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MANAGEMENT DISCUSSION SECTION

Ladies and gentlemen, good morning, and welcome to the CVS Health First Quarter 2022 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 Tom Cowhey, Senior Vice President of Capital Markets for CVS Health. Please go ahead.

Thomas Cowhey

Good morning and welcome to the CVS Health first quarter 2022 earnings call and webcast. I'm Tom Cowhey, Senior Vice President of Capital Markets 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 Jon Roberts, Executive Vice President and Chief Operating Officer; Dr. Alan Lotvin, President, Pharmacy Services; Dan Finke, President, Health Care Benefits; and Michelle Peluso, Chief Customer Officer; and Prem Shah, Chief Pharmacy Officer, both Co-Presidents of the Retail segment.

Our press release and slide presentation have been posted to our website along with our Form 10-Q that we filed this morning with the SEC. Today's call is also being broadcast on our website, where it will be archived for one year.

During this call we will make certain forward-looking statements reflecting 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 currently projected results. We strongly encourage you to review the reports we file with the SEC regarding these risks and uncertainties, including our most recent annual report on Form 10-K, our recent current reports on Form 8-K and this morning's earnings press release and our Form 10-Q.

During this call, we will use non-GAAP measures when talking about the company's performance and financial conditions and you can find a reconciliation of these non-GAAP measures in this morning's press release and in the reconciliation document posted to the Investor Relations portion of our website.
Good morning, everyone, and thanks for joining our call today. We entered 2022 with significant momentum and delivered strong first quarter results across our business. We grew revenue by over 11% to $76.8 billion and increased adjusted operating income by nearly 7% to approximately $4.5 billion. Adjusted EPS was $2.22, up over 8.5% over the prior year. In the quarter, we generated $3.6 billion of operating cash flows, representing growth of over 20% as compared to the prior-year quarter.

Our foundational businesses performed well in the quarter. In Health Care Benefits, revenue increased by 12.8% year-over-year. We achieved adjusted operating income of $1.8 billion. We grew membership sequentially and year-over-year. Overall medical costs remained consistent with projected baseline trends. These results reflect our strong product portfolio, our deep understanding of consumer’s health needs and service excellence.

In Pharmacy Services, revenue increased by nearly 9% year-over-year. Adjusted operating income grew 8.6% despite a flat year-over-year contribution from our 340B product line. Our results demonstrate the consistent value and savings that we deliver to our customers.

In Retail, we strengthened our position as a leading community health destination for millions of Americans. We grew revenues by approximately 9% with approximately 15% adjusted operating earnings growth over the prior year. We grew same-store retail scripts by approximately 6%, approaching twice the growth in the marketplace.

Store visits increased over prior year as more Americans see CVS Health as central to their health needs. We administered more than 6 million COVID-19 tests and more than 8 million COVID-19 vaccines nationwide in the first quarter of 2022. Given these results, we are raising our full year 2022 adjusted earnings per share guidance to $8.20 to $8.40. Our cash flow guidance for the year remains strong in a range of $12 billion to $13 billion. We are well-positioned to achieve near-term and longer-term growth goals.

We are doing this across five strategic value-creating imperatives, which we outlined at our Investor Day. Let me just share a few examples of the strong progress we are making in each.

First, we are advancing our all-payer primary care delivery capabilities. Our community health destinations are engaging more consumers with 6.5 million in-person and virtual visits in 2021, approximately 1.5 million visits in the first quarter, up nearly 35% from the prior year. Our virtual care solution represents one of many care delivery channels and lower-cost sites of high-quality of care. We’ll be broadening our virtual care services in the next 30-days. More people are accessing health care using digitally enabled solutions.

Pre-pandemic, back in 2019, we supported 10,000 virtual mental health visits. Last year, we supported 10 million virtual visits just for mental health. This dramatic increase demonstrates the power of our ability to drive innovation at-scale.

Second, we are optimizing our retail portfolio that will be comprised of three models: advanced primary care clinics, enhanced HealthHUB locations and our traditional CVS Pharmacy locations. As of today, we have closed approximately 100 stores out of the 300 planned for this year, and the 900 planned by the end of 2024. Our early experience suggests we are retaining nearly 70% of the prescription volume within our network, demonstrating strong evidence of our value to consumers. Additionally, we retained more than 95% of colleagues and redeployed them to other CVS locations.

Third, we are diversifying our growth portfolio with new health services. We are expanding our capabilities in home health as we prepare for the 2023 launch of a post-acute transitions pilot for our Aetna membership in select geographies. Partnering in technology and home-based care will allow us to reduce re-admissions and improve care for our customers at this critical juncture on their path to recovery.

As we broaden our capabilities to create new sources of value, we continually evaluate our portfolio for nonstrategic assets. Our recently announced sale of PayFlex and selected assets from our international businesses are two recent examples of our actions. These transactions are in line with our commitment to invest in areas that are aligned with our strategy.

Fourth, we are focused on our digital-first technology-forward approach. We serve nearly 44 million unique digital customers as of the end of the first quarter, up by over 7 million customers since our Investor Day, a testament to the value and ease of our digital offering. Digital customers are omni-channel and, on average, visit CVS Health two times more often than traditional customers.

