Q1 2023 Earnings Call *(Corrected version)*

Event Details

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Company: CVS Health Corp.
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Company Participants

Laurence McGrath - CVS Health Corp., SVP-Business Development & Investor Relations
Karen S. Lynch - CVS Health Corp., President, Chief Executive Officer & Director
Shawn M. Guertin - CVS Health Corp., Chief Financial Officer & Executive Vice President
Michael T. Pykosz - Oak Street Health, Inc., Chairman, Chief Executive Officer & Co-Founder
Daniel P. Finke - CVS Health Corp., Executive Vice President & President-Health Care Benefits
J. David Joyner - CVS Health Corp., Executive VP & President-Pharmacy Services
Kyle Armbrester - Signify Health, Chief Executive Officer

Other Participants

A.J. Rice - Analyst
Lisa C. Gill - Analyst
Justin Lake - Analyst
Michael Cherny - Analyst
Eric Percher - Analyst
Kevin Caliendo - Analyst
Brian Tanquilut - Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning and welcome to the CVS Health First Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the 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 Larry McGrath, Senior Vice President of Business Development and Investor Relations for CVS Health. Please go ahead.

Laurence McGrath

Good morning and welcome to the CVS Health first quarter 2023 earnings call and webcast. I'm Larry McGrath, Senior Vice President of Business Development and Investor Relations for CVS Health. 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'll host a question-and-answer session that will include additional members of our leadership team. Daniel Finke, President of Our Health Care Benefits segment; Michelle Peluso, Chief Customer Officer and Co-President of our Pharmacy & Consumer Wellness segment; Prem Shah, Chief Pharmacy Officer and Co-President of our Pharmacy & Consumer Wellness segment; David Joyner, President of the Pharmacy Services business within our Health Services segment; Kyle Armbrester, Chief Executive Officer of Signify Health; and Mike Pykosz, Chief Executive of Oak Street Health.

Our press release and slide presentation has been posted to our website, along with our Form 10-Q that we filed this morning with the SEC. Today's call is also being broadcast on our website where it will be archived for one year.

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During this call, we will make certain forward-looking statements reflecting current views related to our future financial performance, future events, industry and market conditions, including impacts related to COVID-19, as well as the expected consumer benefits of our products and services, and our financial projections and the benefits of the Signify Health and Oak Street Health acquisitions and the associated integration plans, expected synergies and revenue opportunities.

Our forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from currently projected results, including with respect to COVID-19 and the integration of both the Signify Health and Oak Street Health acquisitions. We strongly encourage you to review the reports we file with the SEC regarding these risks and uncertainties. In particular, those that are described in the cautionary statements concerning forward-looking statements and risk factors in our most recent annual report filed on Form 10-K, our quarterly report on Form 10-Q filed this morning and our recent filings on Form 8-K including this morning's earnings press release.

During this call we will use non-GAAP measures when talking about the company's performance and financial condition and you can find a reconciliation of these non-GAAP measures in this morning's press release and in the reconciliation document posted to the Investor Relations portion of our website.

With that, I'd like to turn the call over to Karen. Karen?

Karen S. Lynch

Thank you, Larry. Good morning, everyone, and thanks for joining our call today. This morning, we reported strong first quarter results that demonstrate excellent performance across CVS Health. We successfully closed the acquisitions of Signify Health and Oak Street Health and are updating our projections to include the financial impact of both transactions.

We are revising our full year 2023 adjusted EPS guidance to a range of $8.50 to $8.70 reflecting positive contribution of our strong underlying results and the impact of the Signify Health transaction, which enable us to partially offset the dilution from the early close of Oak Street and the financing costs for both transactions. Shawn will discuss the details of our updated outlook for the year shortly.

We are purposely executing on our strategy as we continue to expand our health platform of capabilities to serve a broader customer and consumer base. We are addressing the total cost of care, improving health and expanding access to affordable quality care. Today, we are announcing changes to our operating model and Financial Reporting that more accurately reflect how our businesses are managed. These changes allow us to be more nimble in our execution and more innovative when expanding our products and services. We are excited about accelerating our momentum by unlocking long-term value across our businesses and the broader health care marketplace.

Beginning this quarter, we will report our results as follows. First, our new Health Services segment unifies most of the former operations of our Pharmacy Services segment as well as our Health care Delivery operations including primary care, retail health clinics, home-based care services and provider enablement capabilities. This structure will simplify access to our multi-payer capabilities, better align the way we serve clients and create superior health experiences for consumers.

Together, these businesses are positioned to more effectively address the total cost of care, implement new care models and deliver connected solutions that build sustainable health communities. These combined businesses serve more than 110 million people, have more than 20,000 colleagues and in 2022 reported combined revenues of nearly $170 billion.

We also created a new Pharmacy & Consumer Wellness segment that integrates all of our omni-channel pharmacy capabilities, traditional retail pharmacy, specialty and mail-order pharmacy fulfillment and infusion services, along with our front store offerings. We are making the pharmacy experience as easy for consumers as possible while ensuring that we're creating better outcomes, lowering costs and increasing convenience.

These combined businesses serve more than 120 million people, deliver more than 1.6 billion scripts annually, have

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more than 220,000 colleagues and in 2022 reported combined revenues of nearly $109 billion. The Health Care Benefits segment remains largely unchanged and will continue to offer a full range of insured and self-insured medical, pharmacy, dental and behavioral health products and services. This business serves more than 25 million medical members, has more than 40,000 colleagues and in 2022 reported revenues of more than $91 billion.

