04-Aug-2021

CVS Health Corp. (CVS)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning and welcome to the CVS Health second quarter 2021 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 question. As a reminder, today's conference is being recorded.

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

Susan Vissers Lisa
Senior Vice President, Investor Relations, CVS Health Corp.

Thank you and good morning, everyone. Welcome to the CVS Health second quarter 2021 earnings call. I'm Susie Lisa, Senior Vice President of Investor Relations for CVS Health. I'm very excited to be on the call with you today and to have the opportunity to work with you going forward.

I'm joined this morning by Karen Lynch, President and Chief Executive Officer, and Shawn Guertin, Executive Vice President and Chief Financial Officer. Following our prepared remarks, we will host a question-and-answer session that will include: Alan Lotvin, President, Pharmacy Services; Dan Finke, President, Health Care Benefits; Neela Montgomery, President, Retail and Pharmacy; and Jon Roberts, Chief Operating Officer.

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Our press release and slide presentation have been posted to our website along with our Form 10-Q 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 our most recent Annual Report on Form 10-K, this morning's earnings press release, and included in our Form 10-Q.

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 documents 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 it's my pleasure to turn the call over to Karen.

Karen S. Lynch

President, Chief Executive Officer & Director, CVS Health Corp.

Good morning, everyone, and thank you for joining our call today.

This was another strong quarter for CVS Health. We are playing an integral role in connecting experiences across the healthcare system to deliver better health outcomes. This is what truly differentiates us and generates our growth. In the rapidly changing US healthcare environment, we have proven that we can bring solutions at scale to meet individual health needs however they evolve. Our COVID-19 testing and vaccination campaigns for millions of Americans are just one example. We meet customers where they are. We are there when and how they want to access care. That is what's driving growth across our company, and it's where we'll continue to focus our innovation and investments.

During the second quarter, we delivered revenue growth of 11%. We generated adjusted earnings per share of $2.42 and strong cash flow from operations of $5.8 billion. We are raising our adjusted earnings per share guidance to $7.70 to $7.80. This reflects the continued positive momentum across our business, with growth both in new and current markets.

Today we announced an important investment in our employees. We will raise the minimum wage for our colleagues to $15 an hour by July 2022. This wage increase will boost our competitive edge in a tight retail labor market. We estimate it creates an incremental $600 million in labor costs over three years. Approximately $125 million of that impact will be in the final four months of this year. Increasing our minimum wage for hourly employees will help attract and retain the talent needed for our customer-centric business approach. Just as critical, it aligns with our values and our purpose and builds on our history of our investment in our people.

Each of our businesses delivered strong performance, highlighted by overall sales and earnings outperformance and sequential margin improvement. Customers realize the value we are providing across our CVS Health assets, which results in increased customer retention rates and new wins.

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In Health Care Benefits, results were powered by growth in our government business. Our medical benefit ratio of 84.1% was modestly above expectations, driven by COVID-related costs. Underlying non-COVID costs emerged favorably. We continue to believe aggregate medical costs will modestly exceed baseline levels during the second half of the year.

In addition to strong performance in our core business, we are leveraging our broad and unique portfolio of assets with our first CVS/Aetna co-branded offerings. We have submitted our exchange regulatory filings for a January 2022 entrance in eight states outlined in our supplemental earnings materials. With Aetna's strong networks and CVS's significant local presence, we believe we are creating a compelling new offering that combines health insurance, pharmacy, our retail presence, and behavioral health services. This is something that no one else can deliver.

The 2022 national account selling season in Health Care Benefits has been marked by a somewhat compressed industry-wide pipeline. Employers have been focused on developing strategies for vaccinations and other return-to-work activities. As a result, we concentrated on client retention, delivering a strong result of 97%. For those cases that were out to bid for 2022, we have been successful in securing new business and introducing new differentiated products. For example, our virtual-first primary care product is the only nationwide program to offer long-term dedicated virtual primary care and a traditional in-person national network, including MinuteClinics and HealthHUBs.

Turning to Pharmacy Services, we outperformed expectations, delivering 9.8% revenue growth and very strong operating income growth. We continued to build momentum in specialty pharmacy, with revenue up 8.9% year over year. Looking ahead, we have maintained an impressive 98% retention rate, with more than 80% of renewals complete. We have also driven strong new business results, winning over $8 billion in new gross sales for next year. We remain well positioned for continued specialty and pharmacy growth in 2022.

The differentiation we offer is particularly important. It reflects our integrated offering with in-store, mail order, and specialty services. We added nearly 1 million new integrated pharmacy and medical members through the 2021 and 2022 selling seasons alone. This is a testament of our success in the marketplace from the aligned interests and value we bring to our customers.

Our Retail segment continues to play a crucial role as part of our community-focused strategy. We are a vital local health destination for millions of Americans who are resuming more normal activities and fueling macro improvements in the economy.

Our second quarter results for Retail outperformed our expectations and the market. In our pharmacies, we grew prescription market share to over 26%. Importantly, our customer-centric programs continue to improve adherence for our patients. At the same time, we saw a solid rebound in front-store sales, which increased nearly 13% in the quarter, with strength across all categories. Nearly two-thirds of that growth was driven by health and wellness products.

