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EDITED TRANSCRIPT

CVS - CVS Health Corp at JPMorgan Global Healthcare Conference

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CORPORATE PARTICIPANTS

Eva C. Boratto *CVS Health Corporation - Executive VP & CFO*

Karen Sue Lynch *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

Larry J. Merlo *CVS Health Corporation - CEO & Director*

CONFERENCE CALL PARTICIPANTS

Lisa Christine Gill *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

PRESENTATION

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Good morning. My name is Lisa Gill, and I am the Healthcare Technology and Distribution Analyst with J.P. Morgan.

It is with great pleasure this morning that I introduce you to CVS Health. With us this morning is CEO, Larry Merlo. We're going to hold all of our questions and take them across the hall at the Georgian Room.

Larry, just as a side note, I think we're going to have to move you back to the big room next year.

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Well, Lisa, thank you, and good morning, everyone. It's great to see so much interest in CVS Health, and I appreciate you joining us today to learn more about CVS Health and our strategy to transform the consumer health experience, and by doing so, create long-term value for shareholders.

Before I get started, I want to draw your attention to our forward-looking statement, which is also posted on our website. I would ask that you please take a moment to review it. And since I know you're all speed readers, let me just begin by giving you a brief overview of who we are.

And while we go-to-market as one enterprise, CVS Health is comprised of 3 interrelated operating businesses: Our Retail/Long-Term Care; Pharmacy Services; and health care benefits.

Now our Retail/Long-Term Care segment consists of CVS Pharmacy, which today, has more than 9,800 locations and a leading 25% share of the retail prescription market. This segment also includes MinuteClinic, our retail clinic offering, which has more than 1,100 locations, providing convenient access to high-quality, low-cost care. We also operate Omnicare, a leading provider of pharmaceuticals to the long-term care market.

Our Pharmacy Services segment consists primarily of Caremark, the largest pharmacy benefit manager in the country, now with 93 million members. We also operate a leading specialty pharmacy with more than $35 billion in annually dispensed specialty revenues. And you should also note that pharmacy dispensing at Aetna will be consolidated within the PBM.

And finally, our health care benefits segment includes the newly acquired Aetna business with 22 million medical members. And our stand-alone Medicare Part D product, SilverScript, will be included in this segment beginning this year, 2019. Now these businesses working together as an enterprise create a uniquely powerful new platform that will enable us to transform the consumer health care experience, and I'll get into more detail on that in just a few minutes.

Now as to the Aetna transaction, we completed the acquisition on November 28 at an equity value of about $70 billion. The transaction was funded through a combination of cash on-hand, $40 billion in senior notes, $5 billion of term loans and the issuance of about 274 million shares of CVS stock.

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And while we're still going through the review process with the District Court as part of the Tunney Act, I want to unequivocally state that CVS Health and Aetna are 1 company, and our transformation work is already underway. We're making substantial progress on the Aetna integration, and we're already rolling out programs and services that benefit clients by helping their members achieve their best health at a lower cost. The ongoing court review and the voluntary commitments that we have in place will not impact the time line for achieving the targeted synergies that I'll talk about.

Now as I said, we funded a portion of the transaction by placing new debt in the form of senior notes and term loans that, after including the $8 billion of debt we assumed from Aetna, resulted in an outstanding debt of approximately $76 billion, excluding leases, as expected. We have $1.2 billion of debt maturing this year, and we'll be looking for opportunities to retire other tranches as we execute on our plan to achieve a targeted leverage ratio in the low 3x.

Now our plan to achieve this includes: suspending our share repurchase program; maintaining our dividend per share of $2; and refraining from major M&A. And with this, we'll be focusing our cash available on debt retirement in order to achieve the target in a timely manner. Now taking into account our activity in the commercial paper market, this year, we expect interest expense of approximately $3.1 billion.

Now before I move into our discussion of the opportunity to transform the consumer health care experience that will drive long-term growth, I want to remind you that we will provide our 2019 guidance on our fourth quarter earnings call next month. However, I thought it would be good to take a minute to reiterate 2019's tailwinds and headwinds.

In terms of headwinds, we expect this year to be a lighter year from a break-open generics perspective. I think as you all know, we maximize generic profitability during the break-open period with multiple manufacturers in the marketplace. And in '19, we see a lower value of break-open products, noting some delays in launches, such as with Advair. And this also pushes out the benefit we experience once the drug reaches the break-open period.

