with our performance in 2023. We're looking forward to even stronger membership growth this year as we focus on maximizing access to care for redetermined Medicaid beneficiaries. Our relentless focus on affordable products, superior customer experiences and simplicity is yielding strong results.

After growing commercial membership by over 400,000 members last year, we are poised to grow by another 750,000 in 2024. Medicaid eligibility redeterminations remain ongoing, and in many states have accelerated their redetermination processes. To date, over 70% of our members, who lost Medicaid coverage were unenrolled for administrative reasons. This is a challenging reality for many families, but we're encouraged that we are nearly 2/3 of the way through the process. With close to 30% of those unenrolled before September 1, having reenrolled in an Elevance Health product. Our research indicates that many unenrolled members are facing barriers to reenrollment including awareness of the process and required actions to maintain coverage.

To address this, we're executing an extensive renewal campaign and have reached over 3 million people with our omnichannel approach as we remain committed to supporting them as their trusted health partner. Despite accelerated membership attrition from redeterminations to date, our Medicaid business is performing well. Grades remain actuarially sound for the members we are privileged to serve, and we are innovating to meet their needs. For example, in 2024, we will expand our community connected care model into 8 additional states. This program assists Medicaid members with their health-related social needs by identifying gaps and connecting members to support services in their communities.

We will also launch a program in alliance with the affordable connectivity program, major wireless carriers and Samsung that will help increase equitable access to digital and virtual health tools. The program will provide eligible Medicaid members with a curated selection of digital and virtual health tools via smartphone with no data cap at no cost along with training materials and ongoing guidance on how to use these tools.

Strong performance in 2023 allowed us to invest for the long term. In the fourth quarter, these investments were concentrated in Medicare, where we remain intensely focused on building a strong foundation for sustainable long-term growth. This includes improving our star quality ratings and driving profitable growth in markets, where we know we can win over the long term. Unfortunately, pockets of the Medicare Advantage market have remained hyper competitive despite a more challenging funding environment. While our plans continue to offer attractive and valuable benefits, we took intentional actions as part of our 2024 bid strategy to address product sustainability, and as such, we experienced greater-than-expected attrition in certain markets.

As a result, we expect our Medicare Advantage membership to be roughly flat in 2024 on an organic basis, but earnings to improve. Importantly, cost trends in our Medicare Advantage business continued to develop as we expected, and we are confident that the assumptions underlying our bids for 2024 are appropriate.

With respect to [Stars], we have now fully implemented -- my Health Advocate our comprehensive personalized customer service model for Medicare. This has improved the experiences for our members, helping them to easily navigate the health care system and their plan benefits. Early proof points reflect an improvement in first call resolution, a key indicator of future quality performance for our Medicare Advantage plans. We are confident that we have a solid foundation in our health benefits business, from which we will grow Carelon for the long term with many of the building blocks in place to accelerate our enterprise flywheel for growth.

We are positioned to deliver another year of strong earnings growth in line with our long-term target in 2024, while continuing to invest in our future. We expect adjusted diluted earnings per share to be greater than $37.10 this year, reflecting growth of at least 12% over 2023. Finally, advancing Health Equity is foundational to our efforts to improve the health and lives of the individuals and communities we are privileged to serve.

Our industry-leading approach received renewed recognition when the National Committee for Quality Assurance awarded its newly established health equity accreditation plus to 20 of Elevance Health affiliated Medicaid health plans covering over 90% of our Medicaid members and making us the only national plan to have received this distinction to date. We also saw excellent progress on our ambitious goal to improve maternal health equity by reducing the disparity in preterm birth rates between black and non-Black communities, improving the disparity gap by 5.2% relative to our 2022 baseline.

In closing, I want to express my gratitude to our extraordinary team of over 100,000 associates. It is their collective passion and hard work that enables us to deliver on our commitments to all of our stakeholders. This past year alone, our associates logged over 225,000 volunteer hours in our communities, a record high for ElevanceHealth. This remarkable achievement reflects our deep dedication to making a tangible positive impact on the lives of the people we are privileged to serve and for the communities we call home.

As we move forward, we will remain focused on serving our members as their lifetime trusted health partner. With that, I'd like to turn the call over to our new Chief Financial Officer, Mark Kaye. Mark?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

Thank you, Gail, and good morning. I am pleased to join you for my first earnings call as CFO of Elevance Health. As Gail shared, we delivered strong results every quarter of 2023, including in the fourth quarter, which was marked by solid top and bottom line growth and significant progress in the execution of our enterprise strategy to accelerate capabilities and services, invest in high-growth opportunities and optimize our businesses.

Fourth quarter adjusted diluted earnings per share of $5.62 and full year adjusted diluted earnings per share of $33.14 were ahead of expectations. Since 2018, Elevance Health has achieved a compound annual growth rate of nearly 16%, surpassing our long-term target range of 12% to 15%. Operating revenue exceeded a $170 billion in 2023, up 9.3% year-over-year driven by growth in both our health benefits and Carelon businesses.

