

03-Nov-2021

CVS Health Corp. (CVS)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning, and welcome to the CVS Health Third Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow CVS Health prepared remarks, at which point we will review instructions on how to ask your question. As a reminder, today's conference is being recorded.

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

Susan Vissers Lisa

Senior Vice President, Investor Relations, CVS Health Corp.

Thank you and good morning, everyone. Welcome to the CVS Health third quarter 2021 earnings call.

I'm Susie Lisa, Senior Vice President of Investor Relations for CVS Health. I'm joined this morning by: Karen Lynch, President and Chief Executive Officer; and Shawn Guertin, Executive Vice President and Chief Financial Officer. Following our prepared remarks, we will host a question-and-answer session that will include Executive Vice Presidents: Alan Lotvin, President, Pharmacy Services; Dan Finke, President, Health Care Benefits; Neela Montgomery, President, Retail and Pharmacy; and Jon Roberts, Chief Operating Officer.

Our press release and slide presentation have been posted to our website along with our Form 10-Q that we filed with the SEC this morning.

During this call, we will make certain forward-looking statements reflecting our current views related to our future financial performance, future events, industry and market conditions as well as the expected consumer benefits of our products and services and our financial projections. Our forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from what may be indicated in them.

We strongly encourage you to review the information in 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 Factor section in our most recent annual report on Form 10-K, this morning's earnings press release, and included in our Form 10-Q.

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 comparable GAAP measures in this morning's earnings press release and the reconciliation document posted on the Investor Relations portion of our website. Today's call is being broadcast on our website, where it will be archived for one year.

Now, I'd like to turn the call over to Karen.

Karen S. Lynch

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

Thanks, Susie. And good morning, everyone, and thank you for joining our call today. CVS Health has delivered another strong quarter and exceeded expectations. For the third quarter in a row, we are raising adjusted EPS guidance. Throughout 2021, we have made progress executing our strategy to deliver an integrated health care experience centered around the consumer. We sustained strong revenue growth in each of our core businesses, helped improve health outcomes, and reduced costs by broadening access to quality care. We help fight the pandemic and reach millions of consumers with convenient, accessible care in communities across America.

During the third quarter, we delivered revenue growth of 10%. This double-digit growth was led by membership gains in both Health Care Benefits and Pharmacy Services as well as higher volume in Retail. We grew adjusted operating income by 12.5%. We generated adjusted earnings per share of \$1.97 and strong cash flow from operations of \$5.5 billion.

Given these results and our outlook, we are raising our adjusted earnings per share guidance to \$7.90 to \$8. This higher guidance reflects the quarter's outperformance and continued positive momentum, which Shawn will discuss shortly.

Third quarter results again demonstrate that our customers value how we bring together our unique portfolio of assets, our deep health care expertise, and vast consumer touchpoints to meet health needs. There is strong demand for our integrated solutions across the health care continuum, including health management programs for chronic conditions, mental health support, pharmacy services, and health and wellness products.

We added over 1.3 million new integrated pharmacy and medical members through the 2021 and 2022 selling season. More customers are seeking complementary health services that work together, such as virtual care.

Earlier this year, CVS Health launched the first national virtual primary care program. This market-leading solution offers a national network of physicians virtually and access to convenient, face-to-face care in our MinuteClinic locations when needed, often with zero co-pays. Our program has grown to 30 customer accounts with over 750,000 eligible members as of January 1, 2022. This is an indication of our ability to scale nationally and bring innovative products to the marketplace.

Our customers recognize the importance of CVS Health Care Solutions and the ease of access we now provide in the community, the home, and virtually. Our high customer retention rates and new business wins are a testament to the strength of our business model.

Health Care Benefits revenue increased 9.5% year-over-year. Strength in Government Services helped drive an adjusted operating income increase of 2.4% versus prior year, despite higher costs related to COVID-19 net of deferred care, primarily within our Commercial book. We generated sequential membership growth across all three product lines in the quarter: Commercial, Medicare, and Medicaid. Our medical benefit ratio of 85.8% was above our expectations driven by COVID-related costs, primarily driven by Commercial. Underlying non-COVID costs emerged in line with our expectations. We believe aggregate medical costs will slightly exceed baseline levels for the full year.

We produced strong results in our Medicare business and grew membership, both sequentially and year-over-year, across all Medicare products. This reflects our strong product portfolio, Stars performance, and reputation for service excellence. Year-to-date, Medicare Advantage membership has grown 9.2%. In 2022, we anticipate we will achieve double-digit growth in individual Medicare and generate strong momentum in dual eligible.

Our strong performance in Stars continues, as you saw for 2022, with 87% of our members in Star plans rated four and higher, up from 83% in 2021.

In our Commercial business, we expect moderate growth in 2022 for national accounts, driven by both increased sales, which are up approximately 50% year-over-year, and a 95% client retention rate. As we mentioned earlier this year, we are reentering the individual exchanges in eight states as of January 2022. Enrollment began on Monday. And we anticipate our co-branded CVS Aetna offering and benefit design, focused on consumer choice, will result in gains of at least 100,000 new members in 2022.

