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CVS Health Corp. (CVS)

Q4 2024 Earnings Call

CORPORATE PARTICIPANTS

Laurence McGrath

Executive Vice President, Chief Strategy Officer and Chief Strategic Advisor to the CEO of CVS Health, CVS Health Corp.

J. David Joyner

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

Thomas F. Cowhey

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

Steven H. Nelson

Executive Vice President and President, Aetna, CVS Health Corp.

Prem S. Shah

Group President & Executive Vice President, CVS Health Corp.

OTHER PARTICIPANTS

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Justin Lake

Analyst, Wolfe Research LLC

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Andrew Mok

Analyst, Barclays Capital, Inc.

Erin Wilson Wright

Analyst, Morgan Stanley & Co. LLC

Ann Hynes

Analyst, Mizuho Securities USA LLC

Elizabeth Anderson

Analyst, Evercore ISI

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you all for attending the CVS Health Q4 2024 Earnings Conference Call. My name is Brika, and I will be your moderator for today's call. All lines will be muted. [Operator Instructions]

I would now like to pass the conference over to your host, Larry McGrath, Chief Strategy Officer. Thank you. You may proceed, Larry.

Laurence McGrath

Executive Vice President, Chief Strategy Officer and Chief Strategic Advisor to the CEO of CVS Health, CVS Health Corp.

Good morning, and welcome to the CVS Health fourth quarter and full year 2024 earnings call and webcast. I'm Larry McGrath, Chief Strategy Officer. I'm joined this morning by David Joyner, President and Chief Executive Officer; and Tom Cowhey, Chief Financial Officer.

Following our prepared remarks, we'll host a question-and-answer session that will include additional members to the leadership team. Our press release and slide presentation have been posted to our website, along with our Form 10-K filed this morning with the SEC. Today's call is also being broadcast on our website, where it'll be archived for one year.

During this call, we'll make certain forward-looking statements. Our forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from currently projected results. 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 statement concerning forward-looking statements and risk factors in our Annual Report on Form 10-K, filed this morning, and on our recent filings on Form 8-K, including this morning's earnings press release.

During this call, we'll use non-GAAP measures when talking about the company's financial 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 David. David?

J. David Joyner

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

Thank you, Larry, and good morning, everyone. This morning we reported fourth quarter adjusted earnings per share of \$1.19 and adjusted operating income of \$2.7 billion. We also provided our initial full year 2025 guidance for adjusted EPS in the range of \$5.75 to \$6.

Our initial expectations reflect meaningful recovery in our Aetna business, particularly, in Medicare Advantage, as well as continued growth in Health Services. Tom will provide a more detailed overview of the components of this guidance as well as a breakdown by segment.

I'd like to spend some time taking a step back and sharing with you my observations during my first 100 days as CEO. During this time, I have connected with shareholders, customers and clients. I have met with and heard from elected officials and, importantly, I have spent a great deal of time listening to our consumers and

colleagues. I've come away inspired from these conversations and with a clear and strength in understanding of what we need to do to realize the tremendous promise of CVS Health.

We can be America's leading and most trusted healthcare company. A company that measures itself by its ability to improve outcomes, increase access and lower the cost of care, while ensuring a consumer experience that we can be proud of. The combination of these measures will ultimately deliver greater shareholder value.

What makes me confident that we can deliver on this promise? One, CVS Health's collection of assets, its reach, its connection with 185 million Americans, whether in our stores or our clinics, through our health plan or by managing the pharmacy benefits, CVS Health is unlike any other company in the United States, and with that comes opportunity and a responsibility to make a difference.

We take this responsibility seriously and have shown that throughout our history. We did this 10 years ago, when we removed tobacco from our stores. We did this with urgency when the country needed us during the pandemic. And we do this today, as we fight rising drug prices, as we create a viable biosimilar market, and as we innovate the pharmacy model to reduce frictions in the healthcare system, to name a few. We will continue to deliver on this responsibility by being innovative and bold to do what's right for our consumers and customers.

Two, our over 300,000 colleagues who reflect the backgrounds and experiences of all Americans and the communities we serve. I can say every day that our colleagues come to work dedicated to making healthcare in America better for those we serve. In my conversations with our colleagues, I'm proud to say that there are many thousands of inspiring stories for everyone where we could have done better.

Three, while there are external factors that pose near-term challenges, there are also many reasons to be excited. The broader demographic trends of an aging population, advances in AI and technology, the need for more personalized care and the expectations of the American public to create an improved consumer experience are opportunities where we are best positioned to lead.

How will we realize this over the short and long-term? My leadership team and I have spent our time together developing a clear set of priorities. Collectively, we are committed to delivering on the promise of CVS Health. We believe that aligning the power of our employees and the CVS Health enterprise behind four specific priorities will deliver on our potential and, ultimately, the results and experiences that we can all be proud of.

First, ensuring that each one of our businesses is best-in-class through strong execution. Most importantly, we need to deliver on our turnaround at Aetna and restore this business to target margins; second, continuing to develop our integrated capabilities where it matters, in order to make healthcare better, more affordable and more accessible; third, advancing our leading digital strategy and investing in emerging technologies that drive simplicity and efficiency, while delivering better experiences for the people we serve; and finally, ensuring that we are disciplined stewards of capital, as we continue to strengthen our balance sheet, manage our portfolio of businesses and deploy capital to create value for our shareholders.

I'm working closely with my team to ensure we have the right talent, structures and collaboration across our enterprise to execute and deliver on these important priorities.

CVS Health operates in some of the most critical areas of healthcare, and our connections to the people we serve across the country has never been more important because of the challenges we see throughout the US healthcare system. Rising healthcare costs put pressure on consumers as they see increasing challenges with

affordability. These rising healthcare costs also put pressure on employers and the government, who largely pay the bill for healthcare.

To be clear, healthcare costs are increasing because of the combination of greater utilization, rising provider costs, labor shortages and dramatic price hikes for branded pharmaceuticals.