The benefit expense ratio was 89.2% for the fourth quarter and 87% for the full year, representing an improvement of 50 basis points and 60 basis points respectively, compared to the prior year periods. This was primarily driven by premium rate adjustments in recognition of medical cost trend, most notably in our commercial health benefits business.

The adjusted operating expense ratio was 11.6% for the fourth quarter, up 20 basis points compared to the prior year period, driven by accelerated investments made in the quarter, notably in network quality, value-based care and customer experience initiatives designed to address key priority areas for Medicare Advantage stars. For the full year, the adjusted operating expense ratio was 11.3% flat year-over-year. Operating cash flow was $8.1 billion in 2023 or 1.3x GAAP net income. This includes the benefit of approximately $300 million of state-based payments for 2024 dates of service that we received in the fourth quarter and which will correspondingly impact operating cash flow in 2024. We ended the year with a debt-to-capital ratio of 38.9% in line with our targeted range.

Giving confidence in our outlook, we took advantage of market volatility during the fourth quarter to accelerate share repurchases, specifically, we repurchased 2 million shares of our common stock for $929 million, bringing total share repurchases for the year to 5.8 million shares at a total cost of $2.7 billion. Our health benefits business ended the year with approximately 47 million members, a decrease of around 570,000 year-over-year driven by attrition in Medicaid associated with eligibility redeterminations, partially offset by growth in our commercial fee-based membership.

Today, we are 7 to 8 months into the Medicaid redetermination process. And while there is significant variability by state, we believe that nearly 2/3 of our members have had their eligibility evaluated. Of those unenrolled, approximately 70% have lost coverage due to administrative reasons. And we have also seen an elongation in the time some beneficiaries have taken to reenroll into Medicaid, while others have transitioned on to an ACA exchange plan.

As Gail noted, we are executing an extensive renewal campaign to maximize continuity of coverage. Accordingly, we expect reenrollment into Medicaid continue through at least 2024 and for growth in ACA exchange plans to accelerate. This has been incorporated into our membership guidance ranges for 2024. Turning to our financial outlook for 2024. We are pleased to provide initial guidance for adjusted diluted earnings per share of greater than $37.10, reflecting growth of at least 12% year-over-year. We are focused on optimizing our health benefits business, including through the ongoing margin recovery of our commercial risk-based business, the strategic repositioning of our Medicare Advantage plan offerings in certain markets and the transformation of our cost structure.

Further, we are investing in high-growth opportunities with a focus on establishing a foundation for sustained long-term growth. We will scale Carelon's existing capabilities and add new ones in 2024 driving incremental earnings growth and accelerating our enterprise flywheel for growth.

The momentum in our commercial health benefits in Carelon businesses is partially offset by the Medicaid membership headwinds included in our guidance. We anticipate total medical membership to end 2024 in the range of 45.8 million to 46.6 million down approximately 750,000 year-over-year at the midpoint. Medicaid membership is expected to end the year in the range of 8.8 million to 9.2 million members, with attrition driven by the net loss of approximately 930,000 members associated with changes in our footprint discussed on our third quarter earnings call and ongoing eligibility redeterminations.

Commercial membership is expected to grow by ov750,000 at the midpoint, ending the year in the range of 32.4 million to 32.8 million members. This includes over 300,000 net new risk-based members and approximately 400,000 net new fee-based members collectively driven by new business wins and strong client retention reflecting our resolute focus on customer affordability, experience and simplicity. Medicare Advantage membership is expected to end the year approximately flat.

As a reminder, we took intentional actions as part of our 2024 bid strategy to improve the sustainability of our product offerings. And given unexpected competitive dynamics in certain markets experienced greater-than-expected attrition. Nonetheless, these actions will help establish a strong foundation for profitable and sustainable growth over the long term.

And we remain confident in the outlook for utilization and medical cost trends embedded in our 2024 bids. Finally, we expect our Medicare supplement and federal employees' health benefits membership to remain relatively stable year-over-year. On a consolidated basis, operating revenue for 2024 is expected to be flat to up low-single digits. We project operating earnings for the year to be at least $10.3 billion, reflecting 9% growth with contributions from both our health benefits and Carelon businesses, disciplined benefit management and the successful execution of our 2023 business optimization initiatives.

Please note that our guidance metrics do not include the impact of pending M&A, even though we have several transactions we expect to close at this year. Earnings seasonality is expected to be relatively consistent year-over-year with slightly more than 55% of our full year adjusted diluted earnings per share in the first half of the year and more than half of that expected in the first quarter.

