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CVS Health Corp. (CVS)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

I would now like to turn the call over to 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 fourth quarter and full year 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 Alan Lotvin, President, Pharmacy Services; Dan Finke, President, Health Care Benefits; Michelle Peluso, Chief Customer Officer; and Prem Shah, Chief Pharmacy Officer, both Co-Presidents of the Retail segment; and Jon Roberts, Chief Operating Officer.

Our press release and slide presentation have been posted to our website along with our Form 10-K 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 Factors section in this morning's earnings press release and included in our Form 10-K.

During this call, we will use non-GAAP financial measures when talking about the company's performance and financial conditions, and 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.

Thank you, Susie. Good morning, everyone, and thank you for joining our call today.

2021 was an important year for CVS Health. We exceeded our financial goals, we advanced our strategy, and we brought greater value to the people we serve, playing a critical role in the nation's pandemic response. We ended a strong 2021 with another strong quarter. We exceeded our adjusted EPS expectations for the fourth quarter in a row, delivering \$1.98 adjusted EPS in the final quarter of 2021 and \$8.40 adjusted EPS for the full year.

We are entering 2022 with powerful momentum. We are delivering health care solutions that are personalized, connected, and increasingly digital. We are engaging millions of consumers across our businesses and in our community health destinations across America. CVS Health is becoming a bigger part of their everyday health.

Turning now to our performance, for the full year 2021, CVS Health grew adjusted revenue by 8.8% to \$292 billion. We delivered adjusted operating income of \$17.3 billion, up 8.1% year-over-year, and we increased adjusted earnings per share by 12%. We generated strong cash flow from operations of nearly \$18.3 billion for the full year, exceeding our most recent guidance of at least \$13.5 billion.

This strong performance positions us well for 2022. At this early stage of the year, we are maintaining our full year 2022 adjusted earnings per share guidance of \$8.10 to \$8.30. Our forecast reflects increased volume from COVID testing and front store sales in our Retail business relative to our forecast at Investor Day, offset by the accelerated timing of vaccine boosters pulled into the fourth quarter of 2021. Shawn will provide more details on our results and guidance shortly.

Our 2021 performance demonstrates our ability to anticipate, deliver, and exceed consumers' expectations for healthcare. Consumers are a major force driving change in healthcare, and we continue to engage successfully with individuals in more places and on their terms, virtually, in the home, and in their local community. Customers and clients continue to realize the superior value we are providing with our integrated health solutions, particularly those that address the most prevalent, costly, and complex health conditions such as diabetes, cancer, and chronic kidney disease.

Turning to the segment highlights, in Health Care Benefits, we delivered 9.4% adjusted revenue growth for the full year 2021 driven by our performance in Government Services. We had another strong year of Medicare growth with increases across all product lines. Total Medicare Advantage membership grew at 9.8% on a year-over-year basis as we added over 265,000 new members in 2021 and exceeded our initial growth expectations. As a result of our strategic focus on dual eligible, special needs plans, enrollment nearly doubled in 2021.

Our full year medical benefit ratio of 85% was in line with our guidance expectations. For the full year 2021, the utilization of total healthcare services in aggregate was in line with normalized historical baseline levels.

Turning to 2022, we had an impressive annual enrollment period in our Medicare business. For the second consecutive year, we grew all Medicare product lines, and our growth rates this year exceed the industry averages in all categories. We grew total Medicare Advantage membership by 11.6% versus the prior year, reflecting increases in individual and group Medicare Advantage of over 15% and 6%, respectively, year-over-year. We also led the industry in absolute Medicare PDP net membership growth. This added nearly 295,000 net new members while the overall PDP market continues to decline.

We had a solid 2022 selling season in our national accounts commercial business. We expect to grow membership in the low-single digits for the full year and maintain strong client retention of 96%. Our success is driven by the combination of our competitive cost structure, our integrated benefit designs including medical and

pharmacy, and products and services that utilize CVS Health capabilities such as Transform Care Diabetes (sic) [Transform Diabetes Care] and virtual primary care programs.

Membership enrollment was lower than expected in the eight ACA individual exchanges we entered this year. We continued to build this business gradually with select geographic expansion, a focused price discipline, and the appeal of co-branded Aetna CVS Health offerings. Consistent with our prior guidance, we do not expect this offering to contribute materially to our financial results in 2022.

Overall, our deep understanding of consumer needs, innovative product portfolio, and our service excellence will drive growth in our Health Care Benefits segment. Our comprehensive range of products and benefit design that address consumers' whole health needs remains a key differentiator and fueled a strong selling season. For 2022, we forecast 7% to 9% revenue growth and 15% to 17% adjusted operating income growth.

Turning to Pharmacy Services, we delivered 7.8% revenue and 20.6% adjusted operating income growth in 2021. We continue to be a consultative partner to our clients and members. We're delivering industry-leading cost trends and savings, service excellence, a broad product portfolio, and a commitment to transparency.

We consistently create value for our customers and clients with our better-than-market drug trend. We continue to enhance our utilization programs to ensure access to the therapeutics that are the most clinically appropriate. For 2022, we achieved a client retention rate of over 98% and drove \$8.8 billion of net new business revenue.