Turning to our performance in the quarter. We grew total revenue to more than $85 billion, an increase of 11% versus the prior year, and delivered adjusted operating income of $4.4 billion. Adjusted EPS was $2.20. We had another quarter of robust cash flow from operations generating $7.4 billion. Each of our businesses delivered strong performance in the quarter.

Starting with the Health Care Benefits segment, we grew revenues to nearly $26 billion, an increase of more than 12% and delivered adjusted operating income of $1.8 billion. Overall medical costs were well-controlled and in-line with expectations.

Membership in the first quarter increased by 1 million members versus the prior year. This growth was primarily driven by the significant increase in our Individual Exchange business. Our Medicare business remains one of our strongest growth segments. We recently announced that the City of New York awarded us its Group Medicare Advantage plan contract that begins in September 2023. The City of New York is one of the largest client wins in Aetna's history. We look forward to providing access to high quality, affordable and convenient health care to the city's more than 200,000 retirees and their eligible dependents. We now expect approximately 12% membership growth in our Medicare Advantage business for the full year 2023 and are diligently working to improve our competitive position in individual MA to return to market growth in 2024.

The recent award of two additional marquee Group Medicare Advantage contracts serving approximately 45,000 retirees and their eligible dependents will supplement that growth beginning in January of 2024.

Turning to our Commercial business, we ended the quarter with approximately 18 million members, a nearly 6% increase sequentially. In addition to the significant growth in our individual exchange members, this increase was also driven by growth in Key Accounts, Public and Labor and Small Group membership. These results reflect our strong value proposition, innovative solutions and service excellence.

In our Medicaid business, we increased membership in the quarter but expect declines for the rest of the year following expiration of the public health emergency. As Medicaid members face potential disruptions in their health benefits, we are using the full breadth of our portfolio of assets to help them avoid coverage losses and maintain positive health outcomes.

In our Health Services segment, revenues grew to nearly $45 billion, an increase of more than 12%. Adjusted operating income increased more than 14% to $1.7 billion. Our total pharmacy claims process in the quarter grew 3.7% versus the prior year, and 4.8% excluding COVID vaccinations. We continued to deliver strong results in our specialty business with revenue growth of more than 10%.

Our Pharmacy & Consumer Wellness segment delivered a strong quarter, successfully navigating challenging market conditions and normalizing COVID trends. Revenues grew to approximately $28 billion, an increase of nearly 8% versus the prior year. We generated $1.1 billion of adjusted operating income in the quarter, a decrease of approximately 28% from the prior year, largely due to lower COVID-related contributions.

Performance was strong in both the pharmacy and the front store. Pharmacy revenue increased by 10% versus the prior year driven by product mix and prescription growth of 2.5%. Our growth in the retail pharmacy is notable and has resulted in significant market share gains over time. This is a testament to the value we provide our pharmacy patients and the investments we have made to improve their experiences. Front store revenues grew by 5% or nearly 8% on a same-store basis driven by the strength across a variety of categories including beauty and personal care, as well as consumer health products.

We continued to successfully execute on our retail footprint optimization strategy, closing more than 100 locations year-to-date, while exceeding our retention goals for colleagues and scripts. We remain on track to close 300 stores in 2023 and a cumulative total of 900 stores by 2024.

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Turning to our progress on our strategy, nearly 18 months ago, we outlined a bold shift in our strategy and shared our vision to become the leading health solutions company for consumers. Our goal is to redefine health care by creating a model that is convenient, affordable, connects care and puts the patient at the center.

Achieving this vision requires the right set of capabilities to serve a broader patient, customer and community base. At the center of our vision is a value-based platform that is multi-payor, multichannel and successful at driving consumer engagement, all leading to improved health outcomes. Importantly, as I highlighted earlier, we have completed the acquisitions of Signify Health and Oak Street Health. These acquisitions significantly advance our value-based strategy by adding primary care, home-based care and provider enablement capabilities to our platform. They also bring cutting-edge technology and talent that will accelerate innovation in areas such as automation, analytics and technology-enabled data-driven product development.

These premier growth businesses strongly enhance our ability to execute our care delivery strategy. Signify Health has a proven track record of identifying gaps in care and returning patients to care in close collaboration with their payor partners. They have demonstrated their ability to continuously innovate and evolve, further enhancing their value to their payor partners.

Signify has a substantial pipeline of opportunities to enhance their position. This includes updating their in-home evaluations to continue to accurately document conditions and diseases while adapting to CMS risk model changes. We will also introduce a Stars enablement offering that will provide meaningful benefits for all payors.

Oak Street Health has a powerful combination of strong patient engagement, high-quality care and integrated technology that connects care experiences. These capabilities make Oak Street Health the premier clinic-based provider in the ecosystem today and uniquely positions them to manage the risk adjustment changes recently implemented by CMS. The early close of the acquisition will be a short-term headwind to our 2023 adjusted EPS, but will enable us to unlock synergies earlier and evaluate all options to accelerate growth at Oak Street and CVS Health.

More importantly, the combination of Signify, Oak Street and CVS Health creates a value-based person-centered care platform propelled by the powerful connections between our unique capabilities and assets. This will enable us to drive better patient experience and health outcomes while delivering on our long-term financial goals.

We are also making progress on driving integrated value across our foundational businesses. We serve 2.9 million members who are enrolled in our integrated medical and pharmacy plans. For members that utilize our integrated offerings, we are driving higher rates of medication adherence, up to 15% lower hospital admissions and re-admission rates, up to 19% reductions in ER visits, and 25% greater utilization of critical mental health care.