We also continue to expand our digital-first health dashboard offering. This dashboard makes managing your family’s health more seamless, convenient and personalized. It does so by putting critical health information into one place:

Karen S. Lynch

Thank you, Tom. With that, I’d like to turn the call over to Karen. Karen?
health records, pharmacy medications and next-best actions. We have 5 million active health dashboard users, up over 25% in the past quarter. And we will continue to enhance connectivity to more services later this year.

Finally, we are making progress serving our consumers, wherever and whenever they receive health care. In the first quarter, we launched a new fulfillment option for consumers as part of our omni-channel health experience. Consumers can purchase health and wellness products online with an option for free, same-day pickup that will be available in approximately 6,000 CVS community health destinations later this year.

We are partnering with Google and Microsoft in ways that deliver real benefits to consumers. For example, MinuteClinic scheduling is now integrated into Google search, driving new and more convenient appointment bookings. In our specialty pharmacy, we are using Microsoft text analytics and robotics to automate the 40% of prescriptions that are still paper or fax-based, making it easier and faster for us to fill the patient's prescription.

We are increasingly using technology to improve our business process and reduce costs. Here are just two examples. Our specialty intelligent medication monitoring and adherence engine uses machine learning to help our most at-risk patients by predicting the likelihood of individual patients becoming non-adherent to their medication. This approach then prompts ways in which we can coach and help them maintain their overall health.

Also using machine learning and robotics, we can now resolve a wide range of prescription drug claims, which previously required the attention of our pharmacist, freeing them up to spend time with patients. This advanced approach reduces overall cost and improves the patient experience.

These five strategic imperatives, taken together, place the consumer at the center of everything we do. Consumer value is behind the integration of our businesses, and we are making steady and real progress. Ultimately, it's the hard work and commitment of our dedicated colleagues that makes our strategy and results achievable. At CVS Health, we are committed to fostering a culture of value. We have made increasing workforce representation, promoting inclusion and belonging, and equitable access to growth and development our priority.

Our commitment to shareholders, customers and communities remains steadfast. In our 2021 Environmental Social Governance Report released last month, we highlighted our sharpened focus on sustainable business practices and our priority to advance health equity in America. You can find our report on our website.

Our work to fundamentally reshape the delivery of health care in our country is well underway. Before I turn it over to Shawn, I am pleased to announce we have named a new Chief Medical Officer, Dr. Sree Chaguturu. Also, I'd like to acknowledge Jon Roberts, who will be retiring at the end of June and thank him for his many contributions to CVS Health over his 42-year career at our company. I am grateful to our dedicated colleagues, who continue to deliver every day, helping millions of Americans and bringing their heart to every moment of our customer's health.

Let me now turn it over to Shawn for a deeper look into our operational results and outlook for the remainder of the year.

Shawn M. Guertin

Thank you, Karen, and good morning, everyone. Our first quarter results reflect strong performance from all our core business segments with continued momentum in revenue growth, cash flow generation and adjusted earnings per share growth, positioning us to increase our 2022 adjusted EPS guidance to a range of $8.20 to $8.40 per share.

As we continue making progress towards our financial targets, we remain focused on growth, operational execution and supporting the communities we serve. A few highlights of total company performance.

First quarter revenues of $76.8 billion increased by 11.2% year-over-year, reflecting robust growth across all business segments. We delivered adjusted operating income of approximately $4.5 billion and adjusted EPS of $2.22, representing an increase of 6.6% and 8.8% versus prior year, respectively.

Our first quarter adjusted EPS performance reflects both a higher adjusted operating income contribution and lower interest expense versus prior-year due to our proactive deleveraging campaign in 2021. Importantly, our first quarter 2022 adjusted EPS was impacted by $75 million of net realized capital losses, which lowered adjusted EPS performance by $0.04. Of the losses noted, approximately $40 million or $0.02 per share related to write downs of sovereign bonds in Ukraine and Belarus.

Turning to the Health Care Benefits segment. First quarter revenue of $23.1 billion increased by 12.8% year-over-year, driven by membership growth across all product lines. We delivered sequential membership growth of over 670,000 reflecting growth across all product lines. We continue to be pleased with the performance of our Medicare franchise, which has been a key growth engine over the years.

Medicare Advantage grew about 200,000 members sequentially, up 6.7%. Our momentum in dual eligible plans enrollment also continued into the first quarter growing 28% sequentially. In our commercial business, a strong
national account selling season contributed to membership growth, along with growth in commercial risk membership

Adjusted operating income of $1.8 billion was down slightly as compared to the prior year as the previously mentioned
net realized capital losses impacted growth along with the continued progression towards normalized medical cost
trends. Our medical benefit ratio of 83.5% increased approximately 30 basis points year-over-year reflective of the
same continued progression towards normalized total medical costs.

In total, medical cost trends in our commercial business remain in-line with pre-pandemic-trended baselines, with
government remaining slightly lower than pre-pandemic baselines.

Consolidated days claims payable at the end of the quarter was 51.7, up 2.6 days sequentially as we brought on new
government and other membership in the first quarter. Overall, we remain confident in the adequacy of our reserves.

In Pharmacy Services, we continue to achieve strong revenue and adjusted operating income growth. This is a
natural outcome from our execution delivering industry-leading drug trend on behalf of our clients, providing leading
specialty management capabilities and outstanding customer service.