Similarly, pharmacy script growth in the quarter was strong, up more than 14% year over year, one-third of which is attributable to COVID vaccines. We now administered 30 million vaccines and 29 million tests through the inception of the program. Approximately 40% of vaccines we administered over the past two months were to members of underrepresented communities, a rate at or higher than the benchmark population.

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Our effort to make the vaccine accessible and convenient for all Americans continues. However, vaccination rates are slowing from a peak in April despite the impact of new variants. Our COVID work is a powerful example of the trust and relationships we are building with consumers, augmented by our local presence and digital tools. For customers introduced to us through COVID testing, approximately 12% have subsequently chosen to fill new prescriptions or get their COVID vaccine at CVS Health. This helped drive overall strong script growth in the quarter.

The COVID testing outlook remains strong. As public health recommendations evolve, we are prepared and continue to play a critical role in helping Americans prevail against the pandemic. I am grateful for the continued dedication and tireless efforts of the nearly 300,000 colleagues.

We are making considerable progress across key drivers of our growth. The first is our role in care delivery. We continue to focus on our integrated platform to expand access to care that is local, affordable, and connected. HealthHUBs represent one of many channels and lower cost sites of care that allows us to address individual health needs. Aetna Commercial members in the no co-pay/low co-pay product are utilizing our MinuteClinics and our HealthHUBs more frequently, more than twice as often as members without these benefits.

We expanded the spectrum of health services we offer to include common services usually done in primary care settings, such as chronic care management like diabetes and behavioral health, a critical area of need that will continue beyond the pandemic. We expanded our Care Concierge program to support our Medicare members, rolling out as planned the HealthHUB Stars program, designed to close gaps in the quality of care. Early intervention results are promising, as they are demonstrating strong reach and a high engagement rate of 67% for a variety of health screenings such as diabetes and cancer.

The second key area is technology. We are using the power of our digital capabilities to reinvent how consumers experience their care by creating choice, expanding access, and reducing complexity. And we are creating new sources of value, while accelerating the speed, flexibility, and launch of new health solutions.

Today, we regularly serve more than 35 million unique digital customers across our CVS Health assets. Our digital customers are important. Digital retail customers spend 2.5 times more in our front store, manage 1.5 times more scripts, and remain customers longer than other pharmacy patients. And customers who engage with us digitally have lower medical costs related to personalized data insights that guide health behaviors. This quarter, we also saw more than 37% of specialty prescriptions initiated digitally from the 85% of our pharmacy specialty members who have opted into our digital programs. Building these trusted digital relationships with customers generates new growth opportunities across all of our businesses.

At the same time, we are reengineering our cost structure by simplifying operations to benefit both customers and our own colleagues. Our technology-driven programs are leveraging blockchain, driving cloud migration and intelligent automation, and streamlining processes to accelerate results and generate greater impacts. One example is a specialty pharmacy script automation program that uses AI to yield better results more quickly, while eliminating more than 30 manual steps such as benefit verification and prior authorization.

Our commitment to shareholders, customers, and communities we serve does not stop at commercial product offerings. CVS Health plays an important role in the health and vitality of the communities where we live, work, and serve. Our longstanding commitment to corporate social responsibility focuses on four areas: healthy people, healthy business, healthy communities, and a healthy planet. Together, these efforts create our sustainability roadmap, known as Transform Health 2030. It represents an ambitious, but achievable agenda that aligns with eight of the UN's sustainable development goals.

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CVS Health is investing in inclusive wellness, economic development, and advancement opportunities for our colleagues and our suppliers. We are also making social impact investments that will improve health outcomes nationwide, which is already making a critical difference in our pandemic work. In addition, we have set science-based targets to reduce our greenhouse gas emissions by 67% by 2030 from a 2014 baseline. I am proud of what we've achieved, but there is much more to do, and I'll provide regular updates about our continued progress.

In closing, CVS Health is the leading health solutions company, with a broad and unique set of assets. We are accelerating our pace of progress to drive value for our customers, our communities, our people, and our shareholders. Our unparalleled capabilities, reach, and enduring relationship with the consumer uniquely positions us to support them throughout their lifetime while also providing multiple avenues for sustained growth for our company.

I'll turn now to Shawn Guertin, who recently joined CVS Health as Executive Vice President and Chief Financial Officer in late May and has already made an impact. His deep healthcare expertise, financial acumen, and strategic mindset will be instrumental to the successful execution of our strategy. Shawn?

Shawn M. Guertin

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

Thank you, Karen, and good morning, everyone.

I'm very excited to be at CVS Health, particularly at such a dynamic and important time, not only for our company but for our healthcare system as a whole. Our differentiated portfolio of capabilities and local community presence creates a compelling competitive advantage that improves healthcare access and outcomes across a broad population while generating strong cash flow and value for all our stakeholders. I look forward to executing on our growth strategy and reshaping the healthcare experience for the people we serve.

I'll first discuss our second quarter financial results. As Karen stated, we delivered another quarter of outperformance across each of our businesses, exceeding our expectations and further demonstrating the strength of our combined enterprise.

