Bank of America Healthcare Conference ***(Corrected version)***

Event Details

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Company: CVS Health Corp.
Ticker: CVS-US

Company Participants

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

Other Participants

Michael Cherny - Analyst

MANAGEMENT DISCUSSION SECTION

Michael Cherny

Thanks, everyone, for joining us for this session of the BofA Health Care Conference. Mike Cherny, the Healthcare Tech & Distribution Analyst. It's my pleasure to have with us CVS Health, Shawn Guertin, the CFO, and then we have Tom Cowhey, who heads up Capital Markets. Larry McGrath from the IR team in the audience as well.

QUESTION AND ANSWER SECTION

Analyst: Michael Cherny

Question – Michael Cherny: So, CVS reported last week, they (00:22) slide deck, which I think is great. It's going to be fireside chat. So maybe, Shawn, just to kick things off, you've had these targets out for 2024 and 2025, $9 and $10. Maybe just give a sense of some of the building blocks and where you see like you have the most visibility versus areas that might be more moving pieces, both the upside and downside, given that obviously a lot of them would be out of your control too.

Answer – Shawn M. Guertin: Yes. Thanks. And obviously I don't have any slides, but I'm going to be making forward-looking statements today. So I would direct your attention to our description of that and all of our risk factors in our various SEC filings. So let me start off a little bit with like the $9 because there's been some talk about that and kind of people asking us about that target. The $9 that we set for our organization, that this really is, I believe, an attainable target for this company. And I think it's the right target for this company to shoot for. And at the end of the day, I've had people say, yeah, but why didn't – do you do this with expectations or that?

This is about running the company. And I think this company has the ability to produce $9. And I'll talk a little bit about how we get there. But it's the right thing, I think, right now for us to sort of focus and act with discipline to sort of deliver the $9 target. Now, on the quarter – over the last quarter and on the last call, we did talk about some of the headwinds. And I always think from a transparency perspective, it's important for us to share both the headwinds and the tailwinds with you as sort of our longer term projections shape up. And so – we did talk about a couple of the headwinds, which I'm sure we'll talk a little bit more about today.

But the bigger pieces from the last quarter have been some changes based on manufacturer actions around the 340B program and how that might ripple through. And also a bit more of a rapid decline in the COVID contribution and what used to be our retail business that we now refer to as PCW and I'll sort of come back to those things, but we talked about those as being potential headwinds for 2024.

And this is important when I say potential, because these like any long-term projection, there's uncertainty to how this will play out. There's a lot of factors, but I think, frankly it's prudent on our part to think about how these could play out and begin to sort of take those actions now. So with the Oak closing – Oak Street closing a little bit ahead

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of time, with Signify closing, we've updated our guidance that's from – to a range of $8.50 to $8.70. So let me use the midpoint for this discussion of $8.60. So how do I get from $8.60 to $9 next year?

So when I think about our core business and I'm going to exclude the two most recent acquisitions because I want to come back to them. When I think about our core business, when you think about all the things that we've talked about for 2024, the Stars headwind, the PBM contract loss, that these two things that I just mentioned when you kind of put that through and we run that through and project that we think the adjusted operating income for that can be kind of approximately flat, more or less for 2024. And a few things that people are missing when they think about that in sort of this – despite two or three things.

One is that we have a pretty big scaled exchange book of business. Now we're talking a book of business that's probably $4 billion or $5 billion, worth of revenue in HCB that is not meaningfully contributing to profit in 2023. That is now at scale and we have the ability to reprice that for next year. So in many ways, there's a bit of a kind of a one-time pickup that we might be getting in HCB sort of by doing that.

The second is, and this goes back to when we sort of set out our trajectory at the end of 2021. Every year we're trying to achieve something like $200 million to $400 million of G&A savings to increment earnings growth. And so think about that is $300 million. So there's a lot of things we're doing in there and I'll come back but the – another one is share repurchase. So if AOI for that core business excluding the acquisition just flat that sort of finished out the income statement.

