

HUMANA INC
Form 10-Q
August 02, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission file number 1-5975
HUMANA INC.
(Exact name of registrant as specified in its charter)

Delaware 61-0647538
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)
500 West Main Street
Louisville, Kentucky 40202
(Address of principal executive offices, including zip code)
(502) 580-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

Class of Common Stock	Outstanding at June 30, 2017
\$0.16 2/3 par value	144,517,202 shares

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Humana Inc.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

	June 30, 2017	December 31, 2016
	(in millions, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,139	\$ 3,877
Investment securities	8,115	7,595
Receivables, less allowance for doubtful accounts of \$92 in 2017 and \$118 in 2016	2,430	1,280
Other current assets	3,884	3,438
Total current assets	22,568	16,190
Property and equipment, net	1,543	1,505
Long-term investment securities	2,670	2,203
Goodwill	3,280	3,272
Other long-term assets	2,192	2,226
Total assets	\$ 32,253	\$ 25,396
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Benefits payable	\$ 4,838	\$ 4,563
Trade accounts payable and accrued expenses	4,693	2,467
Book overdraft	117	212
Unearned revenues	3,356	280
Short-term debt	701	300
Total current liabilities	13,705	7,822
Long-term debt	4,279	3,792
Future policy benefits payable	2,899	2,834
Other long-term liabilities	417	263
Total liabilities	21,300	14,711
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$1 par; 10,000,000 shares authorized; none issued	—	—
Common stock, \$0.16 2/3 par; 300,000,000 shares authorized; 198,569,658 shares issued at June 30, 2017 and 198,495,007 shares issued at December 31, 2016	33	33
Capital in excess of par value	2,306	2,562
Retained earnings	13,101	11,454
Accumulated other comprehensive loss	(5	) (66
Treasury stock, at cost, 54,052,456 shares at June 30, 2017 and 49,189,811 shares at December 31, 2016	(4,482	) (3,298
Total stockholders' equity	10,953	10,685
Total liabilities and stockholders' equity	\$ 32,253	\$ 25,396
See accompanying notes to condensed consolidated financial statements.		

Humana Inc.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
	(in millions, except per share results)			
Revenues:				
Premiums	\$13,203	\$13,650	\$26,601	\$27,090
Services	230	262	483	522
Investment income	101	95	212	195
Total revenues	13,534	14,007	27,296	27,807
Operating expenses:				
Benefits	10,889	11,509	22,215	22,906
Operating costs	1,453	1,699	3,006	3,433
Merger termination fee and related costs, net	—	27	(947	) 61
Depreciation and amortization	92	89	184	177
Total operating expenses	12,434	13,324	24,458	26,577
Income from operations	1,100	683	2,838	1,230
Interest expense	58	47	107	94
Income before income taxes	1,042	636	2,731	1,136
Provision for income taxes	392	325	966	571
Net income	\$650	\$311	\$1,765	\$565
Basic earnings per common share	\$4.49	\$2.08	\$12.07	\$3.79
Diluted earnings per common share	\$4.46	\$2.06	\$11.98	\$3.75
Dividends declared per common share	\$0.40	\$0.29	\$0.80	\$0.58

See accompanying notes to condensed consolidated financial statements.

Humana Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(in millions)			
Net income	\$650	\$311	\$1,765	\$565
Other comprehensive income:				
Change in gross unrealized investment gains/losses	88	111	126	159
Effect of income taxes	(33)	(41)	(47)	(58)
Total change in unrealized investment gains/losses, net of tax	55	70	79	101
Reclassification adjustment for net realized gains included in investment income	(2)	(19)	(28)	(39)
Effect of income taxes	—	7	10	14
Total reclassification adjustment, net of tax	(2)	(12)	(18)	(25)
Other comprehensive income, net of tax	53	58	61	76
Comprehensive income	\$703	\$369	\$1,826	\$641

See accompanying notes to condensed consolidated financial statements.

Humana Inc.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

	For the six months ended June 30, 2017 2016 (in millions)	
Cash flows from operating activities		
Net income	\$1,765	\$565
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital gains	(28)	(39)
Stock-based compensation	83	48
Depreciation	201	190
Other intangible amortization	36	41
Provision (benefit) for deferred income taxes	2	(24)
Changes in operating assets and liabilities, net of effect of businesses acquired and dispositions:		
Receivables	(1,150)	(1,392)
Other assets	(545)	(678)
Benefits payable	275	282
Other liabilities	317	1,198
Unearned revenues	3,076	(53)
Other, net	67	68
Net cash provided by operating activities	4,099	206
Cash flows from investing activities		
Acquisitions, net of cash acquired	(9)	(1)
Purchases of property and equipment	(233)	(256)
Purchases of investment securities	(3,208)	(2,528)
Maturities of investment securities	649	635
Proceeds from sales of investment securities	1,723	1,853
Net cash used in investing activities	(1,078)	(297)
Cash flows from financing activities		
Receipts from contract deposits, net	2,081	221
Proceeds from issuance of senior notes, net	985	—
Repayment of commercial paper, net	(102)	—
Change in book overdraft	(95)	(109)
Common stock repurchases	(1,578)	(73)
Dividends paid	(104)	(90)
Proceeds from stock option exercises and other	54	—
Net cash provided by (used in) financing activities	1,241	(51)
Increase (decrease) in cash and cash equivalents	4,262	(142)
Cash and cash equivalents at beginning of period	3,877	2,571
Cash and cash equivalents at end of period	\$8,139	\$2,429
Supplemental cash flow disclosures:		
Interest payments	\$92	\$92
Income tax payments, net	\$694	\$536

See accompanying notes to condensed consolidated financial statements.

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Humana Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT EVENTS

The accompanying condensed consolidated financial statements are presented in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America, or GAAP, or those normally made in an Annual Report on Form 10-K. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. For further information, the reader of this Form 10-Q should refer to our Form 10-K for the year ended December 31, 2016, that was filed with the Securities and Exchange Commission, or the SEC, on February 17, 2017. We refer to the Form 10-K as the “2016 Form 10-K” in this document. References throughout this document to “we,” “us,” “our,” “Company,” and “Humana” mean Humana Inc. and its subsidiaries. The preparation of our condensed consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The areas involving the most significant use of estimates are the estimation of benefits payable, future policy benefits payable, the impact of risk adjustment provisions related to our Medicare contracts, the valuation and related impairment recognition of investment securities, and the valuation and related impairment recognition of long-lived assets, including goodwill. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates. Refer to Note 2 to the consolidated financial statements included in our 2016 Form 10-K for information on accounting policies that we consider in preparing our consolidated financial statements.

The financial information has been prepared in accordance with our customary accounting practices and has not been audited. In our opinion, the information presented reflects all adjustments necessary for a fair statement of interim results. All such adjustments are of a normal and recurring nature.

Aetna Merger

On July 2, 2015, we entered into an Agreement and Plan of Merger, which we refer to in this report as the Merger Agreement, with Aetna Inc. and certain wholly owned subsidiaries of Aetna Inc., which we refer to collectively as Aetna, which set forth the terms and conditions under which we agreed to merge with, and become a wholly owned subsidiary of Aetna, a transaction we refer to in this report as the Merger.

The Merger was subject to customary closing conditions, including, among other things, (i) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of necessary approvals under state insurance and healthcare laws and regulations and pursuant to certain licenses of certain of Humana’s subsidiaries, and (ii) the absence of legal restraints and prohibitions on the consummation of the Merger.

On July 21, 2016, the U.S. Department of Justice and the attorneys general of certain U.S. jurisdictions filed a civil antitrust complaint in the U.S. District Court for the District of Columbia against us and Aetna, alleging that the Merger would violate Section 7 of the Clayton Antitrust Act and seeking a permanent injunction to prevent the Merger from being completed. On January 23, 2017, the Court ruled in favor of the DOJ and granted a permanent injunction of the proposed transaction. On February 14, 2017, we and Aetna agreed to mutually terminate the Merger Agreement, as our Board determined that an appeal of the Court's ruling would not be in the best interest of our stockholders. On February 16, 2017, under terms of the Merger Agreement, we received a breakup fee of \$1 billion from Aetna, which is included in our condensed consolidated statement of income in the line captioned Merger termination fee and related costs, net. Prior period Merger related transaction costs, previously included in operating costs, have been reclassified to conform to the 2017 presentation.

Business Segment Reclassifications

During the three months ended March 31, 2017, we realigned certain of our businesses among our reportable segments to correspond with internal management reporting changes and our previously announced planned exit from

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Humana Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

the Individual Commercial medical business on January 1, 2018. Additionally, we renamed our Group segment to the Group and Specialty segment, and began presenting the Individual Commercial business results as a separate segment rather than as part of the Retail segment. Specialty health insurance benefits, including dental, vision, other supplement health, and financial protection products, marketed to individuals are now included in the Group and Specialty segment. Specialty health insurance benefits marketed to employer groups continue to be included in the Group and Specialty segment. As a result of this realignment, our reportable segments now include Retail, Group and Specialty, Healthcare Services, and Individual Commercial. Prior period segment financial information has been recast to conform to the 2017 presentation. See Note 15 for segment financial information.

2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board, or FASB, issued new guidance that amends the accounting for revenue recognition. The amendments are intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices, and improve disclosure requirements. Insurance contracts are not included in the scope of this new guidance. Accordingly, our premiums revenue and investment income, collectively representing approximately 98% of our consolidated external revenues for 2016, are not included in the scope of the new guidance. We expect to adopt the guidance using the modified retrospective approach with a cumulative effect adjustment, if any, to retained earnings. We are analyzing how we may recognize revenue under the new guidance by reviewing selected sample contracts presently in place. While we expect revenue related to our Pharmacy, Provider Services, ASO and other services businesses to remain primarily unchanged, we are still reviewing the impact of the new guidance on the customer arrangements for these businesses. Accordingly, we continue to evaluate the impact of the new standard on our results of operations, financial condition and cash flows. The new guidance is effective for us beginning with annual and interim periods in 2018.

