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OUTPERFORM

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Reason for report:

FLASH NOTE

CIGNA, INC.

CMS Medicare Sanctions Have Minimal Impact on FY16 or ANTM Deal

• **Bottom Line:** CI (OP) released an 8-K disclosing sanctions on Medicare Advantage (MA) and Part D plans to new customers this morning. The drivers are issues with appeals and grievances, Part D formulary and compliance. We estimate little to no top-line impact in 2016 as the open enrollment season is completed, though there could be modest bottom-line impact for 2016 (at about 2% of earnings). Such sanctions have had precedent with peers and take a year or so to resolve, which could keep Cigna out of the 2017 open enrollment season and impact earnings growth negatively. We estimate about 10%-12% of CI's earnings currently come from MA while Part D earnings contribution is de minimis. We expect no impact on the likelihood of the ANTM (OP) deal from an intent perspective and don't expect this to impact anti-trust scrutiny to any meaningful degree. If CI is not in the game for 2017, it could help UNH (OP), AET (OP) and HUM (OP) on MA and Part D growth, though all companies are likely on high alert as far as regulatory compliance with CMS is concerned.

• **CI disclosed CMS intentions to prohibit enrollment in to and marketing of CI's MA and Part D plans to new customers.** The drivers are issues with appeals and grievances, Part D formulary and compliance.

• **We estimate little to no top-line impact in 2016 as the open enrollment season is completed, though there could be modest bottom-line impact for 2016 (at about 2% of earnings).**

• **For 2017, CI's earnings growth could be negatively impacted due to not be able to participate in the Medicare Open enrollment season.** Such regulatory sanctions have had precedent with peers and take a year or so to resolve, which could keep Cigna out of the 2017 open enrollment season and impact earnings growth negatively.

• **We estimate about 10%-12% of CI's earnings currently come from MA.** CI's MA membership exposure remains relatively low at ~3% of Total Medical Membership while Part D membership was at 1,472 K as of 3Q15. CI's revenue exposure to MA and Part D business is ~16% and ~4%, respectively.

• **We expect no impact on the likelihood of the ANTM deal from an intent perspective and don't expect this to impact anti-trust scrutiny to any meaningful degree.**

• **Minimal immediate read-across to other MCOs. However, if CI is not in the game for 2017, it could help UNH, AET and HUM on MA and Part D growth, though all companies are likely on high alert as far as regulatory compliance with CMS is concerned.**

Key Stats:	**(NYSE :CI)**
Sector:	**Managed Care**
S&P 500 Health Care Index:	**772.05**
Price :	**$140.13**
52 Week High:	$170.68
52 Week Low:	$105.23
Shares Outstanding (mil):	261.0
Market Capitalization (mil):	$36,573.9

Disclosures Appendix

Analyst Certification

I, Ana Gupte, Ph.D., certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

Valuation

Our primary valuation methodology is based on relative P/E to the S&P 500. Relative P/E is tracked as a function of company's own history and the Managed Care group average. We assess the potential for P/E expansion over the next 12 months based on our forward forecasts that contemplate underlying fundamentals and the implications of healthcare reform. DCF valuations that leverage our forward forecasts at a WACC of 9% and terminal growth rate of 1.5% inform the potential for multiple expansion, along with sector and company specific catalysts. We expect greater potential for multiple expansion if the DCF valuation points to significantly more upside than peers from current trading levels. Free cash flow yields and PEG ratios also inform the potential for multiple expansion. Exceptionally low PEG ratios and/or high free cash flow yields point to the potential for greater multiple expansion.

Based on a P/E multiple of 17.2x applied to the average of our 2016E & 2017E EPS of $9.56 and $11.83 respectively, we rate CIGNA Outperform with a price target of $175.

Risks to Valuation

• Non -profit BCBS plans or other insurers pricing irrationally in the commercial market, rapidly accelerating medical cost trends.

• Medical cost trends coming in higher than anticipated from a potential economic downturn with provider re-upping intensity of service delivery, COBRA accelerated uptake, and members utilizing more care in advance of layoffs and pandemics.

• Employers exiting very rapidly from the sponsorship of health benefits to combat medical cost inflation catalyzed by an economic downturn.

• Risk from a further decline in investment yields and investment impairments.

• State-based actuarial rate reviews limiting sound pricing and underwriting and causing substantial underwriting margin compressions.

