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Company: **CVS Health Corp.**

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MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning and welcome to the CVS Health Fourth Quarter and Full Year 2022 Earnings Conference Call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the prepared remarks, at which point we will review instructions on how to ask 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.

Tom Cowhey

Good morning and welcome to the CVS Health Fourth Quarter and Full Year 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 of CVS; Shawn Guertin, Executive Vice President and Chief Financial Officer of CVS; and Mike Pykosz, Chairman, CEO and Co-Founder of Oak Street Health.

Following our prepared remarks, we will host a question-and-answer session that will include additional members of the CVS management team. Daniel Finke, President, Health Care Benefits; Michelle Peluso, Chief Customer Officer and Retail Co-President; Prem Shah, Chief Pharmacy Officer and Retail Co-President; David Joyner, new President, Pharmacy Services; and Dr. Alan Lotvin, outgoing President, Pharmacy Services.

Our earnings and Oak Street acquisition press releases and slide presentations have been posted to our website along with our Form 10-K and our Form 8-K 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, including impacts related to the ongoing COVID-19 pandemic as well as the expected consumer benefits of our products and services and our financial projections and the benefits of the pending acquisitions of Signify Health and Oak Street Health and the associated integration plan, expected synergies and revenue opportunities.

Our forward-looking statements are subject to significant risks and uncertainties that could cause actual results to differ materially from currently projected results, including with respect to the ongoing COVID-19 pandemic and the pending acquisition and integration of Signify Health. We strongly encourage you to review the reports we file with the SEC regarding these risks and uncertainties. In particular, those that are described in the cautionary statement concerning forward-looking statements and the Risk Factor section in this morning's earnings press release, Oak Street Health acquisition press release and included in our Form 10-K and the Form 8-K we filed this morning.

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

With that, I'd like to turn the call over to Karen. Karen?

Karen S. Lynch

Thank you, Tom, and good morning, everyone, and thanks for joining our call today. This morning, we're going to discuss our 2022 results, our 2023 guidance and our announcement that we entered into a definitive agreement to acquire Oak Street Health. Mike Pykosz, Chairman, CEO and Co-Founder of Oak Street Health will join Shawn and me during the call to discuss this important transaction.

But first, 2022 was a year of progress for CVS Health. We delivered strong financial results. We made meaningful progress on our strategy and we brought a greater value to the people that we serve.

This morning we announced that we exceeded our adjusted EPS expectation for the fourth quarter in a row, delivering fourth quarter 2022 adjusted EPS of $1.99 and full year 2022 adjusted EPS of $8.69. This result represents nearly 10% growth over our 2021 baseline.

For 2023, we continue to expect adjusted EPS in the range of $8.70 to $8.90 which at the midpoint represents high-single-digit growth off of our 2022 baseline of approximately $8.25. In 2022, CVS Health surpassed the $300 billion mark in total revenue, growing full year revenues by more than 10% to $322 billion. We delivered adjusted operating income of $17.5 billion and generated adjusted EPS of $8.69.

Our ability to generate cash flow from operations was robust at nearly $16.2 billion for the full year. Each of our foundational businesses generated excellent results. Starting with the Health Care Benefits segment, we grew revenues by more than 11% for the year and delivered adjusted operating income of $6 billion. Our medical benefit ratio of 84% improved by 100 basis points versus the prior year and was consistent with our full year expectations after adjusting for the impact of elevated flu in the fourth quarter.

I want to highlight a few areas within the HCB segment. Although our individual Medicare Advantage growth was below our expectations, Medicare Advantage remains a key strategic growth area for CVS Health. We remain focused on delivering superior service to our Medicare Advantage members while advancing our efforts to improve our star ratings. We are executing on the actions we identify to address our CAHPS survey score and are making the necessary investments to drive our stars improvement initiative.

We also made progress in the last 90 days in advancing our efforts to diversify our national PPO contract and have obtained the necessary regulatory approvals to move forward. This will enable us to more effectively manage our Medicare business in the future. As we will discuss shortly, adding both Signify Health and Oak Street Health to our value-based care delivery platform will deepen our focus on this important business.

In our individual exchange business, we now expect to end 2023 with between 900,000 and 1 million individual members. This significant growth in membership is driven by our provider networks, market growth, marketplace disruptions and our co-branded integrated benefit offerings. We anticipate a positive, sustainable contribution from this membership in future years.