In February 2016, the FASB issued new guidance related to accounting for leases which requires lessees to record assets and liabilities reflecting the leased assets and lease obligations, respectively, while following the dual model for recognition in statements of income requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense (similar to current operating leases) while finance leases will result in a front-loaded expense pattern (similar to current capital leases). The new guidance is effective for us beginning with annual and interim periods in 2019, with earlier adoption permitted, and requires retrospective application to previously issued annual and interim financial statements. We have begun the process of identifying the population of lease agreements and other arrangements that may contain embedded leases for purposes of adopting the new standard. While we expect to record significant leased assets and corresponding lease obligations based on our existing population of individual leases, we continue to evaluate the impact on our results of operations, financial position and cash flows.

In June 2016, the FASB issued guidance introducing a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. The guidance is effective for us beginning January 1, 2020. The new current expected credit losses (CECL) model generally calls for the immediate recognition of all expected credit losses and applies to loans, accounts and trade receivables as well as other financial assets measured at amortized cost, loan commitments and off-balance sheet credit exposures, debt securities and other financial assets measured at fair value through other comprehensive income, and beneficial interests in securitized financial assets.

The new guidance replaces the current incurred loss model for measuring expected credit losses, requires expected losses on available-for-sale debt securities to be recognized through an allowance for credit losses rather than as reductions in the amortized cost of the securities, and provides for additional disclosure requirements. Our investment portfolio consists of available for sale debt securities. We are currently evaluating the impact on our results of operations, financial condition, or cash flows.

In January 2017, the FASB issued guidance which simplifies the accounting for goodwill impairment. The new guidance eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. A goodwill impairment charge would be recognized if the carrying amount of a reporting unit exceeds the estimated fair value of the reporting unit. The new guidance is effective for us beginning with annual and interim periods in 2020, with early adoption permitted, and is to be applied prospectively. The adoption of this new guidance is not expected to have a material impact on our financial position or operating results.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

In March 2017, the FASB issued new guidance that amends the accounting for premium amortization on purchased callable debt securities by shortening the amortization period. This amended guidance requires the premium to be amortized to the earliest call date instead of maturity date. The new guidance is effective for us beginning with annual and interim periods in 2019. We do not expect adoption of this guidance will have a material impact on our results of operations, financial condition and cash flows.

There are no other recently issued accounting standards that apply to us or that are expected to have a material impact on our results of operations, financial condition, or cash flows.

3. ACQUISITIONS AND DIVESTITURES

During 2017 and 2016, we acquired health and wellness related businesses which, individually or in the aggregate, have not had a material impact on our results of operations, financial condition, or cash flows. The results of operations and financial condition of these businesses have been included in our condensed consolidated statements of income and condensed consolidated balance sheets from the respective acquisition dates. Acquisition-related costs recognized in 2017 and 2016 were not material to our results of operations. The pro forma financial information assuming the acquisitions had occurred as of the beginning of the calendar year prior to the year of acquisition, as well as the revenues and earnings generated during the year of acquisition, were not material for disclosure purposes.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

4. INVESTMENT SECURITIES

Investment securities classified as current and long-term were as follows at June 30, 2017 and December 31, 2016, respectively:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)				
June 30, 2017				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	\$724	\$ 1	\$ (9)	) \$716
Mortgage-backed securities	1,567	4	(25)	) 1,546
Tax-exempt municipal securities	3,304	23	(21)	) 3,306
Mortgage-backed securities:				
Residential	8	—	—	8
Commercial	394	2	(2)	) 394
Asset-backed securities	135	—	—	135
Corporate debt securities	4,514	206	(40)	) 4,680
Total debt securities	\$10,646	\$ 236	\$ (97)	) \$10,785
December 31, 2016				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	\$800	\$ 1	\$ (15)	) \$786
Mortgage-backed securities	1,662	6	(31)	) 1,637
Tax-exempt municipal securities	3,358	15	(68)	) 3,305
Mortgage-backed securities:				
Residential	9	—	—	9
Commercial	307	1	(4)	) 304
Asset-backed securities	160	—	—	160
Corporate debt securities	3,530	145	(78)) 3,597
Total debt securities	\$9,826	\$ 168	\$ (196)) \$9,798

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Humana Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at June 30, 2017 and December 31, 2016, respectively:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
June 30, 2017						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	\$645	\$ (9)	\$3	\$ —	\$648	\$ (9)
Mortgage-backed securities	1,310	(25)	3	—	1,313	(25)
Tax-exempt municipal securities	1,898	(20)	39	(1)	1,937	(21)
Mortgage-backed securities:						
Residential	—	—	4	—	4	—
Commercial	99	(2)	1	—	100	(2)
Asset-backed securities	92	—	—	—	92	—
Corporate debt securities	1,200	(37)	64	(3)	1,264	(40)
Total debt securities	\$5,244	\$ (93)	\$114	\$ (4)	\$5,358	\$ (97)

December 31, 2016

U.S. Treasury and other U.S.

government corporations

and agencies:

U.S. Treasury and agency obligations	\$697	\$ (15)	\$3	\$ —	\$700	\$ (15)
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Mortgage-backed securities	1,528	(31)	3	—	1,531	(31)
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Tax-exempt municipal securities	2,756	(67)	43	(1)	2,799	(68)
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Mortgage-backed securities:

Residential	—	—	4	—	4	—
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Commercial	182	(3)	24	(1)	206	(4)
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Asset-backed securities	51	—	63	—	114	—
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Corporate debt securities	1,544	(71)	69	(7)	1,613	(78)
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Total debt securities	\$6,758	\$ (187)	\$209	\$ (9)	\$6,967	\$ (196)
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Approximately 98% of our debt securities were investment-grade quality, with a weighted average credit rating of AA by S&P at June 30, 2017. Most of the debt securities that were below investment-grade were rated BB, the higher end

of the below investment-grade rating scale. Tax-exempt municipal securities were diversified among general obligation bonds of states and local municipalities in the United States as well as special revenue bonds issued by municipalities to finance specific public works projects such as utilities, water and sewer, transportation, or education. Our general obligation bonds are diversified across the United States with no individual state exceeding 8%. In addition, 2% of our tax-exempt securities were insured by bond insurers and had an equivalent weighted average

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

S&P credit rating of AA exclusive of the bond insurers' guarantee. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

Our unrealized losses from all securities were generated from approximately 730 positions out of a total of approximately 2,260 positions at June 30, 2017. All issuers of securities we own that were trading at an unrealized loss at June 30, 2017 remain current on all contractual payments. After taking into account these and other factors previously described, we believe these unrealized losses primarily were caused by an increase in market interest rates in the current markets since the time the securities were purchased. At June 30, 2017, we did not intend to sell the securities with an unrealized loss position in accumulated other comprehensive income, and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis. As a result, we believe that the securities with an unrealized loss were not other-than-temporarily impaired at June 30, 2017.

The detail of realized gains (losses) related to investment securities and included within investment income was as follows for the three and six months ended June 30, 2017 and 2016:

	Three months ended June 30, 2017		Six months ended June 30, 2016	
	2017	2016	2017	2016
	(in millions)			
Gross realized gains	\$4	\$20	\$31	\$51
Gross realized losses	(2)	(1)	(3)	(12)
Net realized capital gains	\$2	\$19	\$28	\$39

There were no material other-than-temporary impairments for the three and six months ended June 30, 2017 or 2016. The contractual maturities of debt securities available for sale at June 30, 2017, regardless of their balance sheet classification, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in millions)	
Due within one year	\$538	\$539
Due after one year through five years	2,666	2,680
Due after five years through ten years	2,237	2,235
Due after ten years	3,101	3,248
Mortgage and asset-backed securities	2,104	2,083
Total debt securities	\$10,646	\$10,785

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Humana Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

5. FAIR VALUE

Financial Assets

The following table summarizes our fair value measurements at June 30, 2017 and December 31, 2016, respectively, for financial assets measured at fair value on a recurring basis:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
	(in millions)			
June 30, 2017				
Cash equivalents	\$7,786	\$ 7,786	\$ —	\$ —
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	716	—	716	—
Mortgage-backed securities	1,546	—	1,546	—
Tax-exempt municipal securities	3,306	—	3,306	—
Mortgage-backed securities:				
Residential	8	—	8	—
Commercial	394	—	394	—
Asset-backed securities	135	—	135	—
Corporate debt securities	4,680	—	4,676	4
Total debt securities	10,785	—	10,781	4
Total invested assets	\$18,571	\$ 7,786	\$ 10,781	\$ 4
December 31, 2016				
Cash equivalents	\$3,654	\$ 3,654	\$ —	\$ —
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	786	—	786	—
Mortgage-backed securities	1,637	—	1,637	—
Tax-exempt municipal securities	3,305	—	3,302	3
Mortgage-backed securities:				
Residential	9	—	9	—
Commercial	304	—	304	—
Asset-backed securities	160	—	160	—
Corporate debt securities	3,597	—	3,593	4
Total debt securities	9,798	—	9,791	7
Total invested assets	\$13,452	\$ 3,654	\$ 9,791	\$ 7

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Humana Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

There were no material transfers between Level 1 and Level 2 during the three and six months ended June 30, 2017 or 2016.

Our Level 3 assets had a fair value of \$4 million at June 30, 2017, or 0.02% of our total invested assets. During the three and six months ended June 30, 2017 and 2016, the changes in the fair value of the assets measured using significant unobservable inputs (Level 3) were comprised of the following:

For the three months ended June 30,

	2017			2016		
	Private Rate Placements	Auction Rate Securities	Total	Private Rate Placements	Auction Rate Securities	Total
	(in millions)					
Beginning balance at April 1	\$4	\$3	\$7	\$6	\$3	\$9
Settlements	—	(3)	(3)	—	—	—
Balance at June 30	\$4	\$—	\$4	\$6	\$3	\$9

For the six months ended June 30,

	2017			2016		
	Private Rate Placements	Auction Rate Securities	Total	Private Rate Placements	Auction Rate Securities	Total
	(in millions)					
Beginning balance at January 1	\$4	\$3	\$7	\$6	\$5	\$11
Settlements	—	(3)	(3)	—	(2)	(2)
Balance at June 30	\$4	\$—	\$4	\$6	\$3	\$9

Financial Liabilities

Our debt is recorded at carrying value in our consolidated balance sheets. The carrying value of our debt outstanding, including the current portion, net of unamortized debt issuance costs, was \$4,780 million at June 30, 2017 and \$3,792 million at December 31, 2016. The fair value of our debt, including the current portion, was \$5,179 million at June 30, 2017 and \$4,004 million at December 31, 2016. The fair value of our long-term debt is determined based on Level 2 inputs, including quoted market prices for the same or similar debt, or if no quoted market prices are available, on the current prices estimated to be available to us for debt with similar terms and remaining maturities.

