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# EDITED TRANSCRIPT

CVS - Q1 2020 CVS Health Corp Earnings Call

EVENT DATE/TIME: MAY 06, 2020 / 12:00PM GMT

## OVERVIEW:

Co. reported 1Q20 consolidated total revenues of nearly \$67b and adjusted EPS of \$1.91. Expects full-year 2020 GAAP diluted EPS to be \$5.47-5.60 and adjusted EPS to be \$7.04-7.17.



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## CORPORATE PARTICIPANTS

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**Jonathan C. Roberts** *CVS Health Corporation - Executive VP & COO*

**Karen Sue Lynch** *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

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## PRESENTATION

### Operator

Good morning and welcome to the CVS Health First Quarter 2020 Earnings Conference Call. A question-and-answer session will follow CVS Health's prepared remarks. As a reminder, this call is being recorded.

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

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**Valerie C. Haertel** - *CVS Health Corporation - SVP of IR*

Thank you, and good morning, everyone. Welcome to the CVS Health First Quarter 2020 Earnings Call. As a reminder, this call is being recorded. I'm Valerie Haertel, Senior Vice President of Investor Relations for CVS Health. I am joined this morning by Larry Merlo, President and CEO; and Eva Boratto, Executive Vice President and CFO.

Following our prepared remarks, we'll host a question-and-answer session that will include Jon Roberts, Executive Vice President and Chief Operating Officer; Karen Lynch, Executive Vice President and President of Aetna; and Alan Lotvin, Executive Vice President and President of Caremark. (Operator Instructions)



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In addition to this call, our press release and Form 10-Q, we have posted a slide presentation on our website.

Please note that during this call, we will make certain forward-looking statements that reflect our current views, including our financial projections and statements related to our future financial performance, future events, industry and market conditions and the future impact of COVID-19 on our enterprise. Our forward-looking statements are based on management's estimates, assumptions and projections and are subject to significant uncertainties and other factors, many of which are beyond CVS Health's control, including the future impact of COVID-19 on our enterprise. We strongly encourage you to review the information we file with the SEC regarding these risks and uncertainties, in particular those that are described in the Risk Factors section of our 2019 Annual Report on Form 10-K and the cautionary statement concerning forward-looking statements and risk factor disclosures in our quarterly reports on Form 10-Q. You should also review the section entitled Cautionary Statements Concerning Forward-looking Statements in this morning's earnings press release.

During this call, we will use non-GAAP financial measures when talking about the company's performance and financial condition. In accordance with SEC regulations, you can find a reconciliation of these non-GAAP measures to the most directly comparable GAAP measures in this morning's earnings press release and the reconciliation document posted on the Investor Relations portion of our website.

And as always, today's call is being broadcast on our website, where it will be archived for 1 year.

Now I'd like to turn the call over to Larry.

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**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

Well, thanks, Valerie. Good morning, everyone, and thank you for joining our 2020 Q1 earnings call.

These are certainly unprecedented times for us all. And at CVS Health, our dedicated colleagues have been working on the front lines in the fight against the COVID-19 pandemic, responding in real time with solutions for consumers and patients across the country. And I'd like to take a moment to express my sincere gratitude to our colleagues for their work in all parts of our organization. They are doing a phenomenal job of responding to the needs of our communities, and I could not be more proud of their efforts.

Now as we all know, over the last couple of months, the situation has rapidly intensified as the pandemic has spread from coast to coast. Federal, state and local governments, in partnership with the private sector, have worked to curb the spread of the virus and its impact on our population and the economy. And CVS Health as one of the largest providers of essential services, we are supporting these efforts through our community reach, local presence, broad health care offerings, digital capabilities and our hardworking colleagues, and we are part of the solution during these difficult times.

So let me provide an overview of the actions we've taken in response to COVID-19 with 2 key priorities in mind. First is the well-being and safety of our colleagues, consumers and communities we serve. Second is maintaining the continuity of our businesses and operations. Now to do that, we are making investments to support our consumers, clients and members while deepening our relationships and advancing our long-term strategy of being the most consumer-centric health company.

Starting with our colleagues, we took swift action designed to keep them safe while we kept our stores and other operations up and running with minimal disruption. We implemented social distancing practices, enhanced cleaning protocols, distributed personal protective equipment and outfitted stores with Plexiglass barriers. We also provided our colleagues with enhanced benefits and resources, including family support, and announced bonuses for our frontline colleagues for their outstanding work. All of these actions have helped ensure the continuity of our operations at a time when they are needed the most.

For our consumers and members impacted by COVID-19, we are providing them with continued access to quality health care while relieving some of the added costs and stress resulting from the pandemic.

As previously announced, we waived copays for COVID-19-related diagnostic testing for all of our insured members.

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For our Commercial and Medicare Advantage members, we waived member out-of-pocket costs for COVID-19-related inpatient admissions and telemedicine visits through early June. We have taken a broad approach to helping address the mental and emotional health impacts of the pandemic, including access to telehealth and expanding our employee assistance programs for our members. We're also proactively reaching out to the most at-risk Aetna members to educate them about COVID-19 protection measures and resources available to them. And we're sending care packages to affected members to show our care and support.

CVS Pharmacy has waived the fees associated with home delivery for prescriptions and accompanying front store products for all consumers. And both Aetna and Caremark have worked with clients and their members to support medication access and adherence by waiving early refill limits and extending previously approved prior authorizations for maintenance medications. And for our Aetna-contracted health care providers, we are streamlining processes, easing administrative policies, making timely payments and enhancing telemedicine policies to allow them to focus on patient care.