Overall, these integrated plans offer members access to quality, better coordinated care and improved health outcomes. As we continue to extend our capabilities, we will develop more powerful connections that drive superior patient experiences, better outcomes and lower costs.

We remain critically focused on digital engagement and achieved a significant milestone this quarter, exceeding 50 million unique digital customers. These customers are driving meaningful results with digital sales in the quarter up more than 30% versus the prior year. Engagement levels are strong as these customers spend 2.4 times more than our non-digitally engaged customers and at higher margins. We continue to drive innovation and expand our digital offerings to meet customers' needs.

Last month, we released our 2022 ESG report highlighting the progress we're making towards our ambitious goals. We continue to build on our achievements, including signing two additional renewable energy purchases that meaningfully advance our transition to 50% renewable energy by 2040.

Before I turn the call over to Shawn, I'd like to talk about recent regulatory actions and how our businesses are positioned to successfully navigate through the impact in the months and years to come. We have a long history of successfully working within Medicare Advantage funding levels to support program stability for our members. We're building on that experience to drive more care to value-based arrangements and to clinical care programs that deliver better outcomes and improved member experiences.

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Our strong capabilities enable us to navigate the current environment and deliver offerings that our customers value. We appreciate CMS's approach to provide a three-year phase-in for the risk adjustment model changes. This will allow the industry to work within the guidelines and to reduce disruptions faced by members.

We support CMS's goal to increase the value of risk coding and believe coding should capture the true picture of a patient's health including risk factors, identifying care gaps in patient needs and ultimately driving better outcomes. Aetna, Signify Health and Oak Street are the right combination of assets to successfully manage through these changes. Each have robust processes and infrastructure to handle the increasing complexities in patient care and reimbursement. They also bring an incredible expertise that allows us to quickly evaluate the impacts from these changes and rapidly implement the necessary operational updates to excel in this dynamic environment.

I also want to address the recent regulatory focus on the PBM industry. PBMs have consistently been found to operate in a highly efficient market and drive real savings to health care customers and members. Every day, we deliver product choices for our clients and their members that help make care more affordable, accessible and simple. Our business is centered on transparency, innovation and simplicity, which strengthens our ability to meet customers and health plan client needs and most importantly, drive towards the lowest net cost.

Finally, I want to thank our dedicated CVS Health colleagues for their commitment and extraordinary work driving our vision forward.

I'll now turn the call over to Shawn for a deeper look into our financial results and outlook for the year.

Shawn M. Guertin

Thank you, Karen, and good morning, everyone. Our first quarter results reflect the continuation of outstanding performance from each of our business segments as we delivered strong revenue growth, cash flow from operations and adjusted earnings per share. These results are driven by our steadfast focus on growth, operational execution and supporting the communities we serve.

A few highlights regarding total company performance. First quarter revenues of $85.3 billion increased by 11% year-over-year reflecting strong growth across each of our businesses. We delivered adjusted operating income of $4.4 billion and adjusted EPS of $2.20 representing decreases of 5.1% and 4.3% versus prior-year respectively, primarily due to lower COVID-19 contributions in the current year.

Our ability to generate cash remains outstanding with cash flow from operations in the quarter of $7.4 billion. Cash flows in the quarter benefited from the timing of CMS payments that are expected to normalize by the end of the year. As Karen mentioned in her prepared remarks, beginning this quarter we have resegmented our businesses and our financial reporting to more closely align with how they are managed. I will discuss our first quarter 2023 results and provide comparisons against the prior year based on our new structure. After reviewing the results, I will update our 2023 guidance under the new segmentation.

Starting with Health Care Benefits. We delivered strong revenue growth versus the prior year. First quarter revenue of $25.9 billion increased by 12.1% year-over-year. Membership grew over 4% on a sequential basis reflecting significant growth in Individual Exchange members as well as increases across all other product lines.

Adjusted operating income of $1.8 billion in the quarter declined slightly versus the prior year. This was driven by the expected return to more normalized utilization as the effect of COVID waned and by the lower impact from prior year reserve development. These decreases were largely offset by higher net investment income and membership growth across all product lines during the quarter.

Our medical benefit ratio of 84.6% increased 120 basis points year-over-year reflecting more normalized utilization including the impact of higher flu as compared to last year and modestly lower impact from favorable prior-year development. Our assumption was always that our 2023 medical cost seasonality by business would look more like pre-pandemic patterns. We believe that the consensus estimates for quarterly MBR may have relied too heavily on recent experience that was impacted by COVID-19.

Overall utilization trends remain in-line with expectations. Consolidated days claims payable at the end of the

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quarter was 48.1, down 3.2 days sequentially. This is more in-line with historical levels of days claims payable for the first quarter in pre-pandemic periods. Overall, we remain confident in the adequacy of our reserves.

Our Health Services business, which includes most of the operations of our legacy Pharmacy Services segment as well as our Health care Delivery operations generated revenue of approximately $45 billion, an increase of 12.6% year-over-year. This increase was driven by pharmacy claims growth, specialty pharmacy, and brand inflation, partially offset by continued client price improvements. While results from both Signify, which closed in March, and Oak Street, which closed yesterday, will be included in this segment going forward, the timing of the close of Signify resulted in an immaterial impact of first quarter 2023 results.

Adjusted operating income of nearly $1.7 billion grew over 14% year-over-year driven by improved purchasing economics and increased pharmacy claims volume. This was partially tempered by ongoing client price improvements and lower COVID-19 testing. Total pharmacy claims processed in the quarter increased by 3.7% above the prior-year and 4.8% when excluding COVID-19 vaccinations. This increase was primarily attributable to net new business in 2023, increased utilization and the impact of an elevated cough, cold and flu season.