Due to the short-term nature, carrying value approximates fair value for our commercial paper borrowings. There were outstanding commercial paper borrowings of \$200 million as of June 30, 2017 and \$300 million as of December 31, 2016.

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(Unaudited)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

As disclosed in Note 3, we completed the acquisition of certain health and wellness related businesses during 2017 and 2016. The values of net tangible assets acquired and the resulting goodwill and other intangible assets were recorded at fair value using Level 3 inputs. The majority of the tangible assets acquired and liabilities assumed were recorded at their carrying values as of the respective dates of acquisition, as their carrying values approximated their fair values due to their short-term nature. The fair values of goodwill and other intangible assets acquired in these acquisitions were internally estimated primarily based on the income approach. The income approach estimates fair value based on the present value of the cash flows that the assets are expected to generate in the future. We developed internal estimates for the expected cash flows and discount rates used in the present value calculations. Other than assets acquired and liabilities assumed in these acquisitions, there were no material assets or liabilities measured at fair value on a nonrecurring basis during 2017 or 2016.

6. MEDICARE PART D

We cover prescription drug benefits in accordance with Medicare Part D under multiple contracts with the Centers for Medicare and Medicaid Services, or CMS, as described further in Note 2 to the consolidated financial statements included in our 2016 Form 10-K. The accompanying condensed consolidated balance sheets include the following amounts associated with Medicare Part D at June 30, 2017 and December 31, 2016. CMS subsidies/discounts in the table below include the reinsurance and low-income cost subsidies funded by CMS for which we assume no risk as well as brand name prescription drug discounts for Part D plan participants in the coverage gap funded by CMS and pharmaceutical manufacturers.

	June 30, 2017		December 31, 2016	
	Risk	CMS	Risk	CMS
	Corridor	Subsidies/ Discounts	Corridor	Subsidies/ Discounts
	Settlement		Settlement	
	(in millions)			
Other current assets	\$9	\$ 1,003	\$8	\$ 1,001
Trade accounts payable and accrued expenses	(130)	(2,201)	(158)	(128)
Net current (liability) asset	(121)	(1,198)	(150)	873
Other long-term assets	29	—	—	—
Other long-term liabilities	(110)	—	—	—
Net long-term liability	(81)	—	—	—
Total net (liability) asset	\$(202)	\$(1,198)	\$(150)	\$ 873

7. HEALTH CARE REFORM

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (which we collectively refer to as the Health Care Reform Law) established risk spreading premium stabilization programs effective January 1, 2014, including a permanent risk adjustment program and temporary risk corridor and reinsurance programs, which we collectively refer to as the 3Rs. The 3Rs are applicable to certain of our commercial medical insurance products as further discussed in Note 2 to our 2016 Form 10-K. Operating results for our Individual Commercial medical business compliant with the Health Care Reform Law have been challenged primarily due to unanticipated modifications in the program subsequent to the passing of the Health Care Reform Law, resulting in higher covered population morbidity and the ensuing enrollment and claims issues causing volatility in claims experience. We took a number of actions in 2015 to improve the profitability of our Individual Commercial medical business in 2016. These actions were subject to regulatory restrictions in certain geographies and included premium increases for the 2016 coverage year related generally to the first half of 2015 claims experience, the discontinuation

of certain products as well as exit of certain markets for 2016, network improvements, enhancements to claims and clinical processes and administrative cost control. Despite these actions, the deterioration in the second half of 2015 claims experience together with 2016 open enrollment results indicating the retention of many high-utilizing members

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(Unaudited)

for 2016 resulted in a probable future loss. As a result of our then assessment of the profitability of our individual medical policies compliant with the Health Care Reform Law, in the fourth quarter of 2015, we recorded a provision for probable future losses (premium deficiency reserve, or PDR) for the 2016 coverage year of \$176 million in benefits payable in our consolidated balance sheet with a corresponding increase in benefits expense in our consolidated statement of income. In the first quarter of 2016, we applied \$13 million current period results to the PDR liability. During the second quarter of 2016 we increased the premium deficiency reserve for the 2016 coverage year and recorded a change in estimate of \$208 million with a corresponding increase in benefits expense in our condensed consolidated statement of income for three months ended June 30, 2016. There is no premium deficiency reserve in 2017.

On November 10, 2016, the U.S. Court of Federal Claims ruled in favor of the government in one of a series of cases filed by insurers, unrelated to us, against the U.S. Department of Health and Human Services, or HHS, to collect risk corridor payments, rejecting all of the insurer's statutory, contract and Constitutional claims for payment. On November 18, 2016, HHS issued a memorandum indicating a significant funding shortfall for the 2015 coverage year, the second consecutive year of significant shortfalls. Given the successful challenge of the risk corridor provisions in court, Congressional inquiries into the funding of the risk corridor program, and significant funding shortfalls under the first two years of the program, during the fourth quarter of 2016 we wrote-off \$583 million in risk corridor receivables outstanding as of September 30, 2016, including \$415 million associated with the 2014 and 2015 coverage years. From inception of the risk corridor program through June 30, 2017, we collected approximately \$38 million from CMS for risk corridor receivables associated with the 2014 coverage year funded by HHS in accordance with previous guidance, utilizing funds HHS collected from us and other carriers under the risk corridor program.

On February 14, 2017, we announced we are exiting our Individual Commercial medical business commencing January 1, 2018. As discussed previously, we have worked over the past several years to address market and programmatic challenges in order to keep coverage options available wherever we could offer a viable product. This has included pursuing business changes, such as modifying networks, restructuring product offerings, reducing the company's geographic footprint and increasing premiums. All of these actions were taken with the expectation that our Individual Commercial medical business would stabilize to the point where we could continue to participate in the program. However, based on our analysis of data associated with our healthcare exchange membership following the 2017 open enrollment period, we saw further signs of an unbalanced risk pool. Therefore, we decided that we cannot continue to offer this coverage and plan to exit this business commencing January 1, 2018.

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(Unaudited)

The accompanying condensed consolidated balance sheets include the following amounts associated with the 3Rs at June 30, 2017 and December 31, 2016. Amounts classified as long-term represent settlements that we expect to exceed 12 months at June 30, 2017.

	June 30, 2017		December 31, 2016	
	Risk Adjustment Settlement	Reinsurance Recoverables	Risk Adjustment Settlement	Reinsurance Recoverables
	(in millions)			
Prior Coverage Years				
Premiums receivable	\$291	\$ —	\$ 307	\$ —
Other current assets	—	268	—	260
Trade accounts payable and accrued expenses	(150)	—	(117)	—
Net current asset	141	268	190	260
Other long-term assets	—	—	6	—
Total prior coverage years' net asset	141	268	196	260
Current Coverage Year				
Premiums receivable	12	—	—	—
Net current asset	12	—	—	—
Other long-term assets	30	—	—	—
Other long-term liabilities	(40)	—	—	—
Net long-term liability	(10)	—	—	—
Total 2017 coverage year net asset	2	—	—	—
Total net asset	\$143	\$ 268	\$ 196	\$ 260

During the six months ended June 30, 2017, we received \$60 million for reinsurance recoverables and \$3 million for risk adjustment settlements, in each case associated with prior coverage years. During the six months ended June 30, 2016, we received \$214 million for reinsurance recoverables and \$8 million for risk adjustment and risk corridor settlements associated with prior coverage years.

To the extent certain provisions of the Health Care Reform Law are successfully challenged in court or there are changes in legislation or the application of legislation, there can be no guarantee that receivables established under the reinsurance or risk adjustment provisions of the Health Care Reform Law will ultimately be collected. If we fail to effectively implement our operational and strategic initiatives with respect to the implementation of the Health Care Reform Law, our business may be materially adversely affected. Additionally, potential legislative changes, including activities to repeal or replace the Health Care Reform Law, creates uncertainty for our business, and we cannot predict when, or in what form, such legislative changes may occur.

The annual health insurance industry fee has been suspended for calendar year 2017, but is scheduled to resume in calendar year 2018. In September 2016, we paid the federal government \$916 million for our portion of the annual health insurance industry fee attributed to calendar year 2016 in accordance with the Health Care Reform Law. This fee, fixed in amount by law and apportioned to insurance carriers based on market share, is not deductible for tax purposes. Each year on January 1, except for 2017, we record a liability for this fee in trade accounts payable and accrued expenses which we carry until the fee is paid. We record a corresponding deferred cost in other current assets in our condensed consolidated financial statements which is amortized ratably to expense over the calendar year.

Amortization of the deferred cost was recorded in operating cost expense of approximately \$229 million and \$456 million for the three and six months ended June 30, 2016, respectively, resulting from the amortization of the 2016 annual health insurance industry fee.

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(Unaudited)

8. GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amount of goodwill for our reportable segments has been retrospectively adjusted to conform to the 2017 business segment reclassifications as discussed in Note 1. There was no impairment. Changes in the carrying amount of goodwill for our reportable segments for the six months ended June 30, 2017 were as follows:

	Retail	Group and Specialty	Healthcare Services	Total
	(in millions)			
Balance at January 1, 2017	\$ 1,059	\$ 261	\$ 1,952	\$ 3,272
Acquisitions	—	—	8	8
Balance at June 30, 2017	\$ 1,059	\$ 261	\$ 1,960	\$ 3,280

The following table presents details of our other intangible assets included in other long-term assets in the accompanying condensed consolidated balance sheets at June 30, 2017 and December 31, 2016.

