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CVS - CVS Health Corp at Leerink Partners Global Healthcare Conference

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PRESENTATION

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

All right. I'm going to get started. So thanks, everyone. Good morning. I'm Ana Gupte, I cover managed care and facilities as well as payor services for SVB Leerink. And it's my pleasure to have CVS management here: Larry Merlo; CEO, Eva Boratto, the CFO; we have Mike McGuire, who heads up IR; and Jen Gilligan as well. So we just have fireside chat format today, so I'm just going to dive into the questions and feel free, Eva and Larry, to give me color each of view.

QUESTIONS AND ANSWERS

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

So I'm going to start first with the financials in the 2019, the guidance that you gave us a week ago. The stocks responded pretty negatively to the guidance. Can you give us any color, firstly on the headwinds and tailwinds that you had been talking about for the last month or so? And how many of those headwinds and tailwinds, firstly, if you go into the break-open generics? We had the rebate guarantees on brand inflation, the Omnicare headwind. How much of that is recurring, and we should be viewing that as recurring into 2020 versus a transient headwind? 1x those legacy headwinds will be out of the way, and you can start on your way to integrating at nondriving EPS growth into '20?

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

Yes, Ana, maybe I'll start. Eva will jump in, and maybe what I'll do is just summarize the headwinds and tailwinds and then talk about the transient nature of those. As you look at the headwinds, we talked about this time last year about making investments from the tax reform and that along with the Omnicare performance is impacting the Retail segment. And the other headwind set around, we continue to have ongoing pharmacy margin reimbursement pressures in both legacy businesses. It's more of a question around what are the offsets in any given year to that margin compression. And we're experiencing a lighter year from a year-over-year contribution of generics.

And the second, as you look at the lower brand inflation, that is placing some pressure on our client contracts as it relates to those client commitments around rebate guarantees. As you look at the transient nature of those, acknowledging that in the PBM space, we typically have 3-year contracts. Those rebate guarantees, they peaked this year. We will continue to have some headwind in 2020 to a lesser extent than '19 and then it rolls off after '20. As we look at the genetic space, in any given year, you can have peaks and valleys. As we see the generic year-over-year contribution for 2020, we see that much better than the benefit that we're experiencing in '19. And then obviously, as you look at the investments in tax reform, that rolls off this year, and we have an action plan in place to improve Omnicare's performance, we're working to accelerate that, so we see that business stabilizing and improving from this point forward.

As you look at some of the tailwinds in the business, we continue to have a strong top line growth at Retail, not just in pharmacy but in front store as well. And we expect that to continue. You look at the performance of pharmacy. We are seeing the benefit of our network configurations as well as the clinical programs that we have brought to the market, and we see that continuing as we move through 2019.

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The other things, we are introducing new contracting models in both legacy businesses. And you've seen some press around the Guaranteed Net Cost pricing model in the PBM, which we believe creates absolute alignment with our clients in terms of what's most important. And there are many variables that ultimately get you to the net cost of the drug, which is what clients hire us to do, and this new pricing, this new contracting model puts the focus on that net cost element. We also believe there is opportunities with what we have done at Retail that one of the things that we've learned as we get deeper into the Aetna business that about 50% of the claims that they are paying have some type of value-based reimbursement model tied to it. Now that's largely in the provider space. We see an opportunity to gain traction in pharmacy, so we're going to begin to move that needle. That is not an overnight change. I think it'll take several years, but there are many elements of pharmacy that improve HEDIS measures, improve Stars performance. And we think we can begin to create more of an outcomes-based model that goes beyond just the price of dispensing. And then, of course, there's opportunities to continue to take cost out of the business. So those are things that we're putting in place in response to the headwinds as well as the nature of, Ana, to your question, many of those headwinds are transient nature.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Okay, so it does sound like the rebate guarantees will subside or taper off into '20. You'll have less pressure from break-open generics Omnicare. Going into the tailwinds because I'm trying to get a sense for will you be able to say there's net growth in 2020, which is the top-of-mind question, if you will, for investors.

So let's start with the tailwinds are not on the top line. You talked about retail pharmacy, retail front store. Can you comment on the PBM-selling season? You had really strong retention for '19. How does this play out in 2020? You have Anthem onboarding earlier than expected, for us anyways as investors, and then Centene, though, is beginning to roll off. So on a net basis, what is this going to look like for the PBM as well on the top line?