Our teams are focused on delivering on our mission, and we are working hard to directly address the challenges in the healthcare system. We are using tools across our enterprise to deliver exceptional value and differentiated experiences to our customers and clients.

One of the most powerful forces helping to offset rising healthcare costs are PBMs like Caremark. These entities remain the only part of the drug supply chain entirely focused on lowering cost, but have erroneously been subject to deceptive rhetoric and misinformation. For more than three decades, PBMs have been a proven, unequivocal mechanism to negotiate down the price of drugs for payers and consumers, while promoting better adherence and better health.

In drugs that have no rebates where PBM tools are limited, we've seen egregious price hikes with prices for those drugs increasing more than twice as fast as drugs where we can secure rebates.

In the first three weeks of January alone, branded drug manufacturers added \$21 billion of annual gross drug spend through their price actions. Our work is a critical counterbalance to the monopolistic tendencies of drug manufacturers. This is why PBMs are needed, and why manufacturers fight so hard to limit our capabilities.

Multiple well-known economists have estimated that PBMs generate net value for the US healthcare system of over \$100 billion per year. No one has demonstrated more success than the PBMs at driving down drug prices. A perfect example is the prior administration's negotiated Maximum Fair Price, or MFP, for the first 10 drugs selected as part of the Inflation Reduction Act.

Not only have PBMs kept the rate of drug inflation in Medicare Part D at 1.3% per annum over the last 18 years, CVS Caremark specifically negotiated rates that contributed to a \$1 billion improvement better than MFP.

More importantly, if we don't continue to negotiate further discounts beyond MFP, the lost savings will go directly into the pockets of drug manufacturers. When you look at all the data, not cherry-picked data points like those specifically referenced in the FTC interim reports, the conclusion is clear, PBMs deliver savings to their clients.

Caremark has been and continues to be a critical solution to help ensure Americans pay less for drugs. We will continue to play our unique role in the drug supply chain, bringing the full breadth of our capabilities and market expertise to reduce drug prices for all customers.

Throughout our history, we've led our industry in innovating to solve the issues most important to our clients and customers, whether it's cost, transparency, access to care or experiences. A recent example of how we're using our enterprise assets to solve important issues for our clients and help offset the rising healthcare costs, is through actions we've taken in the biosimilar market.

In 2024, through the combination of Cordavis, Caremark and CVS Specialty, we converted more than 90% of eligible Humira patients to a biosimilar at a list price that was more than 80% below the price of branded Humira. This enabled us to offer a \$0 out-of-pocket cost for individual members and generated almost a billion dollars of

savings for our clients. We are the only company that meaningfully drove biosimilar adoption amongst our clients and will continue to do so with a growing pipeline of additional biosimilars.

In our Pharmacy businesses, we delivered exceptional experiences with record high levels of NPS in our retail business, and PBM retention rates consistently in the high-90s. However, we also recognize that in order to continue improving our customers' experiences, healthcare needs to be more transparent. So, in late 2023, we took a leadership role to create a pathway for increased transparency and simplicity across the Pharmacy marketplace. We addressed this with the introduction of two important transparent price models.

The first is Caremark's TrueCost model. As a reminder, today, we pass through 99% of rebates to our clients. When fully implemented, TrueCost enables patients to see those lower costs at the pharmacy counter, including the full pass-through of the rebates we generated from our negotiations with the manufacturers. TrueCost continues to resonate in the commercial marketplace, and we now have more than 75% of Caremark's commercial members with two or more elements of the model in the pharmacy benefit.

The second is CVS Pharmacy's CostVantage. Effective January 1, all of our commercial scripts dispensed through CVS Pharmacy are contracted through our innovative and transparent CVS CostVantage model. Under this new framework, we have tied reimbursement to our acquisition cost and will deliver savings to our payor partners as we continue to relentlessly drive down prices.

Our team is now working to deliver a cost-based solution for Medicare and Medicaid markets. These models remove the market basket approach and the unintended consequences that existed in the pharmacy reimbursement, ensuring that patients continue to have access to the most durable and frequent interaction in their healthcare journey.

We are also focused on expanding access to high-quality care to help address some of the provider shortages facing the US with our Health Care Delivery businesses, continuing to see meaningful growth. Signify had a record volume year supported by growth in Aetna members, which nearly doubled compared to last year.

We have also seen an accelerated patient growth at Oak Street, supported by our enterprise connections. We continue to expand access to this leading care model and are identifying opportunities to utilize market-leading capabilities more broadly across the enterprise. We are advancing technology to reduce frictions that tarnish the experience Americans have when they utilize their benefits and make it difficult to navigate the complex US healthcare system.

Our updated CVS Health app makes it easier for consumers to manage their health by giving them seamless access to appointments, co-pay details and prescription status. We're also leveraging AI to create a more intuitive workflow and faster turnaround times to reduce frustrations for our members and provider partners.

While we are working to address the issues across the US healthcare system, we are also focused on addressing the performance challenges within our own business. At Aetna, we drove meaningful progress improving and strengthening our operations. We have significant opportunities to unlock embedded earnings that is most pronounced in our Medicare Advantage business.

Our focus remains on delivering on our commitments to our Medicare Advantage members while creating a viable path to appropriate margins. In line with our prior commentary, we expect that we will shrink the Medicare Advantage membership by high single-digit percentage from year-end 2024. Our deliberate approach to our 2025

Medicare Advantage bids, combined with our improved star ratings, will improve margins this year and are part of our ongoing commitment to restore this business to target margins of 3% to 5%.

Last month, CMS released the proposed 2026 Medicare Advantage Advance rate notice. This update does not address the unprecedented utilization trend experienced across the industry over the past two years. Our team is advocating for a more appropriate rate update, including adjustments for the industry-wide cost trends seen in 2024. We are encouraged by the constructive dialogue with the new administration to help ensure that American seniors will not continue to see significant disruption to their benefits driven by drastic changes to the Medicare Advantage program.