Below that is largely interest expense and share count. And so in 2024, the interest expense will go up because it will annualize. But we've always had going back to 2021 in our long-term capital plan, about a 1% to 2% accretive share repurchase that we have factored into our capital planning and so that sort of in there. When you actually look at those two things, they sort of kind of – will cancel each other out and be roughly neutral. So you think about that core business and you're still sitting at $8.60, so you have $0.40 to go to get to $9.

Let me now come back to the acquisitions, especially with this, they're now going to be in there for a good chunk of this year. We actually think the adjusted operating income from the acquisitions will be up about $0.10 to $0.15 year-over-year next year. This is a really important concept, not only for next year, but how you should start to begin to think about the long-term contribution from our health care delivery strategy, begin to think about that as to what kind of earnings growth can that deliver each year from the assets we have, Oak Street and Signify, but also future assets, that we could add into that portfolio.

And I think this $0.10 to $0.15 isn't a bad sort of increment to have in your head as you begin to even think beyond this. But if you think about that for 2024, that still leaves you with about $0.25 to $0.30. That would be about sort of how I would frame as I sit here today with a lot of uncertainty. But it's sort of the amount we've put into our thinking as to what the headwinds might be from these new items that I mentioned before. And so how would I solve those? There's really three things that I think that we can execute on. One is we still got a lot of 2023 to play out. And I think there's a potential for us to outperform still in 2023. And we're going to do everything we can to do better than that $8.60. So you have 2023 performance.

The one big thing that has come out of sort of getting these acquisitions done, realigning the company now kind of in a more streamlined way with our strategy, frankly, the timing and everything that's sort of going on in the world today. I think we have a very timely opportunity to take out a significant amount of incremental G&A in the company. And I would bound that for you about $400 million to $500 million, this in and of itself kind of would sort of solve that $0.25 to $0.30 pull (07:14).

But we are going to take – make a much more aggressive push beyond what we normally are going to do every year and go at G&A. And a lot of that can come because we've had some duplication of efforts and in some organizational cleanup we can do now that we have a lot of these assets sort of in the house and in the house early. So G&A is a big lever that we can pull to kind of hedge against these headwinds.

Question – Michael Cherny: Just to make clear that's $400 million to $500 million on top of the typical or...

Answer – Shawn M. Guertin: Yeah. So I would think about that as $700 million to $800 million, right in total. Again, it's been pretty normal since 2021 for us to shoot for $200 million to $400 million, something like in there. And so we've always had that in our core run rate. So I want to be authentic about that, right? We've always had that in the

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run rate. We've been working towards that. But I think as we've looked at this and we think about the size of our G&A as a company, we think about sort of what we now have in the company.

There's a lot more we can get out of focus and efficiency. And again, the benefit of this and why I think this is important to do now is not just the economic benefit, it is that focus and that efficiency benefit. So that will be a big lever that we will pull and pull pretty significantly. And I think while it's a big number, it's an achievable number, and that's work that's underway in the company.

The last element that has potential for 2024 is a direct result of the early closing of Oak Street. And we have talked a little bit about structurally how we might position that assets or parts of that asset so that we could accelerate clinic growth. And this is really about accelerating clinic growth for the long run, which would have a real long run payback. One of the byproducts of that, I think, is that that could help us mitigate some of the dilution, either of that accelerated growth or even some of the recent vintage clinics.

We originally did not think right that we have the deal closed before the end of 2023 and weren't sure that that would be something we could put in place for 2024. That now looks like something we can explore. And so I think those are at least three big levers that we have to sort of go against sort of these uncertain tailwinds. And I think it's again that's why I continue to think the $9 is a very achievable goal for us for 2024.

Question – Michael Cherny: Perfect starting point. Maybe just to unpack a couple of important hot button topics that both tied to 2024 but also the broader story. So one of the big things that came up as incremental was 340B.