Total revenues of $72.6 billion grew 11% year over year and reflected strong contributions from each of our segments. We reported adjusted operating income of $4.9 billion and adjusted earnings per share of $2.42. We continued to generate excellent cash flow in the second quarter, with year-to-date cash flow from operations now exceeding $8.7 billion. Further, we have repaid $5.4 billion in debt during the first half of the year. All our cash flow metrics exceeded our internal forecast during the quarter.

Moving to the segments, Health Care Benefits total revenue increased 11% year over year, driven by our continued growth in our government services business, slightly offset by the repeal of the health insurance fee, or HIF.

Our Medicare franchise continues to perform very well, with quarterly sequential membership growth across all products. Medicare Advantage membership is slightly exceeding our prior expectations, and is now on track to be up 9% to 10% for the full year. Dual special needs plans membership grew by double digits sequentially and has more than doubled year over year, reflecting our strategic focus in this business. Medicare supplement and prescription drug plan membership also increased in the quarter, providing a sustained strong pipeline of opportunities for future conversions to Medicare Advantage. Our midyear Medicare risk-adjusted revenue

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settlement was in line with our expectations. Finally, for our prescription drug plan business, we are pleased with our bid position below the 2022 low income benchmark in all our targeted regions.

Health Care Benefits adjusted operating income exceeded our projections for the quarter, but was down materially on a year-over-year basis due to the depressed levels of utilization observed in the second quarter of 2020 at the start of the pandemic. The medical benefit ratio for the quarter of 84.1% was slightly higher than our forecast, driven by higher than expected COVID-related costs, which, while materially lower than the first quarter, did not fall off as much as we had forecast. Underlying non-COVID utilization continued its return toward normal baseline levels and was slightly favorable versus our expectations. The combined result was an MBR slightly higher than our forecast for the quarter.

We remain comfortable with the adequacy of our reserves, recording a modest amount of favorable prior-year development in the quarter, while days claims payable of 48 is consistent with both the first quarter of this year and the fourth quarter of 2020.

Turning to Pharmacy Services, we continued to deliver exceptional value for our customers by producing industry-leading low single-digit drug trends. This value proposition allowed us to produce strong revenue growth of nearly 10% versus last year, primarily driven by network volume and specialty pharmacy growth. Total pharmacy claims processed increased by more than 11% versus last year, with approximately one-half attributable to net new business wins from our 2021 selling season and another one-quarter due to COVID vaccine administration. Our Specialty Network and Maintenance Choice business lines all delivered sequential claims growth in the quarter.

Pharmacy Services adjusted operating income exceeded expectations in the second quarter, up more than $400 million or 32% year over year. The three major drivers of this increase are: improved purchasing economics reflecting the products and services of our group purchasing organization launched in the second quarter of 2020; specialty pharmacy, including our 340B claims administration business; and increased pharmacy claim volumes. These favorable items were partially tempered by ongoing client pricing pressure.

Lastly, it's important to note that the initiation of our group purchasing organization and certain generic specialty launches in the second quarter and second half of 2020 respectively created relatively low comparisons in the first half of 2021 that will increase significantly in the second half of the year. Therefore, we expect a much smaller incremental year-over-year improvement in operating income in the second half of this year.

Retail also delivered strong results this quarter, exceeding expectations. Total revenue of nearly $25 billion increased by $3 billion or 14% year over year. This improvement is driven by three main components. One, approximately one-third or $1 billion is attributable to the nearly 17 million COVID vaccines and more than 6 million COVID tests administered during the second quarter. Two, an additional one-third or another $1 billion is due to the broad quarantine restrictions and civil unrest experienced last year that depressed results in the second quarter of 2020. Three, the final one-third or remaining $1 billion was driven by a combination of improved pharmacy growth and mix during the second quarter, as well as broad strength in front-store trends.

Front-store revenue increased by nearly 13% while pharmacy prescription volume was up 14%, including COVID vaccines. This strong revenue growth combined with a 340 basis point improvement in adjusted operating margin produced adjusted operating income well ahead of our forecast and an increase of nearly $1 billion year over year. COVID testing and vaccines, which were immaterial in Q2 2020, represent approximately half of the operating income increase.

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Second quarter 2021 results also reflect a gain from a legal settlement related to an antitrust matter worth $125 million, which is included in both our GAAP and non-GAAP results.

Turning to cash flows and the balance sheet, cash from operations remained strong at $5.8 billion for the quarter and $8.7 billion year to date. We paid down $2.4 billion of long-term debt in the quarter while returning $650 million to shareholders through dividends. Since the close of the Aetna transaction, we have paid down a net $17.6 billion in long-term debt. Our commitment and discipline in this area was recognized during the quarter, as S&P raised our credit outlook from stable to positive.

Let me now turn to our updated guidance for 2021 and share some preliminary thoughts regarding 2022. But first, I want to provide a framework of the pandemic-related dynamics that will impact our business over the remainder of the year and the interplay between the Retail segment and the Health Care Benefits segment.