Additionally, we expect to continue to experience pricing and reimbursement pressure at levels similar to what we've seen over the last few years. It's a very competitive market, and we can sit -- we continue to see this dynamic in both the PBM and Retail segments.

We also expect brand inflation to continue to moderate this year, which would impact client commitments in the PBM business as we have guarantees related to the level of rebates we provide.

And lastly, in the first half of the year, we'll be wrapping the tax reform investments that we made throughout 2018, most of which are incurred in our Retail segment.

Now as we transition this year to our new business model, we are making additional investments in order to realize a number of strategic growth objectives that will benefit us in the long term. These include digital and consumer engagement tools as well as continued investments to grow Medicare and drive improvements in our Star Ratings. Additionally, given the experience-rated nature of our large group commercial insured and group Medicare business, we expect some of Aetna's strong 2018 performance in those businesses to be reflected in pricing for this year, 2019.

For tailwinds, we expect retail script growth to outpace the broader market growth and we continue to expect to benefit from ongoing specialty growth. We're also making good progress on our enterprise streamlining initiative, and we expect that continue -- to favorably contribute to our performance this year, outpacing the benefits we achieved in 2018. And while we had a net positive PBM selling season, the benefit from that will be smaller compared to what we've seen in previous years. In the Aetna business, we expect another strong year of growth in our government businesses as we continue to drive growth in Medicare Advantage membership, and we expect growth in Medicare membership primarily related to Kansas and Florida.

So with that, let me talk more about the benefits now of the CVS-Aetna combination. And I'll start with our framework for the transformational work we are doing and why we are best positioned to remake the consumer health care experience. And then I'll take a deeper dive into our road map for value creation that includes many of the initiatives we're working on to achieve both our short- and long-term goals.

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So let's start with some of the challenges with our current health care system. As we look at it, first, we see the complexity that exists in the system, a lack of support for patients as they try to navigate to the most high-quality and cost-effective care settings.

Second, we see a health care system that was designed for episodic care in a fee-for-service environment. And to-date, there has been little incentive to move to a more holistic care model.

Third, the system remains fragmented with care that often is uncoordinated between various health care stakeholders. And all too often, the patient has to be their quarterback for their own care.

Now all of these factors lead to unnecessary, avoidable or wasteful spending. To underscore that point, the U.S. today spends about $3.5 trillion on health care, and that's growing at an unsustainable pace and continuing the status quo is simply not an option, not for the physical and financial health of consumers or for providers, corporations, the government. We can, and we must do better.

So how do we address these challenges? Well, from our perspective, it starts with how you engage with consumers on their individual health care journeys. And through our consumer-centric assets, we can open a new front door to health that is both easier to use and less expensive, while at the same time, providing convenient access to high-quality health care.

We are uniquely positioned to engage with consumers in a differentiated manner, introducing the appropriate programs and services to help them achieve their individual health goals. And by driving consumer engagement, we can improve health outcomes. You improve health outcomes, we can lower overall health care costs.

And the end result is a better, more satisfying patient experience, a patient who is healthier and more confident in their action plan to achieve better health in a more efficient health care system with a lower-cost trajectory.

Now as we begin our transformation work, we're focused on 3 strategic imperatives that will guide our efforts, and the first is being local. And there are 2 components to this imperative. The first is what we described as reach. We have more consumer touch points than any other health care company, and this enables us to engage patients with the care they need where, when and how they need it, whether it's in the community, in the home or even in the palm of their hand with a digital device.

The second component is what it we'll call frequency. Today, we engage with 1 in 3 Americans. We have become part of their normal, everyday routines. And this is critically important because as we think about the opportunities here, we don't have to build new routines. We simply have to build our programs and services into the existing routines that already exist.

Second imperative is making health care simpler. We've created a health care system that is driving patients to be health care decision-makers, but we would say that, today, they lack the tools that they need to effectively navigate the system. So we're going to change that by helping to guide patients along their health care journeys by providing more convenient access to the information, the resources and the services that they need.

Our third imperative is to improve health. Helping people on their path to better health has been a cornerstone of our purpose at CVS. And by aligning the capabilities of Aetna with our consumer-centric assets, we'll be able to more effectively deliver on that goal.