Turning to Pharmacy Services, we delivered third quarter revenue growth of 9.3% and adjusted operating income growth of 9.5% year-over-year. For the 2022 selling season, we achieved a 98% retention rate. We drove \$10.4 billion of growth new business, resulting in \$8.9 billion of net new business wins, providing evidence of our market-leading trend management, transparency, customer service, and integrated offerings.

We continue to be a leader in specialty pharmacy with programs that drive value in the marketplace, provide substantive savings to customers, and differentiate us as we pair programs with digital assets. We maintained a strong momentum this quarter, with specialty revenue up 8.7% versus prior year. Our service excellence and top-tier execution are key areas of differentiation.

Our Retail segment continues to play a critical role as a local health destination for millions of Americans. Retail outperformed both expectations and the industry in the third quarter. We delivered 10% revenue growth and 22% adjusted operating income growth year-over-year. Pharmacy sales and prescriptions filled both increased 8% year-over-year, largely driven by COVID-19 vaccine administration and core Pharmacy Services. Our patient satisfaction scores remain high, with approximately 90% satisfied with their experience in our CVS Health locations.

We continue to support millions of Americans for COVID-19 testing and vaccine administration. We administered 11.6 million COVID-19 vaccines and 8.5 million COVID-19 tests in the quarter. Since our program began, we have administered 43 million vaccines and approximately 38 million tests.

We also expanded our digital capabilities to provide universal access to CVS Health vaccination records to the millions of adults we have vaccinated. This new capability has driven over 1 million visits per month to vaccination records on cvs.com. This provides another opportunity for us to build deeper engagement with our customers, while simplifying and connecting their health experience.

Front store sales momentum also continued, with revenue growth of 13% versus prior year. Front store sales were led by consumer demand for COVID-19 home testing kits as well as cough and cold products, with year-over-year volume increases across most front store categories.

Our CVS Health Retail presence consistently serves as a strong channel for capturing new lives. In fact this year, 12.5% of new COVID-19 testing customers chose to fill new prescriptions or receive a COVID-19 vaccination with CVS Health. Finally, we anticipate a benefit from administering boosters and pediatric doses to eligible consumers, will occur largely in the fourth quarter of this year.

We continue to make measurable progress with our strategy to deliver a superior customer experience and address the total cost of care. We have focused on several important areas. First, with our unique portfolio of businesses, we continue to expand our role in care delivery, designed around the customer. We are taking a proactive approach to meet the emerging needs of customers, clients, and communities. We are improving access, lowering costs, and combining local points of care to simplify the consumer health experience. We have one of the country's largest network of physician extenders and are able to deliver care locally with our national footprint.

We will continue to drive higher engagement with customers as we evolve the format of select CVS locations, creating community health destinations and shifting into three distinct models: sites dedicated to offering primary care services, an enhanced version of HealthHUBs with products and services designed for everyday health and wellness needs, our traditional CVS Pharmacy store model that provides prescription services and health and wellness and other convenient retail offerings.

Our unique combination of businesses and our presence in communities nationwide enable us to meet consumers where they are to enhance their well being and to be a bigger part of their wellness.

Next, we are further strengthening the consumer experience through the expansion of digital services and platforms that connect to health services and in-person channels for our more than 35 million unique digital customers. For example, more than 70% of CVS Pharmacy customers are enrolled in our text messaging program today. Within that group, this quarter, adherence outreach drove 10% growth in prescriptions filled. Greater adherence leads to improved health outcomes and lower cost.

In today's hyper-connected digital consumer-driven world, the demand for omni-channel pharmacy is greater than ever. We continue to modernize our operating systems and enhance the integration of pharmacy models, simplifying consumer interactions and driving further engagement with our customers.

Finally, we continue to invest in our employees as part of our workforce strategy. Last quarter, we announced a phased increase in the minimum wage to \$15 an hour by July 2022. We invested in modernizing our training

programs and technology for our frontline and clinical colleagues. Despite the tight labor market and anticipation of the higher demand for health services, we strengthened our workforce in every business. We hired a record number of people in the third quarter to advance open enrollment and customer service, as well as enhance technology and clinical capabilities.

Nearly 20,000 pharmacists, pharmacy technicians, and nurses recently joined the CVS Health team, supporting flu season as well as COVID-19 vaccinations and testing. Our pharmacists and pharmacy technicians are an integral part of our overall workforce strategy. We are committed to investing in our pharmacists, awarding immunization bonuses in the second half of this year.

We look forward to sharing more about our strategy to improve access, quality, and customer engagement at Investor Day on December 9.

Our commitment to shareholders, customers, and communities remains steadfast. Health equity is critical as the pandemic continues to disproportionately impact certain communities. In addition to targeted vaccine and booster education efforts, we provided 31 million meals this year to people suffering from food insecurity and invested in 2,800 affordable housing units in 30 cities. By helping address the social determinants of health, permanent housing can reduce health care costs by 59%.