	Weighted Average Life	June 30, 2017			December 31, 2016		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
		(\$ in millions)					
Other intangible assets:							
Customer contracts/ relationships	9.8 years	\$ 566	\$ 374	\$ 192	\$ 566	\$ 347	\$ 219
Trade names and technology	8.2 years	104	75	29	104	69	35
Provider contracts	14.1 years	51	31	20	51	29	22
Noncompetes and other	8.1 years	33	29	4	32	28	4
Total other intangible assets	8.9 years	\$ 754	\$ 509	\$ 245	\$ 753	\$ 473	\$ 280

Amortization expense for other intangible assets was approximately \$18 million for the three months ended June 30, 2017 and \$20 million for the three months ended June 30, 2016. For the six months ended June 30, 2017 and 2016, amortization expense for other intangible assets was approximately \$36 million and \$41 million, respectively. The following table presents our estimate of amortization expense for 2017 and each of the five next succeeding years:

	(in millions)
For the years ending December 31,:	
2017	\$ 71
2018	63
2019	52
2020	48
2021	14
2022	11

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(Unaudited)

9. BENEFITS PAYABLE

On a consolidated basis, activity in benefits payable, excluding military services, was as follows for the six months ended June 30, 2017 and 2016:

	For the six months ended June 30, 2017 2016 (in millions)	
Balances, beginning of period	\$4,563	\$4,976
Less: Premium deficiency reserve	—	(176)
Less: Reinsurance recoverables	(76)	(85)
Balances, beginning of period, net	4,487	4,715
Incurred related to:		
Current year	22,576	23,211
Prior years	(345)	(435)
Total incurred	22,231	22,776
Paid related to:		
Current year	(18,332)	(18,720)
Prior years	(3,626)	(3,925)
Total paid	(21,958)	(22,645)
Premium deficiency reserve	—	337
Reinsurance recoverable	78	75
Balances, end of period	\$4,838	\$5,258

Amounts incurred related to prior periods vary from previously estimated liabilities as the claims ultimately are settled. Negative amounts reported for incurred related to prior years result from claims being ultimately settled for amounts less than originally estimated (favorable development).

Our reserving practice is to consistently recognize the actuarial best estimate of our ultimate liability for claims. Actuarial standards require the use of assumptions based on moderately adverse experience, which generally results in favorable reserve development, or reserves that are considered redundant.

Benefits expense excluded from the previous table was as follows for the six months ended June 30, 2017 and 2016.

	For the six months ended June 30, 2017 2016 (in millions)	
Premium deficiency reserve - Individual Commercial	\$—	\$161
Military services	—	6
Future policy benefits:		
Individual Commercial	(36)	(62)
Other Businesses	20	25
Total future policy benefits	(16)	(37)
Total	\$(16)	\$130

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(Unaudited)

Military services benefits expense in the tables above reflect expenses associated with our contracts with the Veterans Administration.

Incurred and Paid Claims Development

The following discussion provides information about incurred and paid claims development for our Retail, Group and Specialty, and Individual Commercial segments as of June 30, 2017 and 2016, net of reinsurance and the total of IBNR included within the net incurred claims amounts.

Retail Segment

Activity in benefits payable for our Retail segment was as follows for the six months ended June 30, 2017 and 2016:

	For the six months ended June 30,	
	2017	2016
	(in millions)	
Balances, beginning of period	\$3,507	\$3,600
Less: Reinsurance recoverables	(76)	(85)
Balances, beginning of period, net	3,431	3,515
Incurred related to:		
Current year	20,010	19,259
Prior years	(287)	(299)
Total incurred	19,723	18,960
Paid related to:		
Current year	(16,385)	(15,766)
Prior years	(2,707)	(2,946)
Total paid	(19,092)	(18,712)
Reinsurance recoverable	78	75
Balances, end of period	\$4,140	\$3,838

At June 30, 2017, benefits payable for our Retail segment included IBNR of approximately \$2.7 billion, primarily associated with claims incurred in 2017.

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(Unaudited)

Group and Specialty Segment

Activity in benefits payable for our Group and Specialty segment, excluding military services, was as follows for the six months ended June 30, 2017 and 2016:

	For the six months ended June 30, 2017 2016 (in millions)	
Balances, beginning of period	\$578	\$616
Incurred related to:		
Current year	2,629	2,556
Prior years	(31)	(38)
Total incurred	2,598	2,518
Paid related to:		
Current year	(2,117)	(2,000)
Prior years	(518)	(543)
Total paid	(2,635)	(2,543)
Balances, end of period	\$541	\$591

At June 30, 2017, benefits payable for our Group and Specialty segment included IBNR of approximately \$477 million, primarily associated with claims incurred in 2017.

Individual Commercial Segment

Activity in benefits payable for our Individual Commercial segment was as follows for the six months ended June 30, 2017 and 2016:

	For the six months ended June 30, 2017 2016 (in millions)	
Balances, beginning of period	\$454	\$740
Less: Premium deficiency reserve	—	(176)
Balances, beginning of period, net	454	564
Incurred related to:		
Current year	304	1,816
Prior years	(26)	(97)
Total incurred	278	1,719
Paid related to:		
Current year	(223)	(1,396)
Prior years	(378)	(417)
Total paid	(601)	(1,813)
Premium deficiency reserve	—	337
Balance, end of period	\$131	\$807

At June 30, 2017, benefits payable for our Individual Commercial segment included IBNR of approximately \$119 million, primarily associated with claims incurred in 2017.

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(Unaudited)

Reconciliation to Consolidated

The reconciliation of the net incurred and paid claims development tables to benefits payable in the consolidated statement of financial position is as follows:

Reconciliation of the Disclosure of Incurred and Paid
Claims Development to Benefits Payable, net of
reinsurance

	June 30, 2017
Net outstanding liabilities	
Retail	\$4,062
Group and Specialty	541
Individual Commercial	131
Other Businesses	26
Benefits payable, net of reinsurance	4,760
Reinsurance recoverable on unpaid claims	
Retail	78
Total reinsurance recoverable on unpaid claims	78
Total benefits payable, gross	\$4,838

10. EARNINGS PER COMMON SHARE COMPUTATION

Detail supporting the computation of basic and diluted earnings per common share was as follows for the three and six months ended June 30, 2017 and 2016:

	Three months ended June 30, 2017		Six months ended June 30, 2016	
	2017	2016	2017	2016
	(dollars in millions, except per common share results; number of shares in thousands)			
Net income available for common stockholders	\$650	\$ 311	\$1,765	\$ 565
Weighted average outstanding shares of common stock used to compute basic earnings per common share	144,600	149,386	146,212	149,273
Dilutive effect of:				
Employee stock options	158	218	179	218
Restricted stock	876	1,202	862	1,360
Shares used to compute diluted earnings per common share	145,634	150,806	147,253	150,851
Basic earnings per common share	\$4.49	\$ 2.08	\$12.07	\$ 3.79
Diluted earnings per common share	\$4.46	\$ 2.06	\$11.98	\$ 3.75
Number of antidilutive stock options and restricted stock excluded from computation	449	676	693	980

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(Unaudited)

11. STOCKHOLDERS' EQUITY

Dividends

The following table provides details of dividend payments, excluding dividend equivalent rights for unvested stock awards, in 2016 and 2017 under our Board approved quarterly cash dividend policy:

Record Date	Payment Date	Amount per Share	Total Amount
(in millions)			
2016 payments			
12/30/2015	1/29/2016	\$ 0.29	\$ 43
3/31/2016	4/29/2016	\$ 0.29	\$ 43
6/30/2016	7/29/2016	\$ 0.29	\$ 43
10/13/2016	10/28/2016	\$ 0.29	\$ 43
2017 payments			
1/12/2017	1/27/2017	\$ 0.29	\$ 43
3/31/2017	4/28/2017	\$ 0.40	\$ 58
6/30/2017	7/31/2017	\$ 0.40	\$ 58

Stock Repurchases

On February 14, 2017 our Board of Directors replaced a previous share repurchase authorization of up to \$2 billion, of which \$1.04 billion remained unused, with a new authorization for repurchases of up to \$2.25 billion of our common shares expiring on December 31, 2017 exclusive of shares repurchased in connection with employee stock plans.

Under the share repurchase authorization, shares may be purchased from time to time at prevailing prices in the open market, by block purchases, through plans designed to comply with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, or in privately-negotiated transactions, including pursuant to accelerated share repurchase agreements with investment banks, subject to certain regulatory restrictions on volume, pricing, and timing. Our remaining repurchase authorization was \$1.05 billion as of August 1, 2017, which includes \$300 million of stock held back as part of the accelerated share repurchase agreement as more fully described below.

On February 16, 2017, we entered into an accelerated share repurchase agreement, or ASR Agreement, with Goldman, Sachs & Co. LLC, or Goldman Sachs, to repurchase \$1.5 billion of our common stock as part of the \$2.25 billion share repurchase program referred to above. Under the ASR Agreement, on February 22, 2017, we made a payment of \$1.5 billion to Goldman Sachs from available cash on hand and received an initial delivery of 5.83 million shares of our common stock from Goldman Sachs based on the then current market price of Humana common stock. The payment to Goldman Sachs was recorded as a reduction to stockholders' equity, consisting of a \$1.2 billion increase in treasury stock, which reflected the value of the initial 5.83 million shares received upon initial settlement, and a \$300 million decrease in capital in excess of par value, which reflected the value of stock held back by Goldman Sachs pending final settlement of the ASR Agreement. The final number of shares that we may receive, or be required to remit, under the ASR agreement will be determined based on the daily volume-weighted average share price of our common stock over the term of the ASR agreement. Final settlement under the ASR agreement is expected to occur by the end of the third quarter of 2017. The ASR agreement contains provisions customary for agreements of this type, including provisions for adjustments to the transaction terms upon certain specified events, the circumstances generally under which final settlement of the ASR Agreement may be accelerated or extended or the ASR agreement may be terminated early by Goldman Sachs or Humana, and various acknowledgments and representations made by the parties to each other. At final settlement, under certain circumstances, we may be entitled to receive additional shares of our common stock from Goldman Sachs or we may be required to make a payment. If we are obligated to

make payment, we may elect to satisfy such obligation in cash or shares of our common stock. The obligation of Goldman Sachs under the ASR agreement is guaranteed by The Goldman Sachs Group, Inc.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

In connection with employee stock plans, we acquired 0.37 million common shares for \$78 million and 0.44 million common shares for \$73 million during the six months ended June 30, 2017 and 2016, respectively.