Beyond Medicare, we are also encouraged by progress in our other Aetna lines of business. We are advancing our rate advocacy efforts in Medicaid. We've seen high retention and strong welcome season in our national accounts book and have made meaningful progress in the rightsizing of our individual exchange footprint.

Every day, we work hard to improve the health of all the people we serve. This is always a top priority at CVS Health. While we have made progress addressing some of the frictions that exist in the US healthcare system, including leading the industry and increasing transparency and simplicity, we know the healthcare system must be better. Our unique collection of assets and our deep connections with our consumers, members and patients position us to deliver a better and differentiated experience to everyone we serve.

We have strong momentum heading into 2025. We have the right assets, the right leadership and the right strategy in place. Our dedicated employees put our members, patients and consumers at the center of everything we do. We have worked hard to stabilize our Aetna business, and have made meaningful progress to address the issues that led to the underperformance in 2024. We are well positioned to be the leader in driving change in the healthcare system.

As I hand the call over to Tom, I want to reiterate the importance of delivering on our commitments to our shareholders. We are focused on building trust and establishing credibility, as we work hard to deliver on our financial promises in 2025 and beyond. Tom?

Thomas F. Cowhey

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

Thank you, David, and thanks to everyone for joining us this morning. I'll start with a few highlights on total company performance. Fourth quarter revenues of nearly \$98 billion increased more than 4% over the prior-year quarter, primarily driven by growth in our Health Care Benefits and Pharmacy & Consumer Wellness segments.

We delivered adjusted operating income of over \$2.7 billion and adjusted EPS of \$1.19, as we saw strong performance across multiple lines of business and favorable prior period reserve development in our Aetna business. Full year cash flow from operations was approximately \$9.1 billion, benefiting from early receipt of cash, particularly in our Pharmacy Services business.

Turning to our segments. In Health Care Benefits, we grew revenues to approximately \$33 billion, an increase of over 23% over the prior year quarter, reflecting growth in all lines of business. Medical membership of approximately 27.1 million was roughly flat sequentially, as membership in our individual exchange business started to modestly decline in advance of the 2025 rate increases we took in that book.

During the quarter, the segment generated an adjusted operating loss of \$439 million. This result was lower than the prior-year quarter, primarily driven by a higher medical benefit ratio, partially offset by the release of the

premium deficiency reserve we recorded in the third quarter, higher levels of favorable prior-period reserve development, and increased net investment income.

Our medical benefit ratio of 94.8% increased 630 basis points from the prior year quarter. This increase was primarily driven by higher utilization, the premium impact of lower stars ratings for payment year 2024 and higher acuity in Medicaid, partially offset by a 220 basis point impact from the already mentioned premium deficiency reserves recorded in the third quarter, as well as higher levels of favorable prior period reserve development.

While medical trends remained elevated, the experience we observed to-date was less severe than the trends we assumed in the downside scenario we discussed last quarter. Importantly, during the quarter, we experienced positive prior period reserve development across all lines of business, primarily related to second and third quarter dates of service.

In our Medicare book, continued elevated trend levels were attributable to the same categories we discussed last quarter, including inpatient, outpatient, supplemental benefits and pharmacy. Relative to our downside scenario discussed on the third quarter call, we did see some moderation of inpatient trends, while supplemental benefit costs remains stubbornly high. We are cautiously optimistic that our benefit design changes in 2025 will help alleviate some of the supplemental benefit pressure.

In our Medicaid business, acuity remained consistent with the latter part of the third quarter, as redeterminations have largely concluded across our state footprint. We continue to work closely with our state partners to align rates with the changes in acuity.

During the quarter, we made additional progress on rate updates, and with over 40% of our book having it repriced in early January 2025, we have a line of sight to a mid-4 percentage point rate increase. Our overall rate advocacy efforts are currently on track.

In our group commercial risk book, fourth quarter trends remained elevated. And similar to others in the industry, we experienced some pressure on our stop-loss business, which represents less than 3% of our 2024 premiums. We continue to take a cautious outlook on medical cost trends in this block and combined with lower membership, we expect lower contributions from this business in 2025.

Finally, in our individual exchange book of business, we saw continued acceleration of medical cost trends, driven by the specialist, inpatient and ambulatory categories. As we discussed on prior calls, we made meaningful price adjustments at our offerings for this product in 2025, which will lead to a significant rationalization of our membership, while also shifting mix towards bronze plans. Taken together, these actions should improve results in our individual exchange offerings in 2025.

Days claims payable at the end of the quarter was 44 days, down 0.6 days sequentially, primarily reflective of seasonality. DCP was down 1.9 days from the prior year quarter, primarily driven by growth in our Medicare business and the impact of increased pharmacy trends. We remain confident in the adequacy of our reserves.

Our Health Services segment generated revenues of approximately \$47 billion during the quarter, a decrease of approximately 4% year-over-year and primarily driven by the previously announced loss of a large client and continued pharmacy client price improvements. These decreases were partially offset by pharmacy drug mix, increased contributions from our Health Care Delivery assets and growth in specialty pharmacy.

Fourth quarter adjusted operating income of nearly \$1.8 billion drove a full year result of \$7.24 billion, just shy of the high end of the previous guidance range we reiterated for investors last quarter.

On a year-over-year basis, adjusted operating income decreased 5% from the prior year quarter, primarily driven by continued pharmacy client price improvements, the previously announced loss of a large client and the impact of higher healthcare costs in our Health Care Delivery assets that are tied to Medicare, including CVS Accountable Care and Oak Street Health. The decreases were largely offset by improved purchasing economics and increased volume at Signify.

Total pharmacy claims processed in the quarter were nearly \$500 million and total Pharmacy Services membership as of the end of the quarter was approximately 90 million.

We ended the year with another strong quarter of growth in our Health Care Delivery business. As David mentioned, Signify achieved a record volume year completing over 3 million in-home health evaluations. This performance contributed to revenue growth in the quarter of approximately 32% as compared to the prior year.