We are a leader in specialty pharmacy, delivering revenue growth of 12.3% for the fourth quarter and 9.3% for the full year versus prior-period. Our specialty pharmacy programs drive value in the marketplace, and they differentiate us as we pair programs with digital capabilities to deliver a convenient and connected experience.

For Pharmacy Services in 2022, we expect 6% to 8% revenue growth and 7% to 9% adjusted operating income growth as we create long term value for our clients and our members.

Our Retail segment plays a critical role as a community health destination for millions of Americans. This segment outperformed the industry and our expectations in 2021. We grew revenue 9.8% year-over-year to just over \$100 billion, marking an important milestone in the history of this CVS Health business. We delivered an exceptional 24% adjusted operating income growth in 2021.

Pharmacy sales and prescriptions filled both increased by nearly 9% year-over-year. This was notably driven by consumers who came to CVS Health for COVID-19 vaccine administration. For the full year 2021, CVS Health administered more than 32 million COVID-19 tests and more than 59 million vaccines. Over 35% of COVID-19 vaccines in 2021 were administered during the fourth quarter.

Our work to test and vaccinate America for COVID is a powerful example of the relationships we're building with consumers which leads to new customers seeking a range of other health services at CVS Health.

Front store sales growth was strong throughout 2021, up 8.4% versus the prior year. They were led by consumer demand for the over-the-counter COVID-19 tests as well as cough and cold, beauty, and personal care products. We sold over 22 million OTC COVID-19 tests with approximately 70% of sales in the fourth quarter.

We are progressing on optimizing our Retail portfolio and pivoting our stores into three formats: primary care clinics, enhanced HealthHUBs, and traditional CVS Pharmacy locations. We are executing our plan to de-densify stores based on consumer health and buying needs, omni-channel preferences, and shifts in the US population.

For 2022, as I mentioned, given the earnings outperformance and pull-forward of vaccine boosters in 2021, we are maintaining our 2022 guidance. This now implies Retail revenue to be plus or minus 1% versus prior-year and a low-20% decline in adjusted operating income growth. Shawn will provide more details.

Our digital approach is focused on delivering a superior experience for consumers by creating a more connected and seamless health journey. We are making progress towards setting a new standard for digital healthcare for consumers. CVS.com is one of the top health websites with over 2 billion visits in 2021, up nearly 55% over the prior year.

Our digital capabilities for health interactions such as COVID testing and vaccines, prescription services, and sales of health and wellness products, have dramatically increased consumer engagement across all CVS Health businesses. We now serve 40 million customers digitally, up approximately 10% in the last six months alone.

In 2021, we launched several new digital health services powered by advanced analytics to personalize the experience. We made it easier to join our CarePass program, reaching 5.6 million subscribers in the quarter, up more than 40% year-over-year. We integrated CarePass for our Aetna Commercial members and are excited about the adoption we are seeing. We also simplified the CarePass enrollment for all consumers, which is driving more growth in subscribers.

For our HealthHUB and MinuteClinic patients, we simplified and digitized the check-in process for patients. Our self-service digital tool enables individuals to complete traditional paperwork in advance of their appointment. Almost 80% of patients are already utilizing this capability.

At our Investor Day, we promised a superior healthcare experience for consumers that will improve health outcomes, lower costs, and provide broader access to care. We are making several moves to realize our vision for healthcare. We're advancing our care delivery capabilities, optimizing our retail portfolio, and further diversifying the health products and services that we offer.

We're driving this evolution both through internal initiatives and by seeking to execute capability-focused M&A for complementary health services. We will connect consumers in more places, in more ways and on their terms with our digital-first, technology-forward approach as well as an enhanced omni-channel health experience. These strategic moves will accelerate the growth of our foundational businesses. In all this work, we will place the consumer at the center of all that we do.

We remain focused on delivering on our commitment to sustainability for our shareholders, our customers, and our communities. We recently launched CVS Health Zones aimed to advance health equity and to address social determinants of health in high risk communities. We are collaborating with trusted national and local organizations to confront the six key social determinants of health through local investments. Our goal is to equip communities with the resources needed to close gaps in care for specific health conditions, such as diabetes and heart disease. Health Zones is now active in five geographies with additional markets planned in 2022.

We remain committed to the environment and have pledged to reduce our overall impact, cutting greenhouse gas emissions across our operations and supply chain and decreasing resource consumption, especially paper and plastic. In December, CVS Health was named to the 2021 S&P Dow Jones Sustainability North American Index for the ninth consecutive year and the Dow Jones Sustainability World Index for the third consecutive year.

Our financial performance, execution, portfolio of assets, and differentiated strategy all create strong momentum into 2022 and a clear pathway to achieve low-double-digit adjusted EPS growth over time.

I would also like to take a moment to recognize the continued contribution of our colleagues who have played a vital role in helping our nation prevail over the pandemic. I am proud of what we have done and are doing every day to make a difference.

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 fourth quarter results reflect the continuation of the strong performance delivered in the first three quarters of the year, as we once again exceeded our expectations for revenue, cash flow, and adjusted earnings per share. We maintained our focus on growth, operational execution, and supporting the communities we serve as the effects of the pandemic persists.