We recently hired our first-ever Chief Health Equity Officer, Dr. Joneigh Khaldun, to build upon our efforts to advance health equity and better support underserved communities. And our increased wages and bonuses support our employees, their families, and their communities.

For the third quarter in a row, we executed on and exceeded our plan and raised adjusted EPS guidance. We continue to enhance our diverse portfolio of assets to serve the customer. We are guiding to a strong year-end, all possible due to the leadership and commitment of our over 300,000 CVS Health colleagues that bring their heart to every moment of our customers' health.

With that, let me turn it over to Shawn.

Shawn M. Guertin

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

Thank you, Karen, and good morning everyone. Our third quarter results reflect a continuation of the strong performance observed in the first half of 2021, as we exceeded our expectations from both a revenue, cash flow, and adjusted earnings per share basis. These results ensue from our differentiated portfolio of capabilities and keen focus on operational execution. This momentum in our performance enables us once again to raise our outlook for 2021.

Starting with the enterprise as a whole, total revenues of \$73.8 billion increased 10% year-over-year, with robust growth in all three segments. We reported adjusted operating income of \$4.1 billion, a 12.5% increase versus the prior year. This growth in adjusted operating income was also reflected in the strong cash flow generation in the third quarter, with year-to-date cash flow from operations now exceeding \$14 billion.

Adjusted earnings per share of \$1.97 represent a nearly 19% year-over-year increase, generated by our adjusted operating income growth and lower interest expense resulting from our ongoing deleveraging efforts.

Moving to the segments, Health Care Benefits revenue increased by 9.5% year-over-year, driven by sustained growth in our Government Services business, slightly offset by the repeal of the health insurance fee. In the third quarter, we saw Medicaid membership grow sequentially by 67,000 members across multiple geographies.

Medicare Advantage membership also continued to grow in the quarter, increasing by 42,000 members sequentially and representing year-over-year growth of 9.8%. Our Medicare Advantage franchise continues to be a powerful growth engine, with Medicare Advantage membership more than doubling since the third quarter of 2015, representing a 15% compound annual growth rate.

Our attention is now turned to ensuring a successful 2022 annual enrollment period for Medicare, which began on October 1 (sic) [October 15]. While still quite early in that process, we are pleased with what we have seen to date.

Health Care Benefits adjusted operating income grew modestly year-over-year, but fell below our expectations for the quarter due to higher than expected COVID-related medical costs in our Commercial business. With the surge in nationwide COVID cases emanating from the Delta variant, we experienced higher than expected COVID-related medical costs in August and September.

Three key factors drove this difference versus our expectations. First, Commercial COVID inpatient admissions in August and September were in line with the peak levels experienced in January 2021 and were nearly three times the average of the second quarter of 2021.

Second, COVID testing costs, which we had expected to moderate during the third quarter, also approached January 2021 levels and were more than 1.5 times the average we experienced in the second quarter. It is critical to recognize the outsized impact of COVID testing on overall claim costs, as testing costs represented approximately 35% of gross COVID costs in the quarter.

And finally, while non-COVID deferred care was better than we had forecast, it was not enough to entirely offset these higher COVID costs in Commercial. The resultant medical benefit ratio for the quarter of 85.8% was above our forecast and driven almost entirely by the higher than expected Commercial COVID testing and treatment costs.

There are two important aspects of HCB's third quarter performance to note. One, absent these COVID dynamics, underlying performance in our Commercial book of business continues to be in line with our expectations. Two, in our Government Services business, we also saw an increase in COVID treatment and testing costs, but far less pronounced than in Commercial. This lower level of increase was fully offset by better than expected deferred care. As a result, the overall performance of our Government Services businesses was in line with expectations.

Wrapping up HCB, we experienced favorable prior-period development in the quarter on both Commercial and Government products. Days claims payable of 51 at the end of the third quarter is three days higher sequentially and two days above prior year. While influenced by many factors, with the anticipated abatement in COVID-related claims in the fourth quarter, we would expect DCP to return to a more typical result in Q4. Overall, we remain comfortable with the adequacy of our reserves.

Turning to Pharmacy Services, our ability to deliver sustainable, profitable growth remains clear. 2021 is expected to be the second year of adjusted operating income growth in excess of 10%. This sustained growth has been driven by: our track record of delivering industry-leading drug trend on behalf of our clients; our proven industry-

leading capabilities, particularly in the specialty pharmacy arena; and our outstanding customer service, as reflected by our over 98% renewal rate for 2022.

