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CVS Health Corp. (CVS)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning and welcome to the CVS Health Fourth Quarter and Full Year 2020 Earnings Conference Call. At this time all participants are in a listen-only mode. A question-and-answer session will follow CVS Health's prepared remarks, at which point we will review instructions on how to ask your questions. As a reminder, today's conference is being recorded.

I would now like to turn the call over to Valerie Haertel, Senior Vice President of Investor Relations for CVS Health. Please go ahead.

Valerie C. Haertel

Senior Vice President - Investor Relations, CVS Health Corp.

Thank you, and good morning, everyone. Welcome to the CVS Health Fourth Quarter and Full Year 2020 Earnings Call. I'm Valerie Haertel, Senior Vice President of Investor Relations for CVS Health. I am joined this morning by Karen Lynch, President and CEO; and Eva Boratto, Executive Vice President and CFO. Following our prepared remarks, we'll host a question-and-answer session that will include Jon Roberts, Chief Operating Officer; and Alan Lotvin, President of Caremark. Our press release and slide presentation have been posted to our website along with our annual report on Form 10-K that we filed with the SEC this morning.

During this call, we will make certain forward-looking statements reflecting our current views related to our future financial performance, future events, industry and market conditions, as well as the expected consumer benefits of our products and services and our financial projections. Our forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from what may be indicated in them. We strongly encourage you to review the information in the reports we filed with the SEC regarding these risks and uncertainties, in particular, those that are described in the cautionary statement concerning forward-looking statements and risk factors section in this morning's earnings press release and included in our Form 10-K.

During this call, we will use non-GAAP financial measures when talking about the company's performance and financial condition. In accordance with SEC regulations, you can find a reconciliation of these non-GAAP measures to the comparable GAAP measures in this morning's earnings press release and the reconciliation document posted on the Investor Relations portion of our website. Today's call is being broadcast on our website where it will be archived for one year.

Now, I would like to turn the call over to Karen.

Karen S. Lynch

President and Chief Executive Officer, CVS Health Corp.

Thank you, Valerie, and good morning, everyone, and thank you for joining our call today. Before we begin, I'd like to acknowledge Larry Merlo's leadership. He set a bold path for CVS Health to change the healthcare industry in this country. Larry did an incredible job bringing together our unique assets and establishing the foundation for our future. Our transformation over the last decade has enabled us to become the nation's leading diversified health services company. As one of the most trusted brands in America, our presence in communities across the country allows us to meet consumers where they are and become a bigger part of their everyday health.

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Our unparalleled capabilities, reach and relationship with over 100 million people uniquely positions us to support them for every meaningful moment of health throughout their lifetime. These are unprecedented times and our purpose to help people on their path to better health has never been more important. CVS colleagues are on the frontlines every day helping millions of Americans with COVID testing and vaccines, in-home and virtual care services and face-to-face care in our CVS locations. We understand our responsibility to support our customers, members and communities during these difficult times, and we are delivering. I am proud of the nearly 300,000 colleagues on the CVS Health team and all that we've achieved in this past year.

Turning to performance. Our strong results in 2020 show that both our strategy and business model are working. We exceeded our earnings commitments while delivering 6% year-over-year adjusted EPS growth. We grew revenue 4.5% to achieve adjusted revenues of $268 billion. We delivered continued strong growth in our PBM and Government services business, once again achieving solid results in Medicare Advantage. We generated strong cash flow from operations of nearly $16 billion as we continued to delever while investing in our business for future growth. We served a prominent role in supporting our customers, providers and communities, during one of the biggest public health crisis in our nation's history. We continued to progress against our strategic roadmap, and we set 2021 adjusted EPS guidance of $7.39 to $7.55 with mid single-digit growth from our baseline. Eva will go into much more detail about our performance and our outlook.

Turning to our three business segments. We delivered strong results in 2020 in the Health Care Benefits segment. We grew total revenue by 8% for the year with increases in our Government businesses, partially offset by declines in our Commercial business. In the fourth quarter, we saw utilization of total healthcare services in the aggregate return to more near-normal seasonal levels as higher COVID-related costs were partially offset by somewhat lower levels of traditional services. Adjusted operating income was in line with expectations. As we head into 2021, we demonstrated growth within each of our Medicare product lines in January. Overall, we are on track for another very strong year of Medicare growth.

For years we've used our voice to advocate for policies, programs and regulations at the local, state and national levels that support access to affordable care for all Americans. After careful consideration, we have decided to reenter the individual public exchange market as of January 1, 2022. As the ACA has evolved there's evidence of market stabilization and remedies to earlier structural issues. It is now time for us to participate in these markets. We will show that we can bring great value to those who seek coverage. You can expect to hear more about our exchange reentry plans in future updates.

Turning to our PBM. Our Pharmacy Services segment has been resilient through the pandemic. We demonstrated the value we bring to our customers and our members. We achieved strong retention rates and positive momentum in winning new business in 2021. And finally, in our Retail/Long-Term Care segment we continued to advance our clinical programs which improved medication adherence and health outcomes. We increased the level of engagement with our loyalty and subscription customers, and we also achieved high customer satisfaction results.

During the last year, we delivered new market solutions, and we strengthened our role as a personal and trusted healthcare partner in response to COVID-19. We pivoted and rapidly innovated to meet customer needs for COVID testing in the community. We also advanced our digital capabilities to create a seamless experience across CVS Health touchpoints. Today, we remain the largest community testing organization in the US. We've administered approximately 15 million tests at our more than 4,800 testing locations nationwide.