Finally, I'm pleased to announce that our Board of Directors recently approved a 10.1% increase in our regular quarterly dividend, raising it to $1.63 per share. This marks our 13th consecutive annual dividend increase, underscoring our commitment to delivering strong results for our shareholders and the value of our balanced and resilient business model.

In closing, 2023 was a strong year for the company, and I'm looking forward to working alongside the talented and dedicated team at Elevance Health to deliver on our financial targets. I look forward to meeting all of you in 2024. And with that, operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) For our first question, we'll go to the line of A.J. Rice from UBS.

Albert J. William Rice - *UBS Investment Bank, Research Division - Analyst*

Welcome on board, Mark. Congratulations to the company for another year of meeting the growth targets, and I know it's early to talk about this, but maybe you'd have to take some steps today to ensure your positioning. With 2025, you'll have the Star ratings impact to overcome.

Or when you think about that, will the company do anything differently? How do you think about the levers you have to push to offset what appears at least on the surface to be a couple percentage points of headwind from that Star ratings impact. We step up share repurchases, accelerate investments in Carelon -- how do you think about that at this early date and the ability to sustain that 12% to 15% even into next year?

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

Well, thanks for the question, A.J. There's a lot in there. And as you know, '25, it's a little early to point on '25, but I'd like to give you at least a little bit of color on how we're thinking about some of the things that you mentioned. Let me start first with Star Ratings. Because as we shared on the last we are intensely working.

Medicare Advantage is a very important business for us, and we're strategically committed to the long term. And I will reiterate this year, we felt we took very prudent actions for a long-term sustainable business and feel good about our bid. So that positions us well for 2025 in particular. In terms of the star ratings, again, a few things going on there. We shared on our last call that on the group business, we have a number of levers at our disposal that we are able to pull, and we're still moving forward with that.

And then in terms of overall Star ratings, we do think that, that's going to be a multiyear initiative. But I wanted to share, as I shared on my early remarks that we have invested at the last part of the year, and we were investing actually prior to even the announcement. We have been hit success with moving all of our business into our Health Advocate model, and we do know that we're seeing some early signs -- we don't know where the points are going to come out, but we do feel good about the investments we're making.

And again, feel really good about where our bids have come out. Broader, let me take a little bit step further back because I think your question around 25% is broader than just Medicare Advantage and Stars. As I think about '25 again, not giving guidance on '25, but we do expect to accelerate growth in 2025 and we've talked quite a bit in recent calls about our flywheel for growth, which is in our improvement in both the health benefits business and our Carelon segment. We anticipate that our health benefits business is going to continue to grow in '25 after a reset year in '24.

And then we should see an accelerated impact to that growth, which will drive revenue for Carelon. And then Carelon also has been independently scaling its multiple new capabilities, and we'll share, I assume even more of those on the call today. And then finally, as you know, we took some actions at the end of last year around our disciplined operating cost efficiencies, and we expect to see even greater benefits from those as we digitize and use AI in our investments.

So honestly, I think we feel that we've positioned our business very prudently and that the balance and resilience of our enterprise and our earnings power of our health benefits in Carelon together gives us a lot of confidence in our ability to achieve our long-term targets. So just a little bit more color on where we are. Next question please.

Operator

Next, we'll go to the line of Kevin Fischbeck from Bank of America.

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

Great. I guess I wanted to ask about the MLR guidance for 2024. It sounds like you guys are expecting margin improvement in MA, your repositioning commercial and Medicaid is dropping pretty meaningfully. But why is MLR only flat? I would think that we'd be seeing MLR improvement? Is there some offset in there?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

Maybe let me start with the 2023, just to set the context here. So our 2023 benefit expense ratio end of the year is slightly better than our initial expectations at that 87%. And just to remind you, that represented the 60 basis point improvement year-over-year as well as falling in the lower half of our initial 2023 guidance range.

As it relates to 2024, we are guiding to a flat benefit expense ratio of 87%, plus/minus 50 basis points. And our outlook here reflects a consistent approach to reserves and a prudent thought process around utilization, given the dynamic operating environment, especially for our government businesses. If I take a deeper look at the underlying businesses themselves, the health benefit expense ratio reflects that intentional management action we're taking in commercial. It will continue on through into 2024 around the disciplined underwriting practices, In part of our margin recovery efforts. And then certainly, on the Medicare advantage side, continued appropriate expectations around utilization and Medicare -- medical cost trends.

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

Thank you, Mark, and thanks, Kevin, for the question. Next, question please.

Operator

Next, we'll go to the line of Josh Raskin from Nephron Research.

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

I was wondering, if you could speak a little bit more specifically around the growth in Medicare Advantage to start this year. It sounds like a little bit lower than expectations. And I'm curious specifically in the commentary you made around pockets of competition, maybe where you're seeing that, what you think is driving that? And then any specific comments on retention relative to expectations for this year.

