

Dong Capital Research - Investment Memo (LONG)

16 May 2025

**UnitedHealth Group (UNH)**

Entry Price: \$294

*Position sizing: 40% of AUM*

## **EXECUTIVE SUMMARY**

UnitedHealth Group is the largest healthcare company in the United States, operating through two dominant franchises: UnitedHealthcare (insurance) and Optum (Health services, pharmacy benefits, healthcare technology). The company has historically been viewed as one of the highest quality businesses in public markets due to its scale advantages, diversified earnings streams, consistent cash generation and industry leading returns on capital.

Between April and May 2025, the stock experienced one of the largest drawdowns in its history after management lowered full-year EPS guidance and subsequently suspended guidance altogether amid elevated Medicare Advantage utilization. CEO Andrew Witty also stepped down on May 13 with former CEO Stephen Hemsley returning to the helm.

Shares fell from approximately \$585 in November 2024 to roughly \$290 by May 15, erasing nearly half of the company's market value in six months.

The market is pricing UNH as though Medicare Advantage margin pressure represents a permanent impairment to earnings power. I believe the selloff is a clear overreaction to a cyclical utilization spike rather than a structural deterioration in UnitedHealth's competitive position. The company is still the industry leader in scale, vertical integration and healthcare data infrastructure. Even under conservative assumptions, the stock trades substantially below historical valuation ranges.

**I recommend a LONG position with a 12-24 month target of \$450/share (+55%),** based on normalization of Medicare Advantage margins and a partial recovery toward historical valuation.

## INVESTMENT THESIS

- 1) **The market is pricing temporary utilization pressure as permanent earnings destruction**

The entire selloffs centers on one one issue: Medicare Advantage utilization

Historically, insurers estimate future healthcare utilization and price premiums accordingly. Beginning in late 2024, and accelerating into early 2025, Medicare Advantage members utilized more healthcare services than expected.

This caused UnitedHealth's Medical Care Ratio to rise to approximately 84% in Q1 2025, significantly above prior expectations.

Does this represent:

- A) A permanent increase in utilization
- B) A temporary mismatch between pricing and medical costs

I believe the market is assuming A while reality is closer to B. Health insurance has historically been a repricing business. While profitability may be pressured for several quarters, it is difficult to argue that UnitedHealth's long term earnings power has permanently fallen by 40-50%.

At approximately \$295/share, the market appears to be valuing the company as though Medicare Advantage economics have fundamentally broken. I believe that there is no sufficient evidence to validate such an assumption.

- 2) **The Optum franchise remains one of the most valuable assets in healthcare**

Much of the discussion surrounding UNH focuses exclusively on the insurance business. This overlooks Optum.

Optum generated nearly \$64 billion in quarterly revenue entering 2025 and has become arguably the most strategically important healthcare platform in the country.

The business consists of:

**Optum Health** - Physician groups, clinics, value based care networks

**Optum RX** - Pharmacy benefit management, drug procurement

**Optum Insight** - Healthcare software, data analytics, revenue cycle management

Together, these businesses create a vertically integrated healthcare ecosystem that competitors struggle to replicate.

Optum's long-term value proposition remains intact even with pressures on insurance margins:

- More patient data
- More provider relationships
- Lower administrative costs
- Greater negotiating leverage

A business with Optum's scale and positioning would likely command a substantial valuation as a standalone company, while market's focus on short-term risks obscure the strategic value of these assets.

### **3) Current valuation implies earnings power far below historical norms**

Before the selloff, UNH traded near \$600/share. The stock now trades near \$290. The company did not lose half its members, revenue, or its assets. Revenue continues growing near double digits. Q1 2025 revenue reached approximately \$109 billion, representing nearly 10% year-over-year growth. The market's reaction reflects collapsing confidence in future earnings rather than the collapse of the underlying business.

Historically UNH has often traded between 18x and 24x forward earnings. At current levels, the stock trades closer to distressed or no growth health companies despite maintaining:

- Industry leadership
- Massive scale
- Double digit revenue growth

Even a partial recovery toward historical earnings power creates substantial upside.

## **RISKS**

### **1. Medicare Advantage costs remain elevated longer than expected.**

If healthcare usage remains significantly above pricing assumptions through 2026, margins could remain depressed for several years

### **2. Regulatory Pressure**

Changes to reimbursement formulas, Medicare funding or PBM regulations could reduce profitability

### **3. Optum execution**

Integration issues or weaker than expected profitability could reduce future earnings

#### 4. **Political Risk**

Changes to Medicare Advantage reimbursement or drug-pricing policy could impact profitability

#### 5. **Structural Medicare Advantage deterioration**

The bear case is that elevated utilization reflects a permanent shift rather than a cyclical event. If true, valuation recovery could take substantially longer than expected.

## **VALUATION**

The primary valuation is Forward Earnings Power (P/E).

Unlike high-growth technology companies, healthcare insurers are ultimately valued based on normalized earnings and cash flow.

The market currently prices UNH as though earnings have permanently reset lower.

I believe a normalized earnings framework better reflects intrinsic value.

<b>Metric</b>	<b>Historical Range</b>
Forward P/E	18x–24x
Revenue Growth	High single digits
ROE	~20%+
Free Cash Flow	Strong and consistent

The current multiple sits materially below historical averages despite the business maintaining industry leadership.

## SCENARIO ANALYSIS

Scenario	Normalized EPS	P/E	Implied Price	Upside/ Downside
Bear	\$22	12x	\$264	-7%
Base	\$26	16x	\$416	+46%
Target	\$28	16x	\$448	+57%
Bull	\$30	18x	\$540	+89%