During the third quarter, pharmacy revenues increased by 9.3% year-over-year, driven by increased pharmacy claims volume, growth in specialty Pharmacy, and brand inflation. Total pharmacy membership increased by 1.6 million lives sequentially, primarily reflecting growth in government programs. Total pharmacy claims processed grew nearly 7% above the prior year. Nearly half of this growth was attributable to net new 2021 business, with COVID vaccine administration and new therapy prescriptions also contributing to the year-over-year growth. Note that new therapy prescriptions were adversely impacted in the third quarter 2020 due to the pandemic.

Pharmacy adjusted operating income exceeded expectations in the quarter, up more than \$150 million or 9.5% year-over-year. The three major drivers of this increase remain consistent with the second quarter: improved purchasing economics, reflecting the products and services of our group purchasing organization launched in the second quarter of 2020; continued strength in our specialty Pharmacy business, driven by 340B administration and increased pharmacy claims volumes, both of which were partially tempered by ongoing, but stable, client pricing pressure.

Our Retail business delivered strong results this quarter, again exceeding expectations. Total revenue of just under \$25 billion increased by \$2.3 billion or 10% year-over-year. There are two main components to this increase.

Approximately half, or \$1.2 billion, is attributable to the contributions from the more than 11 million COVID vaccines and over 8 million COVID tests we administered, combined with strong front store sales, driven by demand for over-the-counter COVID test kits and related treatment categories. With this quarter's results, we are now on pace to deliver about 44 million to 49 million COVID vaccines and 28 million to 33 million COVID tests for full-year 2021. The remaining half, or \$1.1 billion, was driven by a combination of sustained pharmacy growth and broad strength in front store trends across a range of categories, partially offset by continued pharmacy reimbursement pressure.

This strong revenue growth, combined with a 70 basis point improvement in adjusted operating margin, produced adjusted operating income that exceeded our forecast and drove a year-over-year increase of \$300 million. This adjusted operating income growth, driven by COVID testing, vaccines, and front store sales, was partially tempered by: continued pharmacy reimbursement pressure; business investments, including the minimum wage increase and other performance incentives; and increased staffing to provide expanded levels of service.

Turning to cash flows and the balance sheet, our liquidity and capital position remain excellent at the end of the third quarter, with cash from operations of \$5.5 billion for the quarter and \$14.3 billion year-to-date. Through our proactive liability management transaction in August, we paid down \$1.1 billion in net long-term debt in the quarter. As of the end of the third quarter 2021, we have repaid a net total of \$18.7 billion in long-term debt since the close of the Aetna transaction. In addition, we returned over \$650 million to shareholders through our quarterly dividend.

Let me now discuss our updated 2021 guidance. As Karen noted earlier, we are raising our full-year adjusted earnings per share guidance range this morning by \$0.20 to \$7.90 to \$8 per share. This increase reflects the strong performance in Pharmacy Services and Retail, partially offset by expected COVID pressure in our Health Care Benefits business, specifically in the Commercial block.

We are raising our total revenue outlook to \$286.5 billion to \$290.3 billion and adjusted operating income outlook to \$16.4 billion to \$16.6 billion. We are also increasing expected full-year cash flow from operations to a range of \$13 billion to \$13.5 billion. Note that this increased cash flow forecast is actually lower than our September year-to-date figure, reflecting expected payments in the fourth quarter that were accrued in 2020, including FICA taxes and increased minimum loss ratio rebates as well as the timing of receipts and payments between the third and fourth quarters.

I'll now highlight some key items related to the segments and full-year guidance. For the Health Care Benefits segment, we are lowering our full year adjusted operating income guidance from \$5.25 billion to \$5.35 billion to \$4.9 billion to \$5 billion. We expect the full-year medical benefit ratio to be in a range of 84.4% to 85.6% or an increase of 30 basis points from our prior range. This reflects the higher than expected commercial COVID medical costs observed in the third quarter and our expectation that these will continue, although at a lower level, into the fourth quarter.

Emerging October operational data indicate that COVID inpatient admissions are tracking at approximately half the levels of September. Again, it is important to remember the degree to which testing costs are driving expenses. So while we expect Q4 testing expenses to be lower than Q3, we do not anticipate they will decline as much as inpatient expense.

Finally, recall the normal seasonality of the Health Care Benefits segment, with fourth quarter operating income typically the lowest of the year driven by deductible satisfaction producing the highest quarterly medical costs.

For Pharmacy Services, given the continued strength in the quarter and our visibility to the remainder of the year, we are increasing full-year 2021 adjusted operating income guidance to \$6.85 billion to \$6.94 billion, representing year-over-year growth of 20.5% to 22%. We anticipate that the strength in third quarter Pharmacy Services results will largely continue into the fourth quarter.

In the Retail/Long-Term Care segment, we are also increasing our full year 2021 adjusted operating income guidance to \$6.98 billion to \$7.07 billion. As you consider the fourth quarter, I would note that we currently expect vaccinations to continue, although at a lower rate than the third quarter. We have also contemplated the impact of the CDC's COVID booster recommendations, as well as a modest impact from pediatric vaccinations. We expect testing to decline modestly in comparison with the levels experienced during the third quarter.