Our Pharmacy Services segment grew full year revenues by 11% with adjusted operating income of $7.4 billion. Performance in our specialty pharmacy was again outstanding. Revenue grew more than 19% year-over-year driven by our industry-leading digital and specialty pharmacy capabilities.

As we enter 2023, the first wave of new biosimilars will be coming to market, starting with competitors for Humira. We recently announced that Amjevita will be added to coverage within our commercial formularies alongside Humira and other branded products. Our approach to biosimilars reflects our commitment to drive the lowest net cost for our clients while providing members coverage of clinically safe, effective medications and ensuring continuity of care.

Retail delivered another strong year, outperforming our initial guidance and long-term target. Revenues for the year grew by more than 6% versus the prior year and we generated $6.7 billion of adjusted operating income. We finished 2022 with another quarter of strong performance in both the pharmacy and the front store. Pharmacy

revenue increased by nearly 8% versus the prior year and delivered another quarter of year-over-year market share gains. Front store revenues grew by nearly 7% driven by demand for consumer health and cough, cold and flu products.

We are making significant progress advancing our strategy which includes expanding our care delivery and health services capabilities in primary care, home health and provider enablement. Last year we announced the pending acquisition of Signify Health, which represented an important step forward in our value-based care strategy. Signify will strengthen our presence in the home and enhance our provider enablement capabilities. We now project that this transaction will close in the second quarter of 2023.

At our Investor Day in 2021, we shared our vision to deliver a superior health experience for consumers. Central to our strategy is advancing our value-based care platform of capabilities that drive consumer engagement. This morning, we announced that we have entered into a definitive agreement to acquire Oak Street Health outstanding shares for $39 per share in cash, representing a total transaction value of approximately $10.6 billion.

The acquisition of Oak Street Health will broaden our value-based care platform into primary care and accelerate our long-term growth. Primary care drives patient engagement and positive clinical outcomes. Although it is a very small proportion of total health spend, just about 10% nationally, it will have significant influence over health care utilization. Individuals who seek routine primary care services report fewer serious medical diagnosis, lower mortality rates and a 33% lower annual health care expense.

Oak Street Health has a proven senior focused primary care model that is scalable at a national level. Their innovative care model goes beyond typical primary care to provide patients with comprehensive preventative care to support overall health and well-being. With 169 medical centers across 21 states today, we see a significant opportunity to expand in the next two years and provide superior care to many more patients.

Oak Street has a committed and experienced leadership team with extensive care delivery expertise and a best-in-class, fully integrated technology solution. Oak Street's model focuses on providing more coordinated, holistic and connected care. Oak Street physicians spend three times longer, on average, with their 159,000 at-risk patients and drives markedly better outcomes.

Their approximately 600 providers and 6,000 team members have a proven ability to improve patient outcomes and experiences. At a time when consumers are increasingly frustrated with their experience in the health care system, Oak Street's approach delivers a truly specialized care experience that drives a Net Promoter Score of 90. The quality of this experience is evident by the fact that Oak Street was selected to be the trusted primary care partner of AARP and is the only primary care provider to carry the AARP name across all their sites.

As part of CVS Health, we believe Oak Street's value-based care model will have a far greater impact on patients. Our unparalleled consumer touch point will expand Oak Street's reach and will allow them to engage with more consumers, more frequently and more conveniently. The combination of CVS Health's foundational businesses with Oak Street and Signify Health creates one of the premier multi-payer Medicare value-based care platforms in the marketplace today.

But our ambition does not stop there. These Medicare-focused assets complement our established care delivery assets including our over 1,100 retail health MinuteClinics in a number of ways, creating convenient access and additional clinical capacity for Oak Street with preventive care and chronic care services for seniors, enhancing access to our broad nurse practitioner workforce and providing wrap-around services tailored to seniors and those with complex conditions such as medication reconciliation and post-discharge follow up.

The potential across CVS Health's base of assets is powerful. Together, we will transform the experience for consumers across the country. The Oak Street transaction is financially attractive and enhances our ability to accelerate our sustainable long-term growth. Shawn will provide more details on the financials of the transaction and will discuss the growth and profitability prospects of the Oak Street assets.

At the close of the transaction, Mike Pykosz will continue to lead Oak Street within CVS Health. Mike, we're so excited to welcome you and your team to CVS Health at the close of this transaction.