Now these imperatives help to guide our 5 initial strategies for medical cost savings that include: improved care management for both common and chronic conditions; preventing hospital readmissions; site-of-care management; and optimizing primary care.

Now as we zoom out and look at the broader health care market and the savings that can be achieved by more effectively managing chronic conditions, the opportunity here is massive. As a nation, we spend more than $2 trillion annually on treating patients with chronic conditions. And there are numerous studies out there that estimate that about 1/4 of that spend is preventable. Now you can do the math. This means roughly $500 billion of spend is avoidable.

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This is the spend that we're going to be targeting as we roll out our cost-savings initiatives. The takeaway here is that percentage points matter. Addressing just 5% to 10% of this opportunity results in a savings opportunity that is in the tens of billions of dollars. And if you apply this same methodology to the Aetna book of business, the opportunity still starts with a B, as in billion.

So now that I provided a high-level overview of what we are going to accomplish, let me take a deeper dive into how we are going to drive value for both consumers and shareholders.

Now it's been about 6 weeks since we closed on the transaction, and we have a clear line of sight to achieving our goal of more than $750 million in synergies in 2020. Now the majority of these synergies will be derived from the reduction of corporate expenses and the integration of our operations, and at the same time, we'll begin to produce some reductions in medical costs, which represent a much larger longer-term opportunity.

Now in terms of synergy expectations for this year, please keep in mind that we intend to provide more details when we give our '19 guidance next month. But having said that, I thought it would be helpful to lay out a general time line of when we expect to begin to see some of the benefits of our integration work.

Now we've gone through the process of evaluating all of the corporate functions of both organizations and aligning them under a single leadership structure. And as we rationalize redundant corporate functions, we expect the benefits to begin to accrue starting in the first quarter.

We've also created a combined purchasing organization to assure that goods and services of the 2 companies are being acquired at the most effective price points. And we expect these benefits, along with the benefits derived from formulary and plan design alignment, to begin to accrue throughout the first half of this year.

As I mentioned, we also expect to realize some medical cost savings. That'll be towards the end of the year. And I'll provide more details on the foundational work we're doing to achieve that goal in just a moment.

So now that we've discussed our near-term integration efforts, let me talk more on how we're going to create value over the long term. And I'll start with our portfolio of initiatives to drive medical cost savings. At a very high level, the longer-term savings will come from building upon our near-term initiatives as well as introducing new programs that are only made possible through the combination and close integration of our 2 companies.

And we're targeting substantial savings through a specific portfolio of products and initiatives that include the better management of 5 common chronic conditions. You know their names: Cardiovascular, diabetes, hypertension, asthma and behavioral health. And we'll accomplish this by building on near-term medical cost savings through the tighter integration of pharmacy and medical claims, the rich clinical data set we will have, along with the role of our community assets.

A second program is aimed at reducing avoidable hospital readmissions by utilizing Aetna's clinical programs to identify patients at the point of discharge as well as by engaging them through CVS retail assets to better support them and their care plan.

Another program focuses on increasing utilization of lower-cost sites of care, including home infusion when it's appropriate. We'll also work to reduce unnecessary emergency room visits through the early identification of frequent ER users and education on the care setting options that are available to them.

A fourth program is optimizing and extending primary care by expanding the scope of services available at MinuteClinic to help with the early identification and ongoing management of chronic disease.

And finally, we're developing a series of comprehensive programs to better manage complex chronic diseases, such as kidney disease, where the goal is to reduce hospitalizations and delay the progression of the disease; or oncology, where our objective is to align provider incentives to focus on quality and outcomes while enhancing patient support.

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Importantly, our solutions will be accessible through a broad range of channels, from the local community assets to virtual and digital solutions, all coordinated across the member's journey in order to simplify the process. And we will work to make these solutions not only available to Aetna clients and their members, but to the wide array of health care partners we work with today through an open platform model.

Now we've already taken some meaningful steps to begin to build the foundation for what I just described. And specifically, to improve the management of chronic conditions, we launched a program where pharmacists in our stores provide adherence outreach and counseling to Aetna members who have been identified to be at high risk for an adverse health event. This quarter, we will also launch a specialized program to help support Aetna members being treated for cardiovascular disease.

To prevent avoidable hospital readmissions, this month, we're piloting a program to enable Aetna care managers to facilitate the scheduling of MinuteClinic follow-up visits within 14 days post discharge when patients are unable to see their provider.