Total pharmacy membership remained steady, exceeding 110 million members. In our Pharmacy & Consumer Wellness segment, we delivered strong revenue growth despite continued economic uncertainty and lower COVID-19 contributions. During the first quarter, revenue of $27.9 billion grew nearly 8% reflecting increased prescription and front store volume, pharmacy drug mix and brand inflation. These increases were partially offset by continued reimbursement pressure, decreased COVID-19 vaccinations and diagnostic testing and the impact of recent generic introductions.

Adjusted operating income of $1.1 billion declined 27.9% versus the prior-year driven by reimbursement pressure and decreased COVID-19 vaccinations and testing as well as increased investments in operations and capabilities. These decreases were partially offset by increased prescription volume and improved generic drug purchasing.

Pharmacy prescription volume grew 2.5% year-over-year reflecting increased utilization and elevated cough, cold and flu volume compared to the prior year. Excluding the impact of COVID-19 vaccinations, prescription volume increased by 4.5%.

Turning to the balance sheet. Our liquidity and capital position remain excellent. Through the first quarter we generated cash flow from operations of $7.4 billion, bolstered by the CMS prepayment I discussed earlier, and ended the quarter with approximately $2.7 billion of cash at the parent and unrestricted subsidiaries.

During the quarter we issued approximately $6 billion of long-term debt for general corporate purposes, including funding the Signify transaction. The Oak Street transaction was funded with available resources including proceeds of $5 billion from a term loan that closed earlier this week.

We repurchased approximately 22.8 million shares in the quarter and through our quarterly dividend we returned $779 million to shareholders. We remain committed to maintaining our current investment-grade ratings while preserving flexibility to deploy capital strategically.

A few other items worth highlighting for investors. First, as previously noted, beginning this year, the impact of net realized capital gains or losses will be excluded from adjusted operating income. Net realized capital losses in the three months ended March 31, 2023, and 2022 were $105 million and $75 million respectively.

Second, we recorded an additional loss on assets held-for-sale associated with our Omnicare long-term care business of $349 million. We also recognized acquisition-related transaction and integration costs associated with the Signify and Oak Street transactions as well as additional office real estate optimization charges in the quarter for a total of $68 million.

Finally, effective January 1 of this year, we adopted a new standard related to the accounting for long duration insurance contracts. Our results will reflect this change going forward. The retrospective adoption of the new Accounting Standard also required us to revise our net income for 2022. This change positively impacted our first quarter 2022 results by $42 million and our full year 2022 results by $162 million.

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Before we provide our updated expectations for 2023, I want to discuss the impact of our business resegmentation had on our financials. The primary impact of resegmentation that I want to highlight is the revised treatment of our Maintenance Choice product. Previously, the economics of Maintenance Choice were reflected in both our Pharmacy Services and Retail segments, regardless of where the drugs were dispensed, and drove a large intersegment elimination.

After resegmentation, the economics of Maintenance Choice will only be reflected in our Pharmacy & Consumer Wellness segment which now includes all pharmacy, mail and specialty fulfillment operations. This change correspondingly results in the discontinuation of adjusted operating income eliminations and provides greater simplicity for investors.

In addition to the changes related to our treatment of Maintenance Choice, we shifted our legacy care delivery operations, including MinuteClinic, from Retail into our Health Services segment. This is also where our recently acquired Signify and Oak Street businesses will be reported.

Turning now to updated guidance based on our new segments. Beginning with the Health Services segment, our new adjusted operating income guidance is a range of $6.61 billion to $6.73 billion. This estimate reflects the resegmentation changes previously described, the impact of emerging risks to the 340B program, and the inclusion of Signify Health and Oak Street Health acquisitions, partially offset by underlying strength in our Pharmacy Services business.

For the Health Care Benefits segment, we now expect adjusted operating income of $6.39 billion to $6.52 billion, benefiting from higher net investment income in the first quarter of 2023 and prior period development. We continue to take a prudent and cautious stance with respect to our Individual Exchange business inside our full year outlook.

In the Pharmacy & Consumer Wellness segment, our new adjusted operating income guidance is a range of $5.73 billion to $5.83 billion reflecting lower-than-expected COVID volumes as well as the impact of resegmentation. We are also updating our guidance for additional net investment income generated in our Corporate segment due to higher yields and higher average parent cash balances in the first quarter of 2023. We do not expect these higher corporate cash balances to persist in 2023 following the recent closure of both the Signify and Oak Street acquisitions.

Finally, our new projection for interest expense is $2.7 billion, reflecting the incremental financing costs for Signify and Oak Street. We are also updating our share count guidance to approximately 1.293 billion shares as our previously announced accelerated share repurchase transaction yielded more shares than initially projected.

In aggregate, the headwind of approximately $0.35 resulting from the impact of the Signify and Oak Street acquisitions and their associated financing, partially offset by underlying strength across the enterprise, result in a net headwind of $0.20. This brings our 2023 adjusted EPS guidance range to $8.50 to $8.70.

Shifting to our cash flow, we continue to anticipate strong cash flow from operations in 2023 and are maintaining our guidance range of $12.5 billion to $13.5 billion. Capital expenditures are unchanged at a range of $2.8 billion to $3 billion and we continue to project an adjusted effective tax rate of 25.5%.

I also want to provide an update on the progression of earnings for the year. Due to the strength of our results in the first quarter, the incorporation of Signify and Oak Street and the 340B headwind, we now expect second half 2023 earnings to be slightly more than 50% of the full year results, with the third quarter modestly higher than the fourth quarter.