Mike, would you like to say a few words?

Michael T. Pykosz

Thank you, Karen, and good morning, everyone. Our mission at Oak Street Health is to rebuild health care as it should be. When we started Oak Street, we set out to adjust the root causes of high cost, low quality care and poor experiences for Medicare patients. Ten years in that journey, as we continue to drive our national expansion and look to impact more patients and communities. We could not have found a partner more aligned to our mission than CVS Health.

At Oak Street Health, we operate a network of primary care centers that specialize in care for older adults. We focus on areas with large concentrations with Medicare eligible patients with incomes below 300% of the federal poverty line, areas where we can make the biggest impact.

We created our innovative model from the ground-up and focus on ensuring our patients receive the right care upfront, improving their experiences and keeping them healthy and out of the hospital. This proven and nationally scalable model benefits patients, providers and payers while improving health outcomes, lowering medical costs and delivering a better patient experience.

This focus has generated meaningful results for our patients, including recent hospital admissions by over 50% and lowering 30-day readmissions by 42%. By providing coordinated, holistic care, we can close care gaps and address social determinants of health, delivering five-star HEDIS performance.

Our track record shows that we've been able to deliver consistent performance across different populations and geographies. And while our primary focus is Medicare Advantage at-risk patients, we've also demonstrated our care model can work outside MA. For example, in 2021 we participated in Medicare Direct Contracting program where we took on full risk on traditional Medicare patients. Among all the participants in the program, we generated savings that were two times higher than any other multi-state direct contracting entities and we ranked number one in net dollars saved. These results show that even amongst the most innovative groups in this new program, our capabilities and results stood out.

By joining CVS Health's ecosystem, we will accelerate our journey to improve patient outcomes and experiences while allowing us to continue to invest in both our innovative care model and invest in what we believe is the best human health care. The expansive consumer touchpoints of CVS Health, virtually and in the community, including the trusted CVS pharmacists, will broaden and deepen our connections with the patients under our care.

At Oak Street, we have talked about the massive market opportunity for companies that can address the huge challenges in health care. CVS Health's unique position to deliver market-leading health solutions, the breadth of their offerings and proven ability to scale assets will significantly enhance our ability to tackle these challenges. We believe this transaction is a great outcome for all of our stakeholders, including our patients, all of our payer partners, our team of Oakies and our shareholders.

With that, let me turn it back to Karen.

Karen S. Lynch

Thank you, Mike. CVS Health delivered strong financial results in 2022 and we are entering 2023 with tremendous momentum. We continue to make progress on our strategy and will enhance the capabilities of our value-based care platform through the Oak Street Health and Signify Health acquisitions. We are excited about the opportunities ahead of us.

I'll now turn it over to Shawn for a deeper look into our results, our 2023 outlook and the Oak Street transaction. Shawn?

Shawn M. Guertin

Thank you, Karen, and good morning, everyone. I will first take some time to detail our results and 2023 guidance before discussing this morning's announcement of the Oak Street transaction.

Our fourth quarter results reflect the continuation of our excellent performance from each of our core business segments as we exceeded our expectations for revenue, cash flow generation and adjusted earnings per share.

A few highlights regarding total company performance. Total fourth quarter revenues of $83.8 billion increased by 9.5% year-over-year, reflecting growth at or above internal expectations for each of our foundational businesses. We reported fourth quarter adjusted operating income of $4 billion and adjusted EPS of $1.99. For full year 2022, we reported total revenue of $322.5 billion, an increase of 10.4%, with solid growth across each of our foundational businesses.

This led to a full year adjusted EPS of $8.69, representing an increase of 9.7% off our 2021 adjusted EPS baseline of $7.92, and importantly, CVS Health's ability to generate cash remains strong. For full year 2022, we generated $16.2 billion in cash flow from operations.

Looking at performance by business segment. Health Care Benefits delivered strong revenue and adjusted operating income growth versus the prior year. Fourth quarter revenue of $23 billion increased by 11.3% year-over-year. We grew membership by 548,000 lives in 2022, driven by strong growth in our Commercial and Medicare businesses, offsetting the divestiture of a portion of our Aetna international business earlier this year and a decline in Medicaid membership due to a previously disclosed contract loss.