And we're also piloting a program that leverages CVS pharmacists to provide face-to-face interactions to educate Aetna members on the available care management programs as well as provide patient-specific strategies to mitigate the risk of nonadherence, side effects or gaps in care. So hopefully, you can see, while it's only been 6 weeks, we are absolutely off and running.

Now our retail pharmacies are foundational to our community health strategy and another key to our efforts to simplify the patient journey. And to that end, we're opening a series of health care concept stores which will be a testing ground for a new retail engagement model that brings health care services to consumers in a more convenient, more accessible and more customer-focused manner. And as we pilot new programs and service offerings, we will identify the solutions that are most effective and scalable and then roll them out more broadly across our footprint. We're also excited to announce that next month, we will be opening our first concept store in the Houston, Texas market.

Now to give you an idea of some of the services that will be tested in these concept stores, let's work clockwise around this slide, and I'll start with the upper-left image. In the front store, we're introducing new health and wellness categories as we optimize our merchandising to focus on best-of-category assortments. Moving to the right, we will offer an expanded suite of health care services that includes what we'll call a care concierge and other health and wellness support. Below that, we have MinuteClinic, where we'll introduce new clinical services, such as enhanced screenings for chronic disease as well as in-clinic phlebotomy. And in the lower left, we have our pharmacy, where we will provide enhanced personalized prescription support at key points in care. And we'll use our data and analytics capabilities to provide actionable information for our pharmacy staff in an effort to improve patient care.

Now as we build these out, there are 2 important points to remember when you think about the cost. One is that between CVS Health and Aetna, we already have a substantial capital expenditure budget of about $2.6 billion annually. And we believe that the capital associated with these remodels can be repurposed from existing remodel programs that are a component of our typical CapEx budget.

And second, although our goal is to become a consumer health destination, we will be very thoughtful about how we scale these offerings. We intend to use a hub-and-spoke approach with a selection of hub stores receiving the full expression while other stores receive a lighter-touch refresh.

Another example of our patient-centric approach is a simpler, more personalized program for joint replacements. In this version of a potential patient journey, you can see that the current approach lacks the necessary support and coordination for patients to achieve their best health outcome. You compare that to an enhanced service where we'll be able to provide surround-sound support to the patient to address many of the challenges that one faces: could be arranging transportation to get to and from the procedure; supplying durable medical equipment to the patient's home before the operation; conducting the required pre-op bloodwork or providing post-op support that includes medication reconciliation and delivery. And it's another example of how we're thinking about addressing the pain points at each stage of what we're describing as patient journeys. We know in doing so that we can help patients achieve their best health.

So now that I provided some details on how we're going to remake the consumer health care experience, I thought it would be helpful to translate that into our vision for longer-term value creation, and we've identified 5 key areas.

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First is generating medical cost savings through some of the initiatives we talked about earlier. These medical savings have tremendous implications for our financial performance. Every 50 basis points that we can reduce medical cost trend results in about $500 million of additional underwriting margin.

Second, we plan to take a portion of those savings and reinvest them back into the business to improve our competitive positioning and ultimately grow membership. Additionally, we will work to increase enrollment in the fast-growing Medicare space by leveraging targeted outreach along with other in-store sales opportunities.

Third, we see increased utilization of CVS assets as we integrate our plan designs and introduce new higher-margin programs and services, creating a platform that customers want to use.

Fourth, you think about dramatically improving the customer experience, that's going to improve customer satisfaction, that's going to help improve retention, both for the customers who shop our stores and also for the clients that we serve across both the pharmacy and the medical benefit.

And finally, we will make our new higher-margin products and services available to a wide array of health care partners through the open platform model that I mentioned earlier.

So as we execute on each of these levers of value creation, our goal is to drive enhanced margin, profitability and generate incremental capital. We'll deploy a portion of this capital to enhancing shareholder returns while also reinvesting back into the business to drive membership growth and to create new products that further fuel our self-sustaining growth model.

So let me just wrap up with 3 key takeaways from our discussion here this morning that summarize why we're so excited about the future of this newly combined enterprise. First, the acquisition of Aetna broadens our health care reach and it allows us to play a larger role in the health care system while better addressing the challenges faced by patients every day.

Second, we have a clear line of sight on synergies that exceed $750 million in 2020. We've already begun to execute against that goal.