We continue to experience strong top-line growth at Oak Street, supported by our enterprise connections. During the quarter, Oak Street revenue increased approximately 39% over the prior year, driven by patient growth.

Total at-risk members increased approximately 35% compared to the same quarter last year. While the Medicare Advantage industry experienced elevated utilization throughout 2024, Oak Street's care model achieved trends lower than the broader industry.

Our Pharmacy & Consumer Wellness segment delivered another strong quarter. We generated revenues of over \$33 billion, an increase of approximately 7% versus the prior year quarter and over 10% on a same-store basis.

Adjusted operating income of nearly \$1.8 billion declined approximately 13% from the prior year quarter, primarily driven by continued pharmacy reimbursement pressure and lower front store volumes, partially offset by improved drug purchasing. Results in the fourth quarter were also lower due to a pull forward of the immunizations into the third quarter.

Same-store pharmacy sales in the quarter increased 13% versus the prior year, and same-store prescription volumes increased nearly 6%. Same-store front store sales were down approximately 1% versus the same quarter last year.

We successfully completed our three-year store closure plan and are progressing further footprint optimization in 2025. Despite the reduction in our store count, we continue to maintain a retail pharmacy script share position of over 27%. This highlights our strong execution, robust omnichannel capabilities and our ability to deliver superior customer experiences while maintaining a deep community presence, with 85% of Americans within 10 miles of a CVS location.

Shifting now to cash flow and the balance sheet. We generated cash flows from operations of approximately \$9.1 billion for the full year. This result was higher than our expectations due to early payments in our Pharmacy Services business, which will correspondingly lower our expected cash flows in 2025.

During the quarter, we returned \$838 million to our shareholders through our quarterly dividend, bringing total shareholder dividend payments in 2024 to over \$3.3 billion. We ended the quarter with approximately \$3.8 billion of cash at the parent and unrestricted subsidiaries.

Our leverage ratio at the end of the quarter was approximately 4.7 times, which remains above our long-term target. During the quarter, we executed a liability management transaction that included the issuance of \$3 billion of subordinated debt securities and the retirement of approximately \$2.6 billion of outstanding debt principal. The net result of these transactions modestly reduced our leverage ratio.

We are committed to prudent financial policies, including maintenance of our current dividend, as we work to maintain and improve our investment-grade rating and expect our leverage to return to more normalized levels, as we continue to execute on margin recovery in the Aetna business.

Shifting now to our outlook for 2025. As David mentioned, we are establishing our initial full year 2025 guidance for adjusted EPS in the range of \$5.75 to \$6. Consistent with past practice, this range does not assume the recurrence of prior year reserve development, which contributed approximately \$0.18 to our 2024 adjusted EPS results.

After excluding the favorable impact of prior year reserve development, our initial 2025 adjusted EPS guidance represents year-over-year growth of approximately 10% at the low end of the range. We believe this represents an appropriately achievable baseline with opportunities for outperformance.

Incorporated across our guidance elements is the initial down payment on our multiyear \$2 billion cost efficiency effort. Based on our work to-date, we were successful in identifying actions that, at a minimum, will offset the return of certain variable expenses in 2025, as we work to drive further efficiencies across the enterprise over the coming years.

Now let's turn to some of the segment details. I'll start with our Health Care Benefits segment. We expect aggregate membership to decline by over 1 million members, primarily driven by reductions in our individual exchange and Medicare products. We estimate that membership in our individual exchange block could contract by over 800,000 lives, and we'll have greater visibility when all effectuated members have paid their premiums by the end of March.

We also expect our Medicare Advantage membership to end the year down high single-digit percentage from year-end 2024. This is consistent with the guidance we have been giving investors since last summer and reflects strong execution by our teams, as they made the difficult choices necessary to improve Medicare Advantage profitability in 2025. These membership declines are expected to be partially offset by growth in our commercial self-insured business.

We expect to generate Health Care Benefits revenue of approximately \$132 billion, as membership declines in Medicare Advantage and Individual exchange are offset by Medicare program changes and growth in other products.

At the low end of our Health Care Benefits adjusted operating income guidance range, we project our medical benefit ratio will improve by 100 basis points over 2024, yielding an MBR of approximately 91.5%. Outperformance on this ratio is one of the largest potential factors that could drive us higher than our adjusted EPS guidance range.

The largest driver of the reduction in our medical benefit ratio is projected improvement in our government businesses, particularly in Medicare Advantage. We also project year-over-year improvement in our combined commercial lines business, driven by margin recovery in individual exchange, offset by pressures in group

commercial from membership declines and elevated levels of medical cost trends. We also expect the contribution from net investment income will decline.

Overall, we expect Health Care Benefits to deliver adjusted operating income of at least \$1.5 billion. This projection reflects a respectful view of trends in light of the continued elevated medical cost trends that we experienced in the fourth quarter. As a reminder, every point of trend is worth approximately \$800 million of Health Care Benefits adjusted operating income results.

Shifting now to our Health Services segment. We expect revenue of approximately \$185 billion, primarily driven by growth at Caremark as we continue to deliver value to our clients. Adjusted operating income for this segment is expected to grow approximately 4% to \$7.54 billion. While our 2025 guidance reflects continued core pharmacy services growth, the overall Health Services segment growth rate is diluted by headwinds in our Healthcare Delivery business.

As you know, results in our Healthcare Delivery business are highly correlated to Medicare Advantage medical cost trends and regulations. And at this stage, we have taken a prudent outlook on how those will develop throughout 2025. This initial guidance is consistent with the preview we presented last quarter, where we noted that our initial outlook for this segment would be below our long-term growth framework, but would prudently reflect opportunities for upside over the course of the year.

We expect Healthcare Delivery performance to improve starting in 2026 as the current medical cost trends experienced across the industry are more appropriately reflected in rates and plan bids and our continued investments in this business mature.