To support our communities, we are creating action-based solutions alongside local, state and federal government partners as well as industry peers. For example, across 5 states, we have opened large-scale COVID-19 testing sites. And to date, we have administered nearly 90,000 tests with real-time results. We are also working to further expand our testing capabilities, which will continue to play an important role in helping with the reopening of the economy. We recently expanded our Coram services nationwide, working in partnership with hospitals and providers to help transition eligible IV therapy patients to home-based care, freeing up important hospital capacity. And finally, we are well positioned to provide medication therapies and vaccines when they become available at our retail pharmacy locations nationwide.

Now the actions we have taken all point to our strategy of making health care access local and simple while helping people achieve their best health. And we have worked to accelerate pilots and innovation. And in conjunction with additional actions such as relaxing regulation, we are seeing a new normal emerge. And in the near future, there will be an evaluation point of what worked and what didn't, and, as a result, we expect that elements of today's new norm will become part of tomorrow's everyday routines.

While the actions we have taken in response to the pandemic come at a cost, we believe these investments in our people and our businesses are the right decisions, and our differentiated offerings have enabled us to play a key role in responding to the pandemic.

So what has been the response to the actions we have taken? Well, it is clear our consumer-centric digital strategy has become even more relevant in the current environment as people are using technology more while they stay in place. We've achieved higher levels of engagement across our digital assets in Q1, a trend which began in January and accelerated with COVID-19. And let me provide you a few examples.

Utilization of telemedicine for virtual visits through MinuteClinic is up about 600% compared to Q1 '19. Retail prescription home delivery is up more than 1,000%. Additionally, we saw a fourfold increase in the number of consumers adding front store items to their prescription deliveries, let's call it, the front store attachment rate. We also saw a double-digit percentage increase in app usage across CVS Pharmacy, Caremark and specialty year-over-year. And as an example, in specialty pharmacy, digital refills were up approximately 50%.

Additionally, in our Aetna health app, we engaged more households in Q1 than we did in the first 3 quarters of 2019. And to support our COVID-19 testing sites, our team used our digital platform to quickly launch a streamlined experience, which has enabled online screening and scheduling for testing, with 85% of consumers highlighting a positive experience.

So we are pleased to see higher rates of customer satisfaction and loyalty, thanks to our colleagues' hard work and innovation. And we will continue to mobilize our resources to support nationwide efforts to combat the virus.

So with that, let me quickly touch on our first quarter results and how COVID-19 has impacted our business performance.

In the quarter, we delivered adjusted earnings per share of \$1.91 with total revenues of nearly \$67 billion, up 8%. Our underlying core performance was strong, and in March, COVID-19-related business activity added approximately \$0.10 to our Q1 adjusted earnings per share. And our performance reflects an acceleration of prescriptions dispensed, strong front store sales and a modest reduction in discretionary medical utilization, all largely driven by COVID-19.

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Now we've been able to maintain an adequate supply of medications to meet the increased demand from our customers, benefiting from the scale and expertise of Red Oak. And setting aside the impact of COVID-19, our Q1 results demonstrate the continued success of our integrated health care strategy, which is resonating with stakeholders across the health care system.

Now we are leaving our full year 2020 adjusted EPS guidance range unchanged at \$7.04 to \$7.17, and Eva will take you through the key considerations on our guidance. It is important to note that there are a variety of actions and market forces that will present opportunities as well as risks as we move forward. And rest assured we are diligently working to minimize the adverse effects while harnessing the opportunities to expand access to affordable care and deliver cost saving solutions to our clients and their members.

CVS Health will continue to fight this pandemic on the front lines, and this challenging time demonstrates the importance of our holistic, consumer-centric, enterprise-wide approach. We are committed to supporting the nation so that we come out on the other side stronger together with the communities that we serve.

And with that, I will turn the call over to Eva.

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**Eva C. Boratto** - CVS Health Corporation - Executive VP & CFO

Thanks, Larry, and good morning, everyone. Like Larry, I want to take this opportunity to thank all of my colleagues for their hard work, courage and dedication as we navigate this difficult time. As Larry mentioned, the onset of the COVID-19 pandemic brought about new challenges to all of us, and CVS has been adapting our business operations to support our key stakeholders.

Through this pandemic, we've continued to advance our cost reduction priorities, including delivering integration synergy goals and our transformative goals to become a more digital enterprise. The rapid changes across the country in response to COVID-19 have led us to accelerate some of those initiatives.

In light of the COVID-19 uncertainty, we also took steps to enhance our liquidity and strengthen our capital. We issued \$4 billion in bonds in March as a preemptive measure against cash needs in a severely adverse scenario. While this debt will add about \$15 million additional interest expense monthly, it puts us in a strong liquidity position to weather potential crises with access to over \$5 billion of cash and short-term investments at the end of March as well as \$6 billion available by issuing commercial paper we're borrowing under our backup credit facilities and strong operating cash flows.

Once we return to normalcy, we expect to repay the incremental debt. We will also continue to prudently manage our operating expenses and will reduce our planned capital expenditures by \$200 million this year. Our long-term leverage target remains unchanged, and we continue to prioritize paying down our debt and maintaining our dividend with no share repurchases planned until we meet our leverage target.

Moving to first quarter results. Adjusted earnings per share was \$1.91, nearly 18% higher than prior year. Consolidated revenues increased 8.3% year-over-year with growth coming from all segments. Our business performance exceeded our expectations due in part to strong execution and our ability to meet elevated consumer and member needs resulting from COVID-19. We generated \$3.3 billion of cash from operations and returned approximately \$650 million to shareholders through cash dividends in Q1.