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

And just maybe a couple of overarching comments because I think it's important that I'm going ask solution Norwood, who leads our government business to comment more specifically. And I think it's important to frame that we made some very specific discipline decisions and feel really good about our bids entering into this.

And Felicia, we actually exited some markets very specifically that were underperforming. So I think you have to take that into account. But she'll just provide a lot more detail on kind of where we landed this year and the perspective on the market. So Felicia, please?

Felicia Farr Norwood - *Elevance Health, Inc. - Executive VP & President of Government Health Benefits*

As we headed into 2024, we made some very disciplined decisions that we were going to enhance the financial performance for our Medicaid Advantage business. In the Mainland, we exited as Gail noted specifically certain markets that have been underperforming for 3 years. And with the impending risk model revisions, we really saw no path to long-term attractive sustainable economics in those markets. And that really represented a decline of about 84,000 members.

I also want to note that we've reduced supplemental benefits in Puerto Rico both to turn around their performance after a very challenging 2023 and to position us for the 3-year phase-in of the risk model revisions, which will have a material adverse impact on Medicare Advantage on the island, in part due to the higher mix of duals that we have in Puerto Rico. So we've reset our supplemental benefits there and in the midst of a very highly competitive bid environment, we will see membership declines in somewhere in the neighborhood of about 90,000 in 2024 in Puerto Rico.

Now while the decline is larger than we expected, it certainly has bolstered our confidence in the anticipated improvement in our benefit expense ratio in Puerto Rico. At the end of the day, what we wanted to do was to establish a very strong foundation from which we can grow in Puerto Rico long term, sustainably and profitably.

Back to the mainland. Selling activity for AEP was actually very strong for us as we expected. When we exclude the planned attrition on the island that we mentioned in -- on the mainland that I mentioned earlier, our net Mainland Medicare Advantage membership would be on track to grow by high single digits this year, despite encountering greater disenrollment in certain markets due to very aggressive offerings by select competitors.

At the end of the day, I think that we've made very thoughtful decisions around how we're going to position our business for long-term sustainable growth going forward. And we've done the things that we've always committed to do. We expect to do very well in our blue markets. We are performing better in our Blue markets than the overall growth rates, and we're very much focused on a combination of balancing that perspective between margin and membership growth. So we feel good about how we're positioning our business going forward.

And as we said earlier, in light of all of these dynamics, we'd expect to have flat membership in 2024.

Operator

Next, we'll go to the line of Sarah James from Cancer Fitzgerald.

Sarah Elizabeth James - *Cantor Fitzgerald & Co., Research Division - Research Analyst*

Do you guys have some really nice margin expansion guided to for Carelon in 2024. I was wondering if you could unpack it a little bit for us as we think through the major buckets that are causing the expansion and then also the pacing, if it's ratable as we think about the margin expansion through 2024 and then I guess, further out as we get to 2027?

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

I'm going to ask Pete Haytaian, who leads Carelon to comment on that. And as you know, we're excited about the real flywheel opportunity that we're seeing in Carelon. So Pete?

Peter David Haytaian - *Elevance Health, Inc. - Executive VP and President of Carelon & CarelonRx*

Yes. Let me talk about Carelon Services growth. And we are very excited about the opportunity and the progress that we're making with respect to services growth. I think you saw that play through in 2023. We committed to double-digit increase on revenue, which we achieved. And as it relates to our 2024 guide, you saw that we're talking about high-teens, low-20s growth. And it's really playing through our strategy that we talked about focusing in on complexities in health care, high-cost spend areas. And really driving capitated risk in key areas to support our health plans.

In '23, we did that with our post-acute care initiative, DME, Wound Care. And as we move forward into 2024, I mean Gail mentioned this in the prepared remarks, we have new offerings that are whole health full risk opportunities. Like oncology, assuming full risk in oncology as well as in Medicaid with behavioral health with the seriously mentally ill population.

So these are significant initiatives that are really propelling the trajectory of our business. I would also say that -- as it relates to external growth, we're also seeing really nice improvements from that perspective and really nice momentum. Our pipeline in '23 for '24 growth was much more significant. In terms of our sales this time versus last year, we've seen a real nice trajectory in our growth. And we've had a couple of really nice notable wins with the Blues.

I would say that as it relates to that and the opportunity with the Blues, they are doing exactly what we just talked about in the past and looking closely at some of these full risk comprehensive offerings that we're delivering in Elevance Health. And then very interested in that in terms of the opportunities to create predictable stable cost of care for them. So very pleased with where we are in the trajectory of growth in Carelon.

Operator

Next, we'll go to the line of Stephen Baxter from Wells Fargo.