As mentioned, our Retail segment benefited from strong COVID testing and vaccine administration services in the second quarter, but began to see vaccines fall below expectations in May and June. As a result, we have reduced our forecast for vaccine earnings to below the midpoint of our original range for the full year. In Health Care Benefits, given the ongoing fluidity of the current environment, we have incorporated a higher estimate of COVID-related costs in the second half of the year. As a result, our full-year MBR, while still well within our range, is approximately 20 to 30 basis points higher than our previous forecast.

Overall, we believe the combined impact of a reduced outlook for vaccines and Retail and a slightly higher MBR in Health Care Benefits now make the pandemic a modest negative for 2021. Despite this, given our strong performance in the quarter and solid outlook, we are increasing our guidance. We are raising full-year 2021 total revenue guidance to a range of $280.7 billion to $285.2 billion, representing year-over-year adjusted revenue growth of 4.5% to 6.25%. We are also raising adjusted EPS guidance to $7.70 to $7.80 per share. The significant earnings outperformance in the second quarter is reflected in our updated full-year guidance, but is partially offset by three key headwinds during the second half of 2021.

The first is expectations for full-year COVID-19 vaccine volumes to be below the midpoint of our original guidance. As I mentioned earlier, we saw vaccinations peak in April, then begin to decline in May and June. Although the recent rise in COVID-19 cases has caused a reacceleration in first dose trend, we believe it to be prudent to adjust our full-year outlook for vaccines to a range of 32 million to 36 million. This includes a limited contribution from the administration of pediatric vaccines but does not assume any contribution from booster shots.

Overall, despite the slowdown in vaccine administration, we continue to be pleased with our expanded and strengthened customer relationships stemming from our local presence and see ongoing customer connectivity from the significant role we play in combating the pandemic in our local communities.

The second item is the investment in wages that Karen highlighted. Our work to retain and attract talent includes an additional $600 million investment in wages over three years, primarily for our Retail colleagues and pharmacy technicians, with approximately $125 million impacting the last four months of 2021.

Finally, the third item is increased investments in the second half of 2021 reflecting our efforts to drive and support growth, enhance our consumer experience, and improve our cost structure in 2022 and beyond.

In aggregate, these three items are expected to negatively impact second half adjusted EPS by approximately $0.25 per share.

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In addition to increasing our EPS guidance, we are also raising our expectations for cash flow from operations by $500 million to a range of $12.5 billion to $13 billion. Our expectations for gross capital expenditures remain in a range of $2.7 billion to $3 billion to fund organic growth initiatives and our expanded investments in technology and digital. We remain committed to ongoing deleveraging and our investment-grade rating target.

By segment, for Health Care Benefits, we are maintaining our full-year adjusted operating income guidance of $5.25 billion to $5.35 billion. As discussed, our outlook assumes a slightly higher full-year MBR by 20 to 30 basis points to reflect the higher COVID costs observed in the second quarter and our expectation that slightly higher COVID costs will continue into the second half. Our forecast assumes that non-COVID utilization will return to normal baseline levels by the fourth quarter. This MBR pressure is largely being offset by an improved revenue outlook and operating expense management.

It's also worth recalling the natural seasonality of the Health Care Benefits segment, with fourth quarter operating income typically the lowest of the year. We believe that our forecast is appropriately positioned given that there remains a high degree of uncertainty in terms of how COVID will play out during the second half of the year.

For Pharmacy Services, given the strength in the quarter and visibility to the remainder of the year, we are increasing our full year 2021 adjusted operating income guidance to $6.45 billion to $6.55 billion, representing year-over-year growth of 13.5% to 15.25%. While we expect the factors driving second quarter performance to continue to benefit the second half of 2021, due to the timing elements I discussed earlier, we do not anticipate the same level of year-over-year growth observed in the first half of 2021.

For Retail, we are maintaining our full year 2021 segment guidance for adjusted operating income in a range of $6.6 billion to $6.7 billion. Given the dynamic environment relative to the pandemic and its impact on vaccines, testing, and front-store sales, we have taken what we believe to be a prudent posture in our outlook and have not fully pulled through the favorability we observed in the second quarter to the full year. This full year guidance also reflects the reduced outlook for vaccines and the impact of the wage investment, approximately 80% of which is experienced in the Retail segment. You will find further details in the slide presentation we posted to our website this morning.

Moving on to 2022, while it is premature to provide forward year guidance at this time, I want to share some preliminary thinking on some of the more visible puts and takes we are considering for 2022. Starting with tailwinds, it is reasonable to expect benefits from: one, strong selling seasons in the Pharmacy Services segment and in commercial national accounts in the Health Care Benefits segment; two, anticipated lower COVID-related costs and improved Medicare risk-adjusted revenue reimbursement in the Health Care Benefits business; and three, continued contributions from our ongoing cost savings initiatives.

For headwinds, we anticipate: first, consistent pressure in Pharmacy Services from client price improvements and reimbursement pressure in Retail, both of which are consistent industry headwinds, which we seek to mitigate through improved purchasing economics; second, the impact of annualizing the increase to minimum wage across the company; and third, uncertainty regarding the expected revenue from COVID vaccines and testing in our Retail operations.

