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EDITED TRANSCRIPT

CVS - CVS Health Corp at Barclays Global Healthcare Conference

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PRESENTATION

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

Good morning. Welcome to Day 3 of the Barclays Global Healthcare Conference. I'm Steven Valiquette, the health care services analyst here at Barclays. We have a pretty strong lineup of companies here at the conference today.

Our first session this morning will feature CVS Health. And we're pleased to have from the company, Eva Boratto, the CFO; as well as Alan Lotvin, the EVP and Chief Transformation Officer. And also Valerie Haertel from Investor Relations is on the line as well.

So thank you all for your flexibility around the change in our conference venue, and welcome.

QUESTIONS AND ANSWERS

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

So let's start with comments around coronavirus. So obviously, this is very topical for investors right now. So let's talk about how this might impact the various parts of your business the way you see it right now, and if it's possible, to segment it into Retail and Long-term Care Pharmacy versus PBM versus managed care. But let's start with coronavirus.

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

Yes. Thanks, Steve. This is Eva, and a pleasure virtually meeting with everyone here. I would say overall the financial impact is difficult to quantify at this point. Things are fluid, and we're continuing to monitor the status of the situation and the cases that are identified. I think, first and foremost, the health and safety of our customers, our members and our colleagues is a key priority for us, and we're taking all of the necessary steps to ensure business continuity and their well-being.

So just to give you some color, each of our business leaders are working to ensure business continuity plans are in order to meet the needs of our customers. In terms of that, as we think about pharmacy supply, we've experienced no disruption at this point. We're in close contact with all of our suppliers. And what they've shared with us is they tend to carry, on average, 3 to 6 months of inventory. And I would say, given our size and scale and the power of Red Oak and the diversity of our suppliers, we think we're in very good shape at this point.

We also are able to have, I'll say, additional information around API sourcing and what have you to enable us to be proactive on that front. As you look at what we've done to ensure consistency of care, everyone probably saw our announcement of offering $0 copay telemedicine for visits for any medical reason, not just specific to COVID-19, with the goal of eliminating potential exposure in the physician offices or with others. We have waived our out-of-pocket costs for all diagnostic testing related to COVID-19 for all of our Aetna plan members.

And finally, as you look at the front store of our business. Clearly, we've seen an increase in utilization in certain categories, particularly around cleaning supplies, masks, sanitizers, those types of categories. And overall from a supply perspective, our front store supply remains strong. We

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have had challenges. I'd say we're essentially out of stock on masks. And you could see on sanitizers, sporadically, we're out of stock. But we're continuing to receive supply.

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

Okay, great. So as the company has had a little more time to reflect on the coronavirus situation, are there any prior historical similar situations where CVS is drawing parallels, whether it's SARS, swine flu, MERS, Ebola, et cetera? Or is this one different? And are there any learnings from these past situations?

Alan M. Lotvin - *CVS Health Corporation - Executive VP & President of CVS Caremark*

So Steve, it's Alan Lotvin. Thank you. It's a good question. I think we've gone through a lot of different events over the years that have allowed us to test and refine our business continuity plan to ensure that we keep the business running, that we get drugs to individual members, whether it's Katrina, whether it's local challenges in a given facility.

What's -- this is a little bit different when you think about SARS and MERS and Ebola. Those just clinically were much more timed, limited. And as you've seen, certainly, the response in the country and the world, for that matter, has been far more, I would say, broad-reaching with this.

So it's -- we have had a lot of individual experiences. This is a lot -- enabling or causing us to put all those experiences together in one and saying, how do they all work if you have multiple points of concern? And happy to say right now, everything is going fine. We have good drug supply. We understand colleagues and have the workforce flexibility to continue to deliver high levels of service to our members.

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

And I think, Steve, if I could just emphasize what Alan said, right? The organization has long had enterprise response and resiliency teams and infectious disease response team. And we are actively managing and monitoring the situation. We're in constant -- continuous contact with officials, whether that's at the local or the national level, to ensure we are as prepared as possible as this fluid situation evolves.

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

Okay, great. So if we do focus on the coronavirus impact on the Aetna health insurance operations for a minute. A few other managed care companies at our conference earlier this week seemed to suggest that investors could potentially just think of coronavirus as an extension of a flu season. And if it, let's say, proliferated into next year or next year's season, then these other managed care companies suggest that they could just price for it across some or most of their product lines. I guess I'm curious whether you share this view conceptually or would you characterize it differently.