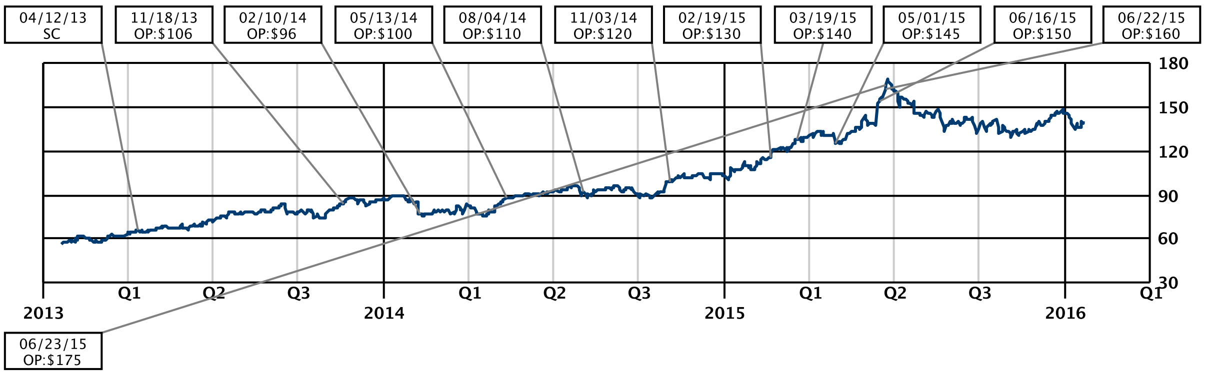
• Longer term, state-based Health Insurance Exchanges with adverse selection reducing sustainable earnings power; and employers "dumping" employees into Health Insurance.

• Exchanges with significant margin compression, and potential downside to membership and top line also present a longer-term risk.

• Political shocks leading to single payer.

• Company specific risk: Significant declines in equity markets could result in increased funding for the company's pension obligations. Political, legal, operational, regulatory, economic and other risks in its foreign operations

Rating and Price Target History for: CIGNA, Inc. (CI) as of 01-21-2016

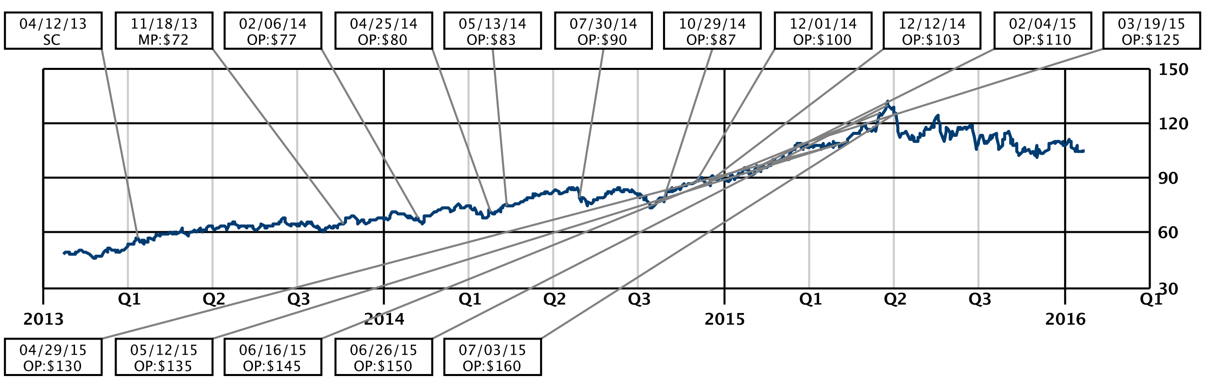


Leerink placed an Outperform rating on CI on May 8, 2009. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

OP=Outperform MP=Market Perform UP=Underperform D=Drop Coverage I=Initiate SC=Suspend Coverage

Created by BlueMatrix

Rating and Price Target History for: Aetna Inc. (AET) as of 01-21-2016



Leerink placed an Outperform rating on AET on March 25, 2011. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