Over 50% of these tests have been administered in communities with significant need for support according to the CDC Social Vulnerability Index. Additionally, we launched our Return Ready solution to help employers and

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universities as they execute their return to work and school strategies. To date 100 clients have enrolled, representing over 1.5 million individuals with interest continuing to grow. Such leadership enabled us to establish new relationships with approximately 8 million consumers through our COVID testing efforts. These are people who are new to CVS Health.

Turning to vaccines. We've been working with the Federal Government on vaccine distribution readiness for several months. We were selected as one of the partners for vaccine administration in long-term care facilities. We've administered more than 3 million vaccine doses to the patients and staff in over 40,000 long-term care facilities across the country. We completed the first doses of vaccine administration in all-skilled nursing facilities and will complete the second doses by the end of the month as planned. We are on track to complete both doses of vaccine administration for assisted-living facilities by mid-March. This will fulfill our commitment to administer vaccines in long-term care facilities.

We've also been selected as one of the national partners for the Federal Pharmacy Partnership Program. This is a linchpin of the Biden administration's plan to vaccinate 300 million Americans by the end of the summer. As part of this program, we are administering approximately 250,000 COVID immunizations across 11 states and in over 350 CVS locations each week. Early feedback from customers has been very positive on their overall experience across both our in-person and digital channels. We will continue to add stores as the vaccine supply increases. With the commitment and hard work of our employees, we have the capacity to administer 20 million to 25 million doses per month, depending on supply availability.

Millions of new customers will engage with CVS Health for the first time through testing and vaccine administration services. We will use this opportunity to shape a health experience that demonstrates the value we bring. It will create the opportunity to expand our customer base, while deepening relationships with current customers. We have made measurable and important progress with our strategy as a health services company that utilizes all our assets, that integrates them for superior consumer experience, and firmly addresses the total cost of care. For example, we are creating health platforms that combine local points of care, remote biometric monitoring and access to healthcare professionals, all within a personalized consumer-centric model.

Our new diabetes program is an example of this. We have approximately 1.4 million members in this new program with about 50% representing integrated Caremark Aetna plan members. We've had strong reception to our fully integrated plan, the Aetna Connected Plan, and expect to add 15 markets in 2021. Key features include zero-dollar co-pays at MinuteClinic locations, standard formulary and use of our Coram infusion services. We deepened our pharmacy penetration in the Health Care Benefits segment through increased cross-sell of medical and pharmacy plans. This is expected to result in approximately $350 million in incremental revenue in 2021.

We are bringing dialysis services into the home to better manage chronic kidney disease. This program offers a simpler, more patient-centered approach. It delays the onset of end-stage renal disease, reduces hospital admissions and supports people with treatment options. Our kidney program will engage a targeted cohort across businesses, currently available to over 7.5 million eligible members. And finally, our oncology program helps patients start on the best treatment and matches eligible patients to clinical trials. Our goal is to improve patient outcomes and lower overall cost at every point of the cancer care journey. Our program has expanded to more than 125 provider systems across 28 states, covering over 30% of Aetna's insured oncology population.

As we engage consumers in addressing their most prevalent, costly and complex health conditions impacting their lives, we are also concentrating on expanding access to affordable quality care. We launched new medical benefit plans designed with low co-pay or no co-pay at MinuteClinics to offer broader access to care. We have approximately 6 million Commercial and Medicare members enrolled to date. In our small group product, which

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was the first to adopt, we achieved 25% greater use of MinuteClinics, and CVS Pharmacy retail scripts increased from 30% to 65%. This continues to strongly demonstrate the value of bringing CVS assets together to support members across their healthcare needs.

We continue to expand access through our integrated care delivery approach. We ended 2020 with just over 650 HealthHUBs nationwide, including locations in underserved communities. HealthHUBs are one of many channels we have to engage with consumers for their health that also complement the traditional healthcare system. We continue to expand our virtual care capabilities. We launched our E-Clinic service in our MinuteClinic footprint across 33 states and in the District of Columbia. Consumers are now able to interact with nurse practitioners for comprehensive virtual care in a convenient way.

Through this offering, we can help customers with both episodic care and provide a longitudinal, integrated care experience. We launched our virtual-first primary care program. Members engage with providers virtually. They are then directed to lower-cost, high-quality sites of care, such as MinuteClinic or other face-to-face in-network provider care settings, as needed. We are delivering value by creating a superior system that is centered around the consumer, where they want and need healthcare.

In closing, we are starting 2021 with strong momentum. We are accelerating our pace of progress to drive our consumer-centric strategy, a strategy built upon the fundamental belief that solving consumer health needs will create value for all: our customers, our communities, our people and our shareholders. We will further develop and refine our strategy to leverage the rapid shift in healthcare underway in the US, trends that we are not only on top of, but in many places, driving.

As we move forward with this work, the touchstones of our strategy will remain focused in the following areas. We will demonstrate the integrated value of CVS Health's unique portfolio of products and assets. We will enhance the consumer experience through the expansion of digital services and platforms that seamlessly connect to in-person channels. We will expand our portfolio with new, innovative, consumer-oriented solutions that improve health, lower medical costs, while creating better health outcomes.

