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EDITED TRANSCRIPT

CVS - CVS Health Corp at Barclays Global Healthcare Conference

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PRESENTATION

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. I see the clock just started cranking here. We'll start our next session. I'm Steve Valiquette, the healthcare services analyst here at Barclays. This is the CVS session. This will be a fireside chat. To my right here is Eva Boratto, the company's new CFO. I also want to introduce Alan Lotvin. He's the EVP of Transformation at CVS, which I think will be a pretty critical role. I think Alan wanted to spend maybe a minute kind of giving more kind of his background, et cetera, and kind of what some of his initiatives are.

So I'll turn it over to Alan first, then we'll blaze through a long list of questions.

Alan M. Lotvin - *CVS Health Corporation - EVP of Transformation*

Great. Thanks, Steve. I'll take just 1 minute. So just my background. I'm an interventional cardiologist. I've been in health services for about 22 years, and most of the last 17 of those have been in specialty pharmacy. I took on this role as a Chief Transformation Officer about 9 months ago, and I have really 2 major areas of focus. One is on using the enterprise assets to create new products and services around the consumer that really help us differentiate in the market. And the second is the legacy medical management infrastructure within Aetna, which is a core part of how we want to change the industry reports in through me. And just for the last about 6 or 7 months, we've been focused really on understanding the near-term medical cost synergies available to us as well as developing a series of pilots and programs that are rolling out into market this quarter and next quarter.

QUESTIONS AND ANSWERS

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Okay. So I'm going to hit on some PBM questions, then I'll touch on some merger integration questions, then we'll talk about managed care. Then we'll hit some retail questions, and we'll try to fit all that in. So maybe let's just start on the PBM side. Certainly, that's a topic though with a lot of investors right now. And I will say as we think about, first, with rebate guarantees, you guys have talked about the impact from that maybe easing in 2020 versus what you're absorbing in 2019. I just want to hear more color around some of the drivers that lead to that expected reduction in that headwind for 2020. Is it more just contracts are renewing at better terms? Are you expecting maybe just better brand inflation trends next year? Maybe just more color around why that will sort of ease up next year.

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

Yes. Thanks, Steve, for that question. So overall, we've spoken about the impact of lower brand inflation and that it's had a negative impact in our underlying rebate guarantees. We began to see that in 2018. We see it peaking in '19 and, as you said, reducing again in 2020. And you're absolutely right. As we cycle through those contracts, we're able to underwrite them at current inflation levels. And we're assuming mid-single digits around our assumptions.

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Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. At the same time, you're also moving towards this new guaranteed net cost contract model. I think that's a certainly pretty unique offering, but now the guys are doing more similar stuff as the industry evolves. But just curious as far as whether or not this is resonating well with clients so far this year. You've also got to have all the consulting firms kind of on board with the nuances here. So just curious on how you're seeing traction so far. I know it's kind of early. And then just a follow-up on that would just be, how's the profitability of that compared to the more traditional spread contract, your spread/rebate type contracts?

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

Yes. I think as you think about our GNC pricing model, I would think about profitability consistent with our overall profitability at the PBM. But we think it's a better model to go to market, as it focuses not on components of discounts but driving to the net lowest cost. And in turn, that delivers what the clients want and need from us as well as aligns our incentives with them. I would say, we've been out talking to consultants for the past number of months speaking to clients. There has been, I would say, very limited pick-up at this point. There is interest, but as you know, it takes some time for things like this to roll out.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Shifting gears here a little bit, talking about this HHS proposal on shifting rebates to the point of sale. Some of your PBM competitors at this conference have said that they're actually pretty comfortable with a 1/1/20 implementation of this proposal if it were to get finalized this year. Just curious to get your latest thoughts on whether you think this will go into effect for 1/1/20. And also, is CVS now fully preparing for this potential implementation?

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

So overall, we continue to believe that a 1/1/20 is a pretty aggressive time line when you think about where we're sitting today and the timing of when bids are due. That said, we're fully planning in either scenario to be prepared for a change, should it come.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Are you able to share any thoughts on in terms of the feedback that you might be giving back during the comment period? Or do you want to leave that one alone for now?

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

I'll leave that one alone, Steve. Okay?