During the first quarter, revenue of $39.5 billion increased by 8.6% year-over-year driven by pharmacy claims growth,
growth in specialty pharmacy and brand inflation, partially offset by the impact of continued client price improvements.

Total pharmacy membership was roughly flat from year-end at 110 million members, as underlying growth in
commercial and other government lives helped to offset significant membership losses from the California Medicaid
carve-out that started this year. Total pharmacy claims processed increased by 5.8% above prior year, primarily
attributable to new business in 2022. Currently, we are approximately 60% through renewals for the 2023 selling
season with over 98% core client retention.

Adjusted operating income of $1.6 billion, grew 8.6% year-over-year driven by improved purchasing economics
reflecting increased contribution from the products and services of our group purchasing organization and specialty
pharmacy, partially offset by continued client price improvements and increased expenses to onboard new business
at the beginning of the year.

As Karen mentioned, our 340B product lines did not grow inside the quarter. In our Retail/Long-Term Care segment,
we delivered strong revenue and adjusted operating income growth versus prior year. First quarter revenue of $25.4
billion, grew 9.2% year-over-year, largely due to increased prescription and front store volume, including the sale of
COVID-19 OTC test kits.

Adjusted operating income of $1.6 billion, grew 15.1% versus prior year, driven by a few key components. Strength in
pharmacy and front store sales, the administration of COVID-19 vaccines and demand for over-the-counter test kits
and related treatment categories particularly at the beginning of the quarter when Omicron incidence was high. These
positive factors were partially offset by the impacts of ongoing but stable reimbursement pressure, business
investments, including the minimum wage increase and store improvements, and investments in store labor as we
were consciously slow to drawdown staffing in response to declining Omicron case levels to ensure we had sufficient
capacity to meet consumer health needs.

Our liquidity and capital position remains strong at the end of the first quarter, generating cash flow from operations
of $3.6 billion and ending the quarter with $3 billion of cash at the parent and unrestricted subsidiaries. We remain
committed to maintaining our investment-grade ratings, while also having the flexibility to deploy capital strategically
for capability-focused M&A. The announced sales of our PayFlex and Aetna International business in Thailand are
expected to provide us with additional deployable capital later this year.

We repurchased approximately 19.1 million shares of common stock during the three months ended March 31, 2022,
marking the first time the company has repurchased shares of its common stock since 2017. We also increased the
quarterly shareholder dividend by 10% effective with the February 1, 2022, dividend distribution which resulted in the
return of $722 million to shareholders through dividends during the three months ended March 31, 2022.

In March, we also announced we had entered into an agreement with the State of Florida to resolve claims dating
back more than a decade related to opioid medications. Under the agreement, we will settle all opioid claims by
Florida for $484 million to be paid over a period of 18 years. As a result, upon satisfaction of the settlement terms by
the State, CVS will be released from the pending litigation in Florida.

Associated with this settlement we have taken a charge of approximately $370 million after-tax in our first quarter
2022 financials, which has been excluded from our adjusted operating metrics. As a result of our first quarter
performance, we are raising our full year adjusted earnings per share guidance to $8.20 to $8.40, which represents
3.5% to 6% growth versus our 2021 adjusted earnings per share baseline. The increase reflects the favorable impact
of prior-year’s development, net of realized capital losses experienced in our Health Care Benefits business, both of
which we do not forecast.
As such, we are raising full year Health Care Benefits guidance as follows. Membership increases to a range of 24 million to 24.3 million members, revenue increases to a range of $89.3 billion to $90.8 billion, adjusted operating income guidance increases by $180 million at the midpoint to $5.94 billion to $6.04 billion. Similarly, MBR guidance is updated to 83.5% to 84.5% to reflect our first quarter experience. We are maintaining all other guidance shared during our fourth quarter earnings call.

Our updated guidance now reflects the assumption that a fourth COVID-19 booster will be administered to adults aged 50 and older, and to certain immunocompromised individuals as per the guidelines set forth by the CDC. Administration of a fourth booster is expected to have a net neutral impact to our enterprise representing an incremental cost to our Health Benefits segment, but helping to maintain our full year outlook for our Retail segment by offsetting first quarter 2022 expense pressures previously mentioned.

As we evaluate the progression of earnings for the remainder of the year, we would remind investors of our prior statements that we expect 2022 earnings to be modestly higher in the first half of the year. Similar to 2021 earnings progression, we currently project that 47% to 49% of adjusted EPS will occur in the back half of 2022, which we project will be fairly evenly split between the third and fourth quarters. You will find additional details regarding our updated guidance in the slide presentation we posted to our website this morning.

We continue to anticipate strong cash from operations in 2022 between $12 billion and $13 billion and capital expenditures 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.

Full year deployable free cash will benefit from our recent divestiture activity, while any earnings impact from these divestitures are incorporated into our updated guidance ranges.

To conclude, we are encouraged by our strong first quarter results and improved 2022 outlook, particularly at this early stage in the year as we continue to sharpen our focus and execute our strategy. As a leader and trusted partner in health care, we strive to deliver a superior health care experience for our consumers through lowering the cost of care, improving access and building engagement and convenience to our consumers in their communities.