Answer – Shawn M. Guertin: Yeah.

Question – Michael Cherny: You talked about the headwind. You gave a lot of clarity on that. It also kind of comes in lockstep with the broader, I guess debate points on your pharmacy services business. So I'm going to try and squeeze in a two part question here, but give us a little sense on why 340B has gotten worse and your visibility into that against the backdrop of your overall pharmacy services profit pool and the dynamics of how that's evolved over time.

Answer – Shawn M. Guertin: Yeah. So it's important to sort of understand what this is and what this isn't. Many of you know, right, the 340B program was really a program designed to provide discounted drugs, if you will, to various kind of covered entities and hospitals in the system. And it's been a very important economic program to these sort of safety net providers for a long time.

At CVS, we really have three ways that we participate in 340B. We have a business that's an administrator of these claims, right, which basically helps these covered entities kind of identify as a valid 340B claim, run that through the system to sort of both get the discount and the reimbursement. And so there's this administrative part. We also participate as a PBM, providing a network for that. We also participate as a contract pharmacy when those drugs can be dispensed so that – participates across the board.

Most recently what has happened is in the last quarter there was a court ruling that allowed manufacturers or manufacturers interpreted as allowing them to dramatically reduce their definition of what was a contract pharmacy that could dispense, if you will, a valid 340B claim. So by means of example, the standard model was it either has to come out of the hospital pharmacy itself or a single pharmacy that's within 40 miles of the hospital or something like, right.

So what that did was reduce the number of contract pharmacies, which reduced the number of 340B claims that sort of run through that whole system that I just described. So this in many ways isn't about 340B going away. It's about sort of a pretty meaningful reduction potentially in volume, right. Some large manufacturers have already taken action in this regard. So, again, we thought it prudent to sort of say, well, we know who has taken action. Let's make our best estimate of who might be likely to take action in the future and what would that look like?

And again, there's a lot of uncertainty here. There's still litigation pending in other cases. This is a big deal to the covered entities, not just CVS. If the number of 340B claims goes down, how they respond is still outstanding. But again, this is about, what do you want to assume not only for your guidance in 2023, but for your planning? So we've made an estimate of not only what has happened from manufacturers to-date, but what we think is likely to

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happen and try to factor that into our thinking in terms of what are the actions we take, we need to take now in anticipation of that, and sort of that's where we are.

There's a lot that remains to play out here. But again, I think a lot of this goes back to sort of transparency and trying to be clear about what the potential headwinds are, even if to some degree they're uncertain. And I think it makes sense to try to air a little bit cautiously here so that when we go to G&A, we go to other things that we're kind of contemplating sort of the right targets, if you will, to do this.

Question – Michael Cherny: And I guess so – to come back to the second part of the question, how does that factor into the dynamics of people's understanding, misunderstanding, whatever term you want to use about the pharmacy services, profit pool and the way that it's changed over time, especially given that you're the biggest specialty pharmacy in the world.

Answer – Shawn M. Guertin: Yeah. So it's a great question, because there's a lot of dialogue, right, with everything that's going on in DC and in the States today about kind of network, spread and rebate retention. And in many ways, that is sort of in a way, yesterday's news and right because what to Michael's point, this has changed a lot over the last 5 to 10 years, right. The profit contribution to a PBM from the network lock or spread, if you will, and retain rebates has decreased dramatically from those time periods. We talked on the call that, we passed through over 98% of our rebates back through to clients, right. So that has really changed.

And what has really grown, right, is the specialty, because – as specialty itself has grown to be 50% of pharma, right by dollars. It's relative contribution sort of to PBM profitability has grown. Specialized administrative areas like 340B, right, have also grown where you're providing services to providers. And so, these other things we do through our GPO and whatnot, right, with pharma and provide specialty services, they've all sort of developed over the last few years. And so this is really changing.

