NO. 002

UNH: Value Trap or Chronically Undervalued?

UNH, a Steady Compounder At a Discount

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Summary -

- UNH has seen several negative events over the last three years, such as an antitrust investigation, the CEO’s assassination, and increased medical costs, leading to a high MLR.
- All of this has led to a near 60% draw down in market cap value. UNH has several competitive advantages that include being vertically integrated, which allows it to price insurance lower than the competition. As well as a proprietary data arm through Optum Insight.
- While the CMS rate increases have caught management off guard, they are well-positioned to rebound in the following fiscal years, with a seriously strong fundamental business centered around their interconnected multi-segment business, which is unique and differentiated in the industry. Attempts to copy the UNH business model have failed; CVS Health is a prime example.

Recent Catalysts/Events -

- In late 2023, the company's earnings report began to show an increase in Medicare utilization.
- October 2023, the DOJ launched an antitrust investigation into the company.
- In January 2024, the company reported the highest MLR of 85% since the pandemic.
- February 2024, the DOJ reopens anti-trust investigation. Full year 2024, earnings fall 36%, MLR increases 2.3%.
- December 4th, Brian Thompson, CEO of UnitedHealthcare, is assassinated. Public sentiment against healthcare companies is clear: Healthcare is "Evil", this is held up by the support shown for Luigi Mangione.
- Q1 2025, earnings guidance, they disclose they have been caught off guard by Medicare utilization rates and expect costs to increase by 6.5 billion.
- 2025 has been full of CMS rate cuts and spending cuts on Medicare by the Trump admin. All of these events have caused serious volatility that has led to a 57% draw down from its Nov 29, 2024, $610 high, to today at 259 at the time of writing.

Business Overview -

UNH is a healthcare and well-being company. They have two distinct lines of business. UnitedHealthcare is their healthcare leg, and Optum, which delivers value-oriented care. Optum Health is a health service business operating on value-oriented care; it has seen significant headwinds in the previous fiscal year. Optum Insight is the data & analytics arm, which sells to clinics and hospitals. This is the smallest of the three businesses, but Optum Bank, which was previously part of Optum Health, has been restructured and is now a part of Optum Insight. OptumRx is the PBM; this is the largest business of the three and faces PBM regulations.

Financials -

- Revenue in 2025: about $447.6 billion, up roughly 12% year over year. Profit in 2025: about $12.1 billion, down from $14.4 billion in 2024.
- 2025 MLR guidance: 86.5% midpoint, up from 85.5%. The balance sheet has remained largely the same from 2024 to 2025.
- Optum Health had seen an 8 billion dollar swing in profitability from 7 billion in operating income in 2024, to -270 million in 2025. This is largely due to cuts in Medicare funding and increases in overhead costs.
- Due to the rising costs, UNH is exiting 100 Medicare Advantage plans across 109 counties in the U.S, exiting less profitable lines of insurance.

The key thing here is the net income compression, which is in parallel with the compression in free cash flow, just to prove there are no outliers. The market sentiment is not wrong; MLR has increased, and as expected, net income has decreased. The key idea is that if CMS rates are reset every year, the MLR increase is temporary. This is an industry-wide occurrence, and MLR increase is not an unusual thing; such has happened in previous periods in the company's history.

Competitive advantages -

- UNH has a massive scale. They are the largest healthcare conglomerate; because of the scale, they have leverage and pricing power, and lobbying power within the government.
- They have vertical integration since they provide healthcare insurance, and they are a healthcare provider. This allows them to have a lower cost structure. Their organic vertical integration has proven strong, as competitors like CVS Health face difficulties vertically integrating their insurance arm.
- Optum Insight gives them a property data advantage, which In theory, should allow them to price better. Since CMS rates are reset each year, the Increase in medical costs should be a short-term problem.
- An analogy for their business model is Amazon Retail and AWS. While not directly related, the insurance business is similar to retail because it has low margins, and little innovation has occurred in the healthcare insurance. While Optum is like AWS because it is a high-margin service business, which has a lot of growth, considering Optum Insight is pretty new and has been growing. Essentially, Optum allows UNH to take lower margins on United Healthcare, which gets more customers, which they can then deliver value-oriented care, which leads to higher margins.

Key Risks -

- The DOJ anti-trust case could potentially cause United Healthcare and Optum to break up, essentially erasing the vertical integration that has been their competitive advantage. In the case of a split, the healthcare segment as a standalone business would command a much smaller part of the market cap, because of its lower margins. Assuming OptumRx is also split up, it would likely be the largest of the companies broken out of UNH.Essentially, this is the key long term risk that is being ignored, and the medical costs, which are more short term is where the focus is. But the margin of safety gives me enough comfort to justify this risk.
- The negative public sentiment around healthcare companies and the “aggressive coding” has led to a CEO assassination and could cause difficulties with regulators.
- The current Medical Costs could become the standard, and this could be a drag on profits long-term.

Conclusion -

Over the last 3 years, UNH has faced many adversities, resulting in negative sentiment and a rapid and significant stock decline. More recently, the Trump administration’s cuts in spending have created nervous sentiment around healthcare broadly. While the CMS rates have increased, because this is changed every year, the likelihood that this is a temporary increase, and that UNH should be able to price in this increased cost in the long term, is very positive. Regardless of the near 60% draw down in value, the fundamentals are intact; they have built a very strong moat around the Insurance castle. By vertically integrating, they have scale, which lowers costs, leverage with clinics and physicians, and they have a proprietary data advantage that will help them underwrite better. And most importantly, the flywheel that Optum allows increases customers, which increases margins through Optum. UNH is a long-term buy that should see a market correction.

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