Treasury Stock Reissuance

We reissued 1.34 million shares of treasury stock during the six months ended June 30, 2017 at a cost of \$94 million associated with restricted stock unit vestings and option exercises.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income included net unrealized gains, net of tax, on our investment securities of \$87 million at June 30, 2017 and net unrealized losses, net of tax, of \$17 million at December 31, 2016. In addition, accumulated other comprehensive income included \$92 million, net of tax, at June 30, 2017 and \$49 million, net of tax at December 31, 2016 for an additional liability that would exist on our closed block of long-term care insurance policies if unrealized gains on the sale of the investments backing such products had been realized and the proceeds reinvested at then current yields. Refer to Note 18 to the consolidated financial statements in our 2016 Form 10-K for further discussion of our long-term care insurance policies.

12. INCOME TAXES

The effective income tax rate was 37.6% for the three months ended June 30, 2017, compared to 51.1% for the three months ended June 30, 2016 and was 35.4% for the six months ended June 30, 2017, compared to 50.3% for the six months ended June 30, 2016, primarily due to the 2017 temporary suspension of the non-deductible health insurance industry fee as well as previously non-deductible transaction costs that, as a result of termination of the Merger Agreement, became deductible for tax purposes and were recorded as such in the three months ended March 31, 2017.

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(Unaudited)

13. DEBT

The carrying value of debt outstanding, net of unamortized debt issuance costs, was as follows at June 30, 2017 and December 31, 2016:

	June 30, December 31, 2017 2016 (in millions)	
Short-term:		
Commercial paper	\$200	\$ 300
\$500 million, 7.20% Senior notes due June 15, 2018	501	—
Total short-term debt	701	300
Long-term:		
Senior notes:		
\$500 million, 7.20% due June 15, 2018	—	501
\$300 million, 6.30% due August 1, 2018	303	304
\$400 million, 2.625% due October 1, 2019	398	398
\$600 million, 3.15% due December 1, 2022	596	595
\$600 million, 3.85% due October 1, 2024	595	595
\$600 million, 3.95% due March 15, 2027	594	—
\$250 million, 8.15% due June 15, 2038	263	264
\$400 million, 4.625% due December 1, 2042	396	396
\$750 million, 4.95% due October 1, 2044	739	739
\$400 million, 4.80% due March 15, 2047	395	—
Total long-term debt	4,279	3,792
Total debt	\$4,980	\$ 4,092
Senior Notes		

In March 2017, we issued \$600 million of 3.95% senior notes due March 15, 2027 and \$400 million of 4.80% senior notes due March 15, 2047. Our net proceeds, reduced for the underwriters' discount and commission and offering expenses paid as of March 31, 2017, were \$991 million. We intend to use the net proceeds from these issuances for general corporate purposes.

Our senior notes, which are unsecured, may be redeemed at our option at any time at 100% of the principal amount plus accrued interest and a specified make-whole amount. The 7.20% and 8.15% senior notes are subject to an interest rate adjustment if the debt ratings assigned to the notes are downgraded (or subsequently upgraded). In addition, each series of our senior notes (other than the 6.30% senior notes) contain a change of control provision that may require us to purchase the notes under certain circumstances.

Prior to 2009, we were parties to interest-rate swap agreements that exchanged the fixed interest rate under our senior notes for a variable interest rate based on LIBOR. As a result, the carrying value of the senior notes was adjusted to reflect changes in value caused by an increase or decrease in interest rates. During 2008, we terminated all of our swap agreements. The cumulative adjustment to the carrying value of our senior notes was \$103 million as of the termination date which is being amortized as a reduction to interest expense over the remaining term of the senior notes. In October 2014, the redemption of our 6.45% senior notes reduced the unamortized carrying value adjustment by \$12 million. The unamortized carrying value adjustment was \$21 million as of June 30, 2017 and \$23 million as of

December 31, 2016.

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Credit Agreement

In May 2017 we amended and restated our previous 5-year \$1.0 billion unsecured revolving credit agreement expiring July 2018 with a 5-year \$2.0 billion unsecured revolving credit agreement which expires May 2022. Under the credit agreement, at our option, we can borrow on either a competitive advance basis or a revolving credit basis. The revolving credit portion bears interest at either LIBOR plus a spread or the base rate plus a spread. The LIBOR spread, currently 110.0 basis points, varies depending on our credit ratings ranging from 91.0 to 150.0 basis points. We also pay an annual facility fee regardless of utilization. This facility fee, currently 15.0 basis points, may fluctuate between 9.0 and 25.0 basis points, depending upon our credit ratings. The competitive advance portion of any borrowings will bear interest at market rates prevailing at the time of borrowing on either a fixed rate or a floating rate based on LIBOR, at our option.

The terms of the credit agreement include standard provisions related to conditions of borrowing, including a customary material adverse effect clause which could limit our ability to borrow additional funds. In addition, the credit agreement contains customary restrictive and financial covenants as well as customary events of default, including financial covenants regarding the maintenance of a minimum level of net worth of \$8.9 billion at June 30, 2017 and a maximum leverage ratio of 3.0:1. We are in compliance with the financial covenants, with actual net worth of \$11.0 billion and an actual leverage ratio of 1.1:1, as measured in accordance with the credit agreement as of June 30, 2017. Upon our agreement with one or more financial institutions, we may expand the aggregate commitments under the credit agreement to a maximum of \$2.5 billion, through a \$500.0 million incremental loan facility.

At June 30, 2017, we had no borrowings and no letters of credit outstanding under the credit agreement. Accordingly, as of June 30, 2017, we had \$2.0 billion of remaining borrowing capacity (which excludes the uncommitted \$500.0 million incremental loan facility under the credit agreement), none of which would be restricted by our financial covenant compliance requirement. We have other customary, arms-length relationships, including financial advisory and banking, with some parties to the credit agreement.

Commercial Paper

We previously entered into a commercial paper program pursuant to which we may issue short-term, unsecured commercial paper notes privately placed on a discount basis through certain broker dealers. On June 15, 2017, we increased the size of the commercial paper program to permit the issuance of the commercial notes with the aggregate face or principal amount outstanding under the program at any time not to exceed \$2 billion. Amounts available under the program may be borrowed, repaid and re-borrowed from time to time. The net proceeds of issuances have been and are expected to be used for general corporate purposes. The maximum principal amount outstanding at any one time during the six months ended June 30, 2017 was \$500 million. There were outstanding borrowings of \$200 million at June 30, 2017 and \$300 million at December 31, 2016.

14. GUARANTEES AND CONTINGENCIES

Government Contracts

Our Medicare products, which accounted for approximately 78% of our total premiums and services revenue for the six months ended June 30, 2017, primarily consisted of products covered under the Medicare Advantage and Medicare Part D Prescription Drug Plan contracts with the federal government. These contracts are renewed generally for a calendar year term unless CMS notifies us of its decision not to renew by May 1 of the calendar year in which the contract would end, or we notify CMS of our decision not to renew by the first Monday in June of the calendar year in which the contract would end. All material contracts between Humana and CMS relating to our Medicare products have been renewed for 2018. However, our offerings of products under those contracts are subject to approval by CMS, which we expect to receive in the fall of 2017.

CMS uses a risk-adjustment model which adjusts premiums paid to Medicare Advantage, or MA, plans according to health status of covered members. The risk-adjustment model, which CMS implemented pursuant to the Balanced Budget Act of 1997(BBA) and the Benefits Improvement and Protection Act of 2000 (BIPA), generally pays more

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where a plan's membership has higher expected costs. Under this model, rates paid to MA plans are based on actuarially determined bids, which include a process whereby our prospective payments are based on our estimated cost of providing standard Medicare-covered benefits to an enrollee with a "national average risk profile." That baseline payment amount is adjusted to reflect the health status of our enrolled membership. Under the risk-adjustment methodology, all MA plans must collect and submit the necessary diagnosis code information from hospital inpatient, hospital outpatient, and physician providers to CMS within prescribed deadlines. The CMS risk-adjustment model uses the diagnosis data to calculate the risk-adjusted premium payment to MA plans, which CMS adjusts for coding pattern differences between the health plans and the government fee-for-service program. We generally rely on providers, including certain providers in our network who are our employees, to code their claim submissions with appropriate diagnoses, which we send to CMS as the basis for our payment received from CMS under the actuarial risk-adjustment model. We also rely on these providers to document appropriately all medical data, including the diagnosis data submitted with claims. In addition, we conduct medical record reviews as part of our data and payment accuracy compliance efforts, to more accurately reflect diagnosis conditions under the risk adjustment model. These compliance efforts include the internal contract level audits described in more detail below. CMS is phasing-in the process of calculating risk scores using diagnoses data from the Risk Adjustment Processing System, or RAPS, to diagnosis data from the Encounter Data System, or EDS. The RAPS process requires MA plans to apply a filter logic based on CMS guidelines and only submit claims that satisfy those guidelines. For submissions through EDS, CMS requires MA plans to submit all the encounter data and CMS will apply the risk adjustment filtering logic to determine the risk scores. For 2016, 10% of the risk score was calculated from claims data submitted through EDS, increasing to 25% of the risk score calculated from claims data through EDS for 2017. In April 2017, CMS revised the pace of the phase-in. For 2018, 15% of the risk score will be calculated from claims data submitted through EDS. The phase-in from RAPS to EDS could result in different risk scores from each dataset as a result of plan processing issues, CMS processing issues, or filtering logic differences between RAPS and EDS, and could have a material adverse effect on our results of operations, financial position, or cash flows.

CMS is continuing to perform audits of various companies' selected MA contracts related to this risk adjustment diagnosis data. We refer to these audits as Risk-Adjustment Data Validation Audits, or RADV audits. RADV audits review medical records in an attempt to validate provider medical record documentation and coding practices which influence the calculation of premium payments to MA plans.

In 2012, CMS released a "Notice of Final Payment Error Calculation Methodology for Part C Medicare Advantage Risk Adjustment Data Validation (RADV) Contract-Level Audits." The payment error calculation methodology provides that, in calculating the economic impact of audit results for an MA contract, if any, the results of the RADV audit sample will be extrapolated to the entire MA contract after a comparison of the audit results to a similar audit of Medicare FFS (we refer to the process of accounting for errors in FFS claims as the "FFS Adjuster"). This comparison of RADV audit results to the FFS error rate is necessary to determine the economic impact, if any, of RADV audit results because the government used the Medicare FFS program data set, including any attendant errors that are present in that data set, to estimate the costs of various health status conditions and to set the resulting adjustments to MA plans' payment rates. CMS already makes other adjustments to payment rates based on a comparison of coding pattern differences between MA plans and Medicare FFS data (such as for frequency of coding for certain diagnoses in MA plan data versus the Medicare FFS program data set).