Turning to our operating results for the quarter by segment, Pharmacy Services total revenue increased 4.2% year-over-year. Specialty pharmacy revenue increased 19%, reflecting the full benefit of IngenioRx that we started onboarding in Q2 2019. Brand inflation also contributed to the increase.

Total revenue growth was partially offset by the previously disclosed client losses and continued price compression. Total adjusted scripts increased 12.4% with approximately 125 basis points related to COVID-19 activity.

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Pharmacy Services adjusted operating income increased 24.7% versus last year driven by specialty pharmacy volume, our continued improvement in purchasing economics and an increase in generic dispensing rate. Growth in the quarter was partially offset by the previously mentioned client losses and continued price compression.

Within Pharmacy Services, there was minimal impact from COVID-19 to operating income during the first quarter.

We continue to progress nicely in Pharmacy Services 2021 selling season with more than 70% of renewals complete with a strong retention rate.

Moving to Retail/Long-Term Care. COVID-19 had a meaningful impact on segment performance with our retail pharmacies meeting essential needs of consumers and patients. Total revenues were up 7.7% with adjusted operating income up 27.7% year-over-year. A few key factors drove the results.

As Larry mentioned, we delivered strong pharmacy and front store volume. Adjusted script growth of 8.2% was primarily driven by the continued adoption of our patient care programs, COVID-19-related volume and leap day. We estimate COVID-19 impacted adjusted script growth by about 200 basis points.

Front store total revenues increased 8.5%, of which a significant portion was due to COVID-19. Before the surge related to COVID-19 began, front store total revenues were up about 2%.

Adjusted operating income growth was driven by strong sales performance, benefit from generics, front store margin improvements and lower SG&A, with SG&A reflecting favorable resolution of legal matters and our ongoing modernization efforts. The growth was partially offset by continued pharmacy reimbursement pressure. COVID-19 contributed about 40% of the adjusted operating income growth for the quarter, including the impact of additional operating expenses.

Moving to Health Care Benefits, total membership increased 2.4% or 554,000 sequentially. Consistent with our strategic focus, we are pleased with our strong sequential Medicare Advantage membership growth of 11.3%, outpacing the industry average.

In Medicaid, we're also pleased with the strength of our sequential membership growth driven primarily by the acquisition of IlliniCare. Commercial membership is down sequentially primarily due to a decline in public and labor. On a year-over-year basis, total revenues increased approximately 7.4% primarily due to strong Government products growth.

Operating expenses increased versus prior year primarily due to the reinstatement of the HIF and our Government membership growth, including higher cost related to the onboarding of IlliniCare members. This increase was partially offset by savings initiatives, including integration synergies.

MBR was 82.4%, primarily reflecting an improvement from return of the HIF. During the quarter, we also saw reduced discretionary utilization related to COVID-19 that started in mid-March. This was partially offset by the growth in our Government business and the impact of leap day.

In Medicaid, while we are pleased with the membership growth, we are experiencing pressure on our MBR due in part to a heavier and longer flu season as well as higher-cost claimants in certain states.

Health Care Benefits adjusted operating income was slightly lower year-over-year, reflecting all the factors I just described. COVID-19 had a modest impact on Health Care Benefits segment for the first quarter as the deferral of discretionary utilization more than offset the impact from lower net investment income, including realized capital losses.

The Corporate segment adjusted operating loss increased by \$54 million over 2019. This was predominantly related to higher legal and transformation costs. In addition, the segment recorded realized capital losses related to the capital markets volatility in Q1. Going below the line, interest expense was lower by approximately \$50 million due to the lower average debt for Q1 2020 compared to 2019.



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Prior to COVID-19, our underlying core business performance was strong. While acknowledging the inherent and unprecedented uncertainty surrounding the ongoing COVID-19 pandemic and its impact, we are leaving our full year 2020 enterprise GAAP EPS and adjusted EPS guidance ranges unchanged at \$5.47 to \$5.60 and \$7.04 to \$7.17, respectively. Cash flow from operations guidance for the full year of \$10.5 billion to \$11 billion is also unchanged. This view is subject to a number of key considerations, including the significant uncertainties that continue to exist around the severity and duration of the COVID-19 pandemic, including its impact on the U.S. and global economies, consumer behavior and health care utilization patterns. Additionally, the timing, scope and impact of stimulus legislation and other governmental responses to the pandemic remains to be seen. The financial impact of these factors on the company will become clearer in the months to come.

Given the unusual situation this quarter, I will elaborate on what we are seeing for select metrics in April. Our slides provide the March comps along with the April comps for additional context.

Prescriptions are about flattish in both Retail/ Long-Term Care and Pharmacy Services compared to April 2019 as we saw the March pull forward of prescriptions reverse and a drop in new prescriptions related to lower physician visits.

Front store sales were down about 11% compared to April 2019 as increased basket size was more than offset by a reduction in store traffic as shelter in place took hold. The reduction in discretionary utilization that Health Care Benefits started to see in mid-March continued through April. And based on what we know today, our MBR could be at its lowest level in Q2. Early data for the month of April suggests decreases in utilization of about 30% across an array of services compared to April 2019. Additionally, we cannot predict what impact delays in utilization will have on its members with chronic conditions as mistreatment could adversely affect their health. In addition, Q2 will reflect a significant increase in COVID-19-related operating expenses over Q1 as we recognize the investments we made in business continuity and other initiatives Larry mentioned.

The quarterly cadence of earnings is likely to vary from historical patterns, and other key performance metrics are likely to play out differently than we expected at the time of our last earnings call.

Given all of the moving pieces, we are not providing our more detailed guidance today.

With that, let's open up the line for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We'll take our first question from Lisa Gill of JPMorgan.