We also want to highlight our expectations for quarterly MBRs. We continue to expect the year-on-year increases in MBR to be higher in the first half than the second half. This dynamic is due to COVID-driven lower utilization trends in the first half of 2022. We expect the MBR progression in the second quarter of this year to look similar to the trend in the first quarter.

Shifting now to our multiyear outlook, we remain committed to achieving the $9 and $10 targets for 2024 and 2025 that we shared during our earnings call in February. We take these commitments seriously and have aligned the organization and our operations to achieve these goals. As with any multiyear plan, new headwinds and tailwinds

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can emerge. Recently, there have been significant developments in the 340B program that create challenges for our pharmacy benefits business, and based on our most recent experience, COVID contributions may dissipate more rapidly than previously anticipated.

The early close of the Signify and Oak Street transactions improve our ability to accelerate synergy realization. In addition, our business resegmentation presents the opportunity to reduce duplicative efforts and enhance focus on rationalizing our core operations. We believe these opportunities, combined with the underlying strength of our business, and our commitment to evaluate all alternatives to accelerate growth and synergies from our new acquisitions, will enable us to mitigate the new headwinds I just discussed.

To conclude, our first quarter results reflect continued strength from all of our core business segments. We are excited to begin the work of integrating Signify and Oak Street into our operations and are pleased with the positive contribution of our foundational businesses on our 2023 adjusted EPS guidance. We will maintain our focus on growth and operational execution and look forward to keeping you updated as we continue to progress on our long-term strategy.

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

QUESTION AND ANSWER SECTION

Operator

We'll take our first question from A.J. Rice with Credit Suisse.

Analyst:A.J. Rice

Question – A.J. Rice: Hello, everybody. Thanks for all of the details. Maybe just on the focus on MA for 2024. Karen, in your remarks you mentioned that you feel like Oak Street is particularly well-positioned to absorb the pending changes around the risk adjustment and so forth. I wonder if I can get you to flesh that out a little more of what you all see in Oak Street relative to some of the other things perhaps you've looked at or whatever that makes you confident of their ability to make the adjustments or if they've already got things in place to do that?

And then maybe to follow-up I'll ask now to Shawn. You guys have laid out the mitigation steps that you are taking to offset the star rating headwind for next year. I wonder if you've got data (00:37:21) on what you're doing with respect to the one plan that got hit with respect to some of the cost reduction programs that you had talked about implementing and other things. Any update on that would be great.

Answer – Karen S. Lynch: Hi, A.J. Yeah, let me take a couple of those things. First of all, as I said in my prepared remarks, we do plan to get back to market growth in our individual MA product for a number of reasons. I'll start with the work that we've been doing on our – kind of in our Medicare product, making sure that we have strong benefits and strong service capabilities. We believe that Oak Street and Signify also give us credibility in the Medicare Advantage space.

We took a long, hard look at Oak Street and their ability to adapt to the Medicare Rate Advantage. The one thing that we were most impressed by was the level of commitment that they have relative to their patient care, and secondly, the technology platform that they have and I'm going to ask Mike to actually talk a little bit more about that, but I would say that they're a very strong performing business. We are excited about what their capabilities will bring to our Medicare and also other payor's Medicare because as you know it's a payor agnostic business, so a lot of the work that they're doing not only benefits us, it benefits their broader customer base as well. Mike?

Answer – Michael T. Pykosz: Thank you, Karen. I mean, to build on that, I think most importantly, the results we're driving, the economics from – with our patients really driven by the strength of our care model and we've been incredibly successful across programs, across different risk adjustment methodologies. For example, we work in the top 1% of the Medicare Shared Savings Program, where in that program we were the top-performing direct contracting (00:39:18). We've obviously achieved phenomenal results in Medicare Advantage, and so what underlines that is a robustness in the clinical model and an incredible medical leadership team and Karen noted a

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really strong technology platform, so when there are changes, we can adapt to those and implement them. And the consistency of our approach, the fact that we operate our centers in a consistent manner across the country really enables us to rapidly change as we need to but most importantly fundamentally what is driving the economics of Oak Street is great patient care and keeping people healthy and out of the hospital, and that's going to be durable regardless of how risk adjustment is done.

Answer – Karen S. Lynch: And let me ask Dan to talk a little bit about our recontracting efforts and what we're doing on Stars.

Answer – Daniel P. Finke: Yeah, so a couple of updates on the Stars program. First of all, on the contract diversification process, that is ongoing and as expected. We're beginning the operationalization of that as we speak, and then Shawn has talked in the past about the investments that we've made from an enterprise perspective with the enterprise focus to improve the clinical experience and member experience for our members. We continue to believe we have the right actions and the team in place. We have some positive momentum there.

As you know, we're between two important times in the rating cycle, the CAHPS survey is currently under way. The investments we've made in customer satisfactions are showing some internal measurement improvement and the member experience measurements. We're also wrapping up the HEDIS season and the team has been very focused on chart collection, and we're seeing some year-over-year improvement there, and all of these actions are added to our robust Stars program, and we look forward to this being reflected in our Stars outcomes going forward.

Answer – Karen S. Lynch: So, A.J., on that point I would just say I'm encouraged by what we're seeing on the internal metrics relative to our Stars performance.

Question – A.J. Rice: Okay. Great. Thanks a lot.

Operator

Thank you. Our next question comes from Lisa Gill with JPMorgan.