We will continue to build a high-performing organization that is passionate about our purpose, that reflects the diverse populations we serve, and is empowered to do the right thing, the right way, for consumers' health and well-being. I am confident in our future and our ability to help people on their path to better health. CVS Health will lower costs, improve customer experience, enhance access, and be their trusted healthcare partner.

Now, I'll turn it over to our Chief Financial Officer, Eva Boratto.

Eva C. Boratto

Chief Financial Officer & Executive Vice President, CVS Health Corp.

Thanks, Karen, and good morning, everyone. As Karen stated, our strong performance across the enterprise continued in the fourth quarter as we executed on our strategy during this challenging time. For the full year, we delivered $7.50 adjusted earnings per share; and importantly, achieved over $900 million of integration synergies, above the high-end of our expectations. We've hit the 2021 run rate and the synergies are fully embedded in the business.

During the quarter, we generated $3.6 billion of cash from operations, bringing our full year to $15.9 billion which is above the high-end of our expectations, and we paid down $2.5 billion of net debt in the quarter exiting the year at a low 4 times leverage ratio. Since the close of the Aetna transaction, we have paid down more than $12.2 billion in net debt and remain on track with our low 3 times leverage ratio goal in 2022. We maintained our

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dividend while we also invested in our enterprise to support our colleagues and customers during the pandemic and to accelerate future growth.

Looking at our fourth quarter results by segment, our Health Care Benefits segment's total adjusted revenues increased 9.6% year-over-year driven by membership growth in our Government products and the reinstatement of the HIF. Adjusted revenues exclude the ACA risk corridor payment received during the fourth quarter. Adjusted operating income was $153 million, in line with our expectations, largely reflecting the planned COVID-19-related investments benefiting customers, testing and treatment costs and the divestitures of the Aetna PDP and our Workers' Comp business.

Total membership increased about 140,000 sequentially, with Medicaid membership up about 90,000 as states continued to respond to the COVID-19 pandemic by suspending eligibility redeterminations. Additionally, our Medicare portfolio continues to show growth with strong Medicare Advantage and Med Supp membership growth increasing sequentially about 90,000, up over 2%. These increases were partially offset by a modest sequential decrease in Commercial membership of about 35,000 members driven by additional membership attrition due to COVID-19.

Our adjusted MBR for the quarter, excluding the ACA payment, was 88.3% and in line with our expectations, representing an increase of 260 basis points compared to the prior year. The higher MBR was driven by COVID-19-related investments, testing and treatment costs, the divestiture of the PDP business, partially offset by the reinstatement of the HIF. Overall, fourth quarter utilization was generally in line with our baseline including higher COVID-19-related costs. Days claims payable were 48 days for Q4 2020, consistent with our Q4 2019 and a day lower than Q3 2020, largely driven by pharmacy payments. We remain confident in the adequacy of our reserves.

Moving to Pharmacy Services, total revenues declined approximately 2% versus last year, primarily driven by the previously disclosed client losses and continued price compression. The decline in revenue was partially offset by growth in specialty pharmacy of approximately 4% and brand drug price inflation. Total Pharmacy claims grew 0.7% in Q4 compared to last year, driven by net new business. Momentum in Pharmacy Services continues with adjusted operating income increasing 7.9% compared to the fourth quarter last year. Improvements in purchasing economics and the ongoing benefit to our clients and CVS Health from several generic launches and our continued success with customers in managing specialty pharmacy continues to fuel the growth. The quarter also reflected higher investments to support our successful 2021 welcome season.

And finally, Retail/Long-Term Care total revenues grew 6.6% year-over-year driven by a 2% increase in prescription volume, including strong flu immunization, as well as benefits from our diagnostic testing and brand inflation, partially offset by a 1.6% decline in Front Store sales. Our COVID-19 diagnostic testing program contributed nearly $400 million in the quarter. Prescription growth was driven in part by continued adoption of our patient care programs. Offsetting the growth was lower incidence of flu and flu-like illness, which reduced flu-related scripts nearly 40% and affected cough and cold sales in the Front Store by approximately 30%. Gross margins for the segment declined 140 basis points versus 2019 driven by continued reimbursement pressure and mix, partially offset by testing. Adjusted operating income declined 12.6% year-over-year reflecting the items I've discussed, as well as costs related to COVID-19.

Moving to other items on the income statement, we incurred lower interest expense as a result of our continued debt paydown, and the adjusted tax rate was higher in Q4 compared to Q4 2019 primarily due to the return of the HIF. Transitioning to 2021 guidance, full year adjusted EPS is expected to be in the range of $7.39 to $7.55, an increase of approximately 4% to 6% from our 2020 baseline of about $7.11, and in line with our mid single-digit growth expectation. Consistent with our practice, net realized capital gains or losses and prior year's development

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are excluded from our outlook. We expect to generate between $12 billion and $12.5 billion of cash flow from operations in 2021. This includes the impact of timing of certain payables and receivables that contributed to our 2020 outperformance.

Our gross capital expenditure expectations of $2.7 billion to $3 billion is above historical levels as we expand our investments in technology and digital, enhancing our app and systems workflow and we continue to invest in our HealthHUBs. As noted over the course of 2020, there were positive and negative impacts from COVID-19, many that offset across our segments, stemming from changes in consumer behavior. We are pleased with our ability to pivot to deliver the products and services in demand to drive continued growth at our enterprise as we create a better way to deliver healthcare. In 2021, COVID-19 is expected to have an immaterial impact on our adjusted earnings per share. As we have highlighted in our slides, COVID-19 is expected to have a benefit to the Retail/Long-Term Care segment and have an unfavorable temporal impact to the Health Care Benefits segment.

