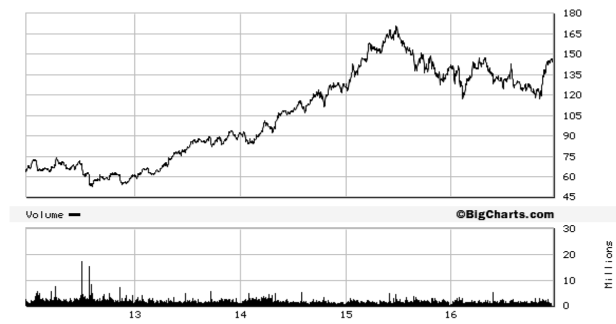
Anthem, Inc.

Capitalization Summary ($MM)	
Price	**$144.69**
Diluted Shares (MM)	**268.1**
Market Cap	**$38,791**
Total Debt	**$15,610**
Cash	**($2,546)**
Enterprise Value	**$51,855**

Share Ownership and Trading Data	
Average Daily Trading Volume (MM)	**1.7**
52-Week Price Range	**$114.85-$148.00**
Short % of Float	**2.8%**
Major Shareholder	**Insiders <1%**

ANTM
NYSE



Valuation and Misc. Stats ($MM) 9/30/16	
Book Value per Share	**$92.29**
Price/Book Value	**1.6x**
EPS (ttm)	**$10.38**
Price/Earnings	**13.9x**
Annual Dividend	**$2.60**
Dividend Yield	**1.80%**

P&L Analysis ($MM)

Fiscal Year Ending December 31,	2013	2014	2015
Premiums	$66,119	$68,390	$73,385
ASO Fees	$4,032	$4,591	$4,977
Adj. EPS	$8.52	$9.35	$10.16
Operating Margin	*5.4%*	*5.9%*	*5.9%*
FCF	$2,445	$2,743	$3,513

Catalysts/Highlights

- If the ANTM/CI merger is approved, our $14.00 2019 EPS estimate jumps to $17.00 with the merger synergies
- The Company has paused its historically aggressive share repurchases due to the pending Cigna merger. If the merger is blocked, share buybacks will resume. If the merger goes through, ANTM will use its FCF to de-lever
- If the Company's PBM contract with Express Scripts is repriced, ANTM stands to gain $1.24 per share in annual savings

INVESTMENT RATIONALE

Anthem, Inc. is the second largest health insurance provider in the U.S., insuring ~40 million Americans. The Company holds the exclusive license to the Blue Cross Blue Shield brand—the most valuable brand in health insurance—in 14 U.S. states (VA, IN, ME, NH, CT, KY, CA, NY, OH, GA, MO, CO, NV, WI). ANTM commands the #1 or #2 market share in these states, with an aggregate share of 28%. Anthem also offers health and specialty insurance products (dental, vision, and life & disability) nationwide under different brands and is a significant player in the administrative services only (ASO), Medicare, and Medicaid markets.

In our view, health insurance is a great business due to the industry's ability to raise prices in line with medical cost inflation and essentially grow revenues without any enrollment growth. In the last 10 years, ANTM grew fully-insured lives at a 0.2% CAGR, while premiums grew at a 6.1% CAGR. The difference, representing a 5.8% CAGR in premiums, is largely attributable to price increases to cover underlying medical cost inflation (which at a constant medical loss ratio results in gross profit growth in line with price increases). With an aging population and medical innovation continuing to drive mid-to-high single-digit medical cost inflation in the U.S., ANTM's revenues should continue to grow regardless of whether the Company grows its membership.

An exemplar of shareholder capital stewardship, the Company returned 90% of its current market capitalization to shareholders over the last ten years in the form of share buybacks ($32.6 billion) and dividends ($2.3 billion). The Company reduced its shares outstanding by 57% during this period, repurchasing shares at an average share price of $68.92, 48% below its current share price.

From 2007-2012, under a previous CEO, ANTM underperformed relative to its peers; however, current CEO Joe Swedish, who joined in 2013, reinvigorated the Company. In July 2015, Anthem announced it would acquire Cigna, creating the U.S.'s #1 health insurer with over 53 million covered lives. While the Department of Justice (DOJ) has sued to block the deal, Anthem is presently fighting the government in court. The case is expected to be resolved by the end of January 2017. Anthem conservatively projects $3.00 per share in accretion from the deal, taking our base-case 2019 EPS estimate of $14.00 to $17.00 if the merger goes through. In March 2016, Anthem sued Express Scripts (ESRX), claiming ESRX is overcharging the Company by $3 billion annually on its pharmacy benefits management (PBM) contract. If ANTM wins the case, it will retain 20% of the savings for itself and pass the rest through to customers, resulting in an annual EPS boost of $1.24. On the 3Q 2016 earnings call, CEO Joe Swedish stated that he is hopeful a settlement could be reached with ESRX by the end of 2017.

We view ANTM as a large cap. special situation where the two lawsuits involving the Company are causing uncertainty, which is acting as an overhang on the shares. Interestingly, both lawsuits result in either meaningful accretion to ANTM or no large detriment to the Company (if the Cigna merger is blocked, ANTM will pay CI a $1.85 billion break-up fee amounting to ~half of annual FCF for ANTM). Given the various potential outcomes, we believe a scenario analysis is the best way to evaluate ANTM and have analyzed six possible scenarios:

1) In a worst-case scenario, we assume the Cigna merger does not go through, the PBM contract is not repriced, and ANTM grows earnings by only 6% annually (substantially below management's 10%-14% long-term EPS growth target), generating 2019 EPS of $12.86, and falling well short of management's $14.00 target. Applying a 10x forward P/E multiple, we derive a worst-case fair value of $129 at the end of 2018 (11% downside risk). 2) In the event the Cigna merger does not go through, the PBM contract is not repriced, but ANTM achieves its $14.00 EPS target in 2019, a 12x multiple results in a fair value of $168 (16% upside). 3) If the Cigna merger is blocked but the PBM contract is repriced, ANTM will realize $1.24 per share in savings, taking 2019 EPS up to $15.24. Applying a 12x multiple yields a fair value of $183 (26% upside). 4) If the Cigna merger is completed but the PBM contract is not repriced, ANTM will generate 2019 EPS of $17.00 ($14.00 + $3.00 of merger accretion). Applying a 12x multiple yields a fair value of $204 (41% upside). 5) If the Cigna merger is completed and the PBM contract is repriced, ANTM will earn a projected $17.87 per share in 2019 (there is less accretion from the PBM repricing due to a higher share count post-merger). Using a 12x multiple, fair value stands at $214 (48% upside). 6) Finally, there is a very real probability that ANTM has understated the expense synergies on the Cigna deal and that Cigna's superior wellness programs can give ANTM a competitive advantage in the market, accelerating the combined Company's long-term growth rate. The EPS impact is difficult to quantify but we believe the accurate way to capture this best-case scenario is to apply a 16x multiple to the $17.87 in 2019 EPS projected in scenario 5, yielding a fair value of $286 (98% upside) at the end of 2018. Since the future is hard to predict, we believe applying an equal weight to all six scenarios is most appropriate. As such, we arrive at an expected fair value of $197 for ANTM at the end of 2018, offering 36% upside.