Stephen C. Baxter - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I just want to come back to the Medicaid redetermination process. So entering 2023, we're expecting some normalization of the Medicaid outperformance that you saw in years prior. Can you give us an update on where that landed in 2023 compared to your initial thinking? And then just a little bit more color on what your guidance assumes for Medicaid in 2024. Does that put you back at historical norms for margins? Or should we think -- should we be thinking about something else there?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

Stephen, thanks very much for the question. On Medicaid membership, our outlook reflects the footprint adjustments we spoke about on our third quarter earnings call and the continued attrition due to redetermination. We believe Medicaid redeterminations are approximately 2/3 complete across our Medicaid markets. And in general, we've seen more front-loaded disenrollment, notably in a few large states that have elected to adopt accelerated processes. And then based on the trends that we've observed relative -- or related to these market-wide coverage shifts, we have adjusted our Medicaid retention assumption to be approximately 30% of our PHE related growth.

We're not planning to provide point to estimates for coverage transitions generally. We do, however, believe that ACA will pick up more than initially expected. While employer group coverage will gain a little bit less than initially expected. But most importantly, these updated projections are factored into our membership guidance that we provided this morning.

Operator

Next, we'll go to 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 your value-based care strategies. And what I would be interested in is from a contracting standpoint, how are you approaching that for '24 and like MA? Are you doing any sort of renegotiation to kind of hold those value-based care providers -- more stable in that year given the risk adjustment changes? And then how is the priority for owning those sorts of assets in Carelon change? And what's your current outlook there?

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

Well, thanks for the question, Lance. There's quite a bit there. But I think let me start with our value-based strategy, we've talked about on this call a number of times, and I think I would say it's remained really consistent, but we're making a lot of very good progress on that. Overall, more than 60% are in value-based care. And in Medicare, it's even more. Specific to your question on renegotiation, we have multiple-year arrangements with our value-based providers, and we're always looking at a couple of things. One, quite frankly, to make sure that it's a win-win and we're aligned, both on cost, quality outcomes and Stars.

So we spend a lot of time focusing on some of the ways that we can get data back and forth more simply. We use our -- we've integrated the way we share data back and forth, and that's really around closing gaps in care and quite frankly, simplifying the process under which we work with those providers. Our goal is to make that ubiquitous across all of our value-based providers. And so we made a lot of progress there and dramatically improve sort of the time to action with those providers. And I think that's important because, honestly, that gives them data to act and that improves their outcomes. We have seen our value-based providers perform better in the circumstance, and we think that, that's going to remain important.

In terms of our strategy around ownership. We've talked about that. We -- as you know, we do have assets inside of Carelon. I guess where I would focus you more is around the specialty high-cost complex areas of specialty because that's where we think that there's a huge differentiated focus between our technology, our clinical domain expertise and our ability to drive trend.

Again, we don't need to own the providers, but we do need to have a significant role in the enablement of those care providers, and we have spent time doing that. We launched a number of new products this year with oncology, serious mental illness and we're getting into other areas like musculoskeletal, renal and more. And I think -- that's where you see the significant spend areas accelerating and Carelon with its assets has a great opportunity.

So we expect Carelon's care provider enablement platforms continue to contribute pretty significantly Carelon's revenue meaningfully over the longer term, and we're building those assets. And again, I'll keep going back to my flywheel, where we think that will improve the performance of our health benefit plans. There's a lot of interest in externally in these. And Pete mentioned, we saw some nice traction in a few of these offerings this year. So overall, I'd say very consistent focus around our value-based care enablement, and we feel like we're getting a lot of traction. And I would focus you a lot on the specialized care Specialty Care, particularly on the Carelon growth opportunity.

Operator

Next, we'll go to the line of Nathan Rich from Goldman Sachs.

Nathan Allen Rich - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Two on the Medicare business. First, you talked about Medicare cost trend developing as expected in the fourth quarter. I guess I'd be curious if there are any areas that came in higher or lower than expected and what the benefit expense guidance for 2024 assumes for Medicare cost trend? And then I guess, higher level, as you reposition the Medicare business, and I understand there's several moving pieces over the next couple of years.

What's the company's current view, I guess, first of the Medicare Advantage market longer term? But then second, the membership growth and margin potential for Elevance, specifically within that market context.

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

I'm going to ask Mark to address your first question, and then I'll come back and share our long-term views on Medicare.

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

Nathan, overall utilization in the fourth quarter developed largely in line with our expectations. And that's evidenced by our reported benefit expense ratio, which came in favorable, as you know, to consensus and really to the midpoint of our initial full year 2023 guidance range. We did see pockets of high utilization, specifically in Medicare related to orthopedics such as knee and hip replacements and other outpatient procedures. But this is broadly planned for as part of our underlying cost trained assumptions.

Similarly, we saw a seasonal uptick in respiratory elements, including the flu and COVID as well as increased RC vaccinations. But again, utilizations were aligned with what we planned. We'll continue to monitor our claims trends closely, including prior authorization data. We remain confident that our Medicare Advantage bids for 2024 and our pricing commercial do reflect appropriate projections for utilization and medical cost trends.