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

Yes. Ana, your point, we're very pleased with the 2019 selling season, in a year in which there was not a lot of new business changing hands. We have about $37 billion, $38 billion up for renewal. We had a 98% retention. And at the same time, we did grow incrementally with new business in the market. It's early in the 2020 selling season. To your point, we're excited to be in a position where we can onboard the Anthem business earlier than what was anticipated, and we've got a great team dedicated to that. They started probably about 15 months ago, and the work is well underway there. I should remind everyone that the nature of that contract -- that business will be reported on a net basis, not a gross basis on the revenue line. And then, I think, as everyone knows, Centene made a significant investment in the RxAdvance business and notified us of their intent to begin to migrate that business on to the RxAdvance platform. That will begin in '19. We expect that to be a multiyear process, so it's -- we don't have a firm, defined timetable around that. So it's early in the selling season. As we've done in pastures, we'll provide updates as we move through the coming months and more to come on that.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Then moving to the final business, if you will, on Aetna. Where Aetna ex the prior development this year and experience rating and all that, I think was generally decent performer for you on the '19 guidance. It's a completely transformed landscape going into 2020. And in the same vein, do you expect to see membership growth in Aetna on a combined basis with CVS and Caremark going into '20? Will that be a tailwind? And then I'll talk about the bottom line aspect of it as well.

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

Maybe I'll take the first part of that and then I'll let Eva take it from there in terms of additional financials. But listen, we are excited in terms of -- as you look at the Aetna business moving into 2019, they've had strong membership growth, certainly in the government space but across the commercial space as well. So we expect it -- when you think about this combination and the opportunity to bring innovative products and services into the marketplace, membership growth is a key element of the value creation that we believe we'll be able to achieve as this combination takes hold.

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

And Ana, the only thing -- I would add a couple of things. As you think about the government space as you know, it's been a key area of investment for Aetna in terms of market expansion as well as capabilities. We strongly expect that momentum to continue. We had a very strong 1/1 operationally as well as the lives win, so we feel good about that. We had wins in commercial. And we'll continue to be prudent as we bid on the business with the actuarial discipline how Aetna has approached the markets in the government and commercial space. And I'd add another point, recall in our earnings call, we indicated that we moved legacy CVS PDP over to Aetna immediately here in the beginning of the year, and that was really around a strategy of how do we have even a broader strategic platform to grow that business, to bring those businesses together for an advance of the bid season, so we can have the best strategies to win.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Okay. So I think you had guided to -- for '19, 84.5% I think in the midpoint on last ratio. And then, that was ex the prior year development. So would we expect, I think, from what I'm hearing you say, it's still the same mantra of margins for actuarial disciplines. You'll grow in Medicare. You'll be more prudent on the commercial side and not just pivot to growth at the expense of margins then.

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

That's right. Our actuarial disciplines will remain consistent.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Then just talking about the synergies, what seems -- to me, it seems like when I look at your print for the fourth quarter and into guidance, you sound confident about the Aetna transaction, the acquisition, the synergies. And you're guiding to $300 million to $350 million in synergies. But this year, you sound really confident about synergies for next year above $750 million, maybe $800 million. And you're also talking about an enterprise initiative on cost savings. Should I interpret that to mean that on top of the synergy guidance that you're offering us? And will that be an offset to these retail pharmacy, perhaps PBM margins as well, which seem to be continuing pressure into next year?

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

So Ana, on the additional cost initiative that we outlined on the earnings call, you should absolutely think about that as incremental to the synergy as well as incremental to the programs that both legacy companies had in place ongoing before the companies came together, and we're pleased. As you think about the initial pass of the synergies, the 750, and we are confident in delivering more than that, they're focused on 3 key areas: around your corporate overlap; your operational efficiencies pharmacy where we can bring things together; your procurement opportunities and some modest medical cost savings. As the companies have come together, we see even greater opportunity as you think about digital capabilities, as you think about some of the operational staff onboarding, in back-office medical claims processing, call centers, et cetera. So there's some of the places that we continue to see opportunities, and we'll have more to say about that in May and June.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

So the medical cost synergies, which is the big additional element, 2020 and beyond. Is that baked into your synergy guidance right now? And how much of it is -- they said a little? And will that continue going forward is the question?

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

Yes, in the 750 I would say there was a modest piece of medical cost synergies in there.

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

But Ana, as you think about that -- your point -- maybe I go to your point about we feel very good about the work that has been done on the integration activities over the last 12 months and the team is ahead of that $750 million target that we had set a year ago. At the same time, as we think about, I'll call them the transformation activities that it's been 10 or 11 weeks since we closed and that team for all the reasons that we all understand as you go through the regulatory process, there are things that you're just not going to have this ability to until you get close to the end. So that team's work really began in detail, probably about 4 months ago, maybe a month ago before the closing. And they too have been moving with speed and a sense of urgency, and we're excited that they've already gotten into the market some test programs. We expect that we will have some products in market for 2020. And that will continue to grow as we test and learn, operationalize and commercialize. So I think we're all encouraged by the work and the early feedback in terms of that, which is being tested.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