And finally, over the long term, this combination creates a platform to accelerate growth as we introduce higher-margin programs and services aimed at reducing medical costs while making investments to grow membership and enhance revenues across the enterprise.

So again, thank you for your time this morning. We'll invite you to the breakout session over in the Georgian Room, which is also being webcast.

QUESTIONS AND ANSWERS

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Good morning. This is the breakout session for CVS Health. My name is Lisa Gill. With us this morning, we have the entire management team. So let me introduce everyone. To my right is CFO, Eva Boratto; to her right is Larry Merlo; and to Larry's right is Karen Lynch. So Karen is heading up the Aetna business. Larry is obviously CEO and Eva is CFO. Also to my right is Mike McGuire in IR.

So first, Larry, thank you so much for the headwinds, tailwinds slide. I know that I've been asking for that. But I couldn't help but notice one big thing that really stood out to me, in that if I just count the number of headwinds versus tailwinds, there's more headwinds versus tailwinds. So -- and one of the tailwinds that I didn't see was accretion from the actual Aetna deal. So maybe it's Eva that we want to talk about this slide. So could you maybe -- I know you're not giving guidance at this point, we're going to wait until the 20th of February to do so, but how do we think about sizing potentially the headwinds versus the tailwinds?

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Eva C. Boratto - *CVS Health Corporation - Executive VP & CFO*

Yes, so Lisa, thanks for the question. And it's difficult because we haven't given the guidance yet. But I think to your first point around accretion from Aetna, clearly, as a result of the deal, bringing the Aetna business on, obviously, as a -- from a stand-alone basis, is a tailwind for us. And as we had said, you have to look at that in the context of the debt as well, and saw the accretion more coming in the year 2. As you look at the list of headwinds and tailwinds, you're right. If you're just, by sheer count, looking at the headwinds, there are more. On the legacy CVS side, long-standing from a retail dispensing perspective, the impact of generics have been a huge tailwind to help us offset the impacts of reimbursement pressure. And as Dave Denton said numerous times, you have ebbs and flows. And we're trying to give you some color there as to it is a lighter year on that front.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Right. And then one of the other headwinds that really stood out is the branded price inflation. A lot of discussion here this week. Looks like it's coming in around mid-single digits. I know there's been talk about some of your PBM contracts that have guaranteed rebates and what that means. Is there a way to size that, number one? And number two, as we think about some of the new contracting that you have in place going more towards a net cost, will that be alleviated as we move forward towards that type of contracting?

Eva C. Boratto - *CVS Health Corporation - Executive VP & CFO*

Well, I think I'll take the first question first. In terms of the brand inflation, what we've seen, and it's pretty consistent with what you've said, coming into early January, we've seen it continue to moderate, in that mid-ish single digits, versus, if you go back a few years, low double digits teens, if you will. So if you think about it, our PBM contracts have a 3-year cycle. So if you go back when that pivoted and if you were underwriting in an environment that had that double-digit, you're thinking about that catch up over the 3-year -- over this 3-year cycle. So as you look forward now in this different environment, you're able to structure your contracts differently. But looking in the past, that's where the headwind comes from. And obviously, the other piece of that, Lisa, is also on the dispensing side. We carry inventory, we dispense products, so the lower inflation also affects us there.

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

And Lisa, to your second point on -- I think probably everyone saw the announcement back in December on a new contractual pricing model for the PBM. Over the last few years, we've all heard this word transparency. And as an organization, we've been working to define exactly what does that mean and how do you make transparency actionable? And our work there probably started with the rollout of what we're calling real-time benefits, where for a Caremark member, we're actually taking one's pharmacy benefit design and placing it in the EHR at the point that it matters: where the prescription starts, at that prescription pad, which now happens to be electronically. The results that we're seeing there, we're quite pleased with because we're showing what is the member's out-of-pocket expense, and then we're showing up to 5 therapeutic alternatives. We're seeing physicians switch more than 40% of the time to a lower-cost alternative with an average savings per script of about $125. So this new pricing model is really another answer to what we believe is important in transparency, where the role of the PBM, right drug, right patient, the lowest possible cost, net cost. So we believe this pricing model creates absolute alignment with our clients, and it allows us to focus on the denominator of lowest net cost without getting preoccupied on any of the various variables that ultimately get you to that number.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And then, again, just kind of sticking initially with this kind of headwind, tailwind. The headwind around investment spending, you talked in your slide today that you have $2.6 billion that you generally have for CapEx. What's the incremental investment spending?

