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Company: **CVS Health Corp.**

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COMPANY PARTICIPANTS

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

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

OTHER PARTICIPANTS

Ricky R. Goldwasser - Analyst

MANAGEMENT DISCUSSION SECTION

Ricky R. Goldwasser

So good morning, everyone. And for those of you who are new to the room, welcome to Morgan Stanley's Global Healthcare Conference. We're very happy to be here in person after a couple of years. I'm Ricky Goldwasser, Morgan Stanley's healthcare services analyst, I'm part of the services team. And joining me this morning are Karen Lynch, President and CEO of CVS; and Shawn Guertin, Executive VP and CFO.

So good morning, Karen and Shawn. So great to have you here with us.

Karen S. Lynch

Good morning, Ricky. Great to be here.

Ricky R. Goldwasser

And before we start, one disclosure. For any holding regulatory disclosures, please go to the Morgan Stanley website and to the research website. And with that, Karen, pass it to you for some introductory remarks.

Karen S. Lynch

Oh, thank you so much. I think what I would first say is our business is performing quite well. We had a very strong second quarter. We saw revenue grow 11% year-over-year. We have very robust cash flows. And as we increased our EPS guidance in the last two quarters.

If you think about each of the segments, we're very strong in our Healthcare segment. We have grown membership across all product lines. And as we look to 2023, we have – we expect to see 98% retention and strong national account growth. And we expect to grow our group Medicare as well.

If you think about pharmacy services, we had a strong second quarter, very good – we have the best pharmacy trend really due to our specialty business. And again, we expect – we're seeing strong retention on that book of business at 98%, we're about (00:01:57) 75% of the contracts.

And then I would say in the retail business, we're quite proud of the results. They're very strong and we've seen script volume growth and we've been taking share for every quarter since the first quarter of 2020. And the biggest news we have in the company as we announced a potential acquisition last week with Signify Health. And we're very excited as you think about our strategy and what our strategy is evolving, Signify is – fits right – fits quite nicely. Our strategy was really to build our foundational businesses, drive into primary care, in-home services and provider enabled services. Signify checks to those boxes. So, we're very excited about that opportunity.

QUESTION AND ANSWER SECTION

Analyst: Ricky R. Goldwasser

Question – Ricky R. Goldwasser: So, this is the first public conference that you are speaking at after announcing Signify. So, I do want to dig a little bit deeper into those capabilities that Signify brings. And one of the things is that just interested in sort of the decision and the thought process behind acquiring an asset that pivots from sort of how people traditionally think about home healthcare.

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Answer – Karen S. Lynch: Yeah. I think I'll start and Shawn can fill in. But I think if you think about the opportunity we have and one of the important parts about our business is we are really shifting into extending into health services and consumer engagement. And this aspect really gives us an opportunity to enhance our consumer engagement where in the home we can direct people to care – to the right sources of care. Think about directing them to our MinuteClinics. For example, think about pharmacy reconciliation. It also gives us a big platform for future opportunities as we extend in to primary care. They have a very strong provider enablement asset so Caravan, which is another entry way into value-based care. And that gives us an opportunity to extend those relationships with providers and really drive that provider at value-based contracting. That asset is strong. They'll have over 700,000 attributed life in 2023 and they are demonstrating real growth. So let me ask Shawn to add anything that I might have missed.

Answer – Shawn M. Guertin: Yeah. No. I think, I would say that, a lot of times strategy is about sort of identifying those trends that you really think are going to be so powerful that you can ride them. Karen mentioned one, right, with the consumer care in the home as a preferred setting. The other big one that we've talked about that, I think is very relevant here and is why I'm excited is the move from fee-for-service to value-based care.

And when you think about what you need in value-based care, you need the technology, you need the network, you need the sort of IP around how to manage costs for chronic care populations. And while the actual delivery of care in the home is a little bit different than what do they have all, they have – 80% to 90% of what you need to enable that. And so, as I've said to many people, as we thought about home, home is so vast. And in some ways, the challenge is where to start. The one thing I know we need and the one thing I know our business will benefit from is the value-based care capability, especially around chronic care populations like Medicare, Medicaid and public exchanges.