Analyst: Lisa C. Gill

Question – Lisa C. Gill: Thanks very much and good morning. Karen, I guess I want to switch gears a little bit and go back to your PBM comment around transparency, lowest net price. We continue to see a lot of chatter in D.C. around potential PBM legislation, around both changes to rebate, changes to spread pricing. Shawn called out changes to 340B having a headwind. There's the net-to-gross bubble popping when we think about influence, you think about these new drugs, GLP-1 coming to the market.

When we put all of this together, can you or welcome back to David Joyner, talk about your outlook for the PBM, how you're thinking about this, and any potential changes that you think will come about on the PBM side and what are you hearing more importantly from your clients as we think about these areas?

Answer – Karen S. Lynch: Hi, Lisa. First of all, I thought your report on the PBM industry was fantastic and let me – I'll just make a few comments on the PBM industry at large and I'll ask David to answer your specific questions.

I think, it's really important that we all recognize that the PBM's play an essential role in lowering drug costs and I think we all would agree that in fact, the PBM is the only player in the supply chain whose specific role it is to lower drug costs for our customers, and I think, we've had a number of investigations. They've consistently concluded that the PBMs operate in a highly efficient and effective manner to really deliver real savings, and I think, you mentioned the customers.

Our clients hire us to manage their pharmacy benefit which includes both the administration and the management of overall drug costs, and almost every case they bring in sophisticated consultants to help them look at that broader service offering, which includes looking at rebates, looking at spread pricing, and our clients have a choice and decide how they want to contract for rebate and spread pricing, and in fact, today, we're passing through over 98% of rebates on behalf of our clients, which obviously has full audit rights, and our scorecard is really how we're

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effectively and successfully managing the client spends which we have consistently demonstrated and low to mid-single-digit growth in overall pharmacy spend.

So I think that we've seen a high level of member and client satisfaction. And I think that the Government – we've answered the Government's questions on transparency and innovation and our clients are making those choices and I think that we have consistently demonstrated that the PBMs play a critical role in the health care ecosystem. Now your specific question, let me ask David to talk about customers.

Answer – J. David Joyner: Thanks, Karen, and, Lisa, thanks for the question. So as you know, I've been in this industry for a long time and maybe have become too accustomed to the scrutiny in the marketplace but it also has allowed us I think to validate the value that we bring to our customers, so as I kind of answer more broadly the customer question and kind of where the focus is, as you know, 9 out of every 10 prescriptions are generic drugs today, so if you look at it from a member affordability, this is a very affordable benefit, and I think, the value that the PBM has been able to accelerate and deliver to our customers.

So the focus now is really on that last 10%, and the 10% in – both in terms of the high list prices and areas in which we have been able to deliver competition and actually create discounts for our customers, so I would say there's a couple different areas that we're focusing on.

One is to make sure that we preserve and protect the transparency that we're delivering to our customers today. As Karen said, we pass through obviously 98-plus percent of the rebates and the customers choose how they want to contract with us with full audit rights, so I think our customers feel very strongly about the value that we're delivering, but there is obviously an area around the member affordability, so we're focusing specifically in the area of insulins.

We have today, 65% of all of our plan sponsors actually offer a $35 or less co-pay for the members that have insulin, so when you look at it from a member affordability and areas where we want to protect the preventive drug classes our customers are actually moving down this path and making sure that they're both focusing on transparency for themselves and also making sure that they're focusing on transparency for the members.

And the last piece I'll say just in terms of kind of the client reaction and/or kind of where they're positioned today. We did have a large client forum upon my return and there's a big focus on kind of the advocacy both in the states and at the Federal level and they're very focused on making sure that they both educate and preserve the tools that we have available to us to manage the spend. So, whether you mentioned biosimilars or the high-cost of GLP-1s, it's making sure that we continue to have the tools in place to drive competition that allows us to reduce cost for our customers. So I'd say, it has been somewhat of a wakeup call and I would expect you'll see more advocacy not just within the PBM, but obviously the payers that actually have to fund the benefit.

Question – Lisa C. Gill: Thank you.

Operator

Thank you. Our next question comes from Justin Lake with Wolfe Research.

Analyst: Justin Lake

Question – Justin Lake: Thanks. Good morning. Appreciate the reiteration of 2024 and 2025 EPS targets. Given you've updated 2023 and there's a ton of moving parts for 2024, wanted to focus here and ask the question for an update on areas like the star rating, Centene loss headwind next year, I know that number has moved obviously. How should we think about the deals year-over-year versus the $0.35 dilution that you've offered for this year and any other areas of potential offset or growth beyond typical core growth and capital deployment as we think about kind of the moving parts that bridges to that $9 would be really helpful.

Answer – Shawn M. Guertin: I will start on that and Karen or anybody else can sort of come in on this. So I think in terms of thinking about the existing headwinds that you mentioned, Stars and Centene, I think we look at those as largely the same, and as I mentioned in my remarks, we're driving the organization to achieve the $9 per share

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for 2023 and approximately $10 for 2024 on an adjusted EPS basis, but as you mentioned over the quarter there has been a couple of things I think that have sort of popped up.

Having said that, we do believe we have two very impactful levers, one of which you mentioned, that can help us mitigate these potential headwinds. The first is to explore all the alternatives to accelerate growth and synergy realization in Signify and Oak Street. For Signify that'll be driven by continued strong multi-payor growth and using our combined assets to expand product and capabilities for all payors.

For Oak Street, the early closing will allow us to explore alternative growth vehicles that allow us to accelerate clinic growth and mitigate dilution, and very importantly, begin this work well in advance of 2024.