Given Retail's Q3 outperformance and Q4 outlook, we now expect the full-year 2021 COVID impact to be neutral. This compares to our prior guidance in August for an overall modest negative net impact. You will find further details regarding our updated guidance in the slide presentation we posted to our website this morning.

As we close the third quarter, we are very pleased with the performance of our businesses, which provides us with a strong foundation as we now look ahead to 2022. While we plan to share more details with you at our upcoming Investor Day in early December in New York, I want to update you on our thoughts regarding the 2022 outlook.

While there are still many factors to play out, we believe that current analyst estimates for 2022 adjusted EPS of approximately \$8.20 are within our anticipated initial guidance range. As we discussed last quarter, there are some significant moving pieces to keep in mind in determining an appropriate baseline for 2021.

First, consistent with our standard practice, we exclude prior year's development net of profits returned to customers and net realized capital gains from our forward-looking guidance. Second, in 2022, we will incur a full

year of expense related to our minimum wage increase announced last quarter. We estimate these factors combined represent approximately \$0.40 per share. Using the midpoint of our updated 2021 adjusted EPS guidance range, which is \$7.95, these adjustments create a 2021 baseline of \$7.55.

The other significant factor in considering 2022 performance is the effect that COVID will have on our Retail and Health Care Benefits businesses. For Retail, we expect that COVID-19 vaccine and testing volume, which is expected to generate over \$3 billion of revenue in 2021, will decline significantly in 2022 to 30% to 40% of the volume we administered in 2021. In addition, we expect COVID-driven front store sales to decline in 2022.

For HCB, we expect to see a significant improvement in results in 2022, as treatment and testing costs decline, with COVID cost estimates and improved risk-adjusted revenue reflected in our pricing. Overall, we estimate the COVID-driven impact in HCB will largely be offset by the expected decline in COVID-related retail performance.

It is important to note that forecasts of future COVID impacts to our business remain extremely difficult and are subject to change as circumstances dictate. Beyond these considerations, other factors affecting our growth for 2022 remain consistent with the commentary we provided last quarter regarding headwinds and tailwinds. With all of this in mind, the current consensus of analyst estimates of approximately \$8.20 for adjusted EPS would represent about an 8% increase over the 2021 baseline.

To conclude, the strong performance of CVS Health in the first half of 2021 continued in the third quarter, producing strong revenue, adjusted operating income, and cash flow results. And we are pleased to again raise our full-year 2021 adjusted EPS guidance. During the pandemic, we have solidified our opportunity to become a national leader in health care delivery, which, at its core, starts and ends with lowering the cost of care, improving access and convenience, ultimately enabling people to live healthier and more fulfilling lives.

During our Investor Day in a few weeks, we look forward to sharing with you more about our path over the coming years to deliver on this ambition and to position CVS Health to generate sustainable low double-digit adjusted EPS growth.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take our first question from Michael Cherny with Bank of America. Please go ahead.

Michael Cherny

Analyst, BofA Securities, Inc.

Q

Good morning. Thanks for the color. Congratulations on the results. And especially, Shawn, thanks for the early 2022 views. Before – I'm sure there will be some other questions there, I did want to get into something on the pharmacy side for next year. You talked about the COVID headwinds year-over-year, which is very much expected. That being said, you also have the positive news on the TRICARE side and reentering their network. As you think about that, either as an example for your network approach or just getting back to what's hopefully steady-state performance, how is the overall trend going relative to network participation, preferred network participation, and what that means for CVS's ability to offset some of those COVID headwinds with sustained script growth and share gains?

Neela Montgomery

Executive Vice President & President, Retail/Pharmacy, CVS Health Corp.

A

Thanks for that. It's Neela here. We continue to see underlying script growth around the 5% level, which is good, both compared to the market and our historical averages. So that's our forward assumption for 2022 as we plan for it. And, as you mentioned, TRICARE was a good win for us starting December 15, and we're pleased to be back in the network. But it's part of a number of network news that are happening in 2022, which mean we'll be at that level of growth moving forward.

Shawn M. Guertin

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

A

Mike, I would say as well, when you think about this issue more broadly, to Neela's point, this is an example of one of the things that I think that we've continued to do to try to tackle it. And one is obviously get more volume and more participation to help offset that. But it's also looking at cost of goods sold and looking not only at just improving that but looking, thinking, and considering new models that we might be able to embark on to deal with this. The pressures here continue to exist, but they are stable. And certainly it's something we're thinking about as we think about next year. The one thing I would say is certainly all of these things are all designed to sort of basically produce a balanced sustainable economic model in the long-term.

Michael Cherny

Analyst, BofA Securities, Inc.

Q

Great, thanks.

Operator: And we'll take our next question from Lisa Gill with JPMorgan. Please go ahead. Your line is open.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Thanks very much. Good morning. Karen, I just want to go back to as we started 2021, you talked about introducing a new low or no co-pay for the MinuteClinic, low or no co-pay for generics at CVS. I think you talked

about 6 million people in that program. Then, today, you made a comment around shifting towards primary care. I just want to better understand. How do we think about the rollout of this in combination with the virtual 360 that you'll offer going into 2022?