Now for our Pharmacy and Consumer Wellness segment. We project script growth of approximately 3.5% and revenue of approximately \$134 billion. We expect adjusted operating income to decline approximately 5%, in line with our long-term guidance framework to \$5.48 billion.

As we have discussed previously, 2025 is a transition year for CVS CostVantage, and we believe the implementation of this model positions us to bend the trajectory of the PCW business over time.

We expect interest expense to increase approximately \$300 million as we annualize the expense associated with our debt offerings in May and December of 2024. We project our tax rate to be approximately 25.5%. We also expect our share count to increase modestly to approximately 1.271 billion shares, and we are not contemplating any share repurchases in 2025.

Finally, we expect cash flow from operations to be approximately \$6.5 billion. The operating cash flow decline versus 2024 is primarily driven by late year timing items that were pulled forward into 2024 cash flow, as well as the impact of lower risk membership on healthcare cost payable, reserves and risk-adjusted revenue accruals, partially offset by improved operating performance in our Health Care Benefits business.

Over the 2024 and 2025 calendar years, we expect that our business will generate operating cash flows of \$15.6 billion, which, when combined with improving operating performance, will help put us back on the path to our target leverage levels.

As you think about the cadence of earnings in 2025, we expect earnings to be more weighted to the first half than the second half, likely a 55-45 split. Seasonal patterns in most of our segments should remain largely unchanged compared to 2024, with the notable exception of our Health Care Benefits segment, where the Part D changes

due to the Inflation Reduction Act and the timing of premium deficiency reserves recorded in 2024 will significantly change the progression of earnings.

You can find additional details on the components of our 2025 guidance on our Investor Relations website.

We are encouraged by our opportunities in 2025 and are excited to demonstrate the enormous potential that we see across CVS Health to unlock embedded earnings. We are working tirelessly to restore Aetna to target margins, which, over time, should represent meaningful upside above the high-end of our 2025 guidance range.

With that, we will now open the call to your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you, Tom. We will now begin the question-and-answer session. [Operator Instructions] We have the first question on the phone lines from Lisa Gill with JPMorgan. Please go ahead.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Thanks very much and good morning. David, I wanted to start with, you made some comments around your observations in the first 100 days. But what are some of the things that you think you can really bring to CVS as the new CEO? And anything else that you'd want to share from an investor perspective as you think about the first 100 days?

And then if I can also just maybe better understand the guidance, which is better than I had anticipated, the guidance being a good starting point. Tom made the comment of an opportunity for outperformance. Last year, you gave a better than number, this year you're giving a range, \$5.75 to \$6.00. Can you maybe just talk about the confidence in that number and the potential outperformance around the guidance for 2025? Thanks very much.

J. David Joyner

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

A

Yeah. Thank you, Lisa, and I appreciate the question. Let me give you a little bit of perspective on the first 100 days and then the things I believe that we're focusing on and can deliver into 2025. So, as I mentioned in the first quarter or the very first earnings call, I needed to focus on the most pressing and urgent issues of the company, which, at this point, I'm happy to report we spent a lot of time focusing on Aetna, and we've actually delivered material progress in terms of stabilizing Aetna's operation and also bringing the financial discipline back to the organization. So, I think as you look towards the open enrollment as well as the progress made, I'm very confident and very bullish on the continued recovery of that business.

I think the second piece, and this speaks to where I've spent the last two years, it's critically important that we continue on this pharmacy transformation journey. We recognize that there are kind of headlines around the role that PBMs and pharmacies play and the fact that we've made significant progress in both changing the pricing models, whether it be on CVS Pharmacy's CostVantage, which we had 100% adoption in the commercial space, or within Caremark's TrueCost model, which we now have more than 70% of our clients adopting more than two of the features or attributes of that model. These are really important elements, I believe, that continue to drive change and/or transformation in the market.

And the last thing I'll say is that the success that we had in the biosimilar launch with Cordavis was unprecedented. We created what I believe is a durable biosimilar market. We led the market in terms of the volume and the conversion change, leading this with both technology and an opportunity to lower cost for our customers. So, those are the two big headlines on the business front. And I think as I look at the role that I'm playing is making sure that I'm surrounded with the right leadership.

So, this right leadership team. I mentioned Steve Nelson coming in from the outside. He's been on the job now 90 days leading Aetna, both stabilizing that leadership team and the operations and the financial organization. And then we've also announced Prem Shah in a new Group President role during the last quarterly earnings. And that's allowed for us to both promote and elevate talent within the organization.

So, we have Len Shankman now running CVS Pharmacy, which is a 20-plus year veteran of the business. We have Dr. Sree now running our Health Care Delivery assets, which again is a long-tenured leader here in our business. And then Ed DeVaney running CVS Caremark, which is another 20-year veteran of the business. So, I think it shows the strength of the leadership team and the bench that we've built in the organization, which is going to continue to allow us, I believe, to lead from the front.

So, as I look at specifically your question about the role that I'm playing, I believe we have the right assets. I think we've established the right priorities for the business and the right strategy. And hopefully, at this point, we're going to continue to, at least in the listening tour, be able to earn the right to become America's leading and the most trusted healthcare company.

So, with that, I'd say my first 100 days was a leadership transition and now the focus will be a leadership transition becoming a transition to leadership.

So, let me spend a second talking about the second question on guidance. It is, without question, important for me to establish both trust and credibility in terms of being able to deliver on the promises and commitments that we've made. So, while we're going to talk about the overperformance and some of the drivers there, I also want to make sure that we – that I'm in a position to make sure that we're delivering on the commitments and promises that we're making to the investment community. So, with that, Tom, if you can share a couple of thoughts on the 2025 year.

Thomas F. Cowhey

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

A

Absolutely. So, Lisa, thanks for the question. And thanks, David to you. We set this out to be an achievable target with opportunities for upside. I think there – and hope that there are opportunities across all of our businesses, but the one that I think investors are rightfully most focused on is Health Care Benefits. And as you think about that, you think about what I said in the prepared remarks, every point of trend is an \$800 million swing on that business.