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Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Yes, Lisa, we talked both headwind, tailwind, that we started a streamlining initiative a few years back. That's continuing to be on track. We expect the benefits from that in '19 will exceed those of '18. At the same time, we are looking to make additional investments. We talked about investments that we're making in digital to enhance our offerings, recognizing, in the prepared remarks when I talked about being local, it's not just about our bricks-and-mortar stores. I do think that's an important point that I want to emphasize because I know there's been a lot of attention of the health hub or the health concept store, whatever, we talk about. And while that is an important element of the strategy, it's not the only element. Being local speaks to the community, it speaks to in the home and it also speaks to the role of that digital device. And we see a real opportunity. That's where many of the investments are going, as well as supporting the high-growth Medicare business.

Eva C. Boratto - *CVS Health Corporation - Executive VP & CFO*

And Lisa, just one more thing. Larry mentioned digital, but also the data and analytics, is the other piece I'd add.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And then I guess, lastly for Karen, when we think about the Aetna experience rating, for people like me that are just new to finally following managed care, can you walk us through how to think about that headwind as we go into next year? And then secondly, one of the tailwinds is growth in the government component of your book of business. Is that business that's already won now for 2019? And how do you view that going forward?

Karen Sue Lynch - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

So let me take the first one. Relative to experience rated business, when you think about pricing insurance products, you look at what your profit targets are, you look at your actual experience. And then when your actual experience is exceeding your target margins in your experience rate business, you'll give some of that back into your pricing. So that's just basically what we're saying there. You'll see if we're fundamentally above our target margins, we'll reposition and reprice that into our book. So that's what that's saying. Relative to Medicare, since we haven't given guidance, just let me give you sort of how to think about Medicare growth for '19, and I'll start with individual. Our strategic objectives have always been to be above market growth. So think about the market, it's growing. We also have expanded our counties. We expanded into 358 additional counties, which really moved us from being at 62% of Medicare eligibles to 72%. So we opened up our opportunity. And then we've continued to have very strong Stars performance. So generally speaking, relative to individual book of business, I want you think about all those positive things as you think about Medicare growth. And then group Medicare, although there wasn't a substantial amount of RFPs out in the marketplace, what I would tell you is we think we won our fair share.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And is there any update, as we think about Medicare Part D, around SilverScript? Or Medicare Part D more broadly as we think on the PBM side?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Yes, Lisa, in terms of Part D as it relates to the legacy CVS business, we would -- at this point, it looks like the enrollment is going to be flattish to what had existed over the prior years. I know one of the questions that we have been getting is we introduced a third plan this year. We called it Allure. And it was our effort. It was a pilot, a little bit of a test where the definition of that product took the -- I'll refer to rebates, discounts as one terminology. So it took those rebates, discounts coming out of the formulary and it applied them at the point of sale. So the result of that was an increase in the premium. So as you looked at the monthly premium of that product, it was in the low 80s versus the low 30s. And while there was a lot of interest in that product, we did not see much enrollment, which kind the gets back to this debate that we have around the rebates, discounts. When they're not applied at the point of sale, they are applied to buy down the monthly premium, which is exactly how Part D works, and that becomes a real focus for beneficiaries.

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Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And I think that, that debate continues, right? And when you think about in D.C., clearly, we have not seen that shift to that point-of-sale rebates because of the cost, the incremental cost. You talked about it on the premium side and the way that this works. But Larry, clearly, a lot of people in this room believe that the system we have today is broken, and that we need some type of new system. You're talking about new contracting on the PBM side. We hear the pharmaceutical industry saying that the way that the system is set up today structurally doesn't work longer term. If we have to start all over again, what would you like to see? If we had a clean slate, so forget where we are today and the cost of that would be, how would it work?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Well, Lisa, I think you have to -- let me kick it up a level. Because if you turned around and said, "How did we find ourselves in his position today?" It wasn't that many years ago that, as a consumer of pharmacy care, you had one variable to consider. If you were in the doc's office, "Doc, are you writing for a brand or a generic?" Because there was a copay for each, and once you had that -- and you knew what it was. And once you had that answer, you were done. Well, plan designs have completely taken that apart. And in the tools with which to look at as a consumer in out-of-pocket cost, they've gotten pretty darn complex. And a lot of that's what led to what I had talked about earlier around real-time benefits. I would sit here and say the second dynamic in play is the growth of formularies. What has driven that? Size, scale, competition. And yes, whether you want to refer to it as a rebate or a discount, the pharmaceutical industry is stepping up to lower the cost of care for formulary placement when there is more than one clinically equivalent product within a therapeutic class. Now Lisa, whatever happens with rebates, I don't see the dynamic that I just described going away. Size, scale, the ability to move market share and competition driving down cost, that dynamic's not going to change. I think the question that has to be answered is, we disclosed back in August that the vast percent of those rebates, discounts are being returned back to plan sponsors. We retained 2% in 2018 of the rebates that we negotiated. Now the big debate should be what happens to those plan dollars? And they're either being applied at the point of sale or they're being applied to buy down the monthly premium. So whatever we answer there, we may squeeze the balloon here, but the balloon's going to grow here. And I think, Lisa, a lot of this comes back to what else can we do that's going to take real cost out of the system? So I know we're going to have that debate, I'll give you a plug. We're going to end up having this debate at 5:00 with Eli Lilly, so.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