Our medical benefit ratio of 86% improved 100 basis points year-over-year. Adjusted operating income of $858 million grew 68.2% year-over-year. Both of these measures were driven by the net favorable impact of COVID-19 compared to the prior year and strong underlying performance, partially offset by the unfavorable impact of the flu.

Outside of an elevated flu season, medical costs remain in-line with expectations, as has been the case throughout 2022. Consolidated days claims payable at the end of the quarter was 52.5, up 3.4 days versus the prior year. Overall, we remain confident in the adequacy of our reserves.

In the Pharmacy Services business, our ability to deliver industry-leading drug trend for our clients, our specialty management capabilities and excellent customer service levels continued to drive growth. During the fourth quarter, revenue of $43.7 billion increased by 11.2% year-over-year, driven by increased pharmacy claims volume, growth in specialty pharmacy and brand inflation, partially offset by continued client price improvements.

Total pharmacy claims processed increased by 3.1% above the prior year, and 4.6% when excluding COVID-19 vaccinations, primarily attributable to net new business, increased utilization and the impact of an elevated cough, cold and flu season. Adjusted operating income of $2 billion grew 9% year-over-year, driven by improved purchasing economics, including increased contributions from the products and services of the company's group purchasing organization, partially offset by continued client price improvements.

In our Retail Long-Term Care segment, we delivered strong revenue growth despite mixed COVID-related trends and continued economic uncertainty. Specifically, during the fourth quarter, revenue of $28.2 billion grew 4%, reflecting increased prescription and front store volume, including the impact of an elevated cough, cold and flu season, pharmacy drug mix and brand inflation. These items were partially offset by decreased COVID-19 vaccinations and diagnostic testing, the impact of recent generic introductions and continued pharmacy reimbursement pressure.

Adjusted operating income of $1.8 billion declined 25.1% versus prior year, but was largely in-line with internal expectations, driven by decreased COVID-19 vaccinations and diagnostic testing, continued pharmacy reimbursement pressure and increased investments in the segment's operations and capabilities, including the vast majority of a discretionary bonus payment to frontline colleagues. These decreases were partially offset by increased prescription volume and improved generic drug purchasing.

Pharmacy prescription volume grew 0.8% year-over-year, reflecting increased utilization and the impact of an elevated cough, cold and flu season, partially offset by decreases in COVID-19 vaccinations. Excluding the impact of COVID-19 vaccinations, pharmacy prescription volume increased by 4% year-over-year.

Turning to the balance sheet. Our liquidity and capital position remain excellent. We ended the year with approximately $5.4 billion of cash at the parent or unrestricted subsidiaries and an adjusted net debt-to-EBITDA of about 2.9 times. Excluding the adjustment for cash at the parent or unrestricted subsidiaries, our adjusted debt-to-EBITDA is approximately 3.1 times.

Through our quarterly dividend, we returned $719 million to shareholders and repurchased $1.5 billion of our common stock in the fourth quarter. We also entered into a $2 billion fixed dollar accelerated share repurchase transaction which became effective on January 3, 2023.

A few other items worth highlighting for investors. We continue to experience the impact of market volatility on our investment portfolio and recorded net realized capital losses of approximately $37 million in the quarter. We recorded $117 million of office real estate optimization charges in the quarter related to the reduction of corporate office real estate space in response to our new flexible work arrangement.

We also recognized a $250 million gain related to the sale of our bswift business in November, and we recorded $99 million of incremental charges related to opioid litigation to address the final terms and other implications of the global settlement executed in December.

Shifting to our outlook for 2023. We expect revenue growth of 3% to 5%, and we are reaffirming our full year adjusted earnings per share guidance range of $8.70 to $8.90. We believe this range is prudent at this stage in the year and reflects approximately 5% to 8% growth versus our 2022 adjusted EPS baseline of $8.25. We detailed the adjustments reflected in our 2022 baseline in the earnings materials posted on our IR website.

I want to point out three things on our 2023 adjusted EPS guidance. First, consistent with past practice, our projections do not assume the recurrence of prior-year reserve development. Second, these projections do not include a specific provision for our pending Signify transaction which is expected to close in the second quarter of this year but which we project will have a small impact on 2023 adjusted EPS. And third, I want to remind everyone that beginning this year, we are shifting to our reporting convention that excludes net realized capital gains and losses from adjusted operating income.