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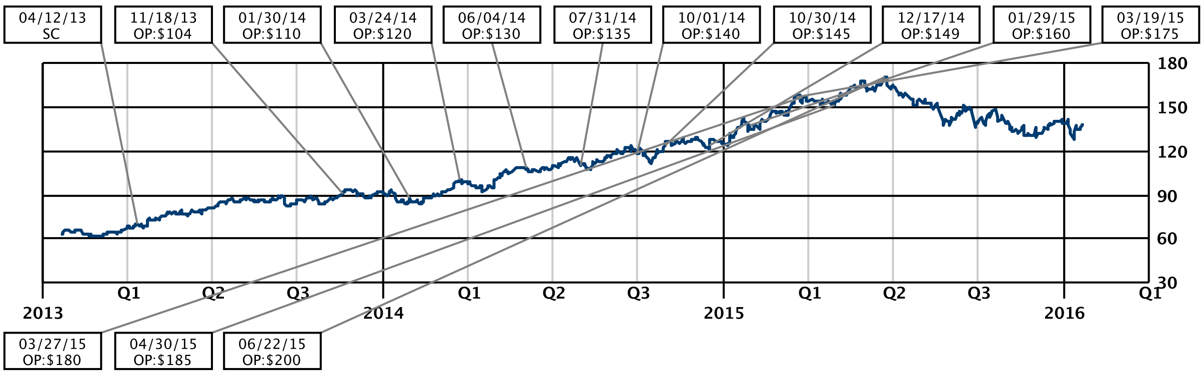
Created by BlueMatrix

Rating and Price Target History for: Anthem, Inc. (ANTM) as of 01-21-2016

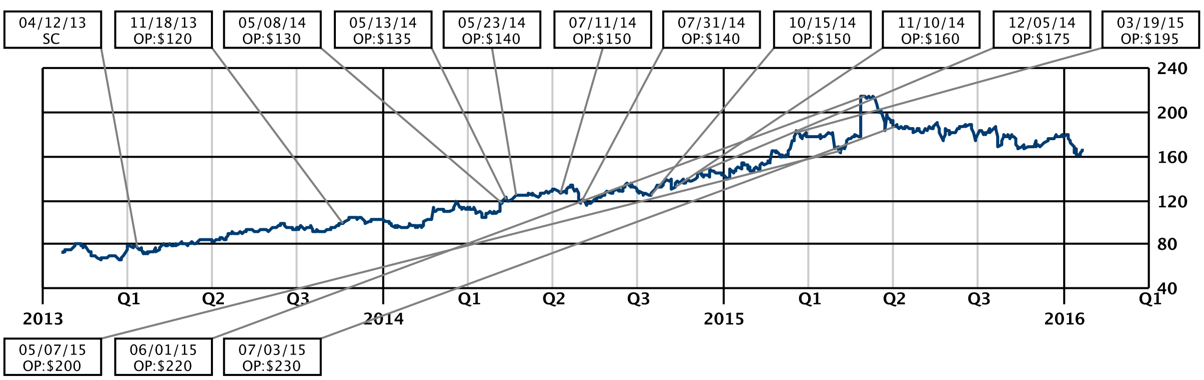


Leerink placed a Market Perform rating on WLP on June 20, 2012. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

OP=Outperform MP=Market Perform UP=Underperform D=Drop Coverage I=Initiate SC=Suspend Coverage

Created by BlueMatrix

Rating and Price Target History for: Humana, Inc. (HUM) as of 01-21-2016



Leerink placed an Outperform rating on HUM on September 4, 2012. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