Question – Ricky R. Goldwasser: So can we dig deeper on that, so how does Signify accelerate your value-based care journey?

Answer – Shawn M. Guertin: Well, as Karen mentioned, right, they have an asset in Caravan, which I think is a relatively new acquisition. So people aren't as familiar with, but they as – that is a scaled platform that today is participating in MSSP and has a documented track record of actually generating savings. And one of the reasons I like that as a quality metric is there's no coding in there, right. So that is about really saving healthcare costs. And so, I think they have the right technology. And there's a logistical element of this too, right, which is getting people to the right places, knowing who those people need to go see. I think for the future, what's really most exciting is the ability to bring care delivery together with a technology-enabled MSO option.

I think that will actually be the long-term model that succeeds in this space. It's not just getting to the independent health systems or docs and getting them the information, but the actual interventional capability that you might have with sort of a clinical home capacity. And frankly, we can use our MinuteClinics and other CVS assets to bolster this. I think that's a really winning formula, I think, in the long run around value-based care. And they have all of the important componentry to sort of do that.

Question – Ricky R. Goldwasser: It's sort of that idea that in order to take risks, you have to have scale, right. You have to have subscale and you have to have...

Answer – Shawn M. Guertin: Right.

Question – Ricky R. Goldwasser: ...kind of like enabling technology, and that's ultimately where we're heading?

Answer – Shawn M. Guertin: Yeah. I mean, we've talked a lot about our acquisition strategy, management, technology, scale.

Question – Ricky R. Goldwasser: Yeah, yeah.

Answer – Shawn M. Guertin: And I think in addition to checking the capability boxes, this checks those boxes as well.

Answer – Karen S. Lynch: And I think the other thing, Ricky, I would say that you have to really think about the power of the size of – Signify's home-based activities coupled with us having a large retail footprint and the power of that coming together to really coordinate care for members is a unique opportunity for us as well.

Question – Ricky R. Goldwasser: So, let's talk a little bit about that, about the consumer as we think about the member. And you have these 360 vantage point in a way. What tools are required to speed up their transformation into a truly consumer-centric system? Everybody talks about the consumer.

Answer – Karen S. Lynch: Yes.

Question – Ricky R. Goldwasser: But how do we really kind of like become these empowered consumers?

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Answer – Karen S. Lynch: Yeah, let me put it in perspective. I think you know at the heart of what we do is very focused on consumer. And I always think about what gets me up every mornings get excited, it is the power of our company and our reach and the breadth of capabilities with consumers.

I would start with, Morning Consult just named us the most trusted brand in our industry and we are the fifth most trusted brand in all industries. And I think that speaks to the connection we have with consumers. And just to give you a sense for that reach – the reach with consumers. We have 100 million people that we interact with through our Aetna and our pharmacy business, 5 million people walk into our stores every single day. We've – 85% of Americans are within 10 miles of our retail locations. We have 45 million unique digital customers. And I think if you think about just the breadth and the scale of our interactions with the consumer, those numbers speak volumes.

So as you think about our opportunities going forward, we have the reach, we have the engagement, we have the digital connections, we have the retail connections, we have the home connections. So we can meet consumers wherever they are on their entire health journey. And that's the power of our company when it comes to the consumer.

Do you want to add anything?

Answer – Shawn M. Guertin: That's perfect.

Question – Ricky R. Goldwasser: So let's switch from Signify. We're still going to be on the consumer, right, because ultimately they're the ones that driving demand. And I want to talk a little bit about the macro because that is a question clearly that's on everybody's minds. There was some discussion about that yesterday from the MedTech companies that presented here. So let's first start with kind of like here and now (00:09:51) what are you seeing in terms of utilization trend?