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**Lisa Christine Gill** - *JP Morgan Chase & Co, Research Division - Senior Publishing Analyst*

And thank you, Larry and team, for all that CVS is doing on the front lines. Let me just first start. Eva, one of the comments you made is that there was a strong underlying core versus your expectations in the first quarter. Can you just maybe talk about what areas performed better on the core side than you were expecting? And I know you're not going to give any incremental guidance, but I just want to understand how we think about the front end and the impact to overall results. So you talked about the April sales, and I appreciate that being down 10.9% on the front end. If it stays like that for some period of time, how does that impact the overall results as we think about the core guidance that you gave?

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**Eva C. Boratto** - *CVS Health Corporation - Executive VP & CFO*

It's Eva. Thanks for your question and your comments about everything the company is doing. I think as we commented on the strong underlying core, right, I'll start with the PBM, you saw really strong top line and bottom line growth with specialty leading the way. We're realizing the benefits

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of some of the initiatives that we had started last year in underlying sales in the PBM. So we're pleased with that and the performance we reported was above our initial expectations.

Additionally, as you look at the retail business, again strong performance ex COVID. Pleased with the front store comps of 2% prior to COVID. Continued strong script growth, and we reported over 8% script growth. When you adjust for COVID, you're still above 6%, and that's the continuation of our patient care programs and what have you.

And from a Health Care Benefits perspective, I'd say our results were largely in line. We're pleased with the growth in the government sector. But on the Medicaid front, as I outlined, we have some MBR pressure that we're working through.

Lisa, on the guidance question, there -- I'll say there are a host of assumptions underneath us leaving our guidance unchanged, and it's based on another factor. As you look at states coming back on board, I don't think it's, I'd say, consistent across the country, right? It'll be state by state, and we've really tried to factor all the different pieces in. And Jon, I don't know if you want to add anything on the front store.

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**Jonathan C. Roberts** - *CVS Health Corporation - Executive VP & COO*

No. I mean, Lisa, listen, all categories are obviously down in April coming off from the peak in March. And it's still very early. We have very limited data, but we are seeing that as shelter in orders (sic) [shelter-in-place order] are lifting and we return our hours of operation to the normal hours, we're beginning to see sales improve. So still early, but the early view is improving.

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**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

And Lisa, it's Larry. Just maybe one final point on it specific to front store sales. Keep in mind front store now represents 8%, 9% of enterprise revenues. Continues to be important. And team has done a great job in terms of -- you think about the underlying ex COVID, the sales performance was around 2%. So that reflects a lot of the activities that we've talked about in the past around personalization.

Lisa, I think one of the things that we're seeing and learning is -- and we talk about things that are happening today that are part of today's norm, but things that will migrate from today's norm to tomorrow's everyday routines. And as you heard in our prepared remarks, we've seen a dramatic increase in home delivery.

One of the questions that we've always had is how do we increase the front store attachment rate to prescriptions. And again, we've seen a fourfold increase in terms of those prescriptions being accompanied with a front store purchase. So we think that's an opportunity that we can capitalize on as we begin to return to, I'll say, a new normal environment.

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**Operator**

Our next question comes from Eric Percher of Nephron Research.

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**Eric R. Percher** - *Nephron Research LLC - Research Analyst*

Eric Percher and Josh Raskin here from Nephron. Maybe building on the last question of what a new norm may look like. You spoke to some of the shifts occurring in mail, kind of like specialty shift and home infusion. How material are these? Do you see the shift, I think mail is 5% of all scripts, as being material. And obviously, across your models, you can capture them a couple of ways. And I'd love to hear the same on specialty and infusion and whether you think there are share gains from the hospital channel as well.





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**Larry J. Merlo** - CVS Health Corporation - President, CEO & Director

Yes, Eric, it's Larry. Maybe I'll start and ask Alan to talk more specifically on mail. I think the Coram, the home infusion, is a great opportunity. It ties back to something that we've talked about many times when you think about how do we provide care in the right care setting with the variables being convenience as well as cost. And our infusion nurses have made 60,000 visits since the pandemic began, which is a great example of what we're talking about in terms of we freed up important hospital capacity by working with the hospitals in terms of expediting discharge back into the home for those patients who needed to continue to require IV therapy and were well enough to do that within the comfort of their home, and we're able to provide that service.

So Eric, a lot of this goes back to the strategy that we've been talking about for the last couple of years in terms of what we can do to make health care local and simple, whether it's in the community, in the home or in the palm of your hand.

**Alan M. Lotvin** - CVS Health Corporation - Executive VP & President of CVS Caremark

So Eric, it's Alan Lotvin. I'll add a couple of points, one on home delivery. We've seen increase in home delivery in mail. But I think when you think about mail and the power of our enterprise, we have the ability to bring prescriptions to people's home not only through traditional mail but also, as John talked about, through home delivery from retail, and that's also up dramatically.

And the last point I would make is that as we talk about the early view into what we're seeing with mail and specialty in April, we're not seeing the same patterns of decline that we're seeing in the retail network.

**Eric R. Percher** - Nephron Research LLC - Research Analyst

And along the same lines of early views, are you seeing any change in pre-authorizations on the HCB side relative to that 30% decline, where that may move?

**Karen Sue Lynch** - CVS Health Corporation - Executive VP & President of the Aetna Business Unit

It's Karen. In April, with pre-auths, we saw almost a 40% decline in prior authorization. And in utilization, it's like down 30% through April. I would tell you that as states are opening up, however, we have seen an uptick in pre-auths and pre-certs but not dramatic increases yet.

**Operator**

Our next question comes from Ann Hynes of Mizuho Securities.