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

I know you guys gave some pretty comprehensive color on that on your last conference call. So I'm guessing you probably haven't changed drastically from that, so.

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

Correct.

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Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Again, still within the PBM. Obviously, you've taken on the Anthem PBM business a little earlier than expected. It seems like it's still going to really not contribute to earnings for 2019 despite the early transition. So I'm just curious whether investors should maybe expect maybe just a sharp ramp in the Anthem-related earnings in 2020 as you get leverage next year from all the cost absorption this year?

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

So we should absolutely expect an improvement in the ramp as we cycle into 2020. 2019 continues to be dilutive as a result of bringing on all the operational areas and finalizing the implementation. So overall, we would expect this client to transition into profitability as we head to 2020 and beyond.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Another follow-up question here just on the PBM. Obviously, it's been publicly announced now that Centene could be transitioning their PBM business away from you. I'm just curious if you're able just to give any financial metrics around that in terms of just the size of that contract in terms of drug spend? I think people are also kind of confused how much of that falls off in 2019 versus 2020? Is it more material in 2020 than 2019? Just curious to get more thoughts around the timing of all those.

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

Yes. As you think about the overall Centene contract, I would think about it in terms of around $6.5 billion what we expect to roll off. That will roll off over an extended time period. The precise amount that will affect '19, '20 or '21, I think, is more to be determined based on how the migration goes. I would say, as you think about '19, '19 is much less than future periods as the roll off will start at the end of the year, the back half of the year.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, got it. Okay, so let's shift gears now to some merger-integration questions. You're still kind of in this difficult spot where you guys have agreed to not fully integrate the merger until U.S. District Judge Leon issues a final judgment. I think investors, when this first started happening 3 or 4 months ago, thought this could lead to reduced synergies for the merger in year 1 and maybe even possibly year 2. But the synergy guidance is still actually pretty solid for actually both years. So I'm just curious for the synergy guidance, would that have been higher in year 1 if you did not agree back in December to these 4 steps to keep the company separate? Then I have maybe 1 or 2 follow-ups just on the synergies.

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

Yes. So overall, as it pertains to our integration work, we're quite pleased with the progress that we're making. The synergies, as you know, Steve, are tracking ahead of our initial target of $750 million, and we've committed to more than $750 million. The commitments that we made to Judge Leon back in December had not affected our ability to move forward on our integration, and I'll quote to a couple of examples. When we gave our guidance back in February, we spoke to, effective January 1, we moved SilverScript PDP over to Aetna. We moved Aetna's pharmacy operations over to Caremark, and this was all in the spirit of integrating more rapidly driving the longer-term value and all in alignment with our commitments made to the judge.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Just thinking about the PBM side of the business for a moment. Obviously, we're in the early stages of the selling season. I'm curious, since the company still can't really market the combined capabilities of both Aetna and CVS together, I mean, are you finding that maybe this lack

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of ability to integrate as being used against you by other PBMs as kind of like an anti-marketing campaign? And what can you do to sort of prevent that from happening?

Alan M. Lotvin - *CVS Health Corporation - EVP of Transformation*

So I think the negative message is just you're in the middle of an integration. That's -- I knew some would take advantage of that. What we've seen from the customers is a tremendous amount of interest in what we're doing. So if it's a health plan customer, the question is how do I take part and become part of the programs and pilots that are starting to roll out. And if it's an employer customer, it's really the question of, okay, I understand the integrated medical pharmacy data story, now tell me how the connectivity to the consumer really makes a difference and how it impacts -- excuse me, how it impacts my members. And so that's -- it's really been, I would say, less of a challenge other than the typical noise you'd expect to be -- try to be created.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Now one of the things you have been able to sort of do somewhat tied to in the merger are these -- the HealthHUBs, where you're, I guess, kind of more like in a pilot phase right now down in Texas. But just curious, I mean, just talk more about some of the programs within that and then how the response has been so far to some of these new concepts.