Answer – Shawn M. Guertin: Yeah. I would say that it's largely been similar to what we've seen all year, right, both by product and by type of service, right? We're continuing to obviously see a lot of COVID activity, but not the severity that we've seen, sort of, in past waves. And across the board, the trends in the second quarter were a lot like we saw in the first quarter in terms of where we see the biggest weaknesses in inpatient hospital compared to, sort of normalized baselines, right, which are going back a few years now when we trend them. And I would say commercial is a lot closer to being at a normal level than the government programs have been.

So it's been a fairly, I think, stable environment this year. I think as we think about that, the other dynamic obviously that's important to appreciate now is that we've been able to put all this into product pricing for the first time, right, in a full and complete way and think about all the different dynamics. And in that way, right, we're sort of back to where we used to be, right? This is now about matching revenue to costs and looking at that sort of performance. But overall, it's still been a fairly stable environment and been consistent with our expectations.

Question – Ricky R. Goldwasser: And as you think about – we hear a lot of – there's a lot of economic data, right, and some of it is conflicting. We still have very low levels of unemployment, but then there's all these concerns that we're hearing and we're hearing about layoffs from some pretty prominent companies. How is this shaping your view as you think about kind of like 2023?

Answer – Shawn M. Guertin: Yeah. So, I mean, there's really sort of two impacts to our business, right, that there's one which is just sort of the macroeconomic effects around employment and utilization. And for the most part, we've been able to navigate that fairly well, right? The inflationary elements in our business you can see, but they're certainly not as pronounced as we've seen in many of the headlines, kind of numbers in the high-single digits. We're not really seeing it in pharmacy yet. We do see it to some extent in front of store and we do see it to some extent in provider contracting on the HCB side. But I think that's proven manageable. From a volume standpoint, we're not really seeing – we're still seeing good membership sort of growth in our businesses.

And so, that all feels good. A lot of this, when you think back at history, has to do with the depth sometimes of the recession and what if, there's a lot of resiliency in our business against that. But obviously, there are times when the depth of the recession and frankly, governmental intervention into that, sort of. That's when we started to create some of the discontinuities in our business. So, we were watching for that, but doesn't feel like we're near that.

Really, the more perhaps effect (00:12:43) on our results has been interest rates and it's just because we have such a large fixed income investment portfolio that supports the insurance business. The effect of that on our business has been more pronounced. Again, that's a short-term strain, but also a long-term good guy. And what I mean by that is as we reinvest new money, we're reinvesting it at much higher rates than we've had, frankly, the last 10 years. And I think people forget how big a component in at least in the managed care world, that investment income was for a long time to sort of a revenue stream. And again, it'll take time as we reinvest the portfolio. But this short-term pain that we're feeling now in the realized capital gain area will eventually also lead to sort of higher net investment income.

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So, it's certainly something we talk about every day and we navigate. And there's – you can see different strains and pushes and pulls. But (00:13:36) I think, we've done okay. I'd be remiss if I didn't say I think the fact that we acted on minimum wage early has really helped us a lot sort of the labor side of this equation as we've gone into this. And it's not to say that that's not still challenging to some degree, but I do think it's given us an element of stability as well.

Question – Ricky R. Goldwasser: So, it sounds like, right, if I step back and it sounds like if I think about what you just said back to sort of that enterprise, right, diversified approach is kind of like that idea that you have the different moving parts. Even with inflation, yes, it's continuing, but it's not at the same pace that we've seen this year as we think about next year then you have interest rates.

So, they're kind of like headwinds and tailwinds. But overall, you're seeing net-net seems to be in line with sort of how you've thought about things when you kind of like gave us the targets back in December.

Answer – Shawn M. Guertin: Yeah. I think it's (00:14:34) certainly had to think about unit cost inflation...

Question – Ricky R. Goldwasser: Yeah.

Answer – Shawn M. Guertin: ...say, in our HCV business and make sure we have appropriate provision for that in our forward pricing, right. You can see it. It's there. But again, like a lot of things, this is all about being able to plan and price for these things and work them into our planning process. And so far, we've been able to navigate that.