Importantly, we will continue to drive our enterprise cost savings initiatives which we expect to deliver between $900 million and $1.1 billion and will ramp as we move throughout the year. Key drivers of savings include ongoing digitization of our businesses along with system technology improvements in our operations such as our call centers, real-estate changes including our decision to reduce office space by about 30% resulting from COVID-19 and workforce management changes in how we are working, as well as productivity and operational efficiency initiatives within each segment. We expect consolidated full year adjusted operating income to be in the range of $15.5 billion to $15.7 billion with consolidated total revenues in the range of $276.1 billion to $280.6 billion, up 3% to 4.5%. We are maintaining our shareholder dividend of $2 per share.

Moving on to our segments, as a result of continued strength in Medicare products we expect HCB total revenues to be in the range of $79.4 billion to $80.7 billion. Medical membership is expected to be between 23.2 million and 23.6 million medical members at the end of 2021, fueled by growth in each of our Medicare lines of business. Partially offsetting the growth in Medicare is the transition of two large Medicaid contracts. Our guidance includes an expectation that State redeterminations do not return in 2021. We believe the strength of our unmatched benefit plan designs that utilize our enterprise assets positions us well for 2021 and beyond.

Within Health Care Benefits, we expect adjusted operating income in the range of $5.1 billion to $5.2 billion. Our outlook reflects the negative impact of COVID-19 of approximately $450 million to $550 million, largely attributable to the Medicare risk adjustor impacts and the recent regulatory changes from the Consolidated Appropriation Act. The removal of the HIF insurance fee, which we expect to decrease 2021 adjusted operating income by approximately $175 million, and strong growth in Medicare membership. Our full year MBR is expected to be approximately 84.7% plus or minus 60 basis points, which reflects the return to more normal levels of utilization, the removal of the HIF, lower risk adjusted revenue and mix shifts in our business.

In Pharmacy Services, we expect total revenue to be in the range of $144.5 billion to $147 billion, driven by strong net new business of $3.3 billion, continued growth in specialty pharmacy and brand drug inflation in the mid single-digit range. The 2021 selling season is largely complete, and we maintained a strong 98% retention rate with gross wins of $4.9 billion. Adjusted operating income is expected to be within the range of $6 billion to $6.1 billion, driven by continued growth in specialty and our ability to drive further improvements to purchasing economics, partially offset by industry-wide price compression.

Turning to Retail Long-Term Care, we expect revenue of $93.8 billion to $95.1 billion. We expect strong adjusted script growth in the range of 7.25% to 9.25% driven by the continued successful execution of our patient care programs, expected return of provider visits and COVID-19 vaccinations. We expect Front Store traffic will increase as we move throughout the year. We expect adjusted operating income to be in the range of $6.6 billion

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to $6.7 billion, benefiting from continued Pharmacy volume growth and approximately $400 million to $500 million from COVID-19. The benefit from COVID-19 reflects the positive impact of vaccines and testing-related revenues, net costs associated with these programs, partially offset by the adverse impacts of Front Store and Pharmacy and our continued investments in COVID-19-related protocols. Operating income growth also continues to be unfavorably affected by reimbursement pressure.

Moving to other income statement items, we expect interest expense of about $2.6 billion benefiting from the paydown of our debt and our liability management actions, and our effective tax rate is expected to be approximately 25% reflecting the repeal of the HIF. Finally, we expect quarterly earnings cadence to be fluid over the course of the year; but let me share some perspectives on Q1. Q1 is expected to be the lowest earnings quarter for the year. In Retail/Long-Term Care lower traffic in the Front Store and lower script volume has persisted into January in part due to the weaker flu season. Q1 is also impacted by investments to advance our vaccine program. Health Care Benefits is expected to have higher earnings in the first half of the year and the lowest in the fourth quarter. Cost savings initiatives across our segments are expected to ramp over the course of the year.

In summary, we continue to deliver on our financial expectations and are confident in our ability to achieve the 2021 guidance we outlined today. We are making progress toward driving sustainable long-term growth. As Karen mentioned, we are accelerating aspects of our consumer-focused strategy to meet the consumers' health needs of the future. Before opening it up for questions, I would like to take a moment to thank Valerie for her work here in Investor Relations. I'm disappointed to see Valerie leave over the next month, but I'm grateful for the advancements that Valerie made during the time she was with CVS Health. I wish Valerie the best of luck in her next venture.