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

QUESTION AND ANSWER SECTION

Operator

We'll take our first question from Lisa Gill of JPMorgan.

Analyst: Lisa C. Gill

Question – Lisa C. Gill: Hi. Thanks very much, and good morning. First, let me give my congratulations to Jon in his retirement. It's been great getting to know you over all these years, Jon, so I wish you well in your retirement.

My question, if I look at the guidance, Shawn, the one area where you raised guidance versus previous was in the Health Benefits business, so can you talk about what the key drivers are of the better MLR going forward? Karen talked about digital. Is that playing a part of it. She talked about virtual, so if you can just give us more color as to how we think about what some of the key drivers are to the better MLR in your guidance.

Answer – Shawn M. Guertin: Yeah, so I think the easiest way to sort of think about that is largely what's being sort of pulled through here is the prior-year development that we experienced in the first quarter less the realized capital losses. And just to be clear on that, we talked in my remarks about $75 million of realized capital losses. About $60 million of that was in HCB, so the net of those two things is right around $180 million and that's really the guidance increase.

To round out the story, though, as mentioned, we now have incorporated the fourth booster for the specific populations that it has been recommended for, so that's going to be a cost item obviously for HCB, but, as you saw, we've had strong volume growth and excellent kind of performance sort of especially post-January as Omicron faded on that side. So the biggest thing is the prior-year development, the realized capital losses, but we should have ongoing strength from volume that should be able to absorb the cost of the fourth booster.

Question – Lisa C. Gill: Okay. Great. Then just as my – I guess my follow-up from my questions I've been asking for the last year and that's around the primary care strategy, I really thought we would have had an announcement by now. You did talk in your prepared remarks about making headway around primary care and some of the offerings you have in the marketplace, but maybe can you talk about are you still looking to make a larger-scale acquisition or will this be more of internal growth? Just any update on that would be helpful. Thanks very much.
Answer – Karen S. Lynch: Good morning, Lisa. Yeah, let me just comment on that. Yes, we are continuing to look for a broader range of primary care capabilities. It's an interesting market. We are trying to make sure that we are prudent, both strategically and financially, but it is part of our strategy and we're – more conversation to come.

Shawn, you want to talk about capital?

Answer – Shawn M. Guertin: Yeah, I'll talk a little bit about the M&A specifically on this, and, Lisa, I certainly understand your question. And I want to be careful because different people will define large different ways. I think, we've been pretty clear. We're not talking about a jumbo acquisition here. We're talking about a capability-based acquisition of some size, but not necessarily anything jumbo.

We've been very active in this space. We've evaluated a range of assets in and around the care delivery space. I'll remind you most of these assets aren't out for sale. And so that dialogue starts a process. Our priority areas remain primary care and MSO capability and a home health capability.

These assets will serve as the foundation of the platform upon which we'll pursue our strategic vision, so it's essential that we fully evaluate their defining characteristics and capabilities. And so while the valuation environment continues to present its own set of challenges, I'm cautiously optimistic with our ability to begin to execute on our strategic plan in 2022.

Question – Lisa C. Gill: Thank you.

Answer – Jonathan C. Roberts: And Lisa, this is Jon. Thanks for your kind words. Obviously, I've had a very rewarding career at CVS and I feel really good about the leadership team that's now here, confident in their strategy and the team's ability to execute. So, thanks.

Question – Lisa C. Gill: Thank you.

Operator

We'll take our next question from Ricky Goldwasser of Morgan Stanley.

Analyst: Ricky R. Goldwasser

Question – Ricky R. Goldwasser: Yeah, thank you, and good morning. So clearly, 2022 is progressing in-line with your expectations, but, Shawn, back in December, you also gave us sort of targets for 2023 and 2024, so with kind of like everything that's happening in the macro environment, how is your thinking of 2023 and 2024 stance now? Has it changed since December or are we still on track with those targets?

Answer – Shawn M. Guertin: Yeah, so we remain committed to achieving those EPS targets for 2023 and 2024 and we're certainly off to a good start in doing that. And as it pertains maybe more immediately to 2023, while we're not providing specific guidance as it's sort of too early, there's a lot of moving parts, but to your point, I understand why the question is being answered when you think about macro factors like COVID and the uncertainty about the future testing and treatment protocols there, as well as all of the macroeconomic factors that are at work right now in the market.

When I think about 2023 at this very early stage, and I sort of think about our businesses, I do think there's certainly some headwinds, but there's also a lot of tailwinds. In PSS, we're having a very good retention season. The sale season is still in progress there, but we have the tailwinds of specialty, specialty generics and biosimilars, and there's a lot of good things happening there that I expect to continue into the future.

On HCB, obviously, we expect some loss in Medicaid as the redeterminations kick in, but we have as good a momentum as we've had in a long time in commercial. We have a strong individual MA franchise. The group MA business is always about jumbo accounts and so we have some of those that are up for renewal, but we'll also have our ongoing exchange expansion, but maybe most importantly for that business is the outlook on margin. And we've had actually a really good start there with excellent baseline development. And I would point out that in light of the macroeconomic conditions today, much of our 2023 pricing is still yet to be set.