**Ann Kathleen Hynes** - Mizuho Securities USA LLC, Research Division - MD of Americas Research

So just for clarification, Eva, I know you said that the Health Care Benefits segment results were in line with your estimates. So when I look at your prior guidance for Health Care benefits, the operating profit guidance was up 5% to 6.7%. So is that decline of negative 4.5%, was that Q1 decline in line with your expectations going into the year will be my first question.

And my second question is, and you touched this in your prepared remarks, can you just remind us some of the initiatives you did in 2019 in specialty which resulted in such strong results?



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**Eva C. Boratto** - CVS Health Corporation - Executive VP & CFO

Yes. Sure. So on the Health Care Benefits, yes, I would say that the results are largely in line, as I said before. And as you think about the results, a couple of things are elevated in Q1 as we're onboarding the growth in the Medicare business that we spoke to as well as IlliniCare and bringing that acquisition on. And recall I spoke last year to some stranded costs related to the Aetna PDP divestiture. We're aggressively working that down as we go throughout the year.

That said, I did highlight some of the pressure on the Medicaid MBR, and that certainly is something we're working through. And I'll let Alan provide some additional color on some of the specialty initiatives.

**Alan M. Lotvin** - CVS Health Corporation - Executive VP & President of CVS Caremark

Yes. So on the specialty side, Ann, we've expanded a program we call Specialty Expedite, which is a way to simplify the process of getting prescriptions started for both physicians and patients in short of time. It's been very well accepted in the provider community.

We continue to refine Specialty Connect, our approach to allowing patients to pick up or drop off prescriptions, specialty prescriptions at retail. It's a very, very popular approach. Again, resonates very strongly in the provider community. And then we've really continued to drive our digital adoption and the ability to interact with our specialty members via text and secure messaging, which again creates just a tailwind for us as we work more closely with these patients.

**Larry J. Merlo** - CVS Health Corporation - President, CEO & Director

And Ann, it's Larry. Just -- maybe just one final point. Keep in mind when we talk about 19% specialty growth, that now includes the specialty business within Ingenio in those numbers as well.

**Operator**

Our next question comes from Charles Rhyee of Cowen.

**Charles Rhyee** - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Yes. Just a follow-up from an earlier question around -- Jon, I think you were responding to Lisa's question around the experience you're seeing in the reopened states. Anything -- any more details you can give like a breakdown between not just pharmacy but also front end? And is it foot traffic that is accelerating? And talk about maybe how consumers are kind of responding as they're kind of going back to sort of a normal life is first.

And then just going back, I think, earlier in the prepared remarks, you talked about strong retention rate in the PBM business. Maybe talk about what new business activity looks like this year. Is it fair to think that with all the disruptions that employers are seeing, we should expect a lot less new business activity?

**Jonathan C. Roberts** - CVS Health Corporation - Executive VP & COO

Charles, this is Jon. I'll start. So we are -- I mean, if you look at where most of the COVID positive cases are, we're seeing more of a significant sales impact both in the front and in the pharmacy than we see in other areas that are less impacted. But as the shelter-in-place orders are lifted, we're turning back on our marketing programs with personalization that is a big part of our sales driving programs. We're also returning our hours of operation back to normal. So as an example, 75% of our stores reduced their front store hours of operation, and it was about 12% of the hours that were turning -- will return those back to normal as the communities open up.



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In pharmacy, we did less of an hour's reduction, about 2%. But listen, there were -- it's still very early, but we are seeing some positive trends, as I said earlier. In pharmacy, we're seeing less of an impact, and I think a lot of that is due to our home delivery program that Larry talked about in his remarks. But I think the biggest headwind we're seeing now in pharmacy is really around new therapy starts. So you've seen doctor visits are down. And as a result of that, we're seeing about 25% less or lower new therapy starts for April than we saw a year ago. So this includes new maintenance prescriptions as well as prescriptions for acute events, and they typically grow about 7% each year.

In certain drug classes such as antibiotics, new starts are down 40% to 50%. So as physicians start seeing patients again, we expect this volume to normalize.

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**Alan M. Lotvin** - *CVS Health Corporation - Executive VP & President of CVS Caremark*

And so I'll jump in. It's on the new business question. So I'll first talk about retention. As Eva mentioned, we've -- we're about 70% -- a little over 70% of the way through our own book. We're at a 97% to 98% retention rate. So we're very happy with that.

And with respect to new business, we'll talk more about that next quarter, but I will tell you that RFP activity is consistent with what we've seen over the last 2 years. We have not seen much of a slowdown. Obviously, I can't predict what's going to happen as we get towards the end of the year. But as of now, we're seeing roughly consistent with what we've seen in the last 2 years.

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**Operator**

Our next question comes from Ricky Goldwasser of Morgan Stanley.

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**Rivka Regina Goldwasser** - *Morgan Stanley, Research Division - MD*

Question is focused on your Medicaid comments around some of the higher cost. But if we look forward -- there was an article yesterday that talked about states that are starting to cut Medicaid rates. So what are your thoughts about how prevalent it's going to be this year, next year and the impact on margins? I think your long-term target at Investor Day was long -- low single digit to mid-single digits. So how should we think about the potential impact of rate cuts on that?

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**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

It's Karen. Relative to your first question on the pressure we're seeing in Medicaid, there's really 2 factors. One is that we had a longer flu season that impacted Medicaid. And the second was really around some unusually high, high-cost claimants in the Medicaid business.

Relative to the Medicaid business on a go-forward basis, it's a little early to tell. We are working very closely with our Medicaid states. We expect to see, obviously, improved enrollment in Medicaid as we continue to see unemployment increase over time. And we haven't had any state come back and cut rates on us yet, but obviously, we would manage to our medical costs and our operating expenses to try to maintain those single margins as appropriate.