Lastly, I'd remind you that our standard practice is not to include any estimates of prior-year development or realized capital gains in our forward-looking guidance. On a year-to-date basis, these two items comprise approximately $0.15 per share. Again, this is not a comprehensive outlook for 2022, but represents some of the key items likely to influence performance next year.

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To conclude, CVS Health continues to produce strong results as we execute on our differentiated strategy, putting the consumer at the center of what we do and redefining the integrated delivery of healthcare. I look forward to updating longer-term financial targets at our Investor Day event this December and detailing our key priorities, positioning CVS Health to deliver sustainable long-term profitable growth and to return to a more balanced and strategic program of capital deployment.

We will now open the call to your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] 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 and thank you for all of the detail. Shawn, just going back to your thoughts around 2022, am I thinking about this correctly? If I take the midpoint of this year at $7.75, add back the $0.25 that you talked about, we get to $8, minus the $0.15 as we think about PPD and capital gains gets us to $7.85. And then how do I think about the headwinds and tailwinds that you talked about? Are they fairly equal between them? Is there any other color that you can give us as we think about the puts and takes going into next year?

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

A

Yeah. I think I'd be careful on the specific math there because, to some extent, as I mentioned, for example, about vaccines and testing revenue, there is just an uncertainty about the level of those things. And I'd also not add back the full $0.25, as an example, because the minimum wage impact in that is only for four months, and obviously that will annualize next year. So, there's some moving pieces sort of in there. But honestly, some of these things, I think we can see, are going to be factors, but we don't have completely quantified at this point.

But I do think when we talk about 2022, it's worth talking about a couple things. I would say, at the outset, we remain very well positioned in our core businesses and our operating performance is very strong, as evidenced by the last couple of quarters of results. And as I mentioned in my remarks, I don't want to provide 2022 guidance today, but I do recognize that there's previous targets out there for a low double-digit earnings growth for 2022. And what I would say is, make no mistake, double-digit adjusted EPS growth remains the benchmark that we're always trying to achieve and, frankly, the benchmark that we're using in considering the strategic choices that we'll make. But an awful lot has changed since 2019 when that target was out there and stated.

And it's not just the composition of our earnings, but sort of to the point of your question, Lisa, what's the visibility that we have into how those components are going to trend forward. Again, the vaccines and testing and COVID treatment costs are just two good examples of factors, but the direction and the degree is a bit hard to see. So a lot of this will come down to thinking about what baseline we're measuring from and how we see these factors playing out here.

But as I sit here today, if I consider a starting point of $7.70 to $7.80, I would say at this point no, that from this forecast baseline I wouldn't reiterate the double-digit sort of growth target for 2022. But again, as I mentioned, this is more about the shifting factors. It does not have anything really to do with the core performance of our

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business, which has been really outstanding. Obviously, we hope to talk in much more detail about 2022 at our Investor Day as well as some of the longer-term financial targets and the earnings power of the business.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

And, Shawn, just as my follow-up, I just want to understand. You talked about COVID costs returning as we go into the back half of the year. Can you talk at all of what you've seen in the last few weeks with the Delta variant and potential increase to cost on the COVID side? And then are you seeing any non-COVID costs coming down that people are pushing off elective surgeries because of COVID? Any incremental color would be helpful there. Thanks again for the comments.

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

A

So what I would say is in the HCB business, obviously there's a lag in sort of what we see in any real time, so we don't have great insight necessarily into July. But what I would say, there certainly has been – I've seen a number of media reports about various facilities beginning to cancel elective procedures again, and so it does feel like there's certainly some push in the system on the deferred utilization side again, but again, premature to conclude for HCB.

I would say, though, that what we do see on the Retail side is pretty strong momentum continuing in testing in particular. And again, while vaccines are still down in July versus the prior month, they've probably had a bit of an uptick, as I mentioned in my remarks. So I think clearly you could reasonably infer that there's sort of the ongoing kind of COVID treatment costs are persisting certainly into early July here, and again, thus why we thought it made sense to be a bit more cautious in our MBR outlook for HCB.

Lisa C. Gill
Analyst, JPMorgan Securities LLC

Q

Great, thank you.

Operator: And we'll take our next question from A.J. Rice with Credit Suisse. Please go ahead, your line is open.

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

Q

Hi, everybody. Welcome, Shawn and Susie. Anyway, I appreciate the conversation the last couple conference calls about how the three businesses can work together. When you look at it today, what are the leading opportunities for the businesses to the Retail, Pharmacy Services, and the Benefits businesses to capitalize on that are still in front of the company? Can you highlight maybe a couple things that you guys particularly focused on and see as opportunities?

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

A

Good morning, A.J. I would highlight a couple things in front of us. One is that, as you know, we have more opportunities in expanding our digital access and digital connections. We've seen across the board with our next best actions using digital connections. For those individuals we've seen reductions in overall medical costs. We also have the opportunity to expand our home service and delivery. As you know, we are in Coram today. We have kidney care. But I do think that there are more expansive opportunities. It's a $100 billion-plus market that I

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think we have more opportunities to penetrate and really enhance our overall care delivery. So I would point to those two as ones.

And then I think there's more than we can do with just the fundamental core business through integration, through selling more of our products, capturing more share of wallet, driving benefit designs across to support lower sites of care like MinuteClinic and the HealthHUBs. So those would be a few I would comment on. Thanks for the question, A.J.