Starting with the enterprise as a whole, total fourth quarter adjusted revenues of \$76.6 billion increased by 10.6% year-over-year. We reported adjusted operating income of \$4.1 billion and adjusted EPS of \$1.98, representing an increase of 40.8% and 52.3% versus prior-year, respectively.

For full year 2021, we reported total adjusted revenues of \$292.1 billion, an increase of 8.8% versus prior-year, reflecting robust growth across all business segments. We delivered adjusted operating income of \$17.3 billion and adjusted earnings per share of \$8.40, up approximately 8.1% and 12% year-over-year, respectively. And we generated significant cash flow from operations of nearly \$18.3 billion. This marks a record year of cash flow from operations for CVS Health and reflects the strength of our financial results, accelerated collections, and focused improvements in our working capital position.

Turning to the Health Care Benefits segment, fourth quarter adjusted revenue of \$20.7 billion increased by 10.1% year-over-year driven by membership growth in our Government Services business and lower COVID-19 related investments, slightly offset by the repeal of the health insurer fee. Adjusted operating income of \$510 million grew by over 230% year-over-year driven by lower COVID-19 related investments and improved underlying performance, partially offset by higher COVID-related medical costs compared to prior-year.

Our adjusted medical benefit ratio of 87% improved 130 basis points year-over-year driven by lower COVID-19 related investments, partially offset by the repeal of the health insurer fee. As a result of the Omicron variant, we experienced higher COVID testing and treatment costs in the fourth quarter, but this was largely offset by lower non-COVID costs, particularly in Medicare and Medicaid.

Days claims payable at the end of the quarter was 49 and was, as expected, lower than the third quarter and consistent with normal seasonal trends and historic levels. Overall, we remain confident in the adequacy of our reserves.

In the Pharmacy Services segment, fourth quarter revenues of \$39.3 billion increased by 8.2% year-over-year driven by increased pharmacy claims volume, growth in specialty pharmacy, and brand inflation, partially offset by the impact of continued client price improvements.

Total pharmacy membership increased by approximately 400,000 lives sequentially, reflecting sustained growth in government programs. Total pharmacy claims processed increased by 8.2% above prior-year. Approximately half of this growth was attributable to net new business in 2021 with COVID-19 vaccine administration and new therapy prescriptions also contributing to the year-over-year growth.

Adjusted operating income of \$1.8 billion grew 16.8% year-over-year driven by improved purchasing economics reflecting the products and services of our group purchasing organization and growth in specialty pharmacy. The quarter also reflected additional investments to support a successful welcome season.

In our Retail/Long-Term Care segment, we delivered exceptional revenue and adjusted operating income growth versus prior-year and once again exceeded our expectations. Fourth quarter revenue of \$27.1 billion was up by 12.7% year-over-year, representing an increase of \$3 billion.

There are two main components to this increase. One, approximately 60% was driven by the administration of COVID-19 vaccines and testing, front store sales including demand for over-the-counter COVID test kits and related treatment categories, as well as strong COVID-related prescription volume. The remaining 40% was attributable to a combination of underlying sustained pharmacy growth and broad strength in front store sales trends, partially offset by continued pharmacy reimbursement pressure.

This strong revenue growth helped produce adjusted operating income of \$2.5 billion. This quarterly result was 38% above prior-year and significantly exceeded our forecasts. The increase in adjusted operating income was driven by a few key components: the administration of COVID-19 vaccines, underlying strength in pharmacy and front store sales, and a \$106 million gain from an antitrust legal settlement, which were partially offset by the combined impact of ongoing but stable reimbursement pressure and business investments including the minimum wage increase and store improvements.

In terms of the improved performance in the quarter versus our expectations, there are two primary components. Approximately 75% was driven by vaccines, largely third dose boosters which we previously expected to impact the first quarter of 2022, and the remaining 25% was driven by the nationwide surge in demand for over-the-counter and diagnostic COVID-19 testing combined with stronger underlying front store sales performance.

Looking at cash flow and the balance sheet, our liquidity and capital position remain strong at the end of the fourth quarter with full year cash flow from operations of nearly \$18.3 billion and non-restricted cash of over \$3.8 billion. Through our proactive liability management transaction in December, we paid down \$2.3 billion in long term debt in the quarter, bringing the total long term debt we have repaid since the close of the Aetna transaction to a net total of \$21 billion.

In addition, we returned over 2.6 billion to shareholders through our quarterly dividends in 2021.

Our consistent outperformance during 2021 provides solid momentum as we head into this year, setting the stage for our continued strong outlook in 2022 despite multiple COVID unknowns that remain challenging to predict such as additional variants, vaccine and testing protocols, and government testing initiatives.

As Karen noted earlier, we are maintaining our full year adjusted earnings per share guidance range of \$8.10 to \$8.30. We feel this is an appropriate stance at this early point in the year, especially given the earnings outperformance of Retail in Q4 was due largely to the pull-forward of third dose vaccine administration from 2022 into 2021. This represents 2% to 5% growth versus our revised 2021 adjusted earnings per share baseline of \$7.92.

As you think about the adjusted earnings per share baseline and year-over-year growth, I'd like to encourage you to keep a few things in mind.

First, recall that our 2021 baseline of \$7.92 removes items we do not forecast: prior-year's development net of profits returned to customers and net realized capital gains. It also includes the annualized impact of our investment in our colleagues through an increase in minimum wage.