The one thing because I know it's been out there where some competitors have talked about the 20% number from network and rebates. The thing I will say at the front-end of this, like most things in pharmacy, it's never simple when you actually go down into the details. But – so I don't really know what's in there, right. And how they did that calculation and what was included? What was not included? But I can tell you that when we look at that and we think we do that on a comparable basis, I think that that our number is certainly not bigger than that. It's probably smaller than that.

And that actually makes sense when I think about the fact that we're passing through 98% of the rebates versus I think the reference point there was 95%. So it's certainly – I'm not going to sit there and say it's not an issue that we're not paying attention to, right. Because those kind of percentages of your profit are still meaningful. But it's not, obviously it's not nowhere near the majority. And we think arguably it's a little bit less than that for us.

Question – Michael Cherny: Appreciate that, it's really helpful. Shawn, maybe sticking in like a unified topic, but GLP-1s, I don't think – basically I ask the (16:20) question about this most of my presentations as is. So obviously there's a yin and a yang for CVS with some weird side track in the sense that can you just maybe remind us the hedging that you have on the business in terms of positive (16:34) on GLP-1 especially the side pieces. The first quarter had some wonky effects on your gross margin on the retail side. So maybe just give a sense of the reminder on how that flows through your business and what it does to the math of your guidance.

Answer – Shawn M. Guertin: Yeah, yeah. It's a really good question because in some ways it's having a differential effect sort of across all three of our major business lines. What I – let me start with the Health Care Benefits business, because that's where it would potentially have a cost and unanticipated cost effect. I would say we're not seeing that. We – part of that is we did price for a certain level of GLP-1 activity. But really the most important thing to HCB is for the most part, this is not automatically covered for weight loss on fully insured and it's usually a rider that a customer would have to buy up and pay for if they do.

So where we're seeing a lot of volume on this is, is from self-insured employers covering it for this reason, many of which are because to your point, Michael would not in all this equation is, what is the long-term benefit actually to health care costs of this. And I think some self-insured employers have sort of taken that viewpoint that they do want to cover it aggressively. But then again they are funding that, right. So for the most part, the volume that we've seen in HCB has been consistent with our pricing on fully insured, where it's generally not covered for that particular purpose.

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When you looked at our PCW or what we used to call retail, the significant majority of our revenue increase in our guidance is actually kind of the contribution of these brand drugs in the revenue line. And as we've talked about before, brand drugs generally are not significant contributors to the profitability of that business. So what you're seeing is a lot of revenue increase and a very, very diminished sort of gross margin contribution from that business. So it's not adding much at all to the retail business. It's volume through the system and things like that. But it's really not having a big effect yet.

We are seeing a lot of it because whether it's self-insured or fully insured or cash favorite, we are seeing that all run through the PBM. So we are seeing some volume uptick there in the PBM, which is good. And I think in the longer run, again, this is a good example. Going back to some of the regulatory stuff where the PBM can add a tremendous amount of value is the set up, I think, for the kinds of things that PBMs do well, multiple agents, right to do something. And can we get lower cost alternatives?

It's a treatment that might have some clinical preconditions that you want to screen for, right. Again, in clinical programs through the PBM could be potentially very beneficial and create economic benefit. So a lot of this stuff still has to manifest itself. So this could be an opportunity for the PBM as this plays out and I think on the HCB side, it becomes a cost of care and it's been a somewhat neutralized item in retail.

Question – Michael Cherny: Got it. Maybe turning to the traditional retail side and I promise I'll start to get used to Pharmacy & Consumer Wellness, but thinking about your retail business as we knew it prior to the quarter in the statement. You've talked at length about the push for a flattish long-term growth trajectory, and the guidance did come down from even for this year and the one key numbers obviously were – I'd say a bit lower than what you typically have but not completely off kilter versus your traditional cadence.

Answer – Shawn M. Guertin: Yeah.

Question – Michael Cherny: But can you maybe just remind us the comfort you have in that builds over the course of the year and what gets you to that, that guidance that you set for the year?