And we have taken a very prudent outlook on what our medical cost trends are in our forward guidance, specifically because of how 2024 developed. And we have respectfully looked at those trends and our guidance assumes that they persist into 2025.

So, whether that's in our Medicare business, or our group commercial block, as we exited the year in 2024, those trends are consistent with what is in our guidance for 2025. And then – so I think that would be the place where you could see the most potential upside, would be inside that Health Care Benefits business.

And this isn't necessarily a 2025 opportunity, but as you think a little bit longer term. The Health Care Benefits business, even at the top end of the guidance range, it's 1.5 points of margin compared to 2023, which was over 5%; and 2022, which was 7%.

And you look at some of our underlying businesses, government has improved, driven by Medicare in particular, but it's still projected to be a negative margin. Group Commercial is a profitable business, but is seeing signs of pressure. IFP, our Individual Exchange Product is expected to still lose money in our current outlook.

And so, if you do the math and you say, with the current share count and revenue base, each point of margin improvement is \$0.75 of adjusted EPS. And so that implies we could have another 3, 4 more dollars of embedded adjusted EPS if we can get our Aetna business back to its target margins, and that's what we're committed to doing over time.

Lisa C. Gill

Analyst, JPMorgan Securities LLC



Thank you.

Operator: Thank you. We now have Justin Lake with Wolfe Research on the line.

Justin Lake

Analyst, Wolfe Research LLC



Thanks. Good morning. I want to follow-up on some of your comments there, Tom. First, on your Medicare Advantage trend. Maybe you can give us a little bit more detail there in terms of what did the trend look like coming out of the year for 2024? And specifically, what are you assuming for trend in 2025?

I know you said it's kind of – you're assuming it to keep that pace. So, what was the 2024 trend and the 2025 assumption? And maybe any detail you could share with us on kind of the costs you've taken out of the business just via the bids, for instance, and how you're seeing your membership mix kind of play out for 2025?

Thomas F. Cowhey

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



Thanks, Justin. Let me answer what I can for you on that. So, I noted this in the prepared remarks. So medical trends remained elevated, although what we experienced in the fourth quarter was less severe than what we assumed in our downside scenario. I'd also note, during the quarter, we experienced positive prior period reserve development across all of our lines of business, and that was primarily related to the second and third quarter dates of service. So, that was also a nice positive tailwind there.

But as you look at the major businesses, starting with government, I'd say and maybe specifically Medicare, we saw some modest improvement. It was mostly driven by our group Medicare and our dual lines of business. And specifically, we saw some relief on inpatient earlier in the quarter. Our general enrollment population continued to see elevated trends, but a lot of where that pressure was, was actually in the specialist lines. And we think that that might be more consistent with what we talked about as a rush to care as people looked at some of the changing benefit patterns in their supplemental benefits for 2025. And so, we're waiting to see how that's going to play out on those changed benefits in early 2025.

On Medicaid, we did start to see some favorability in that book. Our redeterminations came to a close in our state footprint. And that was the primary driver of the year-to-date trend was those redeterminations. So, as that started

to stabilize, we also saw a little bit of improvement there and some modest rate improvements versus what we had forecast. So generally, a good end to the year on the Medicaid business relative to the trends of the first three quarters.

In the commercial block, trends in core commercial remained elevated, and we saw some modest underlying improvement, but that was offset by stop loss. And as you look at the stop loss, it's very similar to what others in this industry have seen. It's about the more specific attachment points than the aggregate attachment points. And also within our commercial block then on IFP, we really continued to see trends accelerate into the fourth quarter, and a lot of that was actually driven by inpatient claims.

We also took a little bit of an enhancement on our risk-adjusted revenue accruals after we got the most recent Wakely data, although that was a little bit less than what we had previously talked about in that downside scenario. I'd say as you think about that book, in particular, the most important factor there in 2025 is going to be the significant pricing changes we took. And we're under – in the process of understanding how that mix changed because that book could easily shrink in half, how that's going to yield the performance this year. And so we've taken a cautious outlook relative to that book overall.

With respect to 2025, it's a little too early to comment with any confidence, particularly given how much our membership mix has changed. I'd say, overall, our outlook remains respectful with respect to trends because they were so high almost all of last year. Thankfully, things like that impact of the two-midnight rule are now incorporated into the baseline, which should help to normalize some of our trends this year. I guess I could also say we feel good about how our reserves as of 12/31 are developing at this stage, but it's really early. And so we'd like to have a better understanding of how that baseline is going to perform in 2025 before we get too far ahead of ourselves.

Operator: Thank you. We now have Stephen Baxter with Wells Fargo.

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Q

Yeah. Hi. Thank you. I was hoping you could update us on where the Medicare Advantage margins ended the full year 2024 and what's assumed in the guidance for 2025. Basically, the pacing of this obviously is going to be a huge area of focus for the investment community. Any kind of general comments you can talk about, progression of MA recovery over the next couple of years beyond 2025 would also be appreciated. Thank you.

Thomas F. Cowhey

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

A

Yeah, Steve, maybe I'll start, and then I'll turn it over to Steve, because I think it would be good for you to hear from him about how he's been thinking about this business and how he's been moving the business along, the Aetna business.

The business itself ended the year with margins consistent with what we last said. They were in the negative 4.5% to 5% range. We're improving that margin in the current outlook. It's not getting back to breakeven, so it will be loss-making. And I think that's one of the biggest swing factors is performance of that business this year between the high and the low end.

A lot of that, I think, is ultimately going to be driven by how Medicare performs over the remainder of the year, how some of those changes in benefits that we made and the changing membership mix and how those new

members perform. And so I think there's still a lot of opportunity there over time to get that back to the 3% to 5% target margins we talked about.

Steven H. Nelson

Executive Vice President and President, Aetna, CVS Health Corp.