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

Q

Great, maybe just a quick follow-up. I know the slide deck says that the priority remains to continue to pay down debt. At what point, Shawn – it's good to see you onboard. At what point do you think you might look at tuck-in acquisitions a little more actively, share repurchase, any of those types of things? What's the timeframe on that?

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

A

Thanks, A.J. It's good to hear from you again as well. So if I thought about the near term being sort of the rest of this year but primarily 2022, we have $4 billion of debt or thereabouts, a little more than that maturing, and it would be our intention to continue to delever by paying that off. However, if you think about the level of our cash flows in 2021, if we achieved a similar level of cash flow next year, even with the dividend, that would still leave a lot of room for other capital deployment, potentially M&A, potentially dividend increase, and potentially share repurchases. So I think 2022 is a year where we can begin to do that in a potentially more limited way but still meaningful.

What I would say is longer term, as I think about this and as you've heard me to say before, my first use of that and my most preferred use of that capital all the time is to grow the business. And undoubtedly, there are capabilities that we will need over the next few years to sort of affect our strategy as efficiently as we can, and so M&A is a part of that. But I've also found that balanced deployment of capital tends to produce sort of the best long-term results, and so that is a combination of M&A, a dividend that moves up as EPS moves up, and share repurchase that's accretive to your EPS growth on sort of a steady basis.

Susan Vissers Lisa
Senior Vice President, Investor Relations, CVS Health Corp.

A

Next question, please.

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

Q

Thanks a lot.

Operator: And we'll take our next question from Ricky Goldwasser with Morgan Stanley. Please go ahead, your line is open.

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

Q

Hi, good morning. Thank you for all the details and congrats on a very good quarter. So my main question, Karen, is around sort of the relationship and how you think about your Medicare Advantage book of business and your

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vision for how you're going to evolve the HealthHUB presence. You talked about Care Concierge for Medicare. I'm just curious to see how that kind of marketplace is really kind of shaping what you're seeing of what HealthHUBs would look in the future versus what it is today.

And then the follow-up question would be to Shawn. Shawn, when you talked about second half guidance, you mentioned investments in future growth as a headwind. You didn't mention it as a headwind for fiscal year 2022. So just from a modeling perspective, should we think about these investments just as happening in second half, or should we also run rate them as we adjust our models for next year?

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

A

Good morning, Ricky. Let me just start with relative to Medicare. First of all, that is one of our single biggest growth opportunities, continuing to sell more Medicare, driving the duals. And so we do think that is a big opportunity for growth on an ongoing basis.

As we think about care delivery and think about Stars performance, the HealthHUBs will play a critical role. But as I said, we have to have a broad expansive approach to care delivery, particularly as it relates to the Medicare patients. So the HealthHUB will play a role. As you know, we have the zero co-pay/low co-pay now, demonstrating that we can have follow-up visits at our HealthHUBs. But we need to expand our capabilities in the home, and we need to make sure that we're staying digitally connected to them.

But this new program that we had just recently introduced as part of our planned rollout in the HealthHUBs is really intended to close gaps in care. And the more that we close gaps in care, the better Stars performance we get, the better revenue we get. So you can see that cycle, and that really is a big opportunity for us. But I really want you to think about Medicare care delivery in a broader role, with HealthHUBs being part of that care strategy. Shawn, let me turn it over to you.

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

A

In terms of the second half guidance, Ricky, I do think there are sort of two levels of investment here, and one of them each year is when we do have growth better than our original plan. For example, as we foresee in PSS now, we do then have to sort of staff up and be prepared for that higher growth. So that's always an element.

So part of your question is how you feel about in essence 2023 growth that we'll achieve in 2022. And I think broadly, I would not run rate the whole thing, but I do think there are pieces that tend to run rate forward in the business, whether they're ongoing investments we make in Medicare distribution and, as I mentioned, in staffing up for customers. So as I sit here today, I wouldn't run rate the whole thing. A lot of this is still to be determined, but there probably is a piece that kind of continues if we continue on the trajectory that we're on.

The other element I would say about second half guidance with some of this is some of this spending gets sort of pushed back into the year more towards the end. I think you sort of take that with the natural seasonality of the Health Care Benefits business, and that would tend to get sort of a slope of earnings for the rest of the year where Q4 is likely less than Q3.

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

Q

Thank you.

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

A

Thanks.

Susan Vissers Lisa
Senior Vice President, Investor Relations, CVS Health Corp.

A

Next question.

Operator: And we'll take our next question from Ralph Giacobbe with Citigroup. Please go ahead, your line is open.

Ralph Giacobbe
Analyst, Citigroup Global Markets, Inc.

Q

Great, thanks. Good morning. Maybe just on the labor commentary, first, are you seeing underlying wage pressure outside of the minimum wage lift? And then just wanted to clarify the numbers because I think you said the cost would be $600 million, $125 million the last four months of this year, but I think you also said it would stretch over three years. So just wanted to reconcile that versus that July 2022 date that you put out there.