My first question would be, did you see the opportunity to really lower the cost trend when we think about those members that utilize, for example, the MinuteClinic and the Retail pharmacy of CVS? And is that being masked because of COVID, that we're not really seeing that trend come through?

And then secondly, as we think about plan design going into next year, can you maybe just spend a minute and talk about where you see the biggest opportunities? And do you feel the need to own or now employ primary care physicians?

Karen S. Lynch

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

A

Good morning, Lisa. There are a lot of questions there. And we actually really look forward to sharing much more of our strategy when we meet in December, but let me just give you kind of a brief overview. I would start with as we kind of look at the consumer, obviously, the consumer has been incredibly challenged by the complexity of the health care system. And our overall strategy is to make sure that we can provide them access points with lower costs, higher quality, with convenience, and overall engagement. And we think those factors will help us with the long-term strategy of driving down health care costs.

As we think about our – you mentioned our MinuteClinics and our trends. We have now 7.5 million people that have this zero co-pay or low-cost co-pay. We have started to see the Aetna members utilizing those services. Obviously, that's a lower site of care. It is convenient. We've also expanded the services, as I mentioned earlier, adding behavioral health care. We've seen repeat customers coming there. So obviously we're starting to get traction with the Aetna members, with these plan designs, and we feel quite good about it.

Now, your question around primary care and what we think we need to do here is – primary care is a small component of overall medical costs. I think we all recognize that. But it wields significant influence on the total medical cost picture. So as you think about us managing and navigating care for our patients, we really believe that we need to kind of push into the primary care so that we can influence the overall cost of care. And by doing that, we think that we can have better engagement, help customers better navigate, and obviously have higher quality, lower cost of care. And so that's the intent here of really pushing into primary care.

And we expect to see continued evolution of our plan designs. If you think about our overall care strategy, it's virtual care, it's in the community, and it's in the home. If you look at what we did this year with our virtual primary care offering, clearly we were able to be in the market early. We have 750,000 people now that are eligible for that virtual primary care. We connected that virtual primary care with an in-person connection with our MinuteClinics and also in the home with diagnostic biometric monitoring. So you can see that we're innovating around the consumer. And that's how we think we're going to really change the game in health care, is innovating around the consumer.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Is there a way to quantify that? I mean, as far as medical cost trend or anything that we should think about as we see incremental adoption of these kinds of programs or is that something you're going to talk about at the Analyst Day?

Karen S. Lynch

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

A

We'll talk about that as well. But I think the two things that we'll be monitoring is, do we expect incremental growth because of our product design? Yes. And then, do we see improvement in overall trends? And we would expect to see that. We'll give you kind of more insights into our kind of longer-term goals here, but that would be the expectation, growth and medical cost improvement.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Great. Thank you so much.

Operator: We'll take our next question from A.J. Rice with Credit Suisse. Please go ahead. Your line is open. And, A.J., your line is open.

A.J. Rice

Analyst, Credit Suisse

Q

Sorry about that. Hi, everyone. Obviously, the Pharmacy Services business continues to perform very well. When you look at, A, the high retention rate, is there any of that that's being driven by customers just deciding that they want to delay a big RFP for another year as they try to get employees back? How much of that activity did you see? And when it comes to where you're getting the wins, maybe just expand a little bit on where in particular? Is it in the middle-market? Is it with the large accounts that you're picking up business? And what particularly of your marketing effort is resonating to get those new wins?

Alan M. Lotvin

Executive Vice President & President, Pharmacy Services, CVS Health Corp.

A

Hey, A.J. It's Alan. Thank you for the question. So I'll answer in order. So the first one, with respect to the retention rate, we didn't really see a tremendously different selling season in 2021 going into 2022 than we have in the past. And that's I think a function of the size. We generally focus on the 5,000 lives and above. And we obviously go through a process where when we can avoid an RFP, we do. But many of those were active competitive RFPs.

When I think about why our sales, why and where our sales came, it was in all segments of the market, right. We won in health plans. We won in Medicaid. We won in pretty much all segments that we participate in. And I think we win for three reasons. We win primarily because we have the best demonstrated ability to manage drug spend, particularly in specialty Pharmacy where you know it's critically important. We've maintained extraordinarily high levels of service and built on that service with a culture of transparency and building trust with our clients and aligning our incentives. And finally, on innovation and bringing new tools to market, largely in the specialty area, to help our clients better manage trend and create better experiences for both providers and patients.

A.J. Rice

Analyst, Credit Suisse

Q

Okay. Great. Thanks a lot.

Operator: And we'll take our next question from Justin Lake with Wolfe Research. Please go ahead. Your line is open.