Alan M. Lotvin - *CVS Health Corporation - EVP of Transformation*

Yes, thanks. So there's really 4 major areas that we've -- of changes in the store. So one is we've expanded the services for the pharmacist. We've really brought pharmacists to the top of their licenses. One quick example is we've given them panels of high-risk patients around the stores and asked them to intervene -- to engage and intervene with those patients on a very specific set of opportunities. MinuteClinic services also similarly expanded to cover much more chronic disease, to cover full suite of, for example, diabetic annual exams. We've brought a series of new healthcare services into the store, so a respiratory therapist focused on sleep apnea and nutritionists and a care concierge to kind of put it all together. And then finally, we've reset a lot of the merchandise in the front store. The early results from both the traditional store metrics are encouraging. The engagement of the customers and the response of the customers on, whether it's overall satisfaction or NPS is really -- we're very pleased with it. And then the ability to identify and engage patients has at least met, if not exceeded, our early expectations.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Final question around merger integration. I think Part D was certainly a focal point tied to the merger. And obviously, you're having to divest some of that business. As we think about the profitability of just the legacy CVS Part D business, I know you kind of changed the segment reporting for that. And you made it if we crunch the numbers hard enough, I think maybe we could figure out the side of profitability there. But are you able just to make our lives easier and disclose kind of what the approximate profitability was within that business? But more importantly, should we expect your Part D profitability to maybe improve materially once the merger is fully integrated?

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

I think in terms of the profitability, Steve, that isn't something we've disclosed. We have shared that, overall, the government segment is overall lower margins than our average. As you look at opportunities to improve that, I think as we bring the best of together between Aetna and SilverScript, SilverScript's legacy strength, there are opportunities to, a, improve the performance; b, improve the strategic positioning across those PDP as well as MA. So we look for opportunities to drive improved performance in that business.

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Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, got it. Okay, let's shift gears here a little bit to the managed care side. And as we think about the Aetna book, I think a lot of the investors are always curious to hear about the Medicare Advantage trends. The membership growth really for Aetna in MA has been phenomenal, both in 2018 and 2019. And I think, overall, the profit guidance for the Aetna book in 2019, it wasn't too far off from where expectations were. But at the same time, I guess the question might be how should we think about the company really harvesting the profit growth from all these fairly astounding membership gains you've had on the Medicare Advantage side?

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

So I think, Steve, how I would answer that is, one, as you've said, we're really pleased with the growth in those individual as well as group. And as you think about the margins, we price at our target margins. And in 2019, part of our success was due to expansion of our benefits and the way we went to market. I think as you look at the underlying profitability and your comment around harvesting, as the company has said for a number of years, they've been operating at the higher end of our target margin ranges -- excuse me, target margin ranges. And each year that we price, we bring those in line with our targets.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. I mean, is there any chance that from the strong membership growth in 2018 and 2019, is there any risk that maybe you had maybe just too rich of a benefit design? And maybe these members won't be quite as profitable as what investors may have been expecting? It kind of ties into what you said, but I'm just curious though.

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

Yes. So it is a lot of growth, and it's early in the year to make predictions. We're confident in our underwriting teams and the assumptions that we utilized. And as we roll through the year, we'll provide you continued updates, but there's no reason to believe that we have a challenge at this point.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. One other question on Medicare Advantage. As we think longer term for Aetna, the growth in MA obviously driven more by the geographic expansion that's been sort of well documented. But thinking kind of beyond 2020, how's the company -- how about the sizing of, right now, the growth and the market and competitive dynamic post this whole geographic expansion period?

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

Yes. So where we stand right now is Aetna has about coverage of 75% of where the Medicare eligibles reside. And while we are highly penetrated there, we continue to see opportunities for industry-leading growth. And we can achieve that through deeper penetration in those markets, our approach to products and services that we bring in as well as just continued ability to drive underlying performance. So we're very bullish on our ability to continue to grow.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Now on the...

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Alan M. Lotvin - *CVS Health Corporation - EVP of Transformation*

I would just add. I think there's -- as you think about the importance of the individual and the consumer in MA, these new services that we're starting to bring out into the stores, starting to use the stores more effectively as distribution points, of course, was in the regulations, creates another opportunity to continue to maintain that growth trajectory in MA.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, great. Just thinking about the commercial side for a moment, you've had a few other competitors talking about trying to regain market share on the commercial side. And I don't want you guys to give any guidance for 2020, but all else being equal, and again, once you kind of get more into merger integration, et cetera, should investors expect the commercial enrollment for Aetna to perhaps be better in 2020 versus what you're sort of thinking about for 2019?