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

Nathan, in terms of your broader question, let me just provide a little bit of perspective. as I think about the market, we still think Medicare Advantage is a very good long-term market. And as I said, we're committed to driving sustainable performance for the long term. Medicare Advantage delivers really strong differentiated value for seniors. I think you have to start there. And as you look at the aligned incentives across the system to deliver better outcomes and better care -- it is very -- it's a very strong marketplace, and it continues to grow.

And importantly, it's incredibly popular with seniors with greater than 50% of seniors selecting Medicare Advantage today. So that's against that backdrop, we know seniors value stability in their benefits year-over-year and the items that are most important to them. And so we have, as you heard from us earlier, look to make sure that we are in this market for the long term balancing that stability. So with what we know is happening in this market, we can make the right benefit decisions and again, feel that we positioned ourselves and are making the right strategic investments to improve our performance.

We see this business maturing, as Mark shared in his comments as well. And again, been very intentional about our desire or decision to exit certain programs or markets and plans where we didn't think we had a long-term sustainable path to performance. And that combined with the risk models, made that choice and then again, reposition Puerto Rico, which we believe is still a very good market, but there were some actions that we knew we had to take.

So as we look at those decisions for the long term, as Felicia shared, our business performed when you look at the mainland and take out those exits. We had very strong selling season. Again, I think that's a testament to the value of the benefits and our position. And importantly, we do believe we can grow this business profitably even in a year with hypercompetitive markets in certain cases, where we outperformed the growth in our blue markets, which, again, has always been a strategy we've had is to go deeper in our blue markets and to gain more share with the value of our brand as well as in other places.

So again, we think it's a good market. We know we have some work to do in that market, but we feel we're positioning for the long term and think that we can add distinctive value for seniors as part of our focus on whole health and continuation of coverage to stay Blue for life and all of their coverage.

Operator

Next, we'll go to the line of Lisa Gill from JPMorgan.

Lisa Christine Gill - *JPMorgan Chase & Co, Research Division - Analyst*

I want to focus on margin drivers. Can you maybe just spend a little time talking about the progression in 2024, getting to those targets that you have in '25 and then secondly, when I think about the margins in CarelonRx, you talked about them improving by 40 to 60 basis points. Can you talk about what the drivers are there as well? Is that Paragon Health and BioPlus, which I would assume carry better margins? Or is there something else that's really driving that improvement as we move into '24?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

I'll talk about health benefits, and I'll pass it over to Pete in a couple of minutes to talk about Carelon. On the health benefits side, we are seeing operating margins expands or expect to expand by 25 to 50 basis points in 2024. And I think about this as really being driven by 3 primary categories.

First is the continued underwriting discipline and the pricing actions that we're taking in commercial, 2023 really marks the end of the first full year of our efforts to recover margins from the pandemic era lows and we expect those supporting initiatives really to continue through 2024 and then possibly into 2025.

Second one, I'd call your attention to here really relates to the Medicare margin expansion. And here, as you've heard us talk about, this is about building that strong foundation for sustainable long-term growth in 2024 and striking that balance between growth and margin. And in 2024, we leaned a little bit more towards the margin and the growth and you see that come through in some of our outlook projections this morning.

And then the third one, I'd call your attention to is really the operating expense leverage -- you see that we are gaining additional incremental leverage in 2024 with our guide down to 11.1% for the operating expense ratio.

Peter David Haytaian - *Elevance Health, Inc. - Executive VP and President of Carelon & CarelonRx*

And Lisa, your question was on the trajectory of the margins in pharmacy. So you'll recall that this year, in 2023, we made pretty significant investments as it relates to the acceleration of BioPlus and advanced home delivery, and that puts some pressure on our margins in 2023. That will not repeat itself in 2024. We did go live with BioPlus on January 1 as well as with respect to advanced 1 delivery. We're really excited about that, and it's moving in the right direction.

And over time, we've built those products for scale. And as that business builds and progresses, we will continue to see margin improvement. So that is what is delivering an improvement in margin in '24.

Operator

Next, we'll go to the line of Scott Fidel from Stephens.

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

I was hoping you could -- just on the commercial risk enrollment guidance, if you can break that down for us between group and individual? And then on the individual piece, I'm curious in terms of what you're thinking in terms of how much of that growth comes from the catchers mitt -- for Medicaid and then how you're thinking about the acuity of those lives that are coming into the exchanges from Medicaid?

We know that in Medicaid, that acuity is generally rising as the redeterminations continue. So I'm curious, though, in terms of those lives that are transitioning into the exchanges, how are you thinking about those as being sort of higher or lower or in line acuity with the legacy population in the exchange market?

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

Well, thanks for the question, Scott. I think we've got about 4 or 5 in there. So we'll try to hit the high points of your question. Let me ask Morgan and then Mark to comment on your question. Morgan?