Now, let's open it up to questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we'll take our first question from Lisa Gill with JPMorgan. Please go ahead.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Thanks very much. I hope you can hear me okay. Karen, I just wanted to go back to the comments that you made around virtual-first primary care. So, can you maybe just help me to understand a little bit better; one, just the number of people that you have enrolled in that program to-day? And then secondly, when you think about that virtual-first primary care, is it virtual, then they come into the MinuteClinic? How is the physician network set up there? I just want to better understand how that program is working and how many people you were able to enroll for 2021.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Hi, Lisa. Good morning. On the virtual care, this is a program that we started with one of our large national accounts. Essentially, what we're doing is, they select a virtual primary care physician, they interact, first, with that virtual primary care doctor. And then, if that person needs to be seen, what they do is they send them first, our hope is, to the MinuteClinic, and that's kind of the way we've contracted. And then if there needs to be other in-network providers, then they would refer them there. But their first interaction would be with this virtual primary care. It is in pilot, and so – with our large national – one customer and our expectation is that we'll continue to roll it out as we go forward.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Can you give us any idea like what the cost savings is to that commercial client versus kind of a traditional program as we think about potential interest around these kinds of things?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

It's a little too early to tell, but we are expecting lower cost savings and that's when we're pitching it to the national account customers. We've seen lower costs with primary care physicians being virtual. But it's a little early to tell at this point.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Okay. Great. And then just my follow up would be for Eva around what you have in the guidance for vaccines. I heard the comments around 250,000 per week at this point, but the capacity for 20 million to 25 million per month, what do you actually have in the guidance that you gave us today?

Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.

A

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Good morning, Lisa. Thanks for the question. I'll start with, as you look at the retail/long-term care segment guidance and the prescription growth of 7.25% to 9.25%, I would think about the vaccines contributing about 2 to 3 percentage points of that growth. Obviously, it's fluid, Lisa. It'll depend on supply availability and the selection of CVS Health. But as Karen said, we're ready to do 20 million to 25 million per month. As you think about the profitability of the vaccine, Lisa, I would say, for the vaccinations that we'll administer in our stores, the EBIT contribution's similar to a flu vaccination. And as we work through long-term care, the profit contribution from that program is pretty de minimis, as it was a complex process requiring multiple visits to the site, and with lower individuals there to vaccinate, overall, the costs were higher. So, I would think about that as de minimis.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thanks for the comments.

Operator: We will take our next question from Robert Jones with Goldman. Please go ahead.

Robert P. Jones
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks so much for the questions. Maybe just a follow-up on the $400 million to $500 million benefit, just one point of clarification. Is that off of the ex-COVID baseline, so we expect the $400 million to $500 million in the retail/long-term care facility to be on top of the $7.11 at the enterprise level? And then, I guess, just more importantly, as we think about the year 2021, ex this COVID-related benefit, could you maybe just share a little bit about how you're thinking about the other underlying assumptions returning back to normal or closer to normal as we get through the year?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Yeah. Let me start with some of the assumptions, and I'll kick it over to Eva for some of the metrics. On the assumptions, we assume that the public health emergency would stay in place all year. Obviously, that impacts the Medicaid business. Relative to utilization, we have modest assumption for deferred utilization in the first quarter, and then we're assuming that we head back to a normal baseline. As we ended the year of 2020, we had near normal baseline levels of utilization. Obviously COVID had an impact on that. So as you think about the year, think about some very modest deferred utilization, but returning to normal levels on the utilization front. Eva?

Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.

A

Yeah, Bob. And your question on the retail side of the business, so the $400 million to $500 million COVID-related benefit, I would think about that across a couple of categories; one is the continuation of testing, while cases remain elevated; two, the benefits from our vaccination program, offset by obviously the incremental costs that we will incur. At the enterprise level, as I said, COVID is de minimis as you look at the impacts on HCB side as Karen just outlined and the impacts on the Retail/Long-Term Care side.

Robert P. Jones
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And then I guess just a quick follow up, Karen, interesting decision to reenter the individual markets for 2022. Maybe if you could just share a little bit more about that decision process there, and then as you think about year one, how many geographies and markets might you be targeting?

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Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Yeah. So we've been studying the individual market for a while. What we decided, it's obviously stabilized over time. Some of the remedies have been put in place. Clearly, there's a big market, 10 million to 15 million people that we aren't participating in today. We view that the combination of the insurance and the CVS Health assets gives us a unique opportunity to put a competitive product into the market. It will be our first branded CVS Health Aetna product that we put into the market. And relative to the number of markets, we still haven't finalized those, so more to come when we talk in the second quarter.

Robert P. Jones
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks so much.

Operator: And we will move next with Ricky Goldwasser with Morgan Stanley. Please go ahead.

Ricky R. Goldwasser
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Hi. Good morning. So Karen, you talked about in the third quarter and today again about the Aetna members that have zero co-pay access to the HealthHUBs. Can you just maybe give us an update of what percent of members have that? And any early announcement, it's been six weeks, but any early indication as how these members are using that benefit?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Yeah, Ricky. So we now have 6 million Aetna members that have the zero co-pay, no-cost co-pay benefit. We put it into the Medicare business this year as well, so that, we went from 4 million to 6 million as we turned the corner on 2021. We have seen where our small group business had adopted this co-pay early on. We've seen an increase in MinuteClinic visits of about 25% from that cohort of individuals. So it is an indication that people are using MinuteClinic or are interested in using it with that co-pay design. So that's the number, that's the 6 million is where we are and we'll be able to watch that throughout the year.