Second, it is also important to note that the baseline now includes a net favorable component attributable to COVID-19, driven by vaccines and testing, of approximately \$0.30 per share.

CVS Health continues to help lead the nation's COVID-19 pandemic response, clearly demonstrating the power of our integrated business model, consumer engagement, and local community health destinations. While there is no change to our Retail segment guidance, I would like to provide more detail on our COVID-19 Retail volume assumptions for 2022.

We expect that COVID-19 testing, both in-store diagnostic and over-the-counter, will continue at higher volumes than anticipated at Investor Day, offset by a reduced outlook on vaccines. In 2022, we expect vaccine volumes to decline approximately 70% to 80% and in-store diagnostic testing volumes to decline 40% to 50% compared to 2021. For over-the-counter test kits, we expect modest full year volume growth versus 2021.

Relative to vaccines, our outlook does not assume any impact from the administration of a fourth COVID-19 booster. As such, we expect the contribution of COVID-19 vaccines to be more heavily weighted to the first half of the year.

As I mentioned, the impact of COVID-19 remains one of the most challenging aspects of developing our guidance, due to many factors including: the risk of additional surges; potential new testing or vaccine protocols; legislative changes; and OTC test kit dynamics, such as supply challenges, coverage mandates, and government initiatives. You will find additional details regarding our updated guidance in the slide presentation we posted to our website this morning.

Turning to items that are below adjusted operating income on our income statement, we expect our interest expense for 2022 to be approximately \$2.3 billion. We are purchasing shares to offset dilution, and, as a result, we expect that diluted share count to be approximately flat versus 2021.

Our expectation for the effective income tax rate is approximately 25.6%, consistent with 2021.

In terms of cash flow and capital deployment, we anticipate continued strong cash flow from operations in 2022. And we are updating our guidance range to \$12 billion to \$13 billion, reflecting the improved cash flow results for 2021.

Capital expenditures are expected to be in the range of \$2.8 billion to \$3 billion as we invest in technology and digital enhancements to improve the consumer experience as well as our community locations.

As we detailed in December, we remain committed to maintaining our investment-grade ratings while also having the flexibility to deploy capital strategically for capability-focused M&A.

To conclude, the strong 2021 performance of CVS Health is expected to carry into 2022 as we continue to execute our strategy. We have solidified our leadership role in healthcare delivery as a trusted partner to our consumers and their communities. As we build upon this trust, we will continue to drive meaningful improvements that lower the cost of care, improve access, and build engagement and convenience, ultimately enabling people to live healthier lives.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take our first question from Lisa Gill with JPMorgan. Please go ahead.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Thanks very much. Good morning, and thanks for all the detail. Karen, I just want to go back to the comment that you made about how to think about the stores in the future. Primary care, HealthHUB, [ph] enhanced (30:57) and traditional. How do I think about the breakdown between each of those?

And then secondly, you talked about making incremental acquisitions around healthcare services. Do you need to buy physicians to make the primary care clinics work? And how do I think about the other enhanced services that you'll bring to the overall CVS offering?

Karen S. Lynch

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

A

Good morning, Lisa. So, let me just start with the three parts of the Retail portfolio. As we said, we'll have primary care clinics, which would serve as a quarterback and serve as the patient's primary care medical home.

And our HealthHUBs, the way you should think about HealthHUBs is they'll extend kind of the primary care for specific lower-risk use cases, which will allow us to expand the patient panel size with the primary care and obviously lower costs. The HealthHUBs will also serve as that extender in virtual care, and our pharmacies will leverage kind of the existing touch points to provide the ancillary and complementary services like next best actions and medication adherence programs.

And then you'd have the third ring, which would just be your typical CVS Pharmacy. So if you think about: we'll have a differentiated experience where we have the primary care clinics; we'll have coordinated assets; we'll bring the breadth of services; we'll connect through a single digital ecosystem; and then we'll have – kind of – and we'll invest in making sure that we're connecting the patient data, the provider workflows, that digital front-end so that we'll have a seamless patient and provider experience. That's the goal.

Now, we mentioned at Investor Day, Lisa, that we would look at M&A activity to supplement our primary care services. We are continuing to evaluate our options there. And when we have more to talk about on that front, we'll be sure to share that with you.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

All right. Karen, can you – just when we think about those three and you think about the number of pharmacies, is there a way to put a number around them as far as like, will a one-third of them be primary care clinics? Half of them? Is there any number that you put around the number of these in each bucket?

Karen S. Lynch

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

A

Yeah. I wouldn't specifically focus on the number. What we're really focusing in on is, how do we have coverage? And if you think about our HealthHUBs and MinuteClinics today, we actually have coverage of 45% of the – a little bit over 45% of the US population. So we would want – and we'd want to have good, strong coverage for our Aetna and our Caremark health plan customers as well. So I look at it as coverage, not necessarily numbers.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

Operator: We'll take our next question from Lance Wilkes with Bernstein. Please go ahead. Your line is open.