One final question on near term, and I know I'm taking a lot of time on the near term. But the feedback I get is that there are no catalyst, why do I need to buy CVS now. So on the '19 number, I think I actually -- my bad, didn't notice that, that was ex prior-period development, which normally if it was just Aetna, it would have been in my sleep, but it's hard when so many segments come at you all at once, but it was a $7 handle. And I republished and I said there was a $7 EPS handle, which there was a $7-handle trade going on. And I think that's part of why your stock sold off so hard. Would you say that there was any element of conservatism in that number at all? And you didn't guide to any pride development, either in the synergy number or your estimation of your margins and retail and the pressure there or otherwise. Your PBM segment looked pretty good.

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

So Ana, I'd say it's early. I'd say the guidance we provided were our best projections with the information we know taking into account risks, opportunities, headwinds, tailwinds in the market and within our control. If you're asking, what could push you higher, right. Higher in your range or above your range, some of the element that we spoke about to think about slower migration of Centene, more rapid realization of synergies, you saw that medical cost trends, it's early to have a prediction on that. But if they come in more favorable, obviously, prior year development and any early wins we could have on the new cost on our project. I think it's too early to make predictions on those things, but there'll be some of the elements that will look at as we proceed through the year. You said this earlier. We're pleased with the Aetna guidance that we provided. And if you looked at that on a stand-alone basis, what we had said was growing modestly. I'd think about that as low single digits. And obviously, we're not pleased with the contraction in the legacy businesses and some of the things Larry outlined earlier around the operational improvement we're making in Omnicare, the cost out there, the new cost initiatives that we're embarking upon, we're examining all aspects of our balance sheet, right. We're laser-focused on driving those improvements whether '19 or beyond.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

And when might we get any visibility into '20? Will we have to wait till your fourth quarter '19 goal? Or might you give us something ahead of time, which investors keenly are looking for?

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

So we understand what investors are looking for, and what I would say is when we're in a position to provide that in a prudent way, we'll certainly do that.

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Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Okay. So thanks for your patience on all of the near-term questions. If I could then move on to all of the debate that's happening right now in Washington around the Part D plans and the PBMs and the rebate changes that have come out through HHS with the dates in early April and then the hearing with the drug company CEOs a couple of days ago? Larry, do you have thoughts on that?

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

I'm trying to figure out, Ana, where to start because I'm looking at the clock, we've got 6 minutes left. Okay, but...

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

You have 5 more than that if you want to go.

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

Okay, all right, well, listen -- maybe I'll start with the proposed role. And as we look at that, we believe that takes us a step backwards, not a step forwards. And I think everyone here knows in the Medicare space, 100% of the rebates get passed back. Those rebates are used by down the monthly premiums. We bend back and looked at what has happened to monthly premiums over a 9- or 10-year period. If you go back to 2009 across all Part D plans, monthly premiums were $29. Last year, they were $32. So they've grown less than CPI, let alone less than medical CPI. So it is a proven fact that, that's where -- that's how the dollars are being utilized to the benefit of the beneficiary.

The second important data point is as you look at the Part D space, we're approaching 90% of all prescriptions that are dispensed as generics, not brands. So you take those 2 factors and you think about if we eliminate rebates in Medicare, then the monthly premiums are going to go up. Some actuaries have pegged it as much as 52%. So costs are going to go up for everyone. And yes, there is going to be a percentage of beneficiaries who will net out, to the positive. But one of the questions that we have is, will we see seniors disenroll? Especially healthier seniors as a result of the increase in monthly premiums. And it's important for us to not point fingers. But what do we see as solutions? And we've talked, and we will respond to the April 8 deadline in terms of our thoughts about what we could do. And we see capabilities in the commercial space where a portion of the rebates are passed back at the point of sale. A company that with a preventive drug list and you can reduce cost at the pharmacy counter without experiencing double-digit premium increases on a monthly basis. So we see that as a more viable solution. And Ana, as I mentioned, we'll respond in turn with that.

Ana, I guess the other question that we get a lot is, would you see this spilling into the commercial space. And as you look at the Caremark book today, we have about 10 million members who we manage whose planned sponsors have adopted point of sale rebates. That's roughly probably between 20% and 25% of our commercial book. So it's clear that benefit managers in the private sector carry the same thought process as what we experience in Medicare that they want to buy down that monthly premium, and we're working to educate them on some of the other options that are available to them like I mentioned, where it's not all or nothing. You can create a win-win here, and there are a lot of folks that are listening and want to understand that more. And I do think we'll see more adoption of those types of plan designs.