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**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

And Ricky, it's Larry. One final point as you look forward. I think that your question around Medicaid margins is -- it's really an open question at this point because if you go back and look at the stimulus activity out of Washington, now there's dialogue beginning on a stimulus 4, and some of this is -- could really be framed as a policy question, that the stimulus to date has not addressed the issue of individual subsidies for COBRA, as an example, acknowledging that there's going to be a relationship between what happens to the Medicaid rosters assuming unemployment does increase to some number versus what happens with COBRA if there are subsidies applied for individuals to enroll in COBRA. So that's something that we'll be watching closely and having discussion around.



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**Rivka Regina Goldwasser** - *Morgan Stanley, Research Division - MD*

So just one follow-up on that. Do you have any view around what would be the risk profile. You can see that uptick in Medicaid enrollment. In past, you used to see sicker population actually signing up to the Medicaid benefit. Do you think that given what we're seeing in COVID and how it's impacting cross-section of the population, that you might have a different risk pool and maybe kind of like younger population signing up? Just wondering what your thoughts are on that.

**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

Ricky, I think if we look at historical patterns when we've seen unemployment, you look back at 2008, 2009 when we saw increases in Medicaid as well, what we saw was a more healthy population come in. I would expect to see that as well because we've got Commercial business, relatively speaking, healthy.

So I would think the risk profile would change somewhat and skew to a healthier group.

**Operator**

Our next question is from Justin Lake of Wolfe Research.

**Justin Lake** - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

A couple of things here. First, can you help us understand the \$0.10 benefit that you discussed here in terms of how much benefit to the bottom line from incremental revenue that you can talk to us about? And then thoughts on incremental cost in COVID in March that might have offset some of that benefit and how we should think about the incremental cost from COVID going forward for the rest of the year?

And then just my follow-up would be that what was the benefit of the legal resolution in the quarter in the pharmacy business that you'd noted in the results?

**Eva C. Boratto** - *CVS Health Corporation - Executive VP & CFO*

It's Eva. I'll take that question. I think if you look at the \$0.10 benefit, and we outlined this on our slide, Slide 19, I would think about Q1 -- you could see the benefit really largely coming from the retail segment as the other segments really had a pretty modest impact and there are some puts and takes.

And I think that as you think about the margins, the investments that we've made and that Larry outlined, a lot of those investments are largely going to hit in Q2 given the nature of those underlying investments. So think about the benefit. There are some investments but more generally in line with underlying margins as the other investments on compensation and what have you. And the additional protective gear really, really ramped as you came toward the end of the quarter.

Going back to your other question on the Retail/Long-Term Care segment, you could see year-over-year we have favorability in our underlying cost. And I'm not going to explicitly break out the legal matter, but year-over-year, we had some costs last year. We had some favorability this year. So net-net, it was a positive as you look at that outside growth.

**Operator**

Our next question is from Michael Cherny of Bank of America.



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**Michael Aaron Cherny** - *BofA Merrill Lynch, Research Division - Director*

I want to kind of summarize a few questions you had. Larry, you went through a lot of details early on some of the benefits you're seeing tied to the increase in telehealth, tied to some of the other dynamics on the ability to deliver at home. As you think about the pause you're taking on some of the longer-term investments, longer-term strategies and particularly around HealthHUB, is there anything you're learning through this pandemic that can better educate you on how to think about the HealthHUB build-out given that there are a lot of dynamics in place that would appear at this point to have people that want to stay away from the average traditional retail store versus coming into more? And so just balancing those dynamics with your approach towards having this incremental differentiated front-end health care service at a time when the entire world is rethinking how much time they want to spend outside their house?

**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

Yes, Mike, it's a great question, and I touched on this a bit earlier that what we're seeing, we see validating our strategy. And we talked about some of the use cases that we're seeing play out and -- whether it's home delivery, telemedicine, and I'll touch one that absolutely is in the community, and that's testing.

So Mike, when you think about -- we call it our triad of care in the community, in the home, in the palm of your hand, think about that as what we're defining here as omnichannel for health, and each one plays a role. But as individuals, we'll need all 3 in terms of what we do, when we do it and how we do it.

And so back to your question, our -- the learnings and the experience that we're seeing, number one, it validates our strategy. Number two, we're looking to further optimize what we're seeing to become part of an everyday routine. And I'll speak to the role of testing in the community as being an important part of diagnostics that, yes, we're focused on COVID testing today, but there's a broader universe of diagnostics and monitoring that we see becoming an important part of our HealthHUB strategy.

So look, we're evaluating all of the products and services road map, and I'm sure you're going to see us accelerate some of the things that are on our drawing board as a result of what we're experiencing.

**Operator**

Our next question is from Ralph Giacobbe of Citi.

**Ralph Giacobbe** - *Citigroup Inc, Research Division - Director*

I was hoping you could bifurcate the Commercial risk membership decline between economic factors versus either a loss or just shift to ASO and then how you're viewing the economic backdrop specifically as it relates to the commercial market. And then just a follow-up to that, is there any greater appetite to get back into the exchanges in a bigger way at this point?

**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

It's Karen. Relative to membership, we lost 2 very large folks in labor cases, and they were fully insured cases, which is really reflective -- reflecting the decrease in overall membership. And on a year-over-year basis, as you know, we have been -- we also have a decline, a small decline in small group. And as you know, we've been pushing on small groups to move it from insurer to ASO. We continue to see those trends.

Relative to the question on unemployment in the last 6 weeks, we do expect to see declines in the latter half of the year. We already are seeing some membership decline in April in our Commercial book as a result of the economic downturn. However, we are seeing an increase in our



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Medicaid membership as well in April. So that's really what we're seeing. But we do expect, depending on what -- how this plays out and what's the duration of this, that we'll continue to see decreases in our Commercial book.