Lance Wilkes

Analyst, Sanford C. Bernstein & Co. LLC

Q

Yeah. Good morning. Kind of a related question on the primary care strategy and overall how you integrate that with Aetna. Was interested in – what sorts of patient types. I'm thinking about like segments such as Medicare, Medicaid, and employer to be more focused on for the primary care, and if that helps you to define what sorts of capabilities you're looking to add into our targets? Thanks.

Karen S. Lynch

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

A

Hi, Lance. Good morning, I'll start, and I'll ask Shawn to supplement here. Well, what we said was we would look – obviously, Medicare is our largest growth driver. We've been very successful, as I mentioned to you, with our growth. That is a growth engine for the company, so we would be focused on that, but not primarily, obviously, these clinics would serve a variety of different patients, and we would build them out, so we would have the opportunity to support other members with those primary care clinics.

And let me ask Shawn to add here.

Shawn M. Guertin

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

A

Yeah. No. No, Lance. I would agree with – I mean, I think that our long term aspiration, especially given the size of the company, right, is to have sort of broad cross-section of customer types. But clearly Medicare is an important business for Aetna. Frankly, the preponderance of chronic conditions in that population I think make it a population that would benefit tremendously sort of from this strategy. And obviously today there's also an economic model that works there.

So Medicare is important for a variety of reasons, but ultimately we would look to serve the local communities and the populations that exist. And I think the footprint and the nature of sort of our community assets will flex to serve the local populations. But Medicare is key, but the ultimate aspiration is our broad cross-section of customers.

Lance Wilkes

Analyst, Sanford C. Bernstein & Co. LLC

Q

Should we think of the additional health services that you'd be looking at as also being kind of focused maybe initially more on Medicare, like home care and those sorts of areas as potential expansion targets?

Shawn M. Guertin

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

A

Yeah. It's hard to predict the exact order with which things will potentially show up if this is something you decide that you'd rather acquire than build. But yes, absolutely. Things that make sense to sort of extend, sort of, the care continuum, again particularly to a Medicare population, would make a lot of sense, and they would be high on the list.

Lance Wilkes

Analyst, Sanford C. Bernstein & Co. LLC

Q

Thanks.

Operator: And our next question will come from Matthew Borsch with BMO Capital Markets. Please go ahead.

Karen S. Lynch

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

A

Matt, are you there?

Matthew Borsch

Analyst, BMO Capital Markets Corp.

Q

Oh. I'm sorry, my mute button. I clicked it, but it didn't click. Medicare Advantage, there's been a lot of chatter, as you well know, about increased competition being an issue for some of the other companies. Are you confident in your growth strategy coming into this year given all that sort of backlash from competitors and the very impressive growth numbers that you're pointing to that you achieved from the open enrollment?

Karen S. Lynch

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

A

Matt, we've had a long-standing growth strategy for Medicare, and I'd just remind everyone that we have a broad portfolio of Medicare products that isn't just focused on individually our group Medicare, our PDP business, and Med Supp. We had a very strong open enrollment period. We attribute that, obviously, to our strength in our product designs, our stars performance, our products and services, our connections with the broader portfolio of assets that we have.

As we look to 2023, clearly the rate notice was positive. It looked like CMS was keeping with the stability that will allow us to have continued flexible benefit design. So we're confident in our strategy. Obviously, there is a competitive marketplace, and we'll continue to play to our strengths. And let me ask Dan if he has anything he wants to add here.

Daniel P. Finke

Executive Vice President & President-Health Care Benefits, CVS Health Corp.

A

Thanks, Karen. I think you said it really well. Look, we've been really deliberate around our growth strategy here across the entire portfolio, making sure that we can provide really solid benefits to the senior population, really focused on our footprint coverage inclusive of our DSNP and that played out during AEP. And so, like you said, we feel really confident in our growth expectations for 2022.

Matthew Borsch

Analyst, BMO Capital Markets Corp.

Q

Okay. Thank you.

Operator: And we'll take our next question from Steve Valiquette with Barclays. Please go ahead.

Steve J. Valiquette

Analyst, Barclays Capital, Inc.

Q

Thanks. Good morning. I was also going to ask a question on Medicare. So part of it was answered, but I guess, at the investor conference last month you guys touched on your internal distribution capabilities for individual MA. So I'm curious if you're able just to provide more color on the mix of how much of your – either the total MA book or just the membership growth in the MA book is driven by the internal sales distribution and marketing capabilities versus the external channel? Thanks.

Karen S. Lynch

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

A

Yeah. So, Steve, we have a number of distribution channels that we rely on for Medicare growth. Clearly, have the national distribution, the [ph] teleservice (39:35), and our own internal proprietary channel. And we've had pretty good strength across all those channels. Obviously, we continue – the other thing we did this year too is we added resource centers in the CVS Health locations so that people could get educated on Medicare more broadly.

I think what's important to look at is the distribution of the book in Medicare, not necessarily where the current sales are going, because that gives you a sense for kind of the future persistency. We had very strong retention across all of our distribution channels and feel good that we have the right focus on the distribution channels.

Coupled with that is our marketing capabilities, and what we've done – we continue to do is really gear our marketing capabilities towards growth areas in the markets. And that has served us well on that generated solid growth for us.

But let me see if Dan has anything to add here as well.

Daniel P. Finke

Executive Vice President & President-Health Care Benefits, CVS Health Corp.