A

Well, thanks Tom. Good morning. Actually happy to make a few comments, just kind of perspective generally about Aetna, and then I'll go into the Medicare Advantage business. But, first of all, thrilled to be part of the CVS Health leadership team and honored to lead Aetna.

I've competed against Aetna for many years and found it to be a really strong brand and really known for its innovation in both product and clinical. And so my early read is there's a lot to build on.

And I add my commitment – my personal commitment to David's remarks and Tom's and the entire CVS Health leadership team and the Aetna team, to return Aetna to its target margins over a multiyear period, so encouraged in the early days and confident that we can do that.

I think we've made some really quick progress in a lot of areas. I will just highlight a few. Our capabilities around forecasting and all the levers and capabilities around managing total cost of care, really encouraged by the early progress and really meaningful progress there.

Also, as you think about our pricing discipline. That's been a topic a lot here, and I'm very encouraged about what we've done there and that specifically relates to Medicare Advantage, our Individual Exchange business and honestly, our Commercial business as well.

And then we've been leaning into member experience with our cutting-edge technology and really happy with some of the progress there. We've stabilized our operations and strengthened them, which has led to and evidenced by a really well-executed welcome season in January. And we've also welcomed one of the largest accounts ever sold in Aetna, the state of North Carolina, and that implementation has gone really, really well.

Specifically in Medicare Advantage, the combination of the Stars tailwind, best in the industry performance there, the discipline that we use when we put together 2025 benefit plan and then the really well-executed AEP, I think all points to a really strong future for our Medicare Advantage business. It's positioned well, the momentum we've talked about.

And specifically, this was a day-to-day, almost hour-by-hour, kind of decision that we made through this execution where we looked at our product mix, and there were several products that we did not see a path to the target margin, and we exited those products and then transitioned our members into new products, and that's gone better than expected.

And so that's just kind of one piece of evidence about how we're executing, how we're thinking about the business, super committed to being an excellent performer and a leader in Medicare Advantage. So I could go on, but I'll just say my early days here, my first three months, I'm very encouraged and very confident in our path forward.

J. David Joyner

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

A

Thanks, Steve. Maybe just one other comment. As I look at the last 90 days with Steve's onboarding, the Aetna team has been incredibly resilient. There's obviously been a lot of pressure and a lot of focus on the turnaround

efforts. And I think Steve's ability to manage and lead and deliver a better and improved culture around that organization has allowed us, I think, to perform and execute, which is really the theme of the day, which is making sure that we deliver and execute against the commitments that we made.

And so we started with the open enrollment, which there was a lot of fine-tuning and making sure we had the right mix. And then we couldn't lose sight of the largest account that we onboarded with the State of North Carolina, which was done – the team did just an exceptional job of staying focused and delivering on the service levels for our customers.

Operator: Thank you. We now have Andrew Mok with Barclays on the line.

Andrew Mok

Analyst, Barclays Capital, Inc.

Q

Hi. Good morning. We spent a lot of time talking about Medicare margins, but you also took aggressive actions on the individual ACA business. So I was hoping you could elaborate on those actions, including any changes to provider networks and expected impact on margins embedded in guidance. Thanks.

Thomas F. Cowhey

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

A

Sure, Andrew. Happy to take a shot at that. As you think about that business, so they ended the year at about 1.85 million members, and it's going to probably be sub-1 million members this year. And that's consistent with the actions that we took. This is a business that had about \$10 billion of premiums last year and lost nearly \$1 billion, and that's just not acceptable performance.

So part of that performance last year was, as we've talked about, that we had a risk-adjusted true-up out of 2023. And I think we've spent a lot of time with the team, with the new CFO there on thinking about how it is that we want to accrue, how we want to understand what the Wakely data is telling us and what the potential risks associated with that data are. I feel good about where it is that we are booked at the end of this year that that should hopefully not be a problem that comes back to bite us in 2025.

So then the question becomes what is the value of the actions that we took. And with a membership mix that has churned so substantially, we think that we will make progress, but we really need to understand a little bit more about who even some of those members are because they have until the end of March to pay their first month's premium and be retroactive.

But we feel good that we will make margin improvement in that business. That's embedded in the guidance. It will not get back to breakeven this year. And it's something that we continue to watch very closely, particularly given the high levels of trend that we experienced and accelerating levels of trend we experienced in that book into the tail-end of 2024. Steve, I don't know, anything you want to add on that?

Steven H. Nelson

Executive Vice President and President, Aetna, CVS Health Corp.

A

Yeah, sure. I'll just add a couple of points. Similarly to the Medicare Advantage AEP execution, I would point to the OEP execution for this business where we made some really positive changes in the geographic and product mix in addition to the pricing discipline. So I think that takes this business into 2025 with improved momentum.

But you referenced network and we are definitely taking a look at all components of what it takes to be successful in this business and not just network contracts, but network design, how we think about our capabilities around risk adjustment. Managing the total cost of care in this population is different than other populations. And so, improving our capability and capacity and just overall, I would just say, sort of confidence in this business has been a priority, and really like the position that we have now going into 2025.

But look, the business needs to perform at target margin, and we're committed to getting it back to that. It plays a really important role for individual consumers and it does play a role in our portfolio, but it needs to perform at the target margin. So I think we're taking good steps, more work to do, but we're committed to getting – returning it to its target margins. Off to a good start.

Operator: Thank you. Your next question comes from Erin Wright with Morgan Stanley.

Erin Wilson Wright

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks for taking my question. How should we think about the quarterly progression for MLR? And you gave us some of the detail on your overall assumptions from a utilization perspective for 2025, but any nuances to consider as we model out for the year, for instance, how IRA should flow through throughout the year? And any surprises on that front or elements to think about as we think about that quarterly? Thanks.

Thomas F. Cowhey

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

A

Thanks, Erin. So, yeah, I did have some comments about seasonality in the prepared remarks. We think it's going to be more of a 55-45 first half, second half split this year. And the primary driver of the seasonality change is Health Care Benefits and it's really that IRA impact, but also don't forget the PDR kind of messes a little bit with the cadence of earnings in 2024, hopefully something we won't have to deal with again.