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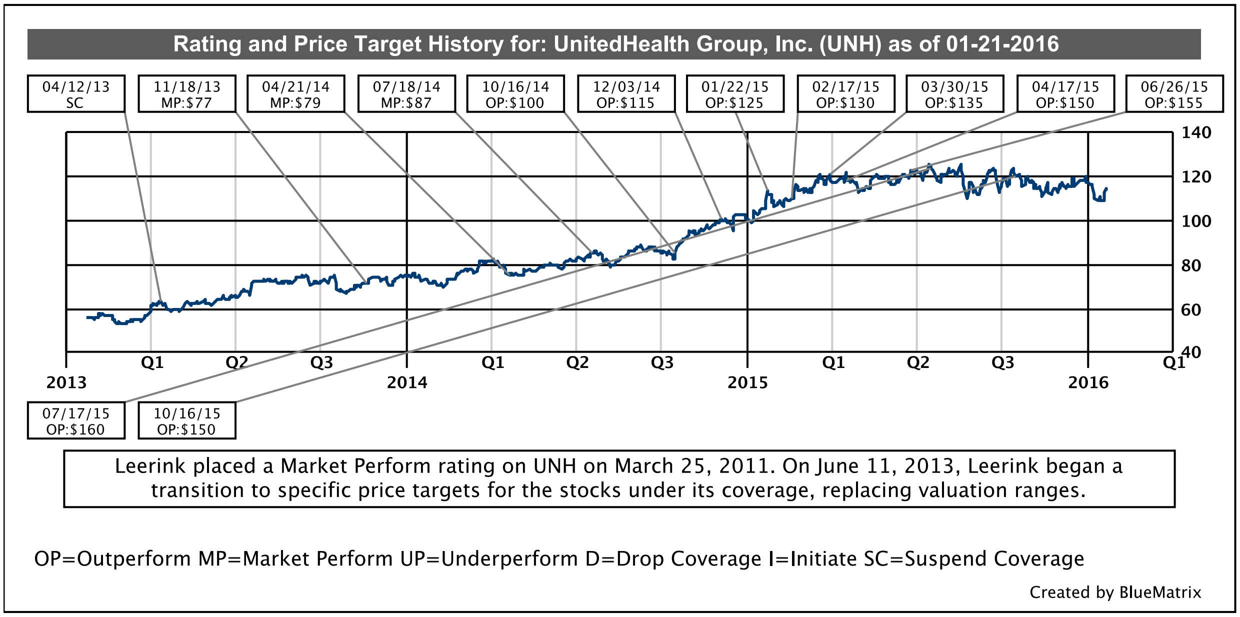
Rating and Price Target History for: UnitedHealth Group, Inc. (UNH) as of 01-21-2016
04/12/13 SC
11/18/13 MP:$77
04/21/14 MP:$79
07/18/14 MP:$87
10/16/14 OP:$100
12/03/14 OP:$115
01/22/15 OP:$125
02/17/15 OP:$130
03/30/15 OP:$135
04/17/15 OP:$150
06/26/15 OP:$155
07/17/15 OP:$160
10/16/15 OP:$150
140
120
100
80
60
40
Q1
Q2
Q3
2013
2014
2015
2016
Leerink placed a Market Perform rating on UNH on March 25, 2011. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.
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Created by BlueMatrix

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Distribution of Ratings/Investment Banking Services (IB) as of 12/31/15			IB Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
BUY [OP]	161	73.20	63	39.10
HOLD [MP]	59	26.80	4	6.80
SELL [UP]	0	0.00	0	0.00

Explanation of Ratings

Outperform (Buy): We expect this stock to outperform its benchmark over the next 12 months.

Market Perform (Hold/Neutral): We expect this stock to perform in line with its benchmark over the next 12 months.

Underperform (Sell): We expect this stock to underperform its benchmark over the next 12 months.The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than $2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over $2 billion.

Important Disclosures

This information (including, but not limited to, prices, quotes and statistics) has been obtained from sources that we believe reliable, but we do not represent that it is accurate or complete and it should not be relied upon as such. All information is subject to change without notice. This is provided for information purposes only and should not be regarded as an offer to sell or as a solicitation of an offer to buy any product to which this information relates. The Firm, its officers, directors, employees, proprietary accounts and affiliates may have a position, long or short, in the securities referred to in this report, and/or other related securities, and from time to time may increase or decrease the position or express a view that is contrary to that contained in this report. The Firm's salespeople, traders and other professionals may provide oral or written market commentary or trading strategies that are contrary to opinions expressed in this report. The Firm's proprietary accounts may make investment decisions that are inconsistent with the opinions expressed in this report. The past performance of securities does not guarantee or predict future performance. Transaction strategies described herein may not be suitable for all investors. Additional information is available upon request by contacting the Editorial Department at One Federal Street, 37th Floor, Boston, MA 02110.

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Leerink Partners LLC makes a market in CIGNA, Inc., Aetna Inc., Anthem, Inc., Humana, Inc. and UnitedHealth Group, Inc.

Leerink Partners LLC is willing to sell to, or buy from, clients the common stock of CIGNA, Inc., Aetna Inc., Anthem, Inc., Humana, Inc. and UnitedHealth Group, Inc. on a principal basis.

Leerink placed an Outperform rating on AET on March 25, 2011. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

Leerink placed a Market Perform rating on WLP on June 20, 2012. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

Leerink placed an Outperform rating on CI on May 8, 2009. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

Leerink placed an Outperform rating on HUM on September 4, 2012. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

Leerink placed a Market Perform rating on UNH on March 25, 2011. On June 11, 2013, Leerink began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

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