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

So what I would say, as you're thinking forward, looking there, right? We always take into consideration setting forward trend with the events and circumstances that we've had. There can be a wide variation of different events. But I would say, conceptually, the thought process that you outlined, we would be aligned with around how to think about it from a trend and pricing perspective.

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

Okay. Okay. Shifting gears a little bit. Given that a lot of major health care companies met with Vice President Mike Pence on Tuesday and to the extent that CVS Health was present, which I believe you guys were. Were the discussions mainly around insurance coverage for coronavirus or

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Client Id: 77

were there other factors as well as far as what was being discussed? Perhaps you can just share some of the color of what came out of those meetings.

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

Yes. So Karen Lynch, President of our Aetna business, participated in those discussions. And I think the key element of the discussion was to eliminate barriers to care around coronavirus. So there were discussions around ensuring alignment on, to agree on, $0 copay for testing as well as access to telemedicine, both things that we had addressed prior to that event.

Another area that was focused on was around just general hygiene in the work and home environment to help mitigate the spread of this. So they were the key aspects of that meeting. And we were pleased with what we had done in advance of that meeting. And we'll continue to communicate with our members and customers to make sure they're appropriately equipped.

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

Okay. All right. Excellent. Okay. So let's shift gears here and talk a little bit more around the CVS Health operations. And as we think around the CVS-Aetna merger, obviously, the HealthHUBs are increasingly important in relation to success of the merger. I wonder if you can just discuss the progress of the buildout as it stands today.

Alan M. Lotvin - *CVS Health Corporation - Executive VP & President of CVS Caremark*

Yes, sure. Steve, it's Alan. I'll take that question to start and Eva can jump in. So I think the first thing I'd say is that while HealthHUBs are the most physical, tangible, visible evidence of the merger. They are one of many programs that represent the opportunities by putting together the assets of both companies to reduce health care cost, bring differentiated services to our customers and members.

So from the perspective of the buildout, it's continuing on pace. As we've spoken before, we had 50 operating at the end of 2019, as we've talked about -- just over 50. And we'll have between 600 and 650 by the end of this year across the states that we've talked about. The first markets obviously being in the Houston, Philadelphia, Tampa and Atlanta areas.

We've been very -- remain very pleased with the results, with the consumer response, with the customer response. We've had a lot of interest from our clients in understanding how HealthHUBs help them meet their goals for their customers as well.

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

Okay. And somewhat tied into that, what do you think are the key differentiators of your model versus others in the market? And can you speak to the integrated value that you envision delivering in the near, let's say, versus long term?

Alan M. Lotvin - *CVS Health Corporation - Executive VP & President of CVS Caremark*

Yes. So I think when you sort of boil everything down, I think there's a couple of really key differentiators. So one, our model, with -- which has the information from the health plan, the information from the PBM, is -- that connects into a local last-mile delivery mechanism to consumers is very, very different. What we've seen is when you interact with people in a standard health services way, whether it's a disease management company or others, you have an engagement rate, if you're really good, in the 20% range.

What we've seen in multiple examples is when you engage with people on their schedule, when they're choosing to think about their health, you get far higher engagement rates. And we've seen that both within the specialty pharmacy and the rare disease care management with Accordant.

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And now we're replicating that with the HealthHUBs and Pharmacy panels. We're getting engagement rates that are north of 50% and 60% with the client -- with the consumers we're trying to reach.

So we're taking all this data, we're doing a really -- a very elegant set of analytics on it, really taking this behavioral -- consumer behavioral approach and thinking about how do we modify behavior? How do we think about it like a consumer tech company? Meaning, at times, we're running 300, 400 different multivaried analyses on what's the best message? What's the best creative? What's the best time? What's the best channel? And we're delivering those through our community assets. And community assets defined as both stores; digital assets, where we have tremendous reach into people's palms; and then to the home as well. So that ability to take the information and make it truly actionable is one key differentiator.

And I'll add one second one very quickly, which is there's also the integration of care management and care delivery, right? So we're no longer with the patient with diabetes saying, "You should do something, you should have your eyes examined, you should have your feet examined," and sending them back to their primary care doctor. We're actually saying, "You haven't had your eyes examined. It's really important for patients with diabetes. You can walk 15 steps across the hall and have a digital retinal exam that will have read through artificial intelligence and backed up with an ophthalmologist." Very quick, very easy, very convenient. Send that information back to the Health Plan, their HEDIS scores go up, their STARs scores go up, and their revenue goes up.