A

Karen, I think you said it really well. Look, our strategy is to really use our diversified distribution channels for growth, digital, our personnel, our partners. We do have a robust internal sales force, and I think that the results really speak to our ability to optimize success across all of those channels.

Steve J. Valiquette

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Thanks.

Operator: And we'll take our next question from Michael Cherny with Bank of America. Please go ahead.

Michael Cherny

Analyst, BofA Securities, Inc.

Q

Good morning. Thanks for all the detail so far. Shawn, I think you said something. I just want to clarify, regarding the baseline, that there's roughly \$0.30 of COVID-related impact that's now in the baseline. A) I just want to make sure you got that right or I got that right.

And then, B) regarding that and how it factors into the store performance, clearly I don't think anyone is expecting double-digit same-store growth forever with this business. But as you get further towards what hopefully is the far side of the pandemic, what are the signs you're seeing relative to the new customers you brought into the stores and how you can continue to make them customers in a post-testing, post-vaccine world?

Shawn M. Guertin

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

A

Yeah. Let me start on the first, and I'll give you some insight. And I'll have Michelle or – and/or Karen talk a little bit about through the customer acquisition. But going back to the \$0.30, you are correct. So for most of this year, when we've looked at the effect of COVID for the organization, it's been neutral plus or minus between the pressure on HCB and the revenue we're getting on the Retail side.

In the fourth quarter, one way to think about it is we had about a \$0.40 beat, and almost \$0.30 of that was sort of sitting in the vaccine and testing including the OTC line. And HCB came in relatively consistent with expectations. So we've gone from having this be a neutral item to being about a 30% contributor during the year, all really kind of manifesting itself in the fourth quarter.

And you're right. I mean obviously in 2022, the revenue from the stream of vaccine and diagnostic testing and OTC testing will decrease significantly, but we have seen kind of, what I'll call, new customer acquisition. We have seen a lot more traffic in the stores, and that's manifesting itself in more prescriptions and increased basket sizes in some instances.

So it's an excellent question that I think we're going to continue to work on, which is, how do we maintain that momentum? But we definitely have built some momentum beyond sort of the direct COVID kind of product line here.

Michelle Peluso

Executive Vice President, Chief Customer Officer and Co-President-CVS Pharmacy, CVS Health Corp.

A

And, Shawn, I would just add from a loyalty perspective three things. First, most important thing we've been working on is making sure that everybody who comes through the door has a great experience, and we've seen overall satisfaction for vaccines and testing extremely strong.

Secondly, using this to drive digital adoption, we see many of these customers come back to get their QR code, their vaccine record, and then few things like next best actions, potentially other vaccines that they need to take and the like. So we're seeing strong, digital adoption from these customers.

And finally, our loyalty programs are critical. You heard Karen mention CarePass is up over 40% year-over-year. When people become CarePass members, we see incremental engagement, and so it's critical as you build loyalty and retention amongst our many new customers.

Shawn M. Guertin

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

A

Yeah, and Michael, let me just clarify. I might have said 30%. I meant \$0.30. I think that was clear. But just to be abundantly clear, it was \$0.30 I was talking about.

Operator: And we'll take our next question from Charles Rhyee with Cowen. Please go ahead.

Charles Rhyee

Analyst, Cowen and Company

Q

Thanks for taking the question. Just wanted to touch on, in the 10-K it was disclosed about the CID, and I know you've been working with the DOJ. But maybe if you could just kind of give sort of your broad thoughts on opioids and sort of the company stance here currently?

Karen S. Lynch

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

A

Shawn, you want to grab that one?

Shawn M. Guertin

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

A

Yeah. Of course. So I think our stance here is very similar to where it's been all along. Our fundamental position is that these prescriptions were written by doctors, not pharmacists. We did not manufacture or market these, and the healthcare system does rely on pharmacists to fill legitimate prescriptions that doctors are deeming necessary.

So based on that, we strongly disagree with the recent court decision in Ohio. And we look forward to the appellate court review of that case. And I'll remind you there that that was a ruling on liability only, not on damages [technical difficulty] (45:50)

And, like any litigation, we will – if we think it's in our interest and the company's interest to sort of resolve matters, we will. But at this point, it's still very early, and there's a lot to play out. And we remain pretty firmly convicted in our position.

Susan Vissers Lisa

Senior Vice President-Investor Relations, CVS Health Corp.

A

Next question, Ashley.

Operator: And we'll take our next question from Kevin Caliendo with UBS. Please go ahead.

Kevin Caliendo

Analyst, UBS Securities LLC

Q

Great. Thanks for taking my question. You said earlier you weren't expecting – your guidance doesn't assume a fourth booster shot, but are you contemplating another different or later COVID surge this year? And how would

that – how do you think a new COVID surge might impact the cadence for the year or the Health Care Benefits business given we have a potential drug that keeps people out of the hospital? And/or if there's no vaccine, how it would impact the Retail part of the business?

Shawn M. Guertin

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

A

Yes. So we are not, Kevin, forecasting a surge later in the year, a la whether it be Delta or Omicron. And again, all of these have been a little bit different, but I'd remind everybody that we have had – we have two large businesses that have tended to move in opposite directions in these surges and which have largely allowed us to sort of navigate them successfully.