Justin Lake

Analyst, Wolfe Research LLC



Thanks. Good morning. Wanted to talk a little bit about the Health Care Benefits business from 2021 to 2022, specifically in Medicare Advantage. Can you talk, Shawn, a little bit about how that business has performed this year, where trends are running versus normal, and how you expect it to kind of bounce back – sorry about that – in 2022?

Shawn M. Guertin

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



I won't look at that as a barking dog barking at me here. So, no. It's a very important question. Obviously, Medicare is the biggest single premium block that we have in HCB, and so its performance is critical to HCB's performance. The good news, I would say, on this is that since we have submitted our bids, our Medicare experience the last two quarters has been completely in line, if not a little better than that. And so we still feel good about our baseline and our forward provision for that.

We continue to see deferred care, i.e. some utilization less than normal in this business. And that did continue this quarter, but we're continuing in our forecasting to assume that that is going to go away over time and continue to sort of edge back to normal. Certainly by the bulk of 2022, we would anticipate that. So from a margin standpoint, I think this business feels like it is on very sound footing.

In terms of looking at our benefits, I think we feel good about where we are, both growth and margin-wise, when we think about next year. And, as I mentioned, it's super early in the AEP, but we feel good about what we've seen so far.

Justin Lake

Analyst, Wolfe Research LLC



And just a quick follow-up specifically, Shawn. The rates were so strong for 2022. And hopefully, everyone's getting back their risk scores after a tough 2021. Do you think yourselves and what you've seen in the industry are positioned to absorb something maybe a little bit more than 100% of typical trend? It feels like given where the rates are maybe 101% or even more could be absorbed before you'd have a margin issue next year.

Shawn M. Guertin

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



Yeah. I wouldn't want to forecast that now, mainly just because of the difficulties I think that exist sort of around this whole deferred utilization kind of COVID interplay. You're certainly right. It was a good reimbursement year. We were able to do a lot of things sort of in our benefit design. And again, I think it's part of my comfort with sort of the foundation that that business is going into 2022 upon.

Justin Lake

Analyst, Wolfe Research LLC



Thanks.

Operator: We'll take our next question from Stephen Baxter with Wells Fargo. Please go ahead.

Stephen Baxter

Analyst, Wells Fargo Securities LLC



Hi. Thanks for the comments and color on 2022. I just wanted to confirm or ask for a clarification here. I think your comments suggested that from a COVID perspective that 2022, your initial view is also that that would be approximately neutral. Can you confirm whether or not that was the case when you were talking about those factors?

Shawn M. Guertin

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

Yes. That is what I said.

A

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Perfect. Okay. And then the commentary on your initial expectations around vaccine and testing contribution decreasing to about 30% or 40% of the 2021 levels. Obviously, it's dynamic, but any directional color on how you're thinking about vaccines related to testing inside of that?

Q

Shawn M. Guertin

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

They both are down fairly significantly in that same general range. I think we have testing down right now a little bit more than vaccines for next year. And I want to be clear, too, that the 30% to 40% we said was a volume number, the number we will administer. At present, I would assume sort of some of the same profile of a margin that we have today, but again that could be also a factor subject to change next year.

A

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Got it. Thank you.

Q

Operator: We'll take our next question from Ricky Goldwasser with Morgan Stanley. Please go ahead.

Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Yeah. Hi. Good morning, and congrats on the quarter and the 2022 comments. Quick question here on capital deployments. So you're on track to bring down debt to your target levels. As you look to sort of innovate around the consumer, what role do you anticipate M&A will have? And maybe you can rank order for us your capital deployment priorities. And then, when we think about it long-term, sort of guide that you provided of low double digit, does that include M&A as well?

Q

Karen S. Lynch

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

Ricky, I'll start, and I'll hand it over to Shawn. As you think about our strategy, we'll lay out our capital deployment in much greater detail. But as you think about managing around the consumer, we have a tremendous amount of assets in our portfolio today which we can build off on. However, there will be additional capabilities that we think we need to either partner or buy. So that will be part of our overall strategy. And I'll ask Shawn to comment on your other questions.

A

Shawn M. Guertin

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

A

Yeah. And I'll answer the second one because it's fairly quickly in terms of my long term kind of goal to get to the low double digit EPS. What I'd say is that includes capital deployment. That capital deployment, in some years, can take the form of accretive share repurchase. Some years, it can take more of a form of M&A.

And, as Karen mentioned, our strategy will require the development of new capabilities. And I think while it's likely some of those we can do ourselves, I think there's some of those that it will make more sense for us to acquire along the way. But it is a good and timely question around capital and long term. We're nearing the end of a sort of three or four-year deleverage cycle, and I think the next three years are going to look different than the last three years.

While we remain committed to our investment-grade target and we will always sort of manage leverage responsibility, my first priority always with capital is to grow the business. And we mentioned that our strategy might require that. So from year to year, that can sort of move between, as I mentioned, share repurchase, dividend, M&A, but my experience is that a balanced deployment over time has tended to work best. And that might look like something with the M&A aspect, a dividend that grows with EPS, and some level of accretive share repurchase.

Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you. And looking forward to seeing you guys in December.

Operator: We'll take our next question from Eric Percher with Nephron. Please go ahead. Your line is open.

Eric Percher

Analyst, Nephron Research LLC

Q

Thank you. The strength in Pharmacy Services was notable after some cautious commentary last quarter, but relative to expansion of PBM profit per script, I think kind of two items I'd like to focus in on here. One, with the GPO benefits, is this primarily CVS, or is Zinc benefiting from added partners in their scale? And then on 340B, is this development of new strategies to serve covered entities, or is it natural growth in the program? What's the driver in that piece?

Alan M. Lotvin

Executive Vice President & President, Pharmacy Services, CVS Health Corp.

A

Hi, Eric. It's Alan Lotvin. How are you? So on the GPO answer, principally this is CVS volume and capabilities that are being brought to market. We have a partner, but it's, I would say, is mostly the CVS volume.

With respect to 340B, there are a few things that drive the growth. So think about 340B in two ways, right. One is we provide third-party administrative services to covered entities. So as we grow the number of covered entities, we grow the size of the contribution. The second area is dispensing margin. We get paid a fixed fee for dispensing the drugs on behalf of the covered entities. So as volume grows, both because specialty is growing, as an example, as our book of business grows from new wins and as our covered entity book of business grows, all three of those contribute to volume growth.

Eric Percher

Analyst, Nephron Research LLC

Q

So how does -

Alan M. Lotvin

Executive Vice President & President, Pharmacy Services, CVS Health Corp.

A

Sorry, I would just add, last point was that, that volume growth substantially benefits the covered entities. And, as you know, many of the covered entities are dependent upon the 340B program for their financial health.

Eric Percher

Analyst, Nephron Research LLC

Q

Right. And then, maybe just a quick follow-up. We're starting to see a little bit more of the structure among what Dems may propose. One of those was transparency provisions. What is your perspective on what increased requirements around transparency would mean at this point in the rebate game?

Alan M. Lotvin

Executive Vice President & President, Pharmacy Services, CVS Health Corp.

A

So we've done a lot of work on the original version of the transparency rule. It creates a really tremendous administrative burden for everyone in the system. I think at this point when you think about transparency and rebates, essentially all large clients or even midsize clients now have 100% pass through of rebates. Many of them have extensive audit rights. So to some extent, I think this is, quite frankly, solving a problem that's already been solved commercially.

Eric Percher

Analyst, Nephron Research LLC

Q

Thank you for that.

Operator: And we'll take our next question from Steven Valiquette with Barclays. Please go ahead. Your line is open.

Steven J. Valiquette

Analyst, Barclays Capital, Inc.

Q

Thanks. Good morning, everybody. So just for the comments around the fourth quarter of 2021 and non-COVID utilization, can you remind us what your assumption is for the fourth quarter specifically for just overall non-COVID as a percent of pre-COVID baseline for the whole book of business or just broken out between Commercial and Government?

And just want to confirm also the increase in the MLR, sounds like it is related more specifically to direct COVID costs, but just want to confirm there's no change to your outlook for the non-COVID utilization into the fourth quarter. Thanks.

Shawn M. Guertin

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

A

Sorry. My mic wasn't on. Yeah. On the second one, you're correct. The MLR increase is entirely driven by COVID fairly consistently over the last couple of quarters. The non-COVID utilization has been at and even better in some places than expected. So the underlying business continues to look strong from that regard. So the increase is clearly COVID.

As I mentioned, we do expect that we will see deferred utilization in the fourth quarter, but we're only assuming half the level that we experienced in Q3. And you could think about that a little bit from kind of where we are

today, taking half a step back to kind of zero deferred utilization. Where this is, is very similar to my commentary last time. Commercial has the least amount of deferred utilization right now in the system. And Government also – Government probably has the most, with Medicare having a little less than Medicaid at this stage. But we see all of those moving back towards normal in the fourth quarter and as we think about next year.

Steven J. Valiquette

Analyst, Barclays Capital, Inc.

Okay. Great. Thanks.



Susan Vissers Lisa

Senior Vice President, Investor Relations, CVS Health Corp.

With that, we're going to conclude the Q&A portion of the call. And I'll turn it back to Karen.

Karen S. Lynch

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

Well, first off, thank you for joining us today. CVS Health reported another strong quarter, exceeding expectations and driving growth in all of our core businesses in a very fluid market. We continue to demonstrate progress executing on our strategy to create an integrated health care experience centered around the consumer. And I am very grateful for the 300,000 dedicated colleagues who continue to deliver every day, helping America combat COVID and its variants, including flu and other everyday health challenges.

We do look forward to seeing you all in December in New York. Thank you.

Operator: Thank you. And this concludes today's CVS Health third quarter 2021 earnings call and webcast. You may disconnect your line at this time and have a wonderful day.

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