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

I think you are asking for 2020 guidance, Steve. No, all kidding aside, again, in commercial, we're very pleased with the growth that we're seeing in 2019. And I would say, our goal is to continue that momentum as we head into 2020 while achieving our underlying target margins. So it's early to provide any specifics. However, we'll continue to look to drive that momentum, and we see a robust pipeline out there to pursue.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay, excellent. Okay, we've still got a few minutes here. Let's shift gears to the retail side for a moment. Now one of the more positive components from the company's earnings guidance was the 6% retail prescription growth on the back of what end up being high single digits in 2018. Now in 2018, that pretty strong script growth on the retail side was driven by rebound on Aetna Part D, you guys had some easy comps as well. But just in terms of what the drivers are in 2019, maybe a little more color around what's driving that prescription growth. So I think that is actually stronger than what some people might have been expecting.

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

Yes. So overall, we're very pleased with our performance in driving underlying top line growth on the retail side of our business. We guided to 4.5% to 6.8% overall script growth, and I would say that's coming from 3 key areas. One, continued penetration of our clinical programs, including better adherence, better patient retention and continued increase in 90-day penetration. We're also benefiting by the wins that you mentioned in 2018. So we became preferred in a few Med D plans, and those plans were again winners in 2019. So we continue to benefit from that as well as, I'll say, some additional wins on the regional plan side. We believe that we continue -- can continue to grow and outpace the market given our capabilities in our retail stores as we continue to innovate and bring services into the stores that Alan is developing.

Alan M. Lotvin - *CVS Health Corporation - EVP of Transformation*

In that, we also have the retail team, the rollout of national same-day delivery, multidose packaging, ScriptSync, I think, is really bringing a new level or another level of innovation into the retail pharmacy to really differentiate that and provide a greater opportunity to patients to stay adherent, to stay compliant, to stay in the channel.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Now on the retail business as well, I think investors are definitely focused on brand inflation trends and potential impact there. From our point of view, the data we look at, I mean, brand inflation trends actually don't look that bad in calendar '19. There's a lot of talk in D.C. about what might happen next year, but for 2019, results don't look that bad from our own personal view. But one of your closest competitors in the retail

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pharmacy sector did recently talk about, publicly, just a 2% brand inflation trend. And people are kind of wondering how they're quantifying that. But I'm just curious, as you think about brand inflation, does that comment from your competitor correlate with what you're seeing? Just curious what you guys are seeing right now in brand inflation so far in 2019. And then does your guidance have a wide range of outcomes around brand inflation for 2019, specifically?

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

So as we've said, we expect mid-single digits in 2019 on brand inflation, given we gave our guidance after we saw all the January actions, which is probably the single largest month when pharma takes price increases. Overall, we feel pretty confident in that range knowing what's already been taken.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. So that comment from your competitor just it is what it is. And you guys are just focused on your own view of the world?

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

It is what it is. Exactly.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Got you. Okay. Well, with that, we've got 1 or 2 final minutes here. Maybe -- you obviously have an Analyst Day now coming up later on this year. I doubt you want to telegraph in advance all the things you're going to talk about, but I am sort of curious if you'd want to give any color around what investors might expect to hear later on this year at the Analyst Meeting.

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

Yes. Thanks, Steve, for that question. I think as we -- we've had a lot of discussions with investors around our Analyst Day, and I would put it into 3 large categories what we expect to deliver. One, we'll provide an update on the strategic combination, including quantification of the value that Alan and his team expect to deliver by bringing these 2 companies together. Two, provide our near-term and longer-term financial targets, including the core assumptions, top line as well as bottom line inclusive of our plans on capital deployment. And finally, a detailed review around the legacy businesses, the 3 key core businesses that we have: health insurance, retail and the PBM.

Steven J. James Valiquette - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. That should be exciting. And with that, we're essentially out of time, so we'll wrap it up. I want to thank Eva and Alan for their time today, and we'll have a breakout now in the Poinciana 3 Room. Thank you.

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