Morgan Kendrick - *Elevance Health's commercial and specialty health benefits - President*

Yes, Scott, thanks for the question. As we think about the ACA business, we've talked about it for a while now. We're quite bullish on that segment. And as we've remarked in other quarterly reports, we operate in all rating areas in our 14 geographies, where we can. And certainly, we've seen an expansion in the actual market share and the market growth actually in these geographies.

In fact, it's certainly a big driver is Medicaid redetermination. As we've indicated earlier on the call today, we've concluded about 2/3 of those. We expect that to continue in 2024. And also, as we've noted in the past, we've seen an elongated period of time from when someone is redetermined and when they actually join Medicare or come on an ACA product moving along. That said, quite pleased that our growth this year is outpacing our market growth. So clearly, we're picking up our fair share and more, quite honestly, of the Medicaid redetermined members.

So at the end of the day, this will continue. We've had a very steadfast and steady approach around the right economics and the right network strategies. -- to draw in these members. It's very important for the business to continue. And I'm going to turn that over to Mark to speak a little bit about the margins and the separation of the various pieces that you asked the questions on...

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

Yes. If I think about Medicaid rates and acuity, the conversations with the states are ongoing. We'll continue to work with them and their consultants really to ensure that all adjustments are reasonable and reflect the risk associated with ongoing redeterminations in 2024.

Our outlook for 2024 does assume a normalization of Medicaid margins -- we already have line of sight into about 70% of Medicaid premiums for 2024. And we are comfortable with the actuarial soundness of the underlying rates, especially understanding the acuity for leaders versus [stayers].

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

Yes. And thanks, Scott. And I think you also asked about the acuity in the individual exchange marketplace. So I wanted to just put a fine point on that. Our risk profile of the members we're picking up certainly in '23, obviously, early in '24 very much aligns with the expectation of what we've historically had. So we feel it's actually rolling out to our expectations.

Operator

Next, we'll go to the line of Ben Hendrix from RBC Capital Markets.

Benjamin Hendrix - *RBC Capital Markets, Research Division - Assistant VP*

I just wanted to follow-up on the Carelon margin question. On Carelon Services, slightly down margins in the guidance. Just wanted to see if that -- the degree to which that is associated with new risk-based arrangements or membership or to the perhaps to the new behavioral benefits and kind of what are the prospects for that kind of ramping up beyond 2024?

Peter David Haytaian - *Elevance Health, Inc. - Executive VP and President of Carelon & CarelonRx*

No. First of all, we're very pleased with the operating performance of Carelon. You saw that play through in 2023. I think we committed to 25 to 50 basis points of improvement. You saw 70 basis points of improvement year-over-year. So that it's performing really well.

You answered the question already as it relates to 2024, quite frankly, we are, as Gail talked about, and as I talked about earlier, launching some very significant at-risk product offerings, both oncology, seriously incrementally ill population as well as others, and that comes with a lower margin in the earlier years, but that improves over time. So that is precisely what was creating the pressure on the margin in '24.

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

Yes. And just to sort of put a finer point on it, we do remain confident in our long-term guidance that we gave in mid- to upper single-digit operating margin. So as Pete said, we think the business we're bringing on is really good. We're committed to bringing in more risk business. But in the early years, that does have a little bit lower profile. But overall, we feel very good about the long term.

Operator

Next, we'll go to the line of Justin Lake from Wolfe Research.

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

Most of my questions have been answered, but a couple of numbers here. First, you reported $200 million plus of positive prior year development a quarter, materially more than I think the company has ever seen in Q4. Just curious, given the MLR was generally in line. Can you tell us whether there were any pressure areas that work to offset the benefit of the PYD in the quarter? And then with the benefits repositioning of Medicare Advantage, which we've clearly done, do you expect to be within your 3% to 5% target margin here for Medicare Advantage in '24?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

We are confident that our year-end reserves are prudent and have been set consistent with historical practice. In the quarter, you are correct that we saw positive prior year development on a gross basis, and that was indeed favorable. It's worth pointing out here that, that was largely offset through premium rebates and colors as well as the reestablishment of reserves for the current year. An alternative way to think about this is that our full year days in claims payable decreased just 0.2 days year-over-year.

And that's noteworthy in the context of the fact that we have observed cycle times to have actually decreased more than 3 days, since the end of December 2022. And that should give you a feel for our comfort level around reserves.

On your second question, just relative to the long-term target margin ranges, commercial is on track to achieve our long-term goals. Let's say, Medicaid is normalizing, but continues to perform well. And then Medicare Advantage for now is below our long-term target margin range.

Operator

Next, we'll go to the line of Gary Taylor from TD Cowen.