But as you think about the inflation reduction impacts to the Part D premium, we now get that premium upfront and monthly and we no longer have the same level of reinsurance protection, particularly at the back part of the year. So your MBRs for the Aetna business, they're going to be lowest in the first quarter and they're going to be highest in the fourth. And you could see 8 points of swing between the first and the fourth quarter as you think about the progression of earnings and the progression of MBRs there. And that's on the total of Aetna.

And the second and the third quarters will probably be more similar to each other, but there'll be a little bit more pressure in the third quarter than the second. But as you think about that changing cadence of earnings, just I would highlight just that's a good proxy for how to think about re-sloping it, given the PDP impacts on our book in particular.

Operator: Thank you. We now have Ann Hynes with Mizuho Securities.

Ann Hynes

Analyst, Mizuho Securities USA LLC

Q

Great. Thank you. Can you remind us with CostVantage, what is the headwind to growth the first year of the implementation? And when would you expect that to turn positive for you? And also, I know CostVantage is only focused on commercial contracts right now. Do you eventually believe it will impact Medicare contracts? And if so, what's the timing on that? Thanks.

J. David Joyner

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

A

All right. Can I just make – I'll make a couple of comments about CostVantage and TrueCost, and I'll let Prem speak specifically to how we're thinking about it flowing through for other product lines. I think this is a really important initiative for this enterprise. I mean we – this is something we announced in late 2023.

We felt like we needed to take a leadership position in terms of changing the marketplace from a market basket to individual price products. We thought this was important for adding simplicity and transparency and was a major push and initiative within the organization. And I'm proud to say we've been able to move the market because we've done this collectively as an enterprise, both leveraging the work that we've done in CVS Pharmacy as well as the TrueCost product portfolio that we have within Caremark. So, Prem, maybe I can have you speak to how we're thinking about CostVantage from a margin standpoint.

Prem S. Shah

Group President & Executive Vice President, CVS Health Corp.

A

Yeah. Thanks, David. And Ann, thanks for the question. So if you think about CostVantage, as we reiterated at the end of 2023 and we walked through this last year, there's really three things that CostVantage was addressing. First and foremost, it was really a shift of our pharmacy reimbursement model to more closely align to our underlying cost of our business and the value that we create as a local community pharmacy for the tens of millions of patients that we serve.

Secondly, when you think about pharmacy reimbursement, there was a lot of cross-subsidization across brands and generics, and this allows us to ensure more stable pharmacy margins and a more durable kind of process as you think about what we do inside the pharmacy supply chain, which is essentially serving the patients at the counter for a more predictable margin for every script that we dispense. And lastly, it creates the path for transparency for PBMs to provide that transparency in their drug pricing as well.

And in our conversations with payers, I'm excited to say that we got this across the finish line, 100% of our commercial market. Your question as it relates to Medicare and Medicaid, we're actively working for 1/1/2026 to move the rest of our book into a CostVantage-like model. Our initial result is from CostVantage and the industry-leading cost of goods that we have, PBMs and payers will benefit from this, and we're trending toward delivering more than \$100 million of annualized purchasing improvement across all of our generics to the PBM and payer customers under CVS CostVantage contracts.

And as we continue to improve cost of goods, we pass that through CostVantage to our customers. And as we continue to move forward, we're excited about building this with our payers to create more clinical models and clinical solutions at the counter, where we can leverage the 30,000-plus pharmacists we have serving patients day-in and day-out.

Operator: Thank you. We have our final question on the line from Elizabeth Anderson with Evercore. Please go ahead.

Elizabeth Anderson

Analyst, Evercore ISI

Q

Hi, guys. Good morning. Thanks so much for the question. Thanks for all the color on the 2025 outlook in particular. I know you said you were looking at 4 points of Medicaid improvement year-over-year in terms of the pricing. Can you – and that you had 40% of it was sort of caught up. Can you talk about how that catches up over

the course of 2025? Should we think of that as like broadly ratable? Or are there any other kind of considerations to think about for that?

J. David Joyner

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

Go ahead, Steve.

A

Steven H. Nelson

Executive Vice President and President, Aetna, CVS Health Corp.

Sure. I'll start and then, Tom, I'm sure you'll have some thoughts, too. But yes, so the team has worked really hard, the local Medicaid teams, across all the different states, worked hard through the redeterminations and worked closely with state partners in combination with our great government affairs team.

And yes, we are anticipating about a 4.5% year-over-year increase as we start 2025. But we have more work to do as we go through the course of the year. And I think that's just going to play out as we continue to work on actuarial soundness with our state partners to make sure the program is adequately funded. But really like the beginning position and the work that's been done. So more work to do. But Tom, any other comments?

A

Thomas F. Cowhey

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

No. Elizabeth, I'd say, the 4.5% on the first 40% of renewals in January is a great start. We're cautiously optimistic that there might be opportunity there on the backside. But our current outlook doesn't assume that we get that same level of rate increase when we see the next bolus. I think we've got about another 40% that renews around the third quarter.

And so our presumption in our forward outlook is that the rate increases there will not be as robust. But we are working, as Steve said, on the advocacy with all of our states. They understand the problem. But the rate timing of when they recognize actuarially sound rates is not always at the pace that we would like them to.

A

J. David Joyner

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

All right. Thank you, Tom, and thank you, Elizabeth. So this wraps up the call today. And before I close, I just want to especially thank our over 300,000 dedicated colleagues. I'm grateful for you, for your commitment to the communities we serve and for your tireless dedication to improving health in America person-by-person.

So thank you for joining our call today and we look forward to providing updates on our progress throughout the year.

Operator: Thank you all for joining today's call with CVS Health. I can confirm, today's call has now concluded. Please enjoy the rest of your day, and you may now disconnect from the call.

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