And I guess the last question is, any comments in terms of the hearing earlier this week that was -- we share the administration's goal of reducing drug cost and reducing out-of-pocket expenses for members. We're very pleased with the tool we put in the market a little over a year ago that if you're a Caremark member -- because if you think about it wasn't that many years ago that if you were focused on cost in the doc's office, you only had one question to ask. Are you writing for a brand or generic because there was a co-pay for each one. Well, that's all out the window, and nobody can keep their benefit design as it relates to pharmacy straight and let alone the physician. So if your a Caremark member, we're taking your benefit design. We're embedding that into the EHR, recognizing that we define transparency as we work to make transparency actionable and when you think about this dynamic, it really starts at the prescription pad. So if the physician's prescribing electronically, we're showing them, you're out-of-pocket expense. And we're showing up to 5 therapeutic alternatives.

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Now quite frankly, we're all thrilled with the results that we're seeing at quite frank -- a little bit surprised that we knew that if the drug wasn't in the formulary, the physician will switch to another alternative. But even when that drug is in the formulary, they're switching over 40% of the time to a lower-cost alternative. And the average savings per script is over $100. So we think functionality like that can have a meaningful improvement at the pharmacy counter. And oftentimes, those things are overlooked.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

All right it's -- a lot of it is about moving money from one constituent to another, rather than just bending the pharmacy trend, if you will. But regardless, however, this plays out, as you contemplate all the scenarios, would you say that your 300 -- I think there was $300 million on rebate disclosure that is everything that's out there and regardless of how this work for whether it spills out into commercial that there's no real meaningful impact to your PBM margins from where this goes? Or do you contemplate any build downside scenarios from what might happen?

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

Well, Ana, I mean from a financial business point of view, your comments are spot on. We worry about the unintended consequences that they can occur. And in the hearing earlier this week and I read some of the reports coming out, I didn't see anyone say that they would lower their list price to the levels that exist today net of rebate. I think we heard them say they would lower their list price, stop. So we're sitting here today utilizing size and scale to drive down the cost for the claims that hire us to provide that service, and I don't see the use of formularies, leveraging size and scale, changing the dynamic.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

I would be remised if I didn't ask you about your HealthHUBs. You've rolled these out now in Houston. Can you talk about any early experience that you're having there? What your target strategies and like that for the rest of the country, and what are the economic drivers if either you and/or Eva want to comment on that?

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

Yes, maybe I'll start and Eva can jump in. To be clear, we've got 3 concept stores. They've been operational now for about a month. As we've talked over the last several months, we saw an opportunity to repurpose some of the front-store space. We've repurposed about 20% of that with services in mind. So when you walk in the HealthHUB, you'll see an expanded medical clinic where we're doing phlebotomy. We have a nutritionist on site, respiratory therapist. We continue to have a focus on the front store on products of health, beauty, personal care and some elements of convenience. But the early returns are very exciting. We've gotten terrific feedback from customers, and I think the component that I'm really pleased with -- well, we're all really pleased with is we're beginning to get learnings that are helping us understand what do we need the HealthHUB to do and what are we learning that we can apply broadly across a wide variety of stores? So we're beginning to get those learnings, and I think that's critical in terms of we talked about this hub-and-spoke concept and, again, 30 days in. But I'm confident that we do not need a HealthHUB in every store to execute this strategy.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

I'm I too -- sorry.

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

Sorry, Ana, the only thing I'd add to that is we've gotten questions from investors around capital deployment and what will cost. Validation of you your don't need a health hub in every store that you can deliver the value with these higher-risk patients in a hub and spoke model. As an early

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proof point around as we think about CapEx, in the $2.3 billion to $2.6 billion range, you can think about it in select stores, it will be repurposing of historical refreshes, and it won't need to be done in every store.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

So repurposing in the clinics and not everywhere?

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

Right, right.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Yes, yes. One final one. Might you move away from just telemedicine with the Teladoc into actually primary care at in-store, which is believed to be an opportunity for you?

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

Well, first of all, through virtual technology, telemedicine, we can bring the physician into MinuteClinic. One of the things that we are laser-focused on is the cost associated with the site of care. And as you look at the growth of MinuteClinic in terms of the breadth of practice, no, we're not treating broken bones. We're not doing x-rays, but there is a lot that we can treat, diagnose from not just an acute but as well as the management of chronic disease as a complement to the role of the physician. So we do not have any plans today to think about staffing MinuteClinics with primary care docs. To the extent that we see the need or the opportunity from, I'll say, an episodic nature, we'll think about telemedicine as filling that void.

Anagha A. Gupte - *SVB Leerink LLC, Research Division - MD of Healthcare Services & Senior Research Analyst*

Truly a pleasure. Thanks, Larry, and thanks, Eva.

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

Okay, thank you. Thanks, everybody.

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