Answer – Karen S. Lynch: And we're pulling lever. So, if you think about the retail business, we can push to CVS branded products. We can use our discounts through our care passes. There's lots of things. And to your point, this is a broad diversified portfolio and we have kind of the pushes in the pulls and we have different levers that we can pull across the continuum of businesses.

Question – Ricky R. Goldwasser: So, if we are in the topic of earnings power, there's a question that I've been getting from people here in the room. And by the way, if you have any questions for Karen or Shawn after this question (00:15:32) and we're going to get you a microphone because we want to make sure that we get all your questions answered.

But one that I got earlier in the day is really about the COVID comparison. So clearly, there was an EPS contribution from everything related to COVID in 2022. We're seeing companies, right, that have underestimated the pull forward of demand from COVID and now are have to revise their numbers. And I think that that's something that's very, kind of, like – it's on investors' mind. So, as you think about 2023 and, sort of, is it $0.80 or $1, sort of, in earnings impact benefit from COVID in 2022, how are you thinking about that sort of kind of like year-over-year comparison?

Answer – Shawn M. Guertin: So...

Answer – Karen S. Lynch: Go ahead.

Answer – Shawn M. Guertin: Yeah. So I think I, sort of, take the HCV business and, sort of, push that a little bit to the side and say this is now about matching price to cost, right, which we've largely done. There will be a COVID element, but this is about how do you feel that we've done sort of putting that into price. And this year, we've done I think a very good job of that, and I think you throw unit cost inflation in there and you sort of have that pricing equation. But that's what that will be all about. And I think we're in a good position on that business as we go into 2023 from a pricing point.

So, this really comes down to retail. And just to be clear, when we – in 2021, we probably had nearly $4.5 billion of revenue from what I call the explicit COVID sources, the over-the-counter test kits, the vaccine administration, and the diagnostic testing that we did through MinuteClinics and things like that. When we came into this year, we thought that would be about $1.5 billion and the marginal contribution of that business is around 50%. So that's sort of what we had just coming in. We now think that will be closer to $3 billion for this year just really given the demand sort of to your point.

The way to think about this and though – and is the same way that I and Karen have challenged these business leaders. When we were at Investor Day, we had this business at about $6.1 billion and that's what we charge our leaders with producing. It's not obviously going to be our most dynamic growth business, but we've asked them to at least hold that business flat while we go through this strategic transition. There's a lot of things, as Karen mentioned, there's assets in that portfolio that enable the strategy. Obviously, it generates a lot of cash.

So, the question then becomes, how do we solve for $6.1 billion with all of the things going on in that business? And so, I think if you kind of reset the year back to where we thought about, you start first with what will the COVID contribution be and whilst – I think it will not be zero, but I think, will it be all the way back to where we thought coming into this year? Maybe not. But there's other levers that we have coming online here like the store closure,

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the effect of the store closures, right, which begins to be accretive in 2023 and 2024. It's something that contributes and there's – to Karen's point, there's levers that we pull all the time in this business to try to make that sort of navigation.

I also think there is some, and I'll call it sort of almost like an endemic tail benefit that's what COVID-related and non-COVID related. We've seen incredible strength in the front of the store for the last five quarters, and there, I think we will get some continuity for at least a while from that. How this ripples through to sort of other respiratory illness treatment, other vaccines, I think is also going to be something that we can continue to capture as a positive. We've done some new things in retail like buy-online-pickup-in-store, which is not a new – it's not a new kind of idea, but it wasn't something we were doing and I think that can have incremental benefit.

So I think there's a number of incremental benefits. But what I've directed everybody to, is to sort of the same thing we've directed our internal team to as I need you to produce $6.1 billion out of that business. And I know you might have to pull a lot of levers and I know COVID is going to move, but I also don't think COVID is going away either.

Answer – Karen S. Lynch: And I would say that the benefits of COVID 45 million people kind of interacted with us or even more for vaccines. We've seen 15% of those individuals come back for – and have a relationship with us. And we've seen the script share coming up. We've been able to manage our labor and keep our stores stable and open at the same time while we're closing. We've retained over 70% of the scripts. As we're closing stores, we retain those people. So, I don't want people to forget the value of COVID and the continuation of that customer engagement. It's a powerful asset for us as well.