Ricky R. Goldwasser
Analyst, Morgan Stanley & Co. LLC

Q

And as a follow up just on the PBM business, if you can just give a little bit more color on just kind of like the strong season, and you talked in the prepared remarks about a change in the business mix in 2020 and into 2021. So how should we think about business mix up for renewal and opportunities in the marketplace for 2022? And what are the key new products that you too are selling this year and you think will continue into next year?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

So Ricky, first let me just comment on PBM. We're very pleased with our integrated approach with the PBM and the healthcare side. As I mentioned in our opening remarks, we have $350 million of incremental revenue. That has been a focus for us to drive integration. The PBM business had, as Eva said, 98% retention and about $4.9 billion of new sales. So we're quite pleased with the performance of the PBM business. And let me turn it over to Alan who can give you more details around the products and the services that we're selling.

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Alan M. Lotvin
Executive Vice President & President-CVS Caremark, CVS Health Corp.

A

Yeah. Hi, Ricky. Thank you for the question. So just with respect to what's resonating in the market, I think there's a couple of key points. So one is the most important thing to our customers right now is the management of specialty, and we've continued to advance in that area and separate ourselves from the pack and differentiate with a series of products, whether it's things that connect us digitally to our customers, whether it's things that connect us digitally to our provider groups, and also as was mentioned earlier, better management of oncology. That's really what's driven that. With respect to when we look at the 2022 in terms of what's up for renewal, it's a year that's smaller exposure of our own customers up for renewal than we've seen for the past two years, about $32 billion compared to sort of in the $50 billion range the prior two years.

Ricky R. Goldwasser
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: And we'll take our next question from Charles Rhyee with Cowen. Please go ahead.

Charles Rhyee
Analyst, Cowen and Company

Q

Yeah. Thanks for taking the question, guys. First question, Karen, I think you talked about in the diabetes management program, about 1.4 million members and you said about 50% of them was sort of representing Caremark Aetna integrated membership. Can you talk a little bit more about, I guess first, is the 50% represents Aetna's fully insured members and the others are ASO clients that are participating in this? And what kind of data have you seen in terms of maybe cost savings by going through this approach?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Yeah. So Charles, let me just comment on the diabetes program. First, it's focused on a data-driven identification and targeting of member-specific gaps in five areas. We're focused on medication optimization, medication adherence, screenings, lifestyle and nutrition and blood glucose monitoring. Basically it's a multichannel approach. We do, as you mentioned, we have 1.4 million members. The 50% represents kind of all of our members. I can't, I don't know the split. We can certainly get you that split at some point. So we launched it. We do have a large group Medicare account on it as well, but preliminary results are showing that our engagement rate is improving. We're closing diabetes gap for about 50% of those engaged members. So far, what we've seen is, we're pleased with the preliminary results, but obviously, it's relatively new to the market. So we need to see sort of that longitudinal study. But it is resonating with our customers.

Charles Rhyee
Analyst, Cowen and Company

Q

And is that being delivered through the HealthHUBs themselves or is it more broadly through the MinuteClinic channel?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

It is being delivered through the HealthHUBs itself, and being sold through both the Aetna and Caremark teams, and we're really looking at it from an integrated perspective.

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Charles Rhyee
Analyst, Cowen and Company

Q

Okay. I have one more follow up. You also talked about the efforts in digital channel. Obviously, a lot of members coming through to CVS for the first time. Are they coming through CVS through the CVS app, for example, or are they coming at first through the store because they're looking to maybe book a COVID appointment? How are they first reaching out to you? Like what percent of that is digital? And then can you maybe talk a little bit about that strategy, retaining them digitally once they leave?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Charles, I assume you're talking about the interactions with our testing and vaccines. All of our customers are coming in digitally. They are required to make an appointment for, and it is all like digital experience. We are receiving quite positive response from those customers relative to their digital experience. Clearly, we also have phone capabilities for people when they don't have those digital experiences, but most of our customers are coming in digitally. I'm very pleased with the level of results we're getting from our digital team and the experience that our customers are having. We've received such positive response in comparison to others as they've been trying to get appointments elsewhere, and our systems have been incredibly stable.

Charles Rhyee
Analyst, Cowen and Company

Q

Thank you.

Operator: We will move next with Matt Borsch with BMO. Please go ahead.

Matt Borsch
Analyst, BMO Capital Markets Corp.

Q

Thank you. Just a question on your outlook for utilization this year. I gather, you're expecting some deferral early in the year, and then really normal utilization after that. Are you projecting that we'll see much sort of pent-up demand or catch-up? And if not, what are some of the factors that influence your view there?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Hi, Matt.

Matt Borsch
Analyst, BMO Capital Markets Corp.

Q

Hi, Karen.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

How are you? So let me just comment on pent-up demand and acuity. We are not projecting high levels of pent-up demand. We think that system capacity will constrain that, the use in the healthcare system. I would also tell you that we have spent a lot of time this year reaching out to our members to close gaps in care. So we have been very specifically targeting individuals that have diabetes, pregnant moms, so that we are reaching out to them so that we were connecting them virtually, that we were connecting them to services, so that we could not

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sort of have that acuity occur over the long periods of time. Obviously, we probably didn't catch everyone, but if there's a huge pent-up demand, that could have an impact, but I think the system will constrain it obviously.

Matt Borsch
Analyst, BMO Capital Markets Corp.

Q

Well, that makes sense. And if I could, as a follow up, how did things go with Commercial enrollment with the large accounts coming into the New Year?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

I'm sorry, Matt. I didn't hear you.

Matt Borsch
Analyst, BMO Capital Markets Corp.