Answer – Shawn M. Guertin: Yeah. So I want to talk about sort of where this business is today, but we'll go to the cadence first. So when you – obviously the last few years, the various – the quarterly cadence on this business has been thrown around a lot because of what has been going on with COVID. If you look back at this business, it always had the fourth quarter being the biggest quarter of the year from a profitability standpoint, and that's certainly how this year is set up and maybe even a little more than we saw.

I would say there's three reasons that this is a bit more back-end weighted than it appears sort of on the surface. One is we always try to forecast for a normalized flu season across our enterprise both in HCB, but we would have obviously some fourth quarter flu would typically sit in there. We also – we have a residual amount that's still in there for COVID vaccinations. That's pretty back-end weighted right now in our guidance. And a reminder that is not nearly the magnitude of money, as we've been talking about the last couple of years, for the full year now, we think COVID might be a $300 million to $400 million contributor half of that has already been realized in the first quarter of this year.

So you're talking about the other half being spread out really with a lot of – a lot of that is the vaccines in the fourth quarter. So you have – sort of have that sort of vaccine effect in the fourth quarter. There are a number of things we've been trying to do to sort of improve our cost of goods sold and as we kind of combat pharmacy reimbursement pressure. Some of those things are a bit more back-end weighted in the year. And another item that has continued to grow in importance are these performance programs that we have with payers on Medicare for things we do to sort of close gaps in care and improve quality and getting performance payments.

Those we generally don't forecast until the end of the year. We think we're tracking well towards those goals, but we generally push those out. So it is a bit more skewed than we've seen certainly the last few years. But it's largely those programs. When you think about this business there is a tendency to sort of think about this business and confused what's been happening with COVID, to be what's happening with the underlying business. And, for example, if you thought about this year where our guidance was around (22:53) and if you think about $300 million of COVID or something, right, you're talking about a number in the mid-5s.

If you went back to the last couple of years, you would see that if you took COVID out, you'd be in that same

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neighborhood. So this business underneath has been very stable despite the fact that we've made significant labor cost investments, we've invested in supply chain, we've had pharmacy reimbursement pressure. So I'm not saying, that there's not a lot of challenges there, but the underlying core of this is – has been in a pretty kind of a nice shot group there sort of around those sort of mid-5s. And I think as we think about this, the COVID contribution is just coming down and down and down and will just become price settle in and just be part of the business going to go going forward and we will sort of work from there.

Question – Michael Cherny: And just to wrap up this, you've talked about 900 store closures over three years. Where are you there? And what does that mean for the long-term future of how you envision the store, as is both now versus the care delivery opportunities that you obviously are pursuing?

Answer – Shawn M. Guertin: Yeah, I think it's – we're well down that path. We're now over 400 stores closed. What I would tell you that the two big metrics we were looking at were colleague retention and prescription retention at nearby stores. Those are both running ahead of the modeling assumptions well ahead. And so this has definitely been successful. I would say this is something that we're going to continue to look at and do. And frankly, you should be looking at this all the time and looking at performance and thinking about sort of how to sort of have the fleet be as optimized this group as we can. So we will continue to look at this. I think – and so I think in time we will do more, right, as these things play out.

But we also have some new alternatives. I think I talked about this when we first announced the 900 stores. There were some stores that were on the list that economically we probably should have pursued. But at the time they might have – we might have been creating a pharmacy desert. And we were sensitive, certainly during the pandemic, the role these stores were playing in getting the vaccines out, in the testing out into the communities. And so we held off.

It's interesting when you think, for example, about the clients that Oak Street serves and those communities maybe that now could look like an Oak Street clinic with the pharmacy and frankly, maybe that's even better for the clinic than the store was. And so I think we have some new alternatives to sort of think about how to deploy these resources going forward. But inevitably, this will be part of us sort of year-in and year-out, kind of looking at sort of how to optimize the delivery system.