The question, obviously, we get a lot about 2023 ends up kind of pointing off in that Retail, and so I think, it's worth spending a few minutes there. Many like to model COVID going to zero for Retail and that's a convenient modeling assumption, but I think a very highly unlikely outcome for 2023 as we move from pandemic to endemic. We have a very strong testing and treatment franchise there as well.

We've had particular strength in the front of the store, both OTC COVID testing as well as other categories. Our CarePass membership is up 33% year-over-year to 6 million members. And while in the pharmacy reimbursement
pressure continues, it has stabilized and moderated a bit in 2022. We'll continue to do all we can to reduce that pressure further, but we're also going to continue to combat this by trying to increase volume and reducing costs.

We took share again in retail pharmacy. In other words, we're growing faster than the market. This is probably at least the eighth quarter in a row that that's happened. We're implementing Buy Online Pick Up In-Store, which should help increase volume overall, both in the front and potentially the back. We're well-positioned for omni-channel pharmacy, which can both help volume, but also give us new ways to fulfill customers' prescriptions, and in so doing, potentially have a more efficient cost-efficient way to fulfill that customer.

And 2023 will be the second year of our store closures, and so far in 2022 those are going at or better-than-expected in terms of the number of stores and the script retention we're having, and as always, we're going to aggressively push on the cost of goods sold.

Maybe most importantly though as we think about the next couple of years, I continue to feel very positive about our significant capacity to deploy capital and you'll recall that our 2023 guidance only assumes that we repurchase shares enough to offset dilution, so this is a lever that not only helps advance our strategy, but it's also a lever that can be used to deliver on our EPS targets as well.

Question – Ricky R. Goldwasser: Great. Thank you. And just one quick follow-up there as we think about those efficiencies and investment in the future. Karen talked about the fact that digital customers visit the stores I think two times more than the average customer. Can you just give us maybe a sense of also how the profitability of those customers compared to sort of the brick-and-mortar customers?

Answer – Shawn M. Guertin: Yeah, I think, it's probably a comparable sort of when you think about things like basket size and what not, but it's been more of a frequency.

Question – Ricky R. Goldwasser: Thank you.

Operator

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

Analyst: Michael Cherny

Question – Michael Cherny: Good morning, and thank you for a ton of details so far. Shawn, you mentioned the dynamics around 2023 at one point that obviously was in there was on specialty and specialty biosimilars. As you think about the conversations you're having during this selling season, with a very clear pipeline of some potential blockbusters coming on the biosimilars side as soon as next year, how do you think your customers across the enterprise are preparing for the potential raft of both interchangeable and non-interchangeable biosimilars? And how willing are they, do they appear to be at this point in time to work with you on driving greater adoption, which obviously seems like it's going to be nicely additive to your overall growth profile?

Answer – Alan M. Lotvin: Hi. It's Alan. Very timely question. So, I would say that our customers are anxiously awaiting the biosimilar kind of wave that's really starting in 2023 and continues through most of this decade. What they're looking to us to do is to deliver to them strategies, plan designs, programs, approaches, that lower their net cost of product, and they're very willing to entertain, I'm not going to say whatever it takes, but they are very willing to entertain the approaches needed to drive to the lowest net cost, and so as you pointed out, there are products that will be interchangeable, some that will be substitutable.

The manufacture pricing strategies aren't entirely set yet so it's – one would say it's not quite clear exactly how that's going to come to fruition, but we are very, very confident that the biosimilars will be an important contributor to our continued success in lowering specialty trend and overall trend for our customers, and as we said many times, generally when we create that sort of value our customers are happy to pay us for it.

Question – Michael Cherny: And if I could just add one more question on Pharmacy Services and growth. You did mention 340B in terms of not growing year-over-year, whether it's within this year's guidance or the multiyear plan, what is the assumption for 340B growth within your overall book of business?

Answer – Alan M. Lotvin: So – it's Alan again, Michael. So, 340B, obviously the way I would think about 340B is think about it as a volume discussion, right? So subsequent to when we put guidance out last year, there were a number, I guess I would phrase it as the manufactures continuing to write their own regulations and deciding what they were and weren't going to apply pricing to, and so that reduced the volume, so when the volume goes down, right, covered entities make less money which is the entire reason for the existence of the 340B program, our clients don't have access to lower-cost drugs, Wellpartner, our third-party administrator, doesn't have the volume to reprocess claims and our dispensing pharmacies don't earn the dispensing fee, so that's when volume goes down.
What we've now seen going into the first quarter of 2022 is that manufacturers have articulated the conditions, by which they will open up contract pharmacy 340B pricing for covered entities, so that volume comes back. Now there is a timing issue, right, how fast the covered entities make the decisions they need to make, what are the restrictions that are placed on it, so – and then there's an ultimate volume, which manufacturers decide to do, so within all of those variabilities, so as the volume comes back, covered entities make money, our clients save money, Wellpartner has more volume to process.

So, within all of the totality, we're estimating basically flat in the program year-over-year, which is sort of our best thinking right now.

**Question – Michael Cherny:** Thank you that's very helpful.

**Answer – Alan M. Lotvin:** You're welcome.

**Operator**

Our next question from Steven Valiquette of Barclays.