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**Ralph Giacobbe** - *Citigroup Inc, Research Division - Director*

And then the exchanges?

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**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

I'm sorry?

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**Eva C. Boratto** - *CVS Health Corporation - Executive VP & CFO*

Exchanges.

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**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

Oh, in the exchanges. Yes. As you know, we are in the exchanges today, it is something that we continue to evaluate, and we'll continue to look at it. We obviously won't be in, in 2021.

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**Operator**

Our next question is from George Hill of Deutsche Bank.

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**George Robert Hill** - *Deutsche Bank AG, Research Division - MD & Equity Research Analyst*

Yes. I have 2. First for Eva. I'm wondering if you can unpack the PBM performance a little bit, maybe talk about the benefit of the improved purchasing economics and the cost savings versus lapping Ingenio planning and the negative impact of rebate guarantees.

And then, I guess a follow-up for Larry strategically, I guess how are you thinking about home delivery versus mail? And you talked a little bit about the retail attachment rate. Walmart is launching a 2-hour home delivery service. I guess do you see this as an answer for CVS to challenge kind of the incursion of online into retail?

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**Eva C. Boratto** - *CVS Health Corporation - Executive VP & CFO*

Okay. So George, I'll start with your question around the PBM. Obviously, as you look at the first quarter growth, right, it's outsized relative to how we spoke about the full year prior to COVID. But I think as you look at that in relation, right, the Q1 operating income growth is above what you would think about as a full year given the specialty benefits that Alan spoke about earlier disproportionately benefiting Q1 as we had the annualization of some generics and the new sales initiatives that Alan spoke about. We also had some timing related to other accruals.

At the core, though, specialty is performing very, very well. On the rebate headwind, I would say we continue to manage that. And the shape of the curve that I've described numerous times that 2019 was the peak, it would come down in '20 and diminishing or be de minimis in 2021, that continues. So that continues to be a benefit as well as just cost management and benefit from integration synergies.



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**Larry J. Merlo** - CVS Health Corporation - President, CEO & Director

And then, George, on your home delivery question. George, think about the discussions we've been having probably for the last year in terms of how do we make sure we don't leave any white space for disruption. And we started home delivery in a few marks -- in a few markets, and I think it was last fall where we expanded it coast to coast.

So George, you think today about -- you can pick up your prescription inside the store in most of our stores, through the drive-through, in the mailbox at the front door or at the office, and we're experimenting with UPS in terms of maybe on the [lawn] trial. So it's -- who do you want to be in terms of what makes the most sense for you from a convenience and access point of view at any given point in time? And when you look at our integrated model, we can satisfy all avenues of access and convenience.

**Jonathan C. Roberts** - CVS Health Corporation - Executive VP & COO

And George, this is Jon. The only thing I would add to that is the reason our home delivery program was so successful as this pandemic took hold is we have 70% of our retail customers engaged digitally. So it was very easy for them to make that transition. So I think that will help us as people decide how they want to get their prescriptions in the future.

**Operator**

We'll take our next question from John Ramson (sic) [John Ransom] Of Raymond James.

**John Wilson Ransom** - Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research

I was wondering, and for Karen, what the medical loss ratio would have looked like in the first quarter without COVID.

**Karen Sue Lynch** - CVS Health Corporation - Executive VP & President of the Aetna Business Unit

The COVID had minimal impact on the quarter. So you can look at that loss ratio and it's minimal. Obviously, it will have a big impact on -- in April as we're continuing to see big utilization drops.

**John Wilson Ransom** - Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research

Great. My followup is, when we look at the commercial marketplace, you're able to combine Aetna and the PBM in a single package. Do you think that we would see more what I would call cross-subsidization as you go to market, i.e., maybe using guaranteed rebates or some other such things such that the margin in the 2 businesses is less and less relevant as you sell them as a single package?

**Karen Sue Lynch** - CVS Health Corporation - Executive VP & President of the Aetna Business Unit

Yes. When we -- well, we do that today. We obviously will price the whole case, and we'll look at the whole case and price it to get a margin that we would want to get on that total case. So maybe not necessarily subsidizing one for the other. We look at the whole case and what we want to write it at.

**Eva C. Boratto** - CVS Health Corporation - Executive VP & CFO

So -- and Karen, just to add to that, right, we'll look at the value that can be generated across the enterprise as we move forward.

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**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

Yes.

**Operator**

Our next question is from Lance Wilkes of Bernstein.

**Lance Arthur Wilkes** - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Yes. And again, thanks a lot for everything that the CVS team has doing out there in the community. Just wanted to talk on HealthHUB a little bit and wanted to focus on 2 particular aspects. One is if you can talk a little bit about how telehealth is integrated in or how separate it is within MinuteClinic and now the HealthHUB structures and what your thoughts are going forward with that. And I guess the follow-up is given some of the instability in the physician practice and urgent care environment today with the drop-off in volumes, those are going to become much more significant acquisition targets going forward. Is acquisition an important part of how you're going to build out capabilities as you look at HealthHUB and maybe the expanded care delivery in retail?

**Jonathan C. Roberts** - *CVS Health Corporation - Executive VP & COO*

Yes. Lance, this is Jon, and I'll take telehealth and MinuteClinic. So we have the capability to do telehealth in MinuteClinic in every state that we operate in. And Larry spoke about the significant increase, I think it was 600%, in telehealth visits. So it's going to be an integral part of how we go to market moving forward.