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

And Steve, if I could just add, I know there's a lot of desire by our investors to understand more quantitatively some of the benefits, the early benefits we're seeing, how we're thinking about value creation. As we've said a few times, right, we think in the midyear time frame, that we'll have some additional quantitative metrics here. I just -- as Alan just described, right, we can really see value creation both inside the 4 walls of the store and more broadly across our enterprise. So we'll look forward to discussing that more.

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

Okay, great. Also tied to the merger, you've increased your synergy guidance in relation to the merger. So I'm curious if you can provide a little more color on the sources of upside.

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

Yes. First, I'll just start with where are the synergies coming from. And obviously, we're quite pleased. If you think when we initially gave guidance, right, our run rate synergy was about $750 million, right? Our expectations now are in the $900 million range.

And I would say the synergies are coming from 3 key areas: Our business integration, general and administrative expense and medical cost savings. All of these areas have contributed to the upside, I would say, as you looked at 2019. And this carries forward. The largest area contributor was from the -- our formulary and integrating the formulary. So both from a purchasing aspect as well as adoption. And we feel good about the momentum that's carried into 2020.

But I just want to emphasize, it is not just one area. We feel we've been executing across an extensive work plan to drive these results.

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

Okay. All right, excellent. Okay. Actually, one other question on coronavirus and how that maybe ties into some of your earnings outlook. So on the fourth quarter of 2019 earnings call, you announced that the first quarter of 2020 is expected to be the lowest earnings quarter due to seasonality in the pharmacy and retail segments; and that for the HCB segment, the fourth quarter of 2020 is expected to be the lowest. So I'm curious if you have any early reads, that still holds and how coronavirus outbreak might impact your business just around those quarterly seasonal comments that you made.

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

Yes. So let me take a step back from the quarterly guidance and just talk about the full year from a -- for a second. Overall, with everything we know today, we're confident with our full year adjusted EPS guidance range that we had provided of $7.04 to $7.17. Obviously, as I said a few minutes ago, right, coronavirus is fluid. There are some positives there, there are some challenges. But with everything we know today, we're confident with that range.

Additionally, as you saw last week, we entered into an agreement to divest our workers' comp business. We've got inbound questions from investors, "How do we think about the impact of that relative to your guidance?" I would say that's about a $0.02 to $0.03 headwind from an enterprise perspective, so pretty modest. We're assuming a mid-year close as we estimate that. And then obviously within the Health Care Benefits segment, you have a revenue impact and the $0.02 to $0.03 is net of benefits on the interest line as we use the proceeds to pay down debt and continue to manage towards our low 3x goal.

As you think about the quarters, I don't have any material changes to those quarterly patterns. As I said, there, we've seen some upside on the front side of our business. However, we are making investments as you think about preparing for coronavirus and such. So overall, I don't have any meaningful changes there.

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

Okay, great. That's definitely helpful. Shifting gears again. So investors are still asking us a little bit around some of the recent management changes in both managed care and PBM segments. So curious if you can maybe just discuss some of those recent changes and what may have driven some of those management changes.

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

Yes. Overall, I think as you can appreciate and as everyone can appreciate, organization structures change over time depending on where the business stands. And we've always thought about that as you think about succession planning and having the appropriate bench. As we outlined in our announcement. As you think about where the business is going and the importance of specialty, the importance of our open platform, the importance of delivering on the transformation, we've restructured the organization to really ensure we can deliver on those.

And Alan, who's here with me, was appointed Executive Vice President and President of Caremark. And Alan has deep experience in the pharmacy benefits and specialty areas. Alan will continue to manage the kidney care program.

Jonathan Mayhew, coming from the legacy Aetna business where he previously managed the local markets, will lead our transformation efforts. Obviously, he'll carry forward the work Alan started, but bring a different perspective to that team as we think about really commercializing those.

So this was just continued management of our business. And to ensure -- we made these changes to ensure we can accelerate growth as we move forward into the future.

And Steve, if you'd like, Alan can give a little bit of his background. But I'll leave it to you how you want to use your time.

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

We still got a few minutes left. I want to hit on some of the Medicare Advantage questions. Maybe we can just jump to that since we are a little more limited on time.