Q

I'm sorry. I was just asking a follow up about the large account retention and enrollment coming in, for on the health HCB side, coming into January 1.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Relative to Commercial membership, for 01-01-2021, essentially, the pipeline was not as strong as we had anticipated. We did have solid retention. What I would tell you, it would assume it was flat for our national account membership.

Matt Borsch
Analyst, BMO Capital Markets Corp.

Q

Great. Thank you.

Operator: We'll take our next question from Michael Cherny with Bank of America. Please go ahead.

Michael Cherny
Analyst, Bank of America Merrill Lynch

Q

Good morning. Wanted to dive in a little bit further and maybe on a more over-arching basis on some of the digital investments that you're making. Karen, you've sprinkled some of the thought process that you have with regards to the primary care first, with regards to some of the other components. As you think about especially the step-up that you have in digital spend and some of the strategic investments you're making, what kind of type of timeline are you giving yourself to measure the success of those? And how are you thinking about the hurdle rate in terms of the conversion factors that you need in order to judge them to be successful or not?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Thanks for the question. As you would imagine, we are investing more in our digital capabilities, clearly to demonstrate that seamless experience for in-person connections connected to our digital capabilities. We'll be – as we look at the return on investment, give us some time to do that. Clearly, to stay competitive, to be in the market, we really do need to enhance those digital capabilities. These are through our virtual-first primary care, or our digital capabilities for our retail locations, our testing and vaccines. We are trying to make the seamless connection across the consumer experience. Today our consumers interact with us through the Health Care

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segment, through the Pharmacy segment, through the Retail segment, and we really want to make sure those connections are seamless across all our segments so that consumer can engage with CVS Health once and feel that experience as a CVS Health. Let me turn it to Eva. She can talk about our returns.

Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.
A

Yeah. Thanks for the question, Mike. I think just to give you some examples and add on to what Karen said, we did a thorough kind of review of our technology and decided to accelerate in a few areas. And it is all about improving the customer experience, while reducing costs. So, I'll highlight a couple of examples for you. First, we're deploying intelligent agents across our call centers, and we utilized this technology at the outset for our COVID vaccine scheduling. And what we've been able to see is the deployment of this technology took 70% to 80% of the calls out of our stores and the call center. So, real meaningful impact in a very short period of time. Another area that we're really focused on is how we utilize machine learning for greater personalization across all aspects of our business to increase the returns there. So, we'll continue to evaluate and look at the returns and invest and learn here to drive the business forward.

Michael Cherny
Analyst, Bank of America Merrill Lynch
Q

Thanks. And if I could just ask one more quick one on the vaccine side, I appreciate all the color you've given around your current pacing. As you think about that rough contribution on the script side relative to the vaccines, how much of that's dependent on some of the new molecules coming to the market? Is that dependent on having J&J and having some of the other ones, or is that built-in on what the current dynamic is in terms of what's available and what you're able to dispense?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.
A

Our current allocations are based on what the government has currently. As we think about ramping up for the rest of the year, it is dependent upon the vaccines, the J&J getting approved. We anticipate that will get approved. Obviously, the country needs to have J&J get approved to get to the numbers that the Biden administration has put out there.

Jonathan C. Roberts
Chief Operating Officer & Executive Vice President, CVS Health Corp.
A

And this is Jon. I would just add that, in our conversations with the pharmaceutical manufacturers, we're estimating about 500 million doses of vaccine between now and the end of June. So, we think there's going to be good supply and it should begin to open up in April.

Michael Cherny
Analyst, Bank of America Merrill Lynch
Q

Great. Thanks.

Operator: And we will move next with George Hill with Deutsche Bank. Please go ahead.

George Hill
Analyst, Deutsche Bank Securities, Inc.
Q

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Good morning, guys, and thanks for taking the question. Eva, you had mentioned the 2022 leverage ratio and a couple of the other 2022 KPIs, I hate to look forward that far. But I guess what I would ask is, do the other long-term earnings targets hold provided in the 2019 Analyst Day, or is there any reason that we should think the double-digit earnings growth target or any of the other targets get reset because of COVID?

Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.

A

Yeah. Thanks for the question. George, what I'll say, we remain very focused on our long-term growth targets that we outlined. Right. As you think about 2022, it's a very fluid environment right now, so it's difficult to comment explicitly on that, but we're focused on driving the organization forward over the longer term to deliver on our targets.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And then maybe my brief follow-up would be, it looks like the COVID, I'll call it the tailwind, represents all the growth to the retail/LTC segment in 2021. I guess, is that the right way to think about that? And I don't know if there's any other big moving pieces that you could talk about, particularly reimbursement.

Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.

A

George, I'll take that one. As you look at the retail algorithm in 2021, our high-single-digit growth rate is attributable to strong prescription growth, 7.25% to 9.25%, which includes our patient care programs as well as the COVID-19 vaccination. We expect diagnostic testing will continue. As you think about it, as vaccines ramp-up, the testing will ramp down, and normal returns in the front store as we move toward the second half of the year. Reimbursement pressure is an offset to that. It continued at consistent levels as we've seen in the past, as well as our cost reduction initiatives. Overall, I think about gross margins as flattish given the mix change in the business, particularly as you think about the COVID-19 vaccination and the revenues not reflecting the product cost, owning the administrative fee.

George Hill
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's helpful. Thank you.

Operator: And we'll move next with Lance Wilkes with Bernstein. Please go ahead.