Question – Michael Cherny: In the short time we have left, nowhere close to getting through my questions, that's fine. But maybe let's check in on the MA business. Obviously, the Stars issue you've been very vocal about. But let's start on the positive (25:54) nice momentum on MA Group (25:56), now with the New York win and some other things. Maybe just characterize what's driving that performance there and some of the dynamics that led you to win that business, especially against the backdrop, obviously, of the regulatory change for the Stars adjustments.

Answer – Shawn M. Guertin: Yeah. So I think, you know, the group MA business in particular has been an area that I think we have done exceptionally well in for a long time. And it's not the same right as the individual MA business. It's a very different buyer generally dealing with different issues, and in particular, one of the things that has always been a hallmark at Aetna is they do have a customer vertical that is focused on public and labor kind of employers. And I think they do have some unique needs. And I think we've served that population extremely well over time. And I think that certainly helps on certain kinds of customers.

But it's a lot about distribution. It's a lot about understanding sort of as an employer what their needs are. And City of New York is probably the biggest contract from a revenue perspective that Aetna has ever won. And I do know, we do have some other marquee clients also coming as well. So that has been a real success story. Now the group MA business can be lumpy because they tend to be big accounts. And so sometimes, you have a year where you don't hit one and you don't get it, but then, you get some kind of big growth.

So – but I feel very good about the momentum, the sales team and the account management teams we have in that business. But to your point, and this sort of now is when you go back to MA, this is a lot about your clinical programs and your ability to sort of bring value. And again, while we have a pretty big book of business, I certainly feel better prepared going into this environment, having both Oak Street and Signify as part of the equation.

I get the question a lot about, well, whether it's the risk model change or just the rate notice, does that worry you? It actually convinces me the opposite. It's exactly why if you think about just reimbursements and reimbursement pressure as an example, well, what do you do to sort of combat reimbursement pressure in a business? You try to

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lower your costs, i.e., your clinical care model, and you also try to enhance, optimize your revenue outcomes and I think Signify helps us sort of on both fronts by performing the home assessment.

We can do that not only for us but for all of our payer clients. But I think that the kinds of things and the knowledge that we're building around sort of what is really effective value-based payment will really serve us well in the long run. And I think we're much better positioned to confront these challenges with Oak Street and Signify.

Question – Michael Cherny: And so I guess as we – probably my last question here, but, getting Oak Street closed early is great on that front in terms of getting in the business. We're coming up on bid dates for MA. So how does that inform the strategy not looking for obviously the bids themselves, but the strategy and how you approach 2024 and having these clinical assets available to you in order to strengthen your overall MA capabilities?

Answer – Shawn M. Guertin: Yeah. So I mean, obviously we want to have as wide an offering of our own business in Aetna of (29:12) before the transaction we didn't have a national contract with them. We will now have a national contract, obviously with them and have sort of full coverage. We align with them exceptionally well. And so we will be doing that, all of the other things that we can sort of bring to bear from our other assets as well in terms of the pharmacy experience.

I think there's just – there's a lot of things to whether it'd be Signify or Oak Street that we can bring together. The best example that I can use as we think about the future is, Signify has often told us when they do a home assessment about 30% of the time they either find somebody who doesn't have a primary care physician or is not actively engaged with one. Well, what CMS really wants us to do is connect these people to the care they need. And so being able to connect them to Oak, which doesn't mean, by the way, that it's an Aetna MA member, just means they're connected with Oak and whoever the payer is, that's like a win-win, right? We help Oak, we help accelerate Oak, but we also sort of satisfy kind of the greater good here of connecting these people with care.

We've got the red dot down there, unfortunately. So we'll have to wrap it up, I'll leave my second page of questions another time. But, Shawn, thank you so much for all the color and details.

(30:26). Thank you to everyone.

We appreciate Tom and Larry, thanks for being here. Thanks, guys.

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