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So within the Aetna book of business, let's talk about Medicare Advantage enrollment growth for 2020 relative to your expectations now that everyone's been able to see a full read on the trends from CMS data.

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

So overall, as you know, this has been a real strategic focus for the Aetna business and a strategy of expanding overall market coverage. Had really strong growth in 2019, 3x the industry. And as we look at 2020, we're quite pleased. I think CMS reported that MA growth in the industry to be about 6%, and Aetna is expected to grow about 10.7%.

So our goal is to continue to outpace the market. Our strong STARs performance, our strong underwriting and sales execution discipline and the deliberate investments that we made, we believe, are key differentiator enabling our success. We have coverage now of over 80%, geographic coverage of about 81% of where the MA lives reside.

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

Okay. Now sticking with the Medicare Advantage topic and drilling in a little bit deeper, it seems that there's always some industry discussion about how Medicare Advantage members are less profitable in year 1, but then become more profitable in years 2 and beyond. And it seems like some investors are hung up on the concept of dilution in relation to this for CVS-Aetna for 2020. So just to maybe give a little more color around this, do you expect the new Medicare Advantage members for 2020 to be profitable this year, but just at lower margins versus the rest of the Medicare book? Or will the company actually have negative margins on these new members in 2020?

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

Yes. So I appreciate you asking this to clarify. And there was some confusion about our expectations in general for year 1 membership. And while the members are below target margins in year 1, they are profitable. Obviously, during year 1, you don't have the risk adjusters, you don't have the experience of those members and you work to improve that, but they are not dilutive to our earnings.

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

Okay. That's helpful. And also on that topic, what about the big Medicare Advantage membership gains that the company enjoyed for 2019? Shouldn't these members -- I mean, you grew almost like 30%, somewhere around there. So shouldn't these members also become much more profitable in 2020 versus what they were in 2019? If you can give any quantification around that. But at the minimum, I'd love to hear about that qualitatively and how that factors into the guidance for this year, but any quantification would also be great.

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

Yes, you would -- and I think I just said that you would expect, in year 2, you are achieving your target margins. That's our goal, that's how we underwrite, and that's how we think about it. So yes, as we contemplated our 2020 guidance, that would have been factored in.

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

Okay. Let's see, we're close to out of time here. I'm just trying to figure out if there's any final question I want to ask. So talking about the WellCare PBM contract, and that was a 3-year renewal. Is there any additional color on that renewal process? And is there still some chance -- it sounds like on the other end, there's some possibility where if both sides agree, that could also be moved "in-house" on their side, for lack of a better phrase. But I'm curious about the durability of that 3-year contract from your perspective.

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Alan M. Lotvin - *CVS Health Corporation - Executive VP & President of CVS Caremark*

Yes. So I would say that they went through a process. We've been a long, long partners with WellCare. We -- they've always been complimentary of the service and appreciative of the value that we've created with them. It's a 3-year contract. And if you're familiar with the contracts in the PBM industry, it's a contract.

With respect to Centene, our relationship with them is also strong. And so we continue to work closely with all of our customers, but in particular with those 2, to ensure seamless service on both sides of their businesses as they pursue their strategies.

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

Okay. And final quick question here also on 2020 PBM. So the guidance calls for PBM revenues and EBIT to be essentially down in the mid single-digit range, but this came in a little bit better than expected as far as prior communications around that. So I guess I'm curious, how much the greater retention of the Centene PBM contract for 2020 played a role in your better-than-expected outlook versus other factors?

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

Yes. So as you look at how our outlook improved from our June Investor Day to our final guidance, we're quite pleased with those improvements. And I'd say there were 2 key areas that drove the improvement.

One, the better net new business selling season. Although it was still down, it improved materially, not just for Centene, but we had other wins in the marketplace.

But additionally, we were able to improve what we call our underlying purchasing economics, whether that's improvements in rebates, our estimates on our generic COGS, our retail network structure. So I would say it was the combination of those factors that enabled us to improve.

Alan M. Lotvin - *CVS Health Corporation - Executive VP & President of CVS Caremark*

And Steve, I would just add, it's an obvious statement, but that second factor is what -- is one of the things that helps drive the first, right? So as we get better purchasing economics, we are -- we do better on the sales season.

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

Okay, perfect. All right. Well, with that, I think we're out of time. So I'd like to thank you, Eva and Alan, for your time today. And everyone, enjoy the rest of the virtual conference.

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

Thank you, Steve. Thanks, everyone.

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