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**Analyst:** Steven Valiquette

**Question – Steven Valiquette:** Great. Thanks. Good morning, everybody. Just for the LTC sub-segment the former Omnicare operation that nobody ever really asks about, just wanted to ask we've seen some pretty notable increases in the skilled nursing facility or SNF industry occupancy gains in the first three or four months of 2022 after slower occupancy recovery in calendar 2021 so I'm just wondering if that's translating into just better Rx volume results for the LTC Omnicare operations in early 2022. Thanks.

**Answer – Shawn M. Guertin:** Steven, we've seen that volume come up a little bit and for the most part that business has tracked with our expectations this year, but I certainly wouldn't characterize it as an inflection point or anything like that. It's definitely been recovering from its bottom during COVID and has more or less been consistent with expectations this year.

**Question – Steven Valiquette:** Okay.

**Operator**

We'll take our next question from Nathan Rich of Goldman Sachs.

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**Analyst:** Nathan Rich

**Question – Nathan Rich:** Hi. Good morning. Thanks for the questions. Maybe just start on the Retail business. Shawn, could you give a little bit more detail on the margin dynamics that you saw play out in the first quarter? I guess, gross margin was down a little more than we expected year-over-year. Can you maybe just talk about what is driving that and kind of what you expect over the balance of the year? And then it looks like on the cost side SG&A came in favorable. Can you maybe just talk about how wage increases have trended relative to your expectations?

**Answer – Shawn M. Guertin:** Yeah, it's – obviously, we had a very strong quarter. There's some dynamics in the quarter year-over-year that have to do with sort of the vaccine program starting last year, and we had very high expense levels last year in the vaccine business and that's obviously been fine-tuned now.

Testing, again, that's probably been down sort of year-over-year, but overall, we probably had a contribution towards growth of a couple hundred million from COVID in Q1. The other dynamics, I think were – so, we had a light kind of cold and flu season, right, so there was that going on both in the front store and back of the store, but again, script growth was good. There was nothing particularly surprising on the reimbursement side. The front store was good across sort of a broader set of categories than just OTC.

In fairness, last year's first quarter 2021 was still probably somewhat depressed because of what was going on, but overall, the metrics look good.

**Question – Nathan Rich:** Okay. Great. If I could just ask a quick follow-up. On your comments on the M&A landscape and I guess it sounds like there's still a disconnect on valuations between buyer and seller. I guess have you seen that conversation start to shift at all just given what we've seen kind of play out in the market so far this year?
Answer – Shawn M. Guertin: Yeah, and it's been an interesting dynamic, right, when we set out on this journey some of these companies were valued at 7 to 8 times revenue, right, and now they've – and that probably wasn't right, right. But now some of them have regressed to maybe one or two, and that may not be completely correct either. So, I mean, the answer is the longer this persists, right, the greater this becomes sort of the reality upon which people make some decisions, and so I would say sort of directionally, yes, but it still remains challenging given sort of the memories of where some of these values were.


Operator

We'll take our next question from Justin Lake of Wolfe Research.

Analyst: Justin Lake

Question – Justin Lake: Thanks. Good morning. First question, just, Shawn, appreciate your comments on COVID. You talked about $200 million contribution year-over-year in Retail. I was getting to an estimate of about $800 million benefit to the year. Is that a reasonable ballpark and then how much was the total benefit in the first quarter? And then lastly, does this completely get offset in your mind by a weakness in COVID – negative COVID impact in the Benefits business?

Answer – Shawn M. Guertin: Yeah, so let me just sort of talk a little bit about what our COVID expectations are and the answer to your question eventually will be that’s probably in the neighborhood, albeit we’ve gotten there with a little bit different path now with the fourth booster.

We expect now about 18 million vaccines for 2022 including the provision for the fourth booster for the defined populations. This would be a decline of about 70% versus 2022. Testing excluding OTC is expected to be down 50% plus or minus, and the OTC test will be in the same neighborhood maybe a little bit higher, but overall, that's going to probably produce a contribution year-over-year that's down 60%, 65% on COVID and if you do the math, you're not going to be far off your number.

A lot of that contribution of maybe half-ish is in the first quarter of this year, and it is more front-end loaded than back-end loaded going forward. And again, to some extent, the jury's out in endemic situation in terms of where we'll go with additional boosters, testing and test to treat and things like that, so there's more to play out as terms of how that ripples out in the second-half of this year, but into next year.

For HCB, the picture is more nuanced in the sense that we’re now three years removed from our 2019 baseline, but maybe most importantly, we've now been able to reflect the COVID expenses in product pricing, and so as I mentioned in my remarks, overall cost trends came in consistent or slightly better versus our trended baseline, which, while I'm not going to declare victory prematurely, that's a very encouraging result both for 2022 and potentially 2023 as well.

I think, what this means for 2023, though, is I think we have to return to how we've traditionally looked at this business, which is by matching price increases with expected cost trends and managing revenue growth and operating margin levels.

Question – Justin Lake: Got it. And if I can just ask a follow-up, you mentioned capital. So, running some numbers there, I'm getting to over that three year period you talked about at Investor Day 2022 through 2024, about $20 billion of potential capital above and beyond what you've already kind of earmarked, with about two-thirds of that coming from free cash flow generation and about a third from potential leveraging up to about 3.5 times. Is that a reasonable ballpark number in terms of what you think your excess capital could be that's already not in guidance, and then maybe you could...