The final RADV extrapolation methodology, including the first application of extrapolated audit results to determine audit settlements, is expected to be applied to RADV contract level audits conducted for contract year 2011 and subsequent years. CMS is currently conducting RADV contract level audits for contract years 2011, 2012, and 2013, in which two, five, and five of our Medicare Advantage plans are being audited, respectively. Per CMS guidance,

selected MA contracts will be notified of an audit at some point after the close of the final reconciliation for the payment year being audited. In recent years, the final reconciliation payment has occurred in July of the calendar year following the payment year, although CMS has stated that this year's final payment will occur in October. Estimated audit settlements are recorded as a reduction of premiums revenue in our consolidated statements of income, based upon available information. We perform internal contract level audits based on the RADV audit

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methodology prescribed by CMS. Included in these internal contract level audits is an audit of our Private Fee-For-Service business which we used to represent a proxy of the FFS Adjuster which has not yet been released. We based our accrual of estimated audit settlements for each contract year on the results of these internal contract level audits and update our estimates as each audit is completed. Estimates derived from these results were not material to our results of operations, financial position, or cash flows. We report the results of these internal contract level audits to CMS, including identified overpayments, if any. However, as indicated, we are awaiting additional guidance from CMS regarding the FFS Adjuster. Accordingly, we cannot determine whether such RADV audits will have a material adverse effect on our results of operations, financial position, or cash flows.

In addition, CMS' comments in formalized guidance regarding "overpayments" to MA plans appear to be inconsistent with CMS' prior RADV audit guidance. These statements, contained in the preamble to CMS' final rule release regarding Medicare Advantage and Part D prescription drug benefit program regulations for Contract Year 2015, appear to equate each Medicare Advantage risk adjustment data error with an "overpayment" without reconciliation to the principles underlying the FFS Adjuster referenced above. We will continue to work with CMS to ensure that MA plans are paid accurately and that payment model principles are in accordance with the requirements of the Social Security Act, which, if not implemented correctly could have a material adverse effect on our results of operations, financial position, or cash flows.

At June 30, 2017, our military services business, which accounted for approximately 1% of our total premiums and services revenue for the six months ended June 30, 2017, primarily consisted of the TRICARE South Region contract. The current 5-year South Region contract, which was set to expire on March 31, 2017, is subject to annual renewals on April 1 of each year during its term at the government's option, including an option to extend for a sixth year through March 31, 2018. On March 2, 2017, we received notice that the Defense Health Agency, or DHA, had exercised its option to extend the TRICARE South Region contract for that sixth year. On July 21, 2016, we were notified by the DHA that we were awarded the contract for the new TRICARE East Region, which is a consolidation of the former North and South Regions, with delivery of health care services expected to commence on October 1, 2017. On March 30, 2017, we received notice that the DHA is moving the date upon which delivery of health care services is expected to commence under the new TRICARE East Region contract from October 1, 2017, to January 1, 2018. We expect the sixth option period under the current TRICARE South Region contract would be terminated in the event that delivery of health care services under the new TRICARE East Region contract commences prior to March 31, 2018.

Our state-based Medicaid business accounted for approximately 5% of our total premiums and services revenue for the six months ended June 30, 2017. In addition to our state-based Temporary Assistance for Needy Families, or TANF, Medicaid contracts in Florida and Kentucky, we have contracts in Florida for Long Term Support Services (LTSS), in Illinois and Virginia for stand-alone dual eligible demonstration programs serving individuals dually eligible for both the federal Medicare program and the applicable state-based Medicaid program as well as an Integrated Care Program, or ICP, Medicaid contract in Illinois.

The loss of any of the contracts above or significant changes in these programs as a result of legislative or regulatory action, including reductions in premium payments to us, regulatory restrictions on profitability, including by comparison of our Medicare Advantage profitability to our non-Medicare Advantage business profitability and a requirement that they remain within certain ranges of each other, or increases in member benefits without corresponding increases in premium payments to us, may have a material adverse effect on our results of operations, financial position, and cash flows.

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Legal Proceedings and Certain Regulatory Matters

Florida Matters

On January 6, 2012, the Civil Division of the United States Attorney's Office for the Southern District of Florida advised us that it is seeking documents and information from us and several of our affiliates relating to several matters including the coding of medical claims by one or more South Florida medical providers, and loans to physician practices. On May 1, 2014, the U.S. Attorney's Office filed a Notice of Non-Intervention in connection with a civil qui tam suit related to one of these matters captioned United States of America ex rel. Olivia Graves v. Plaza Medical Centers, et al., and the Court ordered the complaint unsealed. Subsequently, the individual plaintiff amended the complaint and served the Company, opting to continue to pursue the action. The individual plaintiff has filed a fourth and fifth amended complaint, both of which have been dismissed, and the third amended complaint has been ordered operative by the Court. The Court has ordered trial to commence on November 13, 2017. We continue to cooperate with and respond to information requests from the U.S. Attorney's office. These matters could result in additional qui tam litigation.

As previously disclosed, the Civil Division of the United States Department of Justice had provided us with an information request, separate from but related to the Plaza Medical matter, concerning our Medicare Part C risk adjustment practices. The request relates to our oversight and submission of risk adjustment data generated by providers in our Medicare Advantage network, including the providers identified in the Plaza Medical matter, as well as to our business and compliance practices related to risk adjustment data generated by our providers and by us, including medical record reviews conducted as part of our data and payment accuracy compliance efforts, the use of health and well-being assessments, and our fraud detection efforts. We believe that this request for information is in connection with a wider review of Medicare Risk Adjustment generally that includes a number of Medicare Advantage plans, providers and vendors. We continue to cooperate with and voluntarily respond to the information requests from the Department of Justice and the U.S. Attorney's Office. These matters are expected to result in additional qui tam litigation.

Other Lawsuits and Regulatory Matters

Our current and past business practices are subject to review or other investigations by various state insurance and health care regulatory authorities and other state and federal regulatory authorities. These authorities regularly scrutinize the business practices of health insurance, health care delivery and benefits companies. These reviews focus on numerous facets of our business, including claims payment practices, statutory capital requirements, provider contracting, risk adjustment, competitive practices, commission payments, privacy issues, utilization management practices, pharmacy benefits, access to care, and sales practices, among others. Some of these reviews have historically resulted in fines imposed on us and some have required changes to some of our practices. We continue to be subject to these reviews, which could result in additional fines or other sanctions being imposed on us or additional changes in some of our practices.

We also are involved in various other lawsuits that arise, for the most part, in the ordinary course of our business operations, certain of which may be styled as class-action lawsuits. Among other matters, this litigation may include employment matters, claims of medical malpractice, bad faith, nonacceptance or termination of providers, anticompetitive practices, improper rate setting, provider contract rate and payment disputes, general contractual matters, intellectual property matters, and challenges to subrogation practices. For example, a number of hospitals and other providers have asserted that, under their network provider contracts, we are not entitled to reduce Medicare Advantage payments to these providers in connection with changes in Medicare payment systems and in accordance with the Balanced Budget and Emergency Deficit Control Act of 1985, as amended (commonly referred to as "sequestration"). Those challenges have led and could lead to arbitration demands or other litigation. Also, under state guaranty assessment laws, including those related to state cooperative failures in the industry, we may be assessed (up

to prescribed limits) for certain obligations to the policyholders and claimants of insolvent insurance companies that write the same line or lines of business as we do. Penn Treaty is a financially distressed unaffiliated long-term care insurance company. On March 1, 2017, a court ordered the liquidation of Penn Treaty which triggered assessments from state guaranty associations that resulted in our recording a \$54 million estimate in operating costs in the three months ended March 31, 2017.

As a government contractor, we may also be subject to qui tam litigation brought by individuals who seek to sue

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on behalf of the government, alleging that the government contractor submitted false claims to the government including, among other allegations, those resulting from coding and review practices under the Medicare risk adjustment model. Qui tam litigation is filed under seal to allow the government an opportunity to investigate and to decide if it wishes to intervene and assume control of the litigation. If the government does not intervene, the lawsuit is unsealed, and the individual may continue to prosecute the action on his or her own, on behalf of the government. We also are subject to other allegations of non-performance of contractual obligations to providers, members, and others, including failure to properly pay claims, improper policy terminations, challenges to our implementation of the Medicare Part D prescription drug program and other litigation.

A limited number of the claims asserted against us are subject to insurance coverage. Personal injury claims, claims for extra contractual damages, care delivery malpractice, and claims arising from medical benefit denials are covered by insurance from our wholly owned captive insurance subsidiary and excess carriers, except to the extent that claimants seek punitive damages, which may not be covered by insurance in certain states in which insurance coverage for punitive damages is not permitted. In addition, insurance coverage for all or certain forms of liability has become increasingly costly and may become unavailable or prohibitively expensive in the future.

We record accruals for the contingencies discussed in the sections above to the extent that we conclude it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. No estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made at this time regarding the matters specifically described above because of the inherently unpredictable nature of legal proceedings, which also may be exacerbated by various factors, including: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) there are significant facts in dispute; (vi) there are a large number of parties (including where it is uncertain how liability, if any, will be shared among multiple defendants); or (vii) there is a wide range of potential outcomes. The outcome of any current or future litigation or governmental or internal investigations, including the matters described above, cannot be accurately predicted, nor can we predict any resulting judgments, penalties, fines or other sanctions that may be imposed at the discretion of federal or state regulatory authorities or as a result of actions by third parties. Nevertheless, it is reasonably possible that any such outcome of litigation, judgments, penalties, fines or other sanctions could be substantial, and the outcome of these matters may have a material adverse effect on our results of operations, financial position, and cash flows, and may also affect our reputation.

15. SEGMENT INFORMATION

During the three months ended March 31, 2017, we realigned certain of our businesses among our reportable segments to correspond with internal management reporting changes and our previously announced planned exit from the Individual Commercial medical business on January 1, 2018. Additionally, we renamed our Group segment to the Group and Specialty segment, and began presenting the Individual Commercial business results as a separate segment rather than as part of the Retail segment. Specialty health insurance benefits, including dental, vision, other supplement health, and financial protection products, marketed to individuals are now included in the Group and Specialty segment. Specialty health insurance benefits marketed to employer groups continue to be included in the Group and Specialty segment. As a result of this realignment, our reportable segments now include Retail, Group and Specialty, Healthcare Services, and Individual Commercial. Prior period segment financial information has been recast to conform to the 2017 presentation.