Question – Ricky R. Goldwasser: So, any questions? Okay. I guess we're doing a good job of addressing all the questions. So, next, let's talk a little bit about Medicare Advantage. Clearly, it's a very important business for you, a very important business. Just very important marketplace. Increasingly competitive, always has been, but it seems that it's getting more and more. In the last few years, you've gained share quite nicely. As we think about that business beyond just kind of like one year, what do you need, right? What assets do you need to have in order to stay competitive in that business? Because I do think that as time goes by, the business will become more and more competitive. It's just the growth cycle, right, of that population?

Answer – Karen S. Lynch: Yeah. I think it's important to recognize, when you think about Medicare for us, we're in the group Medicare business. We're in the individual Medicare business. We're in the PDP business. We have the largest PDP. We are Med Supp business. So, there are lots of product offerings in Medicare for us. And if you think about this year, we've reached a major milestone in our individual book of over 2 million members, and that was a big milestone. You're right, Ricky, it is a competitive market. But as you think about what our assets are, we have the opportunity to have innovative products because of the unique capabilities that we have at the company.

The ability for us to offer the MinuteClinics for example, we continue to invest in innovation. Digital will continue to be an area of opportunity for us. We have the Medicare resource centers that we use in those locations – in our retail locations where we can engage with our members. Our Signify asset is another opportunity for us as we think about the potential of Medicare. So, there's a lot of unique capabilities that we have. Signify, obviously, as we think about it, investing in digital and obviously keeping our star ratings performance is paramount for us.

What I missed?

Answer – Shawn M. Guertin: The only thing I would add is in defining our strategy, right, that question actually was at the heart of (00:22:58). As Karen articulated, there's a real business opportunity. We have to do something differentiated from a care delivery perspective. But I'd also say that when you – as well as our Medicare Advantage product has done, which has been exceptionally good, the idea going forward, though, is if you look at our two bigger competitors in Medicare Advantage, they have fairly well-articulated care delivery strategies. And so, strategically, that's a flank we need to address. And I think when I think about the business to the kind of in the context of your question beyond one year, that's one of the reasons why I think this strategy also makes so much sense for us and that is not only offense. It actually also sort of bolsters this very, very important product. And so, I think, continuing to execute on our strategy around provider enablement and home and care delivery is actually very, very important strategically to this business in the long run as well.

Question – Ricky R. Goldwasser: Makes sense. And at the end of the day, when I – you think about sort of the landscape, the competitors, at the end of the day, it's really kind of the assets that fit your existing assets.

Answer – Shawn M. Guertin: Correct.

Answer – Karen S. Lynch: That's right.

Question – Ricky R. Goldwasser: Right. Biosimilars, so to me, biosimilars is when we think about 2023 and 2024, probably, one of the most interesting opportunities. And I think to me, what's so interesting about it is the fact that, there's newness to it. We haven't seen yet a pipeline that is so focused on a pharmacy-type drug. But I also think that there is some confusion in the marketplace because investors haven't seen it yet. And just curious to get kind

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of like from what – from your perspective, what do you think the market is missing about the PBM, right, and specialty pharmacies' role in this new product cycle that we're seeing?

Answer – Shawn M. Guertin: Yeah. So I think, part of it, right, is I – if you started with this, if you asked customers, right, about after price why are they making a PBM decision, it would really be about the capabilities that you have in specialty pharmacy to not only manage costs, but to provide the right experience for the consumer and the provider. Because at times, there's a fair amount of complexity right in the delivery of this. And it's something I think that we've excelled at. A little bit of a misconception is we haven't seen it yet, right. We've seen the tip, right. There has been examples. And the economic model that we sort of talked about has manifested itself. It's just not been in the way like the next 5 to 7 years might be. But there are individual examples of some of these coming on market, thus, getting a lower cost just like happened on pills and tablets with generics, getting a better cost to the consumer, and actually having that be beneficial to the PBM as well.