Answer – Shawn M. Guertin: I think that probably assumes some leverage ratio that's a little bit higher than where we are today, but still consistent with sort of our investment-grade rating strategy, but I think that ballpark is in the neighborhood.

Question – Justin Lake: Thanks.

Operator

We'll take our next question from A.J. Rice of Credit Suisse. Your line is open. And, A.J. Rice, your line is open. Please check your mute switch.

Analyst: A.J. Rice
Question – A.J. Rice: Hi. Can you hear me now?

Answer – Shawn M. Guertin: Yes.

Operator

Yes. Proceed with your question.

Question – A.J. Rice: Yeah, sorry about that. So, as you commented, primary care area is still a little pricey. You also mentioned home health. I wondered if maybe you can flesh out a little more what the capabilities you want. I mean, are you looking, as some of your peers have done, for something that's got a platform in fee-for-service that you can then pivot to value-based? Is there other aspects of a home health platform that would be of interest to you? And I think there's anxiety in the marketplace a little bit that you sort of setup an idea that one of these areas would start to contribute in 2024.

It's been about a year since the Investor Day, not quite, but about, and people are getting a little anxious that nothing has been announced. Can you give us maybe your perspective on your ability? How important is doing some sort of deal to being able to deliver on some of your long-term objectives or do you feel pressure that you need to do something? Maybe just have a few comments on that.

Answer – Karen S. Lynch: A.J., it might feel like a year since Investor Day, but it's actually only been 4.5 months since Investor Day, but I think, we all look like it's been a year, but anyway...

Question – A.J. Rice: Yeah, okay.

Answer – Karen S. Lynch: ...let me just comment broadly on our home health strategy and then I'll kick it to Shawn to talk a little bit about kind of what we're thinking.

Obviously, as a company, we're uniquely positioned to integrate our existing capabilities. As we think about primary care and extending into the home, we – there's a number of opportunities for us. We're starting very early with our post-acute care transitions. We'll look at opportunities to support, first and foremost, the Aetna membership particularly to support improvement in Medicare costs and then expand into a payer agnostic. So there's a lot in the home, but clearly – and, as you know, we're already in the home with Coram, with our virtual care, with our new post-acute transition. And then, we'll expand coverage where we can link it into primary care, so there's a number of options. And we are looking at that, too, as part of our acquisition strategy as well.

Our first and foremost priority is really to advance our primary care capabilities. And, as Shawn mentioned, we continue to navigate our way through the valuation. Shawn, do you want to talk about 2024?

Answer – Shawn M. Guertin: Yeah, so what I would say, A.J. on this is, we certainly remain committed to delivering the EPS target for 2024 and what we described in Investor Day was a pathway to sort of get there with an M&A contribution. And I certainly wouldn't step away from that yet, but it was a pathway. And inevitably, pieces of that pathway might be different. And I am not trying – sort of abdicating the number that we won't get the earnings contribution, but I do want to go back to the capital point that if we were hypothetically in that position, capital continues to be a lever that we can use.

You'll recall at Investor Day, when you just looked at the pure capital, if we did just sort of deploy all that capital, you can get on top of these numbers, so it's – this is about the longer-term strategic positioning that we're doing. And, again, I think it's important that we do the right deal for us and for the strategy. And I'm going to do everything in my power to make sure that we can satisfy both commitments, but I also want to make sure we do the right deal because it's that important for our future.

Question – A.J. Rice: Okay. Just a brief follow-up. You haven't been asked this late in the call – it's sort of surprising – on inflation, supply chain, labor. Any updated thoughts on any of that?

Answer – Karen S. Lynch: Yeah, A.J., on inflation, obviously, we're incredibly mindful of this topic. And, as you know, the US hasn't seen these kinds of inflationary pressures in decades. There are some aspects of inflation that impact, that could be very positive to us, but as we think about each business and inflation, there's varying reactions to inflation. And I'll ask Shawn to kind of go through a little bit of those details by each of those businesses to give you a firmer view of what it looks like.

Answer – Shawn M. Guertin: Yeah, and I would say in the quarter, mainly I think because we made wage moves last year, I don't think we felt a lot of pinch but the one – obviously, the one place that we did see it is actually a result of the kind of cousin of inflation and that's interest rates. And some of the losses that we – the realized capital losses that we took in the portfolio related to that. And that will be something to keep in mind going forward.
We have a $20 billion-plus fixed income portfolio that has moved from about $1 billion gain position – unrealized gain position at the end of the year, to approximately $1 billion unrealized loss position, and there's always some element of portfolio turnover and management during the year, so that's something that I think we'll continue to monitor closely.

As you mentioned, I mean, as we think forward, there's a potential across all of our businesses for both the labor and G&A aspects, but I think as I've thought about this, it's the cost of goods sold aspect that we've certainly thought about a lot. I'd remind everyone that historically, higher inflation has also driven a higher top-line particular in the HCB and the PSS businesses.