We manage our business with four reportable segments: Retail, Group and Specialty, Healthcare Services and Individual Commercial. In addition, the Other Businesses category includes businesses that are not individually reportable because they do not meet the quantitative thresholds required by generally accepted accounting principles. These segments are based on a combination of the type of health plan customer and adjacent businesses centered on well-being solutions for our health plans and other customers, as described below. These segment groupings are

consistent with information used by our Chief Executive Officer to assess performance and allocate resources. The Retail segment consists of Medicare benefits, marketed to individuals or directly via group accounts. In addition, the Retail segment also includes our contract with CMS to administer the Limited Income Newly Eligible Transition, or LI-NET, prescription drug plan program and contracts with various states to provide Medicaid, dual eligible, and Long-Term Support Services benefits, collectively our state-based contracts. The Group and Specialty segment consists of employer group commercial fully-insured medical and specialty health insurance benefits marketed

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to individuals and employer groups, including dental, vision, and other supplemental health and voluntary insurance benefits and financial protection products, as well as administrative services only, or ASO products. In addition, our Group and Specialty segment includes military services business, primarily our TRICARE South Region contract. The Healthcare Services segment includes services offered to our health plan members as well as to third parties, including pharmacy solutions, provider services, and clinical care service, as well as services and capabilities to promote wellness and advance population health. The Individual Commercial segment consists of our individual commercial fully-insured medical health insurance benefits. We report under the category of Other Businesses those businesses which do not align with the reportable segments described above, primarily our closed-block long-term care insurance policies.

Our Healthcare Services intersegment revenues primarily relate to managing prescription drug coverage for members of our other segments through Humana Pharmacy Solutions[®], or HPS, and includes the operations of Humana Pharmacy, Inc., our mail order pharmacy business. These revenues consist of the prescription price (ingredient cost plus dispensing fee), including the portion to be settled with the member (co-share) or with the government (subsidies), plus any associated administrative fees. Services revenues related to the distribution of prescriptions by third party retail pharmacies in our networks are recognized when the claim is processed and product revenues from dispensing prescriptions from our mail order pharmacies are recorded when the prescription or product is shipped. Our pharmacy operations, which are responsible for designing pharmacy benefits, including defining member co-share responsibilities, determining formulary listings, contracting with retail pharmacies, confirming member eligibility, reviewing drug utilization, and processing claims, act as a principal in the arrangement on behalf of members in our other segments. As principal, our Healthcare Services segment reports revenues on a gross basis, including co-share amounts from members collected by third party retail pharmacies at the point of service.

In addition, our Healthcare Services intersegment revenues include revenues earned by certain owned providers derived from risk-based and non-risk-based managed care agreements with our health plans. Under risk based agreements, the provider receives a monthly capitated fee that varies depending on the demographics and health status of the member, for each member assigned to these owned providers by our health plans. The owned provider assumes the economic risk of funding the assigned members' healthcare services. Under non risk-based agreements, our health plans retain the economic risk of funding the assigned members' healthcare services. Our Healthcare Services segment reports provider services revenues associated with risk-based agreements on a gross basis, whereby capitation fee revenue is recognized in the period in which the assigned members are entitled to receive healthcare services. Provider services revenues associated with non-risk-based agreements are presented net of associated healthcare costs.

We present our consolidated results of operations from the perspective of the health plans. As a result, the cost of providing benefits to our members, whether provided via a third party provider or internally through a stand-alone subsidiary, is classified as benefits expense and excludes the portion of the cost for which the health plans do not bear responsibility, including member co-share amounts and government subsidies of \$3.2 billion for the three months ended June 30, 2017 and 2016. For the six months ended June 30, 2017 and 2016 these amounts were \$6.2 billion. In addition, depreciation and amortization expense associated with certain businesses in our Healthcare Services segment delivering benefits to our members, primarily associated with our provider services and pharmacy operations, are included with benefits expense. The amount of this expense was \$27 million for the three months ended June 30, 2017 and 2016. For the six months ended June 30, 2017 and 2016, the amount of this expense was \$53 million and \$54 million, respectively.

Other than those described previously, the accounting policies of each segment are the same and are described in Note 2 to the consolidated financial statements included in our 2016 Form 10-K. Transactions between reportable segments primarily consist of sales of services rendered by our Healthcare Services segment, primarily pharmacy, provider, and clinical care services, to our Retail, Group and Specialty, and Individual Commercial segment customers.

Intersegment sales and expenses are recorded at fair value and eliminated in consolidation. Members served by our segments often use the same provider networks, enabling us in some instances to obtain more favorable contract terms with providers. Our segments also share indirect costs and assets. As a result, the profitability of each segment is interdependent. We allocate most operating expenses to our segments. Assets and certain corporate income and expenses are not allocated to the segments, including the portion of investment income not supporting segment operations, interest expense on corporate debt, and certain other corporate expenses. These items are managed at a corporate level. These corporate amounts are reported separately from our reportable segments and are included with intersegment eliminations in the tables presenting segment results below.

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Our segment results were as follows for the three and six months ended June 30, 2017 and 2016:

	Retail	Group and Specialty	Healthcare Services	Individual Commercial	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)						
Three months ended June 30, 2017							
Revenues - external customers							
Premiums:							
Individual Medicare Advantage	\$8,282	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 8,282
Group Medicare Advantage	1,277	—	—	—	—	—	1,277
Medicare stand-alone PDP	925	—	—	—	—	—	925
Total Medicare	10,484	—	—	—	—	—	10,484
Fully-insured	118	1,350	—	247	—	—	1,715
Specialty	—	323	—	—	—	—	323
Medicaid and other	671	—	—	—	10	—	681
Total premiums	11,273	1,673	—	247	10	—	13,203
Services revenue:							
Provider	—	—	63	—	—	—	63
ASO and other	2	143	—	—	2	—	147
Pharmacy	—	—	20	—	—	—	20
Total services revenue	2	143	83	—	2	—	230
Total revenues - external customers	11,275	1,816	83	247	12	—	13,433
Intersegment revenues							
Services	—	5	4,309	—	—	(4,314)	—
Products	—	—	1,582	—	—	(1,582)	—
Total intersegment revenues	—	5	5,891	—	—	(5,896)	—
Investment income	24	7	8	1	21	40	101
Total revenues	11,299	1,828	5,982	248	33	(5,856)	13,534
Operating expenses:							
Benefits	9,672	1,312	—	86	32	(213)	10,889
Operating costs	963	394	5,677	40	2	(5,623)	1,453
Depreciation and amortization	57	21	35	4	—	(25)	92
Total operating expenses	10,692	1,727	5,712	130	34	(5,861)	12,434
Income (loss) from operations	607	101	270	118	(1)	5	1,100
Interest expense	—	—	—	—	—	58	58
Income (loss) before income taxes	\$ 607	\$ 101	\$ 270	\$ 118	\$ (1)	\$ (53)	\$ 1,042

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	Retail	Group and Specialty	Healthcare Services	Individual Commercial	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)						
Three months ended June 30, 2016							
Revenues - external customers							
Premiums:							
Individual Medicare Advantage	\$8,050	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 8,050
Group Medicare Advantage	1,085	—	—	—	—	—	1,085
Medicare stand-alone PDP	1,015	—	—	—	—	—	1,015
Total Medicare	10,150	—	—	—	—	—	10,150
Fully-insured	106	1,357	—	1,024	—	—	2,487
Specialty	—	321	—	—	—	—	321
Medicaid and other	678	5	—	—	9	—	692
Total premiums	10,934	1,683	—	1,024	9	—	13,650
Services revenue:							
Provider	—	—	74	—	—	—	74
ASO and other	2	176	—	—	3	—	181
Pharmacy	—	—	7	—	—	—	7
Total services revenue	2	176	81	—	3	—	262
Total revenues - external customers	10,936	1,859	81	1,024	12	—	13,912
Intersegment revenues							
Services	—	6	4,767	—	—	(4,773)	—
Products	—	—	1,433	—	—	(1,433)	—
Total intersegment revenues	—	6	6,200	—	—	(6,206)	—
Investment income	22	6	7	1	16	43	95
Total revenues	10,958	1,871	6,288	1,025	28	(6,163)	14,007
Operating expenses:							
Benefits	9,327	1,302	—	1,089	31	(240)	11,509
Operating costs	1,069	423	5,974	152	4	(5,923)	1,699
Merger termination fee and related costs, net	—	—	—	—	—	27	27
Depreciation and amortization	48	22	35	9	—	(25)	89
Total operating expenses	10,444	1,747	6,009	1,250	35	(6,161)	13,324
Income (loss) from operations	514	124	279	(225)	(7)	(2)	683
Interest expense	—	—	—	—	—	47	47
Income (loss) before income taxes	\$514	\$ 124	\$ 279	\$ (225)	\$ (7)	\$ (49)	\$ 636

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	Retail	Group and Specialty	Healthcare Services	Individual Commercial	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)						
Six months ended June 30, 2017							
Revenues - external customers							
Premiums:							
Individual Medicare Advantage	\$16,658	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 16,658
Group Medicare Advantage	2,595	—	—	—	—	—	2,595
Medicare stand-alone PDP	1,866	—	—	—	—	—	1,866
Total Medicare	21,119	—	—	—	—	—	21,119
Fully-insured	236	2,728	—	530	—	—	3,494
Specialty	—	645	—	—	—	—	645
Medicaid and other	1,324	—	—	—	19	—	1,343
Total premiums	22,679	3,373	—	530	19	—	26,601
Services revenue:							
Provider	—	—	133	—	—	—	133
ASO and other	4	304	—	—	4	—	312
Pharmacy	—	—	38	—	—	—	38
Total services revenue	4	304	171	—	4	—	483
Total revenues - external customers	22,683	3,677	171	530	23	—	27,084
Intersegment revenues							
Services	—	10	8,619	—	—	(8,629)	—
Products	—	—	3,134	—	—	(3,134)	—
Total intersegment revenues	—	10	11,753	—	—	(11,763)	—
Investment income	49	18	16	2	42	85	212
Total revenues	22,732	3,705	11,940	532	65	(11,678)	27,296
Operating expenses:							
Benefits	19,723	2,598	—	242	61	(409)	22,215
Operating costs	1,917	793	11,357	102	6	(11,169)	3,006
Merger termination fee and related costs, net	—	—	—	—	—	(947)	(947)
Depreciation and amortization	115	42	69	7	—	(49)	184
Total operating expenses	21,755	3,433	11,426	351	67	(12,574)	24,458
Income (loss) from operations	977	272	514	181	(2)	896	2,838
Interest expense	—	—	—	—	—	107	107
Income (loss) before income taxes	\$977	\$ 272	\$ 514	\$ 181	\$ (2)	\$ 789	\$ 2,731