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

A

Hi, Ralph. Let me just start with the minimum wage adjustment. It's a series of investments that we've been making for our employees since the pandemic, and we are seeing 65% of our employees that are hourly are already at or above $15 an hour. So this is a very targeted investment for our pharmacy technicians, our front-store colleagues. And we will start a series of wage increases beginning in September, which is really what's driving that $125 million impact to the latter half of the year.

Obviously, it's a tight labor market. We are paying attention. We've got a lot of hiring to do to support growth. And so far we see pressure, but we've been managing through it. But we're watching that labor market. We're seeing impacts in the stores, and that's part of why we're making this wage investment today. Shawn, do you want to answer the three-year question?

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

A

Ralph, the way this will play out over the next few years is, as you mentioned, there would be – the change in September would be $125 million for the last four months of this year. That will annualize next year, but there will also be a second change sort of in July of next year, I believe. So the total cost of this in 2022 will be $485 million, which is a step up, if you will, of about $360 million from the $125 million. That second step in July 2022 will annualize again in 2023 but not to the same degree. So the total cost is right around $600 million by the time you get to 2023, and that's a step up year over year from 2022 to 2023 of about $115 million.

Ralph Giacobbe
Analyst, Citigroup Global Markets, Inc.

Q

Got it. All right. That's helpful. And then just quick follow-up. Just want to clarify. Shawn, I think you said you would not factor in low-double-digit growth on the $7.75 base. I think I heard that. But if I do look at consensus, it factors about 7% growth, so we're not at that double-digit level. And given your commentary around capital

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deployment alone, are you willing to say if there is comfort in that sort of mid-single-digit EPS, or is it just still too early to even give that comfort or clarity? Thanks.

Shawn M. Guertin
Chief Financial Officer & Executive Vice President, CVS Health Corp.
A

I would say it's too early for me to give you specific guidance. But if you go back to what I said, I think the businesses are performing very well, and we will have the ability potentially to deploy some capital next year. So, I certainly wouldn't dismiss that as something that's not sort of in the thinking or not a viable target. But again, I want to stay away from giving precise guidance. But the core fundamentals of our business are excellent right now. And again, with the return to kind of a more balanced capital deployment, I certainly feel good about sort of the longer-term trajectory.

Ralph Giacobbe
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Fair enough. Thank you.

Susan Vissers Lisa
Senior Vice President, Investor Relations, CVS Health Corp.
A

Next question.

Operator: And we'll take our next question from Mike Cherny with Bank of America. Please go ahead, your line is open.

Michael Cherny
Analyst, BofA Securities, Inc.
Q

Good morning, everyone. Thanks for all the color so far. So, I'm going to dance around the 2022 outlook a bit without obviously trying to hold you to anything, Shawn. But as you talked about some of the tailwinds particularly with regards to the strong PBM and commercial selling season so far, can you give us any characteristics of the type of customers that you're winning? What the real pitch that they're looking at relative to how you're going to market? And what that driving force is? Obviously, you had the federal employee plan specialty that came back that we know about in Pharmacy Services. But beyond that, any characteristics that you can point to that are really resonating in the strong performance year to date?

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

Yeah. Michael, it's Karen. As I mentioned in my opening remarks, we're very much having a strong 1/1. Part of it's due to the integration and the products and services that we're offering, and part of it's just due to the service delivery that we've been delivering to our customers and the value that we've been delivering to our customers. I'm going to ask Alan and then Dan to talk about specifically what they're seeing and the types of customers that we're winning in the market. So, Alan?

Alan M. Lotvin
Executive Vice President-CVS Healthl and President-Pharmacy Services, CVS Health Corp.
A

Yeah. Thank you, Karen. So when you look at the Caremark selling season and the Caremark kind of array of clients, it is, I would say, a relatively normal distribution of clients. We won obviously the Federal Employee

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Program specialty, but we've won in the health plan segment, we've won in the employer segment, and we're winning in the coalition segment. So across the board we continue to win.

And I think the key drivers there are: one, delivering on what is most important to our clients, which is controlling their drug trend; number two, providing kind of an outstanding level of service, so not just avoiding service issues, but proactively addressing our clients' needs; and the third sort of related to the first is innovating particularly around new programs in specialty, like our oncology program, medical benefit management program. So, it's really there isn't a specific segment that's over-performing other than specialty obviously because of the FEP win.

Daniel P. Finke
Executive Vice President and President, Health Care Benefits, CVS Health Corp.

A

Yeah. And I would just add that, similar to Alan, we have quite a few areas of focus that are resonating in the market. That's leading to that improved persistency that Karen stated, but also some really strong wins in the market. Alan and I have been working really close together on improving the further penetration of our integrated offerings specifically in pharmacy, which is resonating really strongly, also dental and behavioral health.

And then, like Alan, with our innovative solutions, we're targeting some new capabilities for chronic disease that use the breadth of the assets of CVS like Transform Diabetes and Transform Oncology, which are resonating, as well as our new access point products like our virtual primary care. And so, that's really what's leading to a strong and improved national account selling season.

Michael Cherny
Analyst, BofA Securities, Inc.