Lance Wilkes
Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah. Good morning. Could you just talk a little bit about your comment on an increase in the pace of targeted investments? And was interested to just understand in which areas and will those be both organic or also through acquisitions?

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Hi, Lance. Relative to our investments, they are organic investments really focused on technology, our digital assets. And also, we have some investments for reentry into the ACA marketplace. So, those are primarily some of the incremental. And let me turn it to Eva to add some more comments here.

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Eva C. Boratto
Chief Financial Officer & Executive Vice President, CVS Health Corp.

A

I think – Karen, I think you got it all.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Yeah. Okay. Well.

Lance Wilkes
Analyst, Sanford C. Bernstein & Co. LLC

Q

Perfect. And then just – could you just comment related to that on – you've obviously added a bunch of talent already. Could you talk a little bit about your talent additions, and then if there are any implications for org structure, new roles, et cetera, as you're thinking about that? Thanks.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

So, Lance, we've brought in three new individuals on to the team. Neela Montgomery, who is leading our Retail organization. She brings significant consumer and digital experience. We've also brought in Michelle Peluso, who brings great, again, digital experience, customer experience, marketing experience. And we've also brought in a new leader of our – new Chief People Officer, Laurie Havanec, who brings cultural change, diversity inclusion and really can help drive the workforce of the future. I'm quite pleased with the talent that we have on the team across the board, so very pleased with the complement of talent to drive the business forward.

Lance Wilkes
Analyst, Sanford C. Bernstein & Co. LLC

Q

Great. Thanks.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Operator, we have time for one more question.

Operator: And we'll take our last question from A.J. Rice with Credit Suisse. Please go ahead.

A.J. Rice
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. Hi, everybody. Just maybe ask about the Medicare Advantage outlook. I know CMS is out this morning with the February numbers. It looks like year-to-date you're up 6%. Could you give us maybe a little flavor for where you think that'll land over the course of the year? And I know in your 10-K filed this morning, you're talking about increasing costs of medical care and CMS local and national coverage decisions, sort of begs the question of where do you think MA margins are going to go this year.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

A

Hi, A.J. Let me just take a step back. I think it's important to look at our Medicare business as a portfolio of products. And we have grown in January in each of the products in our Medicare portfolio. So if I start with

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Medicare Advantage, as you mentioned, the new files are out. We're pleased with the year-over-year growth of – double-digit growth on a year-over-year basis. We have made progress in our Group Medicare Advantage business, as well we're growing in January. We've also, as part of our strategy, saw a large Commercial-to-Group MA conversion. You would have saw that in the files this morning as well.

We've had very strong performance in our Duals business. We grew 100% in our Duals business. And as you might recall, that was a deliberate strategy of ours. And then our Medicare Supplement business grew impressively in 2020. We expect it to continue to grow in 2021. And then finally, A.J., our PDP grew in January, outperformed the industry there as well. It was a very targeted and disciplined approach to growing PDP. As you know, our strategy is to see if we can drive PDP performance, PDP conversions to MA. We've had good success there and we expect to continue to do so. We are targeting our business at our targeted margins, A.J., so we expect that's where the performance will be.

A.J. Rice Q
Analyst, Credit Suisse Securities (USA) LLC

Okay. And if I could just follow up, it'll be the last question, I've got two little clean-ups here. When you get back into the public exchange, do you have a view on what the target margin for those public exchange lives should be? And then on the vaccine, you didn't say anything about front-end add-ons. Should we think of the vaccine for COVID like the vaccine for flu where there is some added benefit in the front end of the store?

Karen S. Lynch A
President and Chief Executive Officer, CVS Health Corp.

Yeah. So for the IVL, more to come. We're still evaluating our pricing, our markets, so more to come on that. And then relative to vaccines in Front Store, let me ask Jon to answer that question for you.

Jonathan C. Roberts A
Chief Operating Officer & Executive Vice President, CVS Health Corp.

Yeah. So we do see an opportunity with the vaccines in building relationships with new customers to convert them to long-term CVS Health customers. So let me just give you an example. Our customers, after they get the vaccine, have to wait 15 minutes as we observe them to make sure they don't have an adverse reaction. So we're going to give them a series of value-adds to encourage them to engage further, so from shopping passes in the store to MinuteClinic education and ultimately CarePass onboarding. And then remember, as we said earlier, every one of these customers is coming through our digital front end. So we have their e-mail, we have their text message and we have the ability to communicate with them regularly. So I would think of it beyond just the add-on front store. I would think about it as adding new customers to the CVS channel and getting their Pharmacy business plus their Front Store business.

A.J. Rice Q
Analyst, Credit Suisse Securities (USA) LLC

Okay. Thanks. Interesting.

Karen S. Lynch
President and Chief Executive Officer, CVS Health Corp.

Well, that's all we have for today. So I'd like to thank everyone for our call this morning. As you can see, we've made measurable and important progress on our strategy as a health services company. We're starting 2021 with strong momentum, and we are accelerating our pace of progress to drive our consumer-centric approach. And I do again want to thank all of our employees for their strong performance.

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With that I'll say thank you for joining us today.

Eva C. Boratto

Chief Financial Officer & Executive Vice President, CVS Health Corp.

Thanks, everyone.

Operator: This concludes today's CVS Health Fourth Quarter and Full Year 2020 Earnings Call and Webcast. You may disconnect your line at this time. Have a wonderful day.

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