Gary Paul Taylor - *TD Cowen, Research Division - MD & Senior Equity Research Analyst*

I just wanted to follow-up on enrollment. I kind of thought the story for '23 was that with the intentional commercial repricing, which has been pretty successful this year, you lost some commercial risk enrollment because of that? And I'm just trying to figure out on the 1 million plus decline in risk enrollment for '24, how much of that is commercial risk versus the expected Medicaid redeterminations?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

We're all pleased with the performance of our commercial business in the fourth quarter and in 2023. We did make meaningful progress towards our margin recovery goals in the year. I'd say January renewals have gone well. We certainly experienced to date higher retention than we did at the same period last year. Repricing actions, as you would expect, do continue to impact membership growth, but this is expected. And so we're really continuing to expect approximately flat membership growth overall in our group risk business this year, while continuing to improve margins in line with our stated goals.

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

And just again, to put a fine point, most of the losses in risk membership is driven by both the Medicaid redeterminations and the adjustment in the footprints that we've shared with you in the past. So that really is the key driver.

Operator

Next, we'll go to the line of David Windley from Jefferies.

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

Squeezing in here. I wanted to go to CarelonRx on the revenue growth side. High growth in '23 low single digits, I think you're expecting in '24. I suspect the BioPlus acquisition inorganically would have contributed to some of that growth in '23, but I don't think it bridges the full change. So maybe you could add some color around the slowdown in growth, the lower growth expectations for CarelonRx in '24?

Peter David Haytaian - *Elevance Health, Inc. - Executive VP and President of Carelon & CarelonRx*

As it relates to 2023 and the growth of around 18.6% that did exceed our initial guidance -- and as you alluded to, that was driven primarily by the BioPlus acquisition and including BioPlus and our results to a lesser extent, drug mix and trends -- but I would say as it relates to 2024, I would say we have tremendous momentum in the business. And we're really excited about how our strategy is playing through.

We've talked about assuming the strategic levers that really matter in our business. We've done that with Specialty Pharmacy and BioPlus. We've done that with advanced home delivery. You heard about the recent announcement of Paragon and infusion, which we're really excited about. And then there are several new product launches that are resonating in the marketplace that we've talked about previously, like EnsureRx as one of the examples.

And this momentum is playing through in our sales in 2024. We are having a good season. Obviously, that activity occurred in 2023. Our retention remains strong. Our sweet spot does remain in that 3,000 to 10,000 range in terms of the business that we're attracting. And as you know, there's a little more reticence in terms of the larger jumbo accounts moving. But I would say that a couple of notable wins there. We saw a couple of wins in the 20,000 to 50,000 range. So we're really excited about the momentum in Carelon and what we're doing strategically and how that's playing through in the marketplace.

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

Our next question will be our last question.

Operator

For our final question, we'll go to the line of George Hill from Deutsche Bank.

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

I'm going to come back to M&A margins 1 more time. And I'm going to ask you, if you could expand a little bit, if there is a way to disaggregate kind of the MA margin expansion thinking about your pricing initiatives versus utilization expectation versus mix and kind of the market exits that you guys have targeted just trying to figure, if you can kind of maybe rank order the contribution on margin expansion in MA from each of those 4 initiatives[LL1]?

Mark Bradley Kaye - *Elevance Health, Inc. - Executive VP & CFO*

We are not looking to necessarily provide individual margin guidance within the Health Benefit segment. Certainly, we feel comfortable with where we're guiding to in aggregate for 2024 and the 25 to 50 basis point range -- and we think that the qualitative commentary that we provided in the call today should give you enough to get a feel for how the management team is thinking about this.

Given this is my first earnings call, I just want to spend a minute on capital deployment before we close out here. And I just wanted to make the point that I expect to continue with Elevance Health's existing strategic policy around capital deployment, as I believe it really strikes the right balance between growth and the return of capital to our stockholders.

And just as a reminder, we are going to target 50% of our free cash flow towards M&A or organic reinvestment and approximately 50% is a return of capital to our stockholders, either via the 30% for share repurchases -- or the 20% for dividends. And each year may differ. But over the years, we expect to allocate capital consistent with this framework.

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

Thank you, Mark, and thank you to everyone who joined us. In closing, we're pleased to have delivered another strong year in 2023, and we're confident that the ongoing execution of our strategy and the balance and resilience of our diverse set of businesses positions us well for 2024 and beyond.

We're very excited about our future, and we look forward to sharing more on our progress with you in the coming year. Thank you again for your interest in Elevance Health, and have a great rest of your week.

Operator

Ladies and gentlemen, a recording of this conference will be available for replay after 11:00 a.m. today through February 23, 2024. You may access the replay system at any time by dialing (800) 568-3942. International participants can dial (203) 369-3812. This concludes our conference for today. Thank you for your participation and for using Verizon conferencing. You may now disconnect.

[LL1]There is some background noise during George Hill's question. Not sure if it from George or from the room. Can this be cleaned up?