From a COGS standpoint, I wouldn't say we're seeing it show up in Pharmacy yet. 2022, I think, we're in very good shape as most of our contracts are all locked down in HCB. Our average HCB contract is about three years in duration and so obviously, some number of those will be coming up for 2023, but I'd also point out one of my earlier comments that we still have a lot of pricing leverage on 2023 and we'll certainly fully reflect our thinking on inflation as we think about forward pricing.

On Retail, obviously, we'll be watching that as well, but it is a dynamic that can actually help frankly with our membership programs and also make our store brands more attractive relative to other products, so there are certainly a lot of fingers of this, but I do think we're looking at this kind of thoroughly and thinking about all the levers we can pull to mitigate the impact.

**Answer – Karen S. Lynch:** And, A.J., on your labor question, obviously, we continue like everyone else to experience a very tight labor market, but as I mentioned in the prepared remarks when we're closing stores we've been able to retain those Retail colleagues, which has been really helping us out in those locations.

We also had very strong retention across our business, and we've been very successful in hiring some of the key areas that in our company like digital and tech and analytics, so – and the other thing I would just say is we're very pleased that more than half of our hires are diverse and are reflecting the communities that we serve.

**Question – A.J. Rice:** Great. All right. Thanks so much.

**Operator**

We'll take our next question from Eric Percher of Nephrion Research. Your line is open.

**Analyst:** Eric Percher

**Question – Eric Percher:** Color on the factors impacting quarterly profit in HCB and Pharmacy, I wanted to drill into Pharmacy Services. For the year, do you expect fluctuation given COVID, large onboarding, and is there any fluctuation from sourcing benefit or 340B through the year?

**Answer – Shawn M. Guertin:** On PSS, to your point, I think, when you looked at our first quarter result and this is something we anticipated, but we did have a very successful growth season and a very successful welcome season, and we did staff to sort of create that positive experience for our new customers, so expense levels are certainly a little bit higher in Q1 than sort of the run rate for the rest of the year.

There's some movement, but the rest of the year, the quarters are generally sort of in the same neighborhood as each other for the rest of the year. Alan mentioned before from a 340B standpoint, we're largely assuming a flat year-over-year contribution, so a lot of the increases are coming sort of from the core elements of the business on growth and specialty, and things like that.

**Question – Eric Percher:** And Alan's comment, if I caught it correctly, was that there are ways to expand volume. Does that suggest that your view is that your support-covered entities providing data and that's key to seeing volumes increase which ultimately gets you flat for the year?

**Answer – Alan M. Lotvin:** So, Eric, it's Alan. The volume growth is off of the kind of depressed base from the actions that the manufacturers took, right? So, it's not year-over-year volume growth. It's just a kind of recovery of the volume, and so that's the first thing I'd say.

The second thing is ultimately the decision about whether or not they supply data to the manufacturers is up to covered entities, and so they will work with us and tell us when they are or aren't ready to turn the program back on and under what conditions.

**Question – Eric Percher:** Okay. Thank you.

**Operator**

We'll take a question from Brian Tanquilut of Jefferies. Please go ahead.
Question – Brian Tanquilut: Hey. Good morning. Alan, just a follow-up question on – just on your side of the business. As I think about some of the changes that we saw – we’ve seen with site of service shift because of the pandemic, does things normalize in terms of hospital visits and physician visits, what are you seeing in terms of the durability of your Coram Home Infusion side or maybe even specialty mail, just in terms of volumes and how that shift has – if that's sticking on those sides.

Answer – Alan M. Lotvin: Yeah, so I guess, I think of the three business units within the company, the Pharmacy Services segment probably had the least variability in terms of underlying core business activity so the specialty pharmacy itself, there was a little bit of a dip along the way in new prescriptions as you saw people not going to the doctor, but by and large, the site of service shifts there were non-material.

The Coram business was a little bit more impacted. Obviously, a lot of the acute scripts, the infusion and antibiotics, there weren't as many hospitalizations. That was offset to some extent by more oncology, things that were kind of traditional hospital outpatient that we picked up on, so net-net I would say it's probably not a material change that impacts the Pharmacy Services segment just given the relative size of Coram versus the rest of the company.

Answer – Karen S. Lynch: I want to thank you...

Question – Brian Tanquilut: And then Shawn just a quick follow-up, as I think about buybacks, a little – probably a little earlier than I would have expected, so is this just capital deployment because your cash flow is really strong during the quarter, or is it because of the delays with some of the acquisitions that you had planned, and should we expect potential upside from the buybacks as a result?

Answer – Shawn M. Guertin: Yeah, I mean, it certainly emanates in some ways, right, from the strength of our ongoing ability to generate sort of deployable capital, and I want to make sure people understand that. It's less that it's something that we're going to rush out to do than it is to fully understand the strength of that capital, and the fact that remains a lever that we can pull over time, and in some ways, has the potential to be a safety net from year-to-year given just the normal fluctuations of the business.

I want to thank you all for joining our call today and just leave you with a few comments. As you can see, we – our team continues to execute. We entered into 2022 with very powerful momentum and strong growth across all of our businesses. We remain confident we’ll continue that momentum for the remainder of the year and beyond, and we look forward to updating you on our progress throughout the year. Thanks for joining the call.

Operator

This concludes today's CVS Health first quarter 2022 earnings call and webcast. You may disconnect your line at this time and have a wonderful day.