And we just got some recent consumer research, and that compares last year consumer sentiment to this year's consumer sentiment, and this is one example. Where would they prefer to get their flu vaccines? And we saw a significant uptick in consumers that are interested in getting their flu vaccines in their local pharmacy as opposed to their doctor's office. So it's a good example how MinuteClinic will be able to provide services like that plus telehealth and provide the convenience and choice that consumers are looking for.

**Lance Arthur Wilkes** - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Great. And just on how you're looking at maybe the opportunities that could present themselves with respect to the practices that are out there. And I guess a follow-up on the telehealth. Are you actually having telehealth deployed using the MinuteClinic clinicians? Or is it in a centralized format?

**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

Yes, Lance, we actually have both where the telehealth is integrated with MinuteClinic as well as telehealth with physician is accessed through our digital applications. And we talked about the percent increase. Aetna is seeing about 60,000 telehealth engagements on a daily basis, which is a dramatic increase as well. And it's not just -- one of the things we were looking at is it COVID related. And the answer is no. We're seeing an increase in, I'll say, PCP utilization as well as an increase in, let's call it, behavioral health concerns and other type of specialist services.

So we do believe that it plays a complementary role to what we're doing with our HealthHUBs, and it brings us right back to community, home and hand.





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**Operator**

We'll take a question from A.J. Rice of Crédit Suisse.

**Albert J. William Rice** - *Crédit Suisse AG, Research Division - Research Analyst*

Glad to hear everyone's safe. Appreciate all the comments that were made about the economic impact on the health benefits business. I wonder if we could broaden it out. Obviously, it's been 10 years since the last economic downturn. How does -- how do you think the other businesses respond? And how are they maybe positioned differently today versus the last time we went into an economic downturn?

**Larry J. Merlo** - *CVS Health Corporation - President, CEO & Director*

Yes. A.J., it's Larry. A.J., look, it's probably premature and a difficult comparison because, to your point, a lot has changed over the last 10, 12 years, and there are still an awful lot of uncertainties as to where we're going to be in the latter part of this year.

I will say that the nature of our business is, to a degree, recession resistant. I wouldn't describe us as recession proof and whether it's what you're looking at around the role of our retail asset. And you think about our strategy that we've talked a lot about, the triad of community, home and the hand and the fact that as you think about the provision of health care in a more challenging economic environment, cost will become a bigger issue, and we believe that we have the assets and the capabilities when you think about the cost associated with care provision and the offerings that we have with our integrated model.

**Eva C. Boratto** - *CVS Health Corporation - Executive VP & CFO*

And Larry -- if I could just add, A.J. As you -- looking back at the past, this is an unprecedented situation and so many, so many unknowns. But as Larry highlighted, we're a different business. We have a lot of diversified assets. Karen got some questions on Medicaid. In our PBM, we have a very large Medicaid. We have a very large Medicaid. You saw and you heard in Larry's prepared remarks around the health services that we're offering and expanding and accelerating some of our diagnostic testing. So there's a tremendous amount of moving pieces, and we're going to work to really drive -- to drive the business forward in these challenging times.

**Operator**

We'll take our final question from Steven Valiquette of Barclays.

**Steven James Valiquette** - *Barclays Bank PLC, Research Division - Research Analyst*

I hope everyone's staying safe. Hopefully, you can hear me okay. Just a quick follow-up question regarding the -- those April prescription trends. I'm curious if there is any way from your analytics capabilities to determine how much of the slowdown in April was tied to the pull forward in March versus the reduction in physician visits. And you mentioned that 30% reduction in utilization of an array of health care services in April. Are in-person physician visits in particular down in line with that 30%? Or is it higher or lower from your view just separate from telehealth, obviously?

**Karen Sue Lynch** - *CVS Health Corporation - Executive VP & President of the Aetna Business Unit*

Yes. Let me just -- I'll give you a couple of the pieces in April relative to utilization. We saw pharmacy about flat. We saw inpatient down over 30%. Outpatient was down about 25%, and our physicians were down almost 35%. And then all other, which would be our lab and our radiology and home health kinds of services, they were down about almost 50%. So that just gives you sort of a broad array of the pieces that contributed to the 30% reduction in utilization.



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**Jonathan C. Roberts** - CVS Health Corporation - Executive VP & COO

And then, Steve, this is Jon. We saw a lot of 30- to 90-day conversions in March in pharmacy. So that did take some prescriptions out of the April pipeline. And I would say the -- when I talked about the new therapy starts being down, I think that is -- we think about it as being in line with physician visits. So as physician offices start to open and patients start coming back, we expect that volume to normalize.

**Larry J. Merlo** - CVS Health Corporation - President, CEO & Director

And Steve, the one thing that I do want to emphasize because I'm proud of the work that we've done at CVS, and quite frankly, I'm proud of the work that our industry has done, the continuity of the pharmaceutical supply chain is not something that you've seen a lot in the news, and everyone has worked hard to make sure those with chronic disease are staying adherent to their medications and not compounding this problem that we have today with COVID with another problem that would just gridlock our health care system. So it's really been a job well done in that regard.

So with that, let me just wrap up. And again, we're very pleased with our underlying business performance in the quarter. We believe, as you've heard from the dialogue we've had in the Q&A, that our integrated, innovation-driven health care model is proving to benefit participants across the health care system in these unprecedented times, and it will continue to do so both through the crisis and well into the future. And we remain focused on growing CVS as an integrated health care enterprise, and we'll continue to invest for sustainable, long-term growth.

So thanks again for joining us this morning and please stay safe and healthy, and we'll talk to you soon.

**Operator**

This does conclude today's CVS Health First Quarter 2020 Earnings Call and Webcast. Please disconnect your line at this time and have a wonderful day.

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