So I would say our overall cadence of earnings right now with that assumption is actually very similar to 2021. A little bit more than half the earnings are in the front of the year. It's all hypothetical, but if we did – we don't have a lot of vaccine volume, for example, right now in the second half of the year. So if that did tick up or if there was a fourth booster or if there was even more testing activity, that would be certainly something that would sort of lift that on the Retail side, but, obviously, we would have some of the offset on the HCB side.

So there are a lot of moving parts, but we've been fortunate to sort of navigate, frankly, both the surges because of the kind of the opposite performances of these two businesses in the face of the surge.

Kevin Caliendo

Analyst, UBS Securities LLC

Q

Thanks.

Operator: We'll take our next question from A.J. Rice with Credit Suisse. Please go ahead.

A.J. Rice

Analyst, Credit Suisse

Q

Hi, everybody. I thought I might ask about the at-home testing. Obviously there's been a lot of discussion about the mandate for commercial insurers to cover that and so forth. You're saying in your guidance, I guess, you've got modest year-to-year growth. I'm assuming that a lot of that would be what you've seen in January. Can you comment on sort of beyond the first quarter? Do you really have much continued at-home testing?

And maybe give a little bit of flavor for your strategy on the Retail side as well as on the Benefits side, network, out of network, how you're dealing with the different ways that you can potentially cover that on the Benefits side and then participate on the Retail side?

Shawn M. Guertin

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

A

A.J., I'm happy to start on the forecast, and I can have Karen and/or Michelle sort of talk about the other side. But most of the OTC test volume is in the first quarter right now and certainly the first half of the year in our forecast. The year-over-year comparisons are a little funny here because we really didn't have any meaningful volume until the third quarter, and almost all the volume is in the fourth quarter. So that was pretty back-end loaded in 2021. And conversely, our forecast I think is it's pretty front-end loaded right now.

Obviously there's a lot of dynamics here that are moving around, whether it be the insurance coverage of the benefit, the free tests from the government, supply chain issues. This is a great example of an area where there's

an awful lot of moving pieces that make the forecasting challenges. But I think this is also a good example of something that I think we will largely see play out in Q1 and hopefully have a more informed view on this for the full year.

Karen S. Lynch

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

A

And, A.J., the kind of way we think about it is more testing could lead to earlier diagnosis, and when it's necessary, you could see COVID therapeutics and help minimize the spread of the disease and drive fewer hospitalizations.

Relative to the Benefits, let me ask Dan to just comment on how we're thinking about coverage and actually what we're doing today.

Daniel P. Finke

Executive Vice President & President-Health Care Benefits, CVS Health Corp.

A

Yeah. Thanks, Karen. I mean our top priority has really been to ensure that our members have access to the tests in a really convenient way. Obviously, supply plays into this. And so early on as we're looking at making sure that our members have access, we're using our broad network opportunities. But we are working very closely with our retail partners to bring a more convenient digital solution into play that can be even more convenient for our members.

Karen S. Lynch

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

A

Yeah, and maybe I'll have Michelle comment on we are – we have – part of our strategy is to become digitally oriented, and we're working on a new digital strategy, so, Michelle, maybe share what we're doing there.

Michelle Peluso

Executive Vice President, Chief Customer Officer and Co-President-CVS Pharmacy, CVS Health Corp.

A

Sure. Thanks, Karen. Just like we did with vaccine and testing, our aim is to provide the best experience for consumers. And next week, we'll be launching what we believe will be a really great solution where consumers can come online, enter their information, and immediately be adjudicated and figure out the stores near them, pick up the stores – pick up the test kits in that store for free.

So it'll be an incredibly smooth digital experience for our customers. So we're excited to launch that next week.

A.J. Rice

Analyst, Credit Suisse

Q

Okay. Great. Thanks a lot.

Operator: And we'll take our next question from Stephen Baxter with Wells Fargo. Please go ahead. Your line is open.

Stephen Baxter

Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Wanted to ask about the labor market and your latest thinking there. Obviously, some headlines during the quarter were challenges on the staffing side. And in the release you mentioned that you hired 45,000

associates through a virtual career day, that seems like a pretty big number relative to the size of your workforce. Hopefully you can give us an update on where that puts you for staffing today, how many open positions you have, how turnover is trending, and how you're thinking your strategy and labor will play out from here? Thanks.

Karen S. Lynch

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

A

As you know, talent is always our top priority. And as you mentioned, we have been strengthening our workforce despite a very tight labor market. We did have significant hiring throughout the year, and as you might imagine, we weren't immune to some of the Omicron issues. And some of our colleagues did get sick, but we were able to maintain strong store hours and pharmacy hours across the country.

This is a big focus. I think the minimum wage that we mentioned that we put in place has helped us. Keep in mind that I continue to evaluate that minimum wage to see if there's more that we could or should be doing as we continue to address labor shortages in the country.

Susan Vissers Lisa

Senior Vice President-Investor Relations, CVS Health Corp.

A

Next question?

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

Justin Lake

Analyst, Wolfe Research LLC

Q

Thanks. Good morning. Just wanted to see if I can follow up with a little bit more detail on the membership side. Hoping you can run us through maybe what you're expecting on the commercial risk book, how you're thinking Medicaid redeterminations play out, and how that impacts your Medicaid membership. And I'm not sure if you gave a specific Medicare Advantage membership number that I might have missed. Thanks.