Q

Got it. If I can just ask one more, you highlighted a lot of the investments that you made into the store base to prepare for the COVID vaccines, COVID testing. As you think about your outlook going forward and the uncertainty around what the pacing will be of vaccines, pediatric boosters, et cetera, what happens to a lot of those costs, the incremental labor, the incremental staffing that you've done in terms of how that should factor into the model on a go-forward basis?

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

A

Michael, so you're right. We did have to stand up a fairly sizable operation to sort of handle volume like this. And it's a delicate balance of kind of trying to adjust that as you see volumes change, but we sort of see how quickly volumes can go up and down. So, I think we've been a bit cautious with that and tried to make sure that we have the capacity if things go in a different direction. This is kind of an important role that we play, even more important now without as many large-scale sites up, and so we want to make sure we have the capacity.

So, the thing I think that kind of comes off of that is, as you think now about sort of vaccine volume up and down, the marginal impact of those vaccines is probably greater than average. So, it is something that we're paying very close attention to, but a balance.

Neela Montgomery
Executive Vice President and President, Retail/Pharmacy, CVS Health Corp.

A

It's Neela. I'll just add to that and Shawn's comments, which is that we started the vaccine campaign with a number of dedicated clinics which had dedicated labor. And since then, we've expanded to all stores and are seeing about 40% of the appointments are now walk-in appointments. So they are really within our existing labor

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model within the pharmacy. So, that does help us to flex up and down much more with demand that we're seeing on a weekly basis.

Susan Vissers Lisa
Senior Vice President, Investor Relations, CVS Health Corp.

A

Next question.

Operator: And we'll take our next question from Kevin Caliendo with UBS. Please go ahead, your line is open.

Kevin Caliendo
Analyst, UBS Securities LLC

Q

Hi. Thanks. I just want to go through the headwinds and tailwinds and try to figure out – I think we're all trying to figure out sort of what is the baseline. I know Lisa tried earlier. I think when we think about the vax benefit, when you sized it earlier as $500 million, was that for the quarter? And how should we think about that benefit for the full year, net-net? And I guess the question really is how to think about what that headwind could be for next year? Like what can we anticipate over the economics of the vaccine change in your opinion? That's the first one.

And then the second one is, do you think you can still get the same purchasing synergies that you're seeing this year next year in the PBM? It sounds like you're getting massive new growth there. I'm just wondering if you can continue to see the sort of year-over-year kind of growth, which I'm guessing is driven by the purchasing synergies, next year.

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

A

I can let Alan comment more deeply on the second one. But what I would say is recall that some of these initiatives, as I mentioned in my comments, were launched sort of midway or in the second half of last year. So the effect we're seeing year over year is more pronounced in sort of the first half of the year than we'll see in the second half of the year. But Alan can comment on the longer-term potential.

On the vaccine and the testing economics, as we mentioned, $1 billion of the revenue increase is attributable to those two things. In our full-year outlook, the full-year revenue is probably double that. The margin dynamics are probably a little high just in this quarter just because of some of the timing issues. But to date, I don't have any insight into sort of changing reimbursements or changing kind of the labor model we're using to sort of deliver those. So I think that's a reasonable sort of the baseline to begin to work off of as we can and as we think about next year.

And again, as you think about the dynamics here as you have FDA approval mandates, booster shots, there's a lot of things. And listen, you could make a bull case if you wanted to on this certainly with what's going on now, and I wouldn't dispute that. And I'd acknowledge that if our guidance has some upside, this could be a place depending on how things play out. The only kind of caution I would put there, though, is to think about some of the interplay of just looking at this in isolation. So even in sort of inside Retail, if we do see an uptick and it does see increased activity, what does this mean for cough, cold, and flu? What does it mean for front of store? And then obviously the HCB ripple. So again, I'd acknowledge that there is a bull case that you could make here, but I'd also say this has changed rapidly over the last couple of months. And I'd just ask you to sort of think about it in a broader context.

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Alan M. Lotvin

Executive Vice President-CVS Healthl and President-Pharmacy Services, CVS Health Corp.

A

And, Kevin, it's Alan. When I think about the drivers of purchasing economics on the manufacturer side and sustainability, the first thing I'd acknowledge is, as Shawn has said, when you launch something new, there's always going to be an outsized step up. Having said that, I think the future viewpoint on the ability to create more competition through – whether it's biosimilars and biosimilar interchangeability as we saw recently through generics, particularly in the specialty area, we see that as we're at the beginning of the specialty era, of the generic era, biosimilar era of specialty. So I think that's sustainable and a good opportunity longer term.

I think the growth of our value creation will grow as volume grows. So as we continue to win new business, we'll continue to grow there. And the last is we built this platform as a platform for a series of services. So we've just launched our first set of services. We think there's a number of other ones that we can continue to launch into the market within the GPO that will create meaningful value for both us and for our customers.

Susan Vissers Lisa

Senior Vice President, Investor Relations, CVS Health Corp.

Great. With that, it brings us to 9:00. We appreciate your interest and time. And, Ashley, if you could, please give the replay information. Thank you all.

Operator: And this concludes today's CVS Health second quarter 2021 earnings call and webcast. You may disconnect your line at this time and have a wonderful day.

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