We're going to have -- exactly. We'll have a very good discussion at 5:00 today with Eli Lilly. I guess -- and I'll open it to the audience in a minute here, but I thought it was fascinating when you talked about the medical cost savings, 50 basis points equals $500 million. And I think, over the years, I've heard Mark Bertolini talk about something similar to that. But you talked about reinvesting it in membership growth, and I think that's something that sometimes investors fear, in taking some of these savings and reinvesting it and making it a more competitive marketplace. So 2 things I would just really ask is, one, when we think about underwriting a product and making assumptions around underwriting those products, Karen, help us to have confidence in your visibility around that cost savings when you're thinking about underwriting something for membership growth, number one. And number two, when we think about where those medical cost savings are coming from, what are the biggest buckets? Is it really the site-of-care? Is it pharmacy? I mean, pharmacy is 15% of the dollar. I have to imagine that it's probably other things beyond pharmacy.

Karen Sue Lynch - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

I think, Lisa, the question really is at hand is, will you maintain your pricing and underwriting discipline in this kind of new world? And I can unequivocally say yes, we will continue to remain very disciplined around our pricing and around our underwriting. When we price, we have certain margin targets we need to hit. We get a lot of -- when you're underwriting, it's -- you're making judgments, but you're getting a lot of data, where we have very seasoned, skilled actuarial professionals to maintain that discipline around our underwriting philosophy and our underwriting margin. And it's a balance, as you know. You balance for growth and for margin. In our commercial business, we have consistently tried to maintain that balance by always making sure that we're hitting our margin targets. And that is important to us as we think about the financials going forward.

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Larry J. Merlo - *CVS Health Corporation - CEO & Director*