Karen S. Lynch

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

A

Thanks. Dan, you want to grab that?

Daniel P. Finke

Executive Vice President & President-Health Care Benefits, CVS Health Corp.

A

Yeah. Sure. So let me take those in part. I mean first of all, Karen mentioned the commercial book. We've seen some really strong retention in the fourth quarter, certainly related to national accounts in the fourth quarter. We also saw continuing strong retention and strong sales. We also saw a little bit of shift in that change in force dynamics due to the pandemic that we were expecting, which is good, and that's leading to our lower single-digit growth overall there.

As far as Medicare, we mentioned really strong AEP season. The team is really focused on OEP and making sure that we sustain that momentum, and so we're really confident in our ability to deliver on that double-digit individual growth in 2022.

And then the last piece is the Medicaid piece. Look, we're following PHE really, really closely. Redeterminations are obviously something that we're watching as it relates to that. I think it's reasonable to expect that the

suspension of redeterminations will continue through the second quarter, and then we'll be monitoring it closely and of course working with our state partners to make sure that when that does occur that's timely and appropriate. We don't consider that to be a sort of a day one event. It will be a gradual process, but we'll work closely with the states around that.

Justin Lake

Analyst, Wolfe Research LLC

Q

So just to be clear, if your membership guidance I think is flat to up slightly for the year and Medicare Advantage is going to grow give or take maybe 300,000 members, is most of that decline going to be in Medicaid to kind of offset the growth in Medicare Advantage? Or is Commercial also going to decline year-over-year?

Daniel P. Finke

Executive Vice President & President-Health Care Benefits, CVS Health Corp.

A

Yeah. It'll be mostly focused on Medicaid. That component of the redetermination is at play, but recall we also had a large known group that's coming off the books in Medicaid as well.

Justin Lake

Analyst, Wolfe Research LLC

Q

Great. Thanks.

Operator: We'll take our next question from Eric Percher with Nephron Research. Please go ahead.

Eric Percher

Analyst, Nephron Research LLC

Q

Thank you. Eric Percher and Josh Raskin here. Question related to labor making the back of the store. In 4Q, did Omicron require you to change either to ramp up or stop a ramp down relative to what expectations of needs in the back of the store are?

And how do you view the flexibility of labor in the back of the store as you see a decline in vax and test? And is some of that offset by the desire to have the pharmacist providing more services from the store?

Karen S. Lynch

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

A

Go ahead, Prem.

Prem Shah

Executive Vice President, Chief Pharmacy Officer and Co-President-CVS Pharmacy, CVS Health Corp.

A

Yeah. Thanks, Eric. This is Prem. It's a great question. So we are obviously doing three things. One is if you think about how we're thinking about our pharmacy assets and what I'd say is consumer-led, digitally focused, really taking out a lot of work that would be duplicative or challenging, so creating efficiencies in the back of the store.

The part of your question around Omicron, it absolutely led to a little bit of what I would say is stress where we saw vaccination volumes grow very quickly and then come down. So that also we were able to absorb that and be able to deliver that care in a very what I'd say is high customer value way in the back of the store in December and in January.

And we're definitely continuing to look at our back of the store and creating what I'd say is a digital-first experience for consumers but also creating efficiencies across stores when you look at our pharmacy assets and how we can leverage those efficiencies across stores and the back of the store.

So absolutely looking at that, there's more to come, and we see a tremendous opportunity there with our large fleet of stores to really maximize our efficiencies.

Eric Percher

Analyst, Nephron Research LLC

Thank you.

Q

Susan Vissers Lisa

Senior Vice President-Investor Relations, CVS Health Corp.

One last question, please, Ashley.

A

Operator: Certainly. We'll take our final question from Nathan Rich with Goldman Sachs. Please go ahead.

Nathan Rich

Analyst, Goldman Sachs & Co. LLC

Great. Thank you. Karen, if I can maybe go back to your comments on the primary care strategy, you talked about the need to have a digital platform to connect the physical assets that you have. Is that the starting point for this strategy as you think about kind of integrating primary care into the CVS Health business? And do you see this as something that you'd look to develop internally? Or could you look externally for these capabilities as we think about the best way to scale this strategy? Thank you.

Q

Karen S. Lynch

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

Karen Lynch>: Thanks for that question, Nathan. I think digital is a part of the strategy. It's not necessarily the driver. I think it's important when you think about the connectivity of care, the continuity of care, the seamless experience, you have to have those digital connections. So that will be part of our overall strategy, and we will continue to look at what we can do internally versus what opportunities there are externally as we think about tech stacks and things like that in target companies that we're looking at today.

A

Karen S. Lynch

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

So I'm going to wrap-up the call. So, first of all, thank you for joining us today. As we said, 2021 was really marked by strong financial performance across all of our businesses and very good progress on our strategy, and we are entering into 2022 with very powerful momentum and strong growth across all our businesses.

So thank you for joining our call today.

Operator: Thank you. And this does conclude today's CVS Health fourth quarter and full year 2021 earnings call and webcast. You may disconnect your line at this time, and have a wonderful day.

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