The second item is that the closing of these two strategic transactions and the resegmenting of our operation provides us with a timely opportunity to both improve focus and reduce administrative and operational costs by streamlining, eliminating duplicative efforts and achieving greater organizational operational efficiency. We believe both areas represent sizable opportunities that have the potential to serve as mitigating tailwinds for 2024 and 2025. So I'd say in summary, while there's still a lot to play out here on both the headwinds and tailwinds side, we still believe these are goals that are within an attainable range of outcomes.

Question – Justin Lake: And, Shawn, when do you think you'll be able to share or rather put some numbers around the benefits you'll see with those deals versus kind of what consensus numbers maybe assume for 2024 and this efficiency cost-cutting that you think you might be able to achieve for next year. Any idea in terms of magnitude of timing?

Answer – Shawn M. Guertin: Yeah, I think this is really at the top of the priority list for the next really quarter or two, and I think we'll have greater clarity on both headwinds and tailwinds sort of over that time period, and I just want to be clear. I might have said $9 and $10 for 2023 and 2024, that's for 2024 and 2025 just to be clear, but Justin this is really at sort of the top of the performance agenda for the next couple of quarters for us.

Question – Justin Lake: Great. Thanks for the color.

Operator

Thank you. Our next question comes from Michael Cherny with Bank of America.

Analyst: Michael Cherny

Question – Michael Cherny: Good morning and thanks for taking the question. I think this is a quasi two-parter, one technical and one more facts, the (00:50:26) numbers, but just first on the segmentation change. I just want to confirm especially based on the press release that the specialty and mail revenue and EBIT moved from Health Services, the former Pharmacy Services to Pharmacy & Consumer Wellness just because I'm trying to make sure I understand the full footing of where the guidance changed.

And I guess the real question along those lines is can we dive a little bit more into what goes into 340B in terms of the changes that you've seen. And you called it out specifically for Health Services. Is there any impact that you can bridge in terms of the total number both for Health Services, as well as if there is an EBIT (00:51:06) impacts in Pharmacy & Consumer Wellness? Thanks so much.

Answer – Shawn M. Guertin: Michael, I'll jump in on this one. So I want to be clear that the economic benefit really of specialty and the mail is still in HSS. What we've done here is consolidate the fulfillment functions in the PCW organization, and there's no meaningful sort of transfer of profit around sort of the fulfillment angle of that. So when you look at the guidance change on HSS, it looks like a big number. The biggest component of that is really the elimination of the dual credit of maintenance choice being in both.

When you take that out, you will see the guidance has come down about $300 million for HSS. That's basically two main pieces. One you saw in our earnings slides. There's about a $0.07 decrement or about $130 million that's sort of the core performance of the pharmacy business, which I'll come back to vis-à-vis 340B. The other is we're now

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including the adjusted operating income for Oak and Signify in there, and that is the other piece that would get you to about a $300 million change in the guidance. But the thing to keep in mind is the elimination and then also the elimination then of the elimination entry that we had around Maintenance Choice. That's going to look a lot bigger.

The 340B impact, as I mentioned, it's a very fluid situation. We're reacting to sort of what the actions that various manufacturers are taking. What I'd say is as I mentioned, there's about a $0.07 decrease in our guidance related to pharmacy performance. That actually is an underlying positive strength in the non-340B elements of our pharmacy business and then we've put in sort of a best estimate at this point, so that 340B impact is a little bigger than the $0.07.

I think there are various – there's been a note or two published about this and I'd say those aren't unreasonable proxies for sort of what we've incorporated into our guidance on this topic, but again, I can't stress enough, it's still – it's sort of a dynamic process that's moving around.

Operator

Thank you. Our next question will come from Eric Percher with Nephron Research.

Analyst: Eric Percher

Question – Eric Percher: Thank you. Appreciate the incremental detail on Signify and Oak's impact on the guidance. My question would be how are you prioritizing the development of Oak? Are you focusing on getting existing membership into existing clinics near-term? It sounds like there is new clinic build that's maybe accelerated by the early close? What can you tell us there?

Answer – Shawn M. Guertin: Yeah, I'll turn it to Mike but it's really both, right. We're considering obviously the key financial levers, getting membership into the clinics, it's always been – it's one of the synergy values we've discussed when we announced the deal, and then as I mentioned, one of the opportunities we've had once we closed is to explore solutions to accelerate that growth, but I'll let Mike comment as well.

Answer – Michael T. Pykosz: Yeah, from an Oak Street perspective, we couldn't be more excited getting to work with CVS. The breadth and the number of older adults that CVS is interacting with across all the different business units is really unprecedented in the US. And that creates an incredible opportunity for us to meet more people, introduce them to what we do at Oak Street Health, which we think is highly differentiated from a care model perspective and a patient experience perspective.

That can allow us to bring more and more patients in which can really move up the profitability timing in our J-curve, and so that is an incredible excitement point. And I think even thinking more broadly than just the kind of traditional CVS as we're really excited to work with Signify. We think that's a huge opportunity there as well. So that's just on the filling of clinics perspective, and obviously, we are always excited with a huge market opportunity to put more clinics up and so that combination I think is really powerful.

Answer – Kyle Armbrester: Yeah, this is Kyle. I'll just weigh in briefly too. When we go into the almost 3 million homes we go into each year, so many of them don't have a primary care physician or are completely isolated from a care team. And so we're very excited to have an option for those folks and to be able to drive them back to a model that we know is going to drive better outcomes and to connect them into Oak Street.

So there's a tremendous amount of synergies I think bringing all these three assets together. CVS with the brand and the reach, Oak with their differentiated model, and now our presence into the home and when we pull all three of those together, I think we're going to have a really unique experience that drives better patient outcomes across the country.