So, the unit economics of the idea sort of have – sort of are underway, right. And I think some of this has, at times, when we've talked about this got conflated to being like something about 2023 and partly because that (00:26:20) so big, I forget it. But I think as we've thought about this, I would sort of boil it down simply to say, if you thought about this business, maybe it's a mid-single-digit growth business systemically, but this particular opportunity can probably add a little bit to that over the next 5 to 7 years as we roll this out. It is likely the timing will be a little choppy, because sometimes it's unpredictable. Sometimes this has to do with interchangeability, multiple agents, and things like that, and that can be a little trickier to predict. So, I think we can debate the timing of it. So, do I think everything's going to kick in on 02/01/2023? No, not necessarily when you look at the specifics. But when I think about this over a 3, 5, 7 year period, I think there is a longer term opportunity that will benefit both the consumer and the PBM.

Question – Ricky R. Goldwasser: Makes a lot of sense. And one thing that I'll go back to, as you said, we've actually seen...

Answer – Shawn M. Guertin: Correct.

Question – Ricky R. Goldwasser: ...this in the past. Maybe...

Answer – Karen S. Lynch: That's right.

Answer – Shawn M. Guertin: Yeah.

Answer – Shawn M. Guertin: ...it wasn't in the context of biosimilars in specialty, but we saw those in generics...

Answer – Karen S. Lynch: That's right.

Question – Ricky R. Goldwasser: ...which will be interesting to watch what's going to happen with the pricing dynamics.

Answer – Shawn M. Guertin: Correct.

Question – Ricky R. Goldwasser: Perfect.

Answer – Shawn M. Guertin: Right.

Question – Ricky R. Goldwasser: Okay. So, I think we have time for one more question. And we started with M&A, we started with Signify, and I'm going to circle back to that. As we think about the M&A environment, I mean, you've clearly articulated your strategy back in the Analyst Day in 2021. But over the last few months, we started to see a step up, right, in activity and we're seeing non-traditional players coming in.

And I would say that up to a few months ago, we could have debated what will Amazon do or not do in health care, but now they are. They're doing and we're seeing them more involved. I think for us, what's most striking is the speed at which they operate. So as you think about that as you kind of like look at this new information that we have in the market, how is this sort of shaping your thoughts and sort of the urgency, right, around doing things?

Answer – Karen S. Lynch: I think we – we're urgent. Obviously we're very urgent. Just ask our teams. And I think, if you think about our strategy, we really we've been very clear that we want to extend into care delivery. And, we're starting with Signify. We can't always determine the order. Obviously, primary care is something we believe we need to advance because we really want to enable consumers to have a differentiated experience and improve health outcomes.

So we're playing our games. We have a continuum of health care capability, starting with the financing through insurance, with the PBM, through retail health, through in-home when we do make the acquisition. We're missing that one piece. I'll let Shawn talk about the M&A environment, so to speak. But I think that we have a very clear

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strategy. We're executing on that strategy and we're moving at the pace that I want to move faster, but if the market doesn't let me move as fast as you always want to move, but [I don't if you have...

Answer – Shawn M. Guertin: Let the bruises on my shins shows that we have a sense of urgency down this issue. But what I would say is no part of our strategy was ever premised on our biggest competitor sitting idly by, right. We always knew that there would be response that we'd have competition.

The other thing that I would just say that's important is so much of this always revolves around the valuation discussion and that is obviously important getting a deal done. But this is about capabilities for us. And when I reflect on my time in deals that didn't work out so well, it wasn't because of valuation. It was because we misread something about the capabilities, the management team, the techno – whatever it is, right.

So, there's as much work we're putting in thinking about are these the right capabilities for our portfolio of assets to enable our strategy in addition to valuation. And so, that is an important part of our thinking. And I think that is something that while it can take a little time, but it's important to sort of be delivered about where we go through this. But I still have a lot of confidence that we can execute our strategy as we articulated it, notwithstanding sort of the activities of others.

Great. Well, Karen and Shawn, thank you. It's always a pleasure.

Thank you.

Thank you, Ricky.

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