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	Retail	Group and Specialty	Healthcare Services	Individual Commercial	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)						
Six months ended June 30, 2016							
Revenues - external customers							
Premiums:							
Individual Medicare Advantage	\$16,077	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 16,077
Group Medicare Advantage	2,162	—	—	—	—	—	2,162
Medicare stand-alone PDP	2,054	—	—	—	—	—	2,054
Total Medicare	20,293	—	—	—	—	—	20,293
Fully-insured	210	2,694	—	1,917	—	—	4,821
Specialty	—	639	—	—	—	—	639
Medicaid and other	1,308	10	—	—	19	—	1,337
Total premiums	21,811	3,343	—	1,917	19	—	27,090
Services revenue:							
Provider	—	—	145	—	—	—	145
ASO and other	3	353	1	—	6	—	363
Pharmacy	—	—	14	—	—	—	14
Total services revenue	3	353	160	—	6	—	522
Total revenues - external customers	21,814	3,696	160	1,917	25	—	27,612
Intersegment revenues							
Services	—	12	9,551	—	—	(9,563)	—
Products	—	—	2,793	—	—	(2,793)	—
Total intersegment revenues	—	12	12,344	—	—	(12,356)	—
Investment income	46	12	14	3	31	89	195
Total revenues	21,860	3,720	12,518	1,920	56	(12,267)	27,807
Operating expenses:							
Benefits	18,960	2,524	—	1,818	56	(452)	22,906
Operating costs	2,151	857	11,916	321	8	(11,820)	3,433
Merger termination fee and related costs, net	—	—	—	—	—	61	61
Depreciation and amortization	94	43	71	18	—	(49)	177
Total operating expenses	21,205	3,424	11,987	2,157	64	(12,260)	26,577
Income (loss) from operations	655	296	531	(237)	(8)	(7)	1,230
Interest expense	—	—	—	—	—	94	94
Income (loss) before income taxes	\$655	\$ 296	\$ 531	\$ (237)	\$ (8)	\$ (101)	\$ 1,136

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Humana Inc.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The condensed consolidated financial statements of Humana Inc. in this document present the Company’s financial position, results of operations and cash flows, and should be read in conjunction with the following discussion and analysis. References to “we,” “us,” “our,” “Company,” and “Humana” mean Humana Inc. and its subsidiaries. This discussion includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in filings with the Securities and Exchange Commission, or SEC, in our press releases, investor presentations, and in oral statements made by or with the approval of one of our executive officers, the words or phrases like “believes,” “expects,” “anticipates,” “intends,” “likely will result,” “estimates,” “projects” or variations of such words and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions, including, among other things, information set forth in Item 1A. – Risk Factors in our 2016 Form 10-K, as modified by any changes to those risk factors included in this document and in other reports we filed subsequent to February 17, 2017, in each case incorporated by reference herein. In making these statements, we are not undertaking to address or update such forward-looking statements in future filings or communications regarding our business or results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this document might not occur. There may also be other risks that we are unable to predict at this time. Any of these risks and uncertainties may cause actual results to differ materially from the results discussed in the forward-looking statements.

Executive Overview

General

Humana is committed to helping our millions of medical and specialty members achieve their best health. Our successful history in care delivery and health plan administration is helping us create a new kind of integrated care with the power to improve health and well-being and lower costs. Our efforts are leading to a better quality of life for people with Medicare, families, individuals, military service personnel, and communities at large.

To accomplish that, we support physicians and other health care professionals as they work to deliver the right care in the right place for their patients, our members. Our range of clinical capabilities, resources and tools - such as in-home care, behavioral health, pharmacy services, data analytics and wellness solutions - combine to produce a simplified experience that makes health care easier to navigate and more effective.

Our industry relies on two key statistics to measure performance. The benefit ratio, which is computed by taking total benefits expense as a percentage of premiums revenue, represents a statistic used to measure underwriting profitability. The operating cost ratio, which is computed by taking total operating costs, excluding Merger termination fee and related costs, net, and depreciation and amortization, as a percentage of total revenue less investment income, represents a statistic used to measure administrative spending efficiency.

Aetna Merger

On July 2, 2015, we entered into an Agreement and Plan of Merger, which we refer to in this report as the Merger Agreement, with Aetna Inc. and certain wholly owned subsidiaries of Aetna Inc., which we refer to collectively as Aetna, which set forth the terms and conditions under which we agreed to merge with, and become a wholly owned subsidiary of Aetna, a transaction we refer to in this report as the Merger.

The Merger was subject to customary closing conditions, including, among other things, (i) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of necessary approvals under state insurance and healthcare laws and regulations and pursuant to certain licenses of certain of Humana’s subsidiaries, and (ii) the absence of legal restraints and prohibitions on the consummation of the Merger.

On July 21, 2016, the U.S. Department of Justice and the attorneys general of certain U.S. jurisdictions filed a civil antitrust complaint in the U.S. District Court for the District of Columbia against us and Aetna, alleging that the Merger would violate Section 7 of the Clayton Antitrust Act and seeking a permanent injunction to prevent the

Merger from being completed. On January 23, 2017, the Court ruled in favor of the DOJ and granted a permanent injunction of the proposed transaction. On February 14, 2017, we and Aetna agreed to mutually terminate the Merger Agreement, as our

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Board determined that an appeal of the Court's ruling would not be in the best interest of our stockholders. On February 16, 2017, under terms of the Merger Agreement, we received a breakup fee of \$1 billion from Aetna, which is included in our condensed consolidated statement of income in the line captioned Merger termination fee and related costs, net.

Business Segments

During the three months ended March 31, 2017, we realigned certain of our businesses among our reportable segments to correspond with internal management reporting changes and our previously announced planned exit from the Individual Commercial medical business on January 1, 2018. Additionally, we renamed our Group segment to the Group and Specialty segment, and began presenting the Individual Commercial business results as a separate segment rather than as part of the Retail segment. Specialty health insurance benefits, including dental, vision, other supplement health, and financial protection products, marketed to individuals are now included in the Group and Specialty segment. Specialty health insurance benefits marketed to employer groups continue to be included in the Group and Specialty segment. As a result of this realignment, our reportable segments now include Retail, Group and Specialty, Healthcare Services, and Individual Commercial. Prior period segment financial information has been recast to conform to the 2017 presentation. See Note 15 for segment financial information.

We manage our business with four reportable segments: Retail, Group and Specialty, Healthcare Services and Individual Commercial. In addition, the Other Businesses category includes businesses that are not individually reportable because they do not meet the quantitative thresholds required by generally accepted accounting principles. These segments are based on a combination of the type of health plan customer and adjacent businesses centered on well-being solutions for our health plans and other customers, as described below. These segment groupings are consistent with information used by our Chief Executive Officer to assess performance and allocate resources.

The Retail segment consists of Medicare benefits, marketed to individuals or directly via group accounts. In addition, the Retail segment also includes our contract with CMS to administer the Limited Income Newly Eligible Transition, or LI-NET, prescription drug plan program and contracts with various states to provide Medicaid, dual eligible, and Long-Term Support Services benefits, collectively our state-based contracts. The Group and Specialty segment consists of employer group commercial fully-insured medical and specialty health insurance benefits marketed to individuals and employer groups, including dental, vision, and other supplemental health and voluntary insurance benefits and financial protection products, as well as administrative services only, or ASO products. In addition, our Group and Specialty segment includes military services business, primarily our TRICARE South Region contract. The Healthcare Services segment includes services offered to our health plan members as well as to third parties, including pharmacy solutions, provider services, and clinical care service, as well as services and capabilities to promote wellness and advance population health. The Individual Commercial segment consists of our individual commercial fully-insured medical health insurance benefits. We report under the category of Other Businesses those businesses which do not align with the reportable segments described above, primarily our closed-block long-term care insurance policies.

The results of each segment are measured by income before income taxes. Transactions between reportable segments primarily consist of sales of services rendered by our Healthcare Services segment, primarily pharmacy, provider, and clinical care services, to our Retail, Group and Specialty, and Individual Commercial segment customers.

Intersegment sales and expenses are recorded at fair value and eliminated in consolidation. Members served by our segments often use the same provider networks, enabling us in some instances to obtain more favorable contract terms with providers. Our segments also share indirect costs and assets. As a result, the profitability of each segment is interdependent. We allocate most operating expenses to our segments. Assets and certain corporate income and expenses are not allocated to the segments, including the portion of investment income not supporting segment operations, interest expense on corporate debt, and certain other corporate expenses. These items are managed at a corporate level. These corporate amounts are reported separately from our reportable segments and are included with intersegment eliminations.

Seasonality

One of the product offerings of our Retail segment is Medicare stand-alone prescription drug plans, or PDPs, under the Medicare Part D program. Our quarterly Retail segment earnings and operating cash flows are impacted by the

Medicare Part D benefit design and changes in the composition of our membership. The Medicare Part D benefit design

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results in coverage that varies as a member's cumulative out-of-pocket costs pass through successive stages of a member's plan period, which begins annually on January 1 for renewals. These plan designs generally result in us sharing a greater portion of the responsibility for total prescription drug costs in the early stages and less in the latter stages. As a result, the PDP benefit ratio generally decreases as the year progresses. In addition, the number of low-income senior members as well as year-over-year changes in the mix of membership in our stand-alone PDP products affects the quarterly benefit ratio pattern.

In addition, the Retail segment also experiences seasonality in the operating cost ratio as a result of costs incurred in the second half of the year associated with the Medicare marketing season.

Our Group and Specialty segment also experiences seasonality in the