And Lisa, the second part of that question on savings. I do think that there will be elements of what I described that we'll be able to translate into savings more rapidly. I mean, just think about the ability to reduce -- or better align site-of-care as it relates to the acuity of care required with the cost level of that acuity where the consumer ends up. The easy example is why do people go to the ER with a sore throat and 102-degree temperature when they have other options, other lower-cost, where the acuity level required to adequately treat them is much less than what's required in the ER? I know we can do better around that.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And don't you think that just one visit to the ER and the $2,000, right, bill that you get on the other end that you realize, hey, maybe I need to find somewhere else to go to? I think as we look at the MinuteClinic, you've owned the MinuteClinic since 2005, 2006 time frame, is that right? 2006 time frame? It has grown during the period of time, but it still feels underutilized to me. So what is it that you put this as part of the plan design within Aetna that helps to grow that? Is it Net Promoter Scores that help to grow that? What do you think helps to grow this whole idea in consumerism that we actually get people to that low-cost site of care?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Yes. Lisa, I don't think there's just one answer to that. I think it's a combination. I think plan design will play an important role. I think expanding our scope of practice, whether it's -- I talked over in the other room on we're going to add in-clinic phlebotomy. We're going to be adding some additional services around the management of chronic disease. So I do think that there are a handful of activities that will drive utilization. The good news is that there is excess capacity in many of our clinics today, and the scalability of that is it's not that difficult. And in some respects, it is analogous to what we described as to how the pharmacy works. Yes, there's a threshold when you begin to add staff based on volume, but whether it's that next prescription or that next patient visit, that's going to be the most profitable one.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And can you talk about virtual care? So as you think about, right, that the whole offering and you think about your relationship with Teladoc, the entire -- when I think about Teladoc, it's really, like, the intel inside of your app today. And that opportunity to leverage a group of doctors by having a lower-cost nurse practitioner or physician's assistant in your MinuteClinic. So how do you think about your virtual care strategy as it pertains to business today, but then also around chronically ill patients?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Yes, Lisa, there's probably a couple of strategies in there. One is that it can provide access in areas or geographies where maybe it just doesn't make sense for a bricks-and-mortar MinuteClinic, but it's going to expand our reach. The second dynamic in play is that it can also expand our scope of practice. I think the easy example that folks get their head around is, today, we don't do a lot with derm. But the opportunity now through telehealth, to immediately engage with a dermatologist, recognizing that there's a lot that can be treated in a virtual way. So that's how we're thinking about it. And to your point in terms of there is an opportunity around more of the complex chronic disease where mobility is compromised for the individual. That's something that we have on our radar screen in terms of how do we think about that. I think if you were in the other room, you heard me use patient journey multiple times. And that's how we're thinking about these various opportunities because I've been impressed with the quality of -- Lisa brought -- Lisa -- you, in one of the earlier questions, Eva talked about the role of analytics. And I think we've all been impressed with the quality of analytics that resides in Aetna and their ability to understand what is the next best action for the members that they serve. I think one of the opportunities that is unlocked in this combination is Aetna is an insurer, how do they execute against that next-best action to create a behavior change and action? And that's -- again, that's where this combination comes to life in a differentiated way because of the role that the legacy CVS assets play in the community.

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Eva C. Boratto - *CVS Health Corporation - Executive VP & CFO*

And Lisa, just one more thing on site-of-care to add to Larry. We didn't talk about Coram and our presence in the home and our infusion capabilities. And if you think about other things that have been discussed here and where innovation is coming from, that's also an asset that we can think about differently going forward.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Right, I would agree with that. And I guess in the last few minutes here, just really want to talk about the concept of open platform for broad partnerships. And so I think we get a lot of questions around how do you convince those that you compete with in many aspects of your business to also come and bring services to your platform?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Yes, Lisa, it's a great question and it's an important one. And listen, if you look at the status of the marketplace today, the lines are blurring like never before. And there are several proof points. We have our own proof points in terms of we can be competitors, and at the same time, we can be business partners. We look at the role of Caremark in Medicare Part D where we have grown SilverScript quite nicely to more than 6 million members. And at the same time, we managed the Part D benefit for more than 40 health plan clients. And we've been able to demonstrate for them the intel inside Caremark has allowed them to grow faster than the overall market with a large percent of their beneficiaries in 4-star-plus performing plans. So that's important to this discussion because what is the point of differentiation that we can provide? That, I know I compete with them, but based on the opportunities that are afforded to me, I'm not going to move my business forward to the level that I possibly can if I get emotional about I got a competitor in the marketplace. And so I believe that we can do this. We've got some proof points today, not just with Part D, but what we've done at CVS Pharmacy in terms of partnering with the PBMs that are not Caremark with some of the differentiation we provide. I should also mention that there will be elements of what we create that will have the benefit of owner economics that will reside within the CVS/Aetna combination and will be much more difficult to open-platform, if you will. Now that doesn't mean that there won't be many things that we can. And if you look at what we've learned along the way, Maintenance Choice is a great example of that. Maintenance Choice has has driven the growth of 90-day plan designs. But today, almost 9 years later, there is not an exact equivalent of Maintenance Choice because of the role of owner economics. But CVS Pharmacy has partnered with some of the innovation with other PBMs that it doesn't destroy the value proposition that Caremark has in the market.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

So Larry, when we're sitting here next year together, what will investors appreciate at that point that they don't appreciate about the CVS Health story today?

Larry J. Merlo - *CVS Health Corporation - CEO & Director*

You know what, Lisa, it's a great question, and I think it stems from our belief that putting the consumer, that there is consumerism in health care, that's not going to diminish, it's only going to grow. And having a strategy that puts the consumerism at the center of their care, you can produce viable results for long-term growth.

Lisa Christine Gill - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

Great. Well, thanks, everybody. We appreciate your time.

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Larry J. Merlo - *CVS Health Corporation - CEO & Director*

Thank you.

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