Answer – Karen S. Lynch: Yeah, and Eric, I wouldn't lose sight of the fact that there are a lot of other assets that we can connect the dots for these members, including kind of our retail health clinics, including our pharmacy. You can think about pharmacy adherence, pharmacy reconciliation, so there's lots of touchpoints that will create additional value for us across the entire enterprise as we connect all these assets together.

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Question – Eric Percher: And, Karen, do you believe you have all the assets you need now, or can we see more inorganic addition to health care services?

Answer – Karen S. Lynch: Yeah, I think over time we'll look at what other assets but right now, we need to focus on execution of the assets that we just acquired and then as you think longer-term around the corner, there might be additional opportunities in the home, or Health Services, tech kinds of things, but right now for the near-term, it is important for us to execute on these important assets and bring our products and services to bear for our customers.

Question – Eric Percher: Thank you.

Operator

Thank you. Our next question comes from Kevin Caliendo with UBS. And, Kevin, your line is open. Please unmute.

Analyst: Kevin Caliendo

Question – Kevin Caliendo: Oh, sorry about that. Just looking at the MBR guide. I just want to make sure I got this right. So, Shawn, you said second quarter MBR would be flat, right, with first quarter MBR and that utilization expectations were in-line with your expectations. I guess just can you remind us what the utilization expectations were or are, and any way to segment out what you're seeing? You mentioned higher flu but maybe across the different business lines, just to get a better understanding of what sort of the assumption is for 2Q as well in terms of utilization and how to think about that going forward.

Answer – Shawn M. Guertin: Yeah, I'll have Dan talk a little bit more about the specifics on utilization, but specific to the MBR discussion, just to be clear, it may mathematically work out to be what you said, but we expect a similar kind of year-over-year increase in Q2 MBR and then sort of a leveling out for kind of Q3, Q4 and I think this has more to do I think with how 2022 manifested itself, in terms of how COVID was playing out, and I think that's why that's going to sort of drive that pattern.

We have been pricing all along for a return to normal utilization across the product portfolio. I think we're getting closer and closer to that all the time, certainly with some of what we've seen in first quarter, but I can have Dan comment a little bit more, but as you mentioned, overall, we thought it was in-line with our expectations and our pricing, so Dan?

Answer – Daniel P. Finke: Yeah, thanks, Shawn. As Shawn said, we've been expecting the quarter-over-quarter increases towards a normalized level of utilization and we certainly continued to see that in the first quarter. In-patient volume has continued to be slightly below normalized levels. We also saw some transitions of care to some alternative sites of care out-patient ambulatory and obviously, we think that's a good thing offering alternative sites of care, which is lower overall costs, so we see that trend continue.

Mental health remains above pre-pandemic levels. We also think that's a good thing because demand is being met. And then general services like physician services, ambulatory, ER and specialists are all generally at normalized levels and all of that, like Shawn said, is priced within expectations. When you think about the lines of business the way I think about it is Commercial and Medicare in-line with expectations, generally at normalized levels, and Medicaid is still being somewhat favorable.

Question – Kevin Caliendo: Great, thank you.

Operator

Thank you. Our next question will come from Brian Tanquilut with Jefferies.

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Analyst: Brian Tanquilut

Question – Brian Tanquilut: Good morning, guys. As I think about the Oak Street acquisition and the guidance you had given at the time of the deal being announced, $2 billion EBITDA target for 2026, I think I heard Shawn talk about driving accelerated growth there. How do you reconcile, first do you still believe that that's the goal, and then how do you reconcile the J-curve with the increase or the acceleration in growth in units that you're contemplating?

Answer – Shawn M. Guertin: Yeah, just to be clear, I think, I'm not sure, but the EBITDA number you're referencing was sort of the embedded EBITDA kind of concept and I think that's again, when we talk a lot about sort of accretion dilution, we're in the GAAP world and what that does is it leaves out sort of the embedded EBITDA that that's building. But as I mentioned, there's significant long-term value because of that embedded EBITDA and accelerating clinic growth, and as we've discussed though, there are vehicles and models where we could see kind of both accelerating the clinic growth and better managing the dilutive impact of that clinic growth, and now that we're closed and we're closed well in advance of 2024, I think one of the opportunities we have is to explore and potentially execute on those in time to have an impact on 2024, but I'll let Mike as the expert here talk more about this.

Answer – Michael T. Pykosz: Yeah, I mean, what I would add to that is if you look at the economics of an Oak Street J-curve, which we've shared a lot publicly, on the Oak Street level, the biggest driver of that is the quality of care for patients and how fast you can fill up centers and we think there's still opportunity to continue to improve the quality of care for patients as we have year-over-year. There's a lot of capabilities in CVS that can accelerate that but even more importantly, if we can just pull up the time it takes to fill up a center, we will pull up those extremely profitable years to the back-end J-curve, which right now are taking six, seven years to get to.

If we can pull that up faster, obviously now that number that Shawn referenced, that embedded EBITDA number becomes a reality much faster, and I think that's the biggest opportunity from an economic perspective and while we are so excited to be part of CVS, as we're doing that we can reinvest it even more to more centers, more capability, that creates an incredibly powerful flywheel, and obviously interacting with a broader CVS ecosystem will both help Oak Street. I mean you can actually do a lot to help different parts within CVS as well, so again, we couldn't be more excited about that, but the opportunities are huge.

I want to thank you all for joining our call today. We obviously entered 2023 with really strong execution and we are committed to achieving our goals. So thank you.

Operator

This concludes today's CVS Health first quarter 2023 earnings call and webcast. You may disconnect your line at this time and have a wonderful day.

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