Now let's turn to some of the segment details. In our Health Care Benefits segment, we expect to see membership growth of 2% to 4% with increased membership in both Medicare and Commercial, partially offset by declines in Medicaid, due to the impact of redeterminations in 2023. Overall, we expect to generate revenue growth of 11% to 13%. Our projected medical benefit ratio for 2023 is 84.7% plus or minus 50 basis points. As I just noted, we do not assume prior-year reserve development in our projections.

We are providing a cautious outlook for HCB adjusted operating income, expecting growth in a range of about 2% to 4% and reflecting a prudent assumption regarding the performance of our individual exchange business, lower individual MA enrollment and investments in our stars improvement initiatives.

Moving to our Pharmacy Services Segment. We expect revenue in a range from 1% to 2% growth driven by a successful 2023 selling season and strong retention, partially offset by lower Medicaid volume. For the full year 2023, we expect pharmacy claims to range from flat-to-growth of 1%. Overall, we expect these results to generate adjusted operating income growth of 4% to 5%.

Finally, shifting to our Retail/LTC segment. As we discussed previously, this segment will be burdened by the lower contribution from COVID as we transition into the endemic stage as well as continued reimbursement pressure on the pharmacy. We expect revenue growth of 1% to 3%, and prescription growth of 2% to 4% despite continuing decreases of COVID-19 vaccines. Overall, for the Retail/LTC Segment, we expect 2023 adjusted operating income to decline from 2022 to between $5.95 billion and $6.05 billion. For items below adjusted operating income, we expect our interest expense for 2023 to be approximately $2.23 billion, our tax rate is expected to be approximately 25.5%.

I want to make a few comments as you think about the cadence of our earnings throughout the year as Retail returns to earnings seasonality more aligned to pre-pandemic patterns. We are currently projecting the lowest contribution to earnings in the first quarter of the year. The remaining three quarters will be relatively consistent, with slightly more than half of our earnings coming in the second half of the year.

Shifting to shares. We expect our diluted weighted-average share count to be approximately 1.298 billion reflecting the impact of both our fourth quarter 2022 repurchase activity as well as the accelerated share repurchase that is currently under way.

We anticipate another strong year of cash generation. We expect cash flow from operations of $12.5 billion to $13.5 billion. Capital expenditures are expected to be in the range of $2.8 billion to $3 billion.

Turning to the Oak Street transaction. We committed to investors that we would be diligent when deploying our capital, seeking assets with the best technology, capabilities and cultural alignment to our vision. After a thorough and robust review of the market, Oak Street was the primary care asset that proved to be the most strategically and financially compelling.

Oak Street will operate as a payer agnostic business within CVS Health. Oak has done improving outcomes and experiences for the Medicare populations it serves. CVS Health has a strong and proven track record of helping its payer client succeed and we will continue to prioritize that success after this transaction.

What we saw when we looked into Oak Street's portfolio of clinics was a remarkably consistent path to clinic profitability. This trend was true across diverse geographies, populations and payers. As Oak Street drives strong patient experiences and engagement, their patient panels grow and as Oak Street's providers engage with those patients, they improve outcomes and increase patient contributions over time.

These two factors combine to drive clinics to maturity, achieving profitability within the first three years and unlocking annual adjusted EBITDA potential of approximately $7 million per-clinic using Oak Street's definition of adjusted EBITDA. Within the 169 clinics Oak Street has today, we have high visibility into embedded adjusted EBITDA of over $1 billion. We also recognize the tremendous opportunity to scale Oak Street's clinics, to reach more seniors across the nation. At their current rate of expansion, we expect Oak Street to have over 300 clinics by 2026, at which point we project they will have more than $2 billion of embedded Oak Street adjusted EBITDA.

Shifting to synergies. We envision five main opportunities to realize more than $500 million of value over time. One, accelerating Oak Street patient growth through CVS Health channels. Two, improving Oak Street's economics through integration with our broad portfolio of assets. Three, improving the retention of our Aetna MA members through the improved outcomes and experience provided at Oak Street clinics. Four, driving greater utilization of CVS Pharmacy and Caremark capabilities. And five, capturing modest savings from external public company and lease costs.

We project that our investment in Oak Street will drive double-digit returns on invested capital over time, as clinics mature and synergies are realized. We are committed to exploring additional avenues to further accelerate growth, synergy realization and returns from this transaction, while balancing further near-term dilution to our EPS trajectory.

As stated in our press release, this transaction will be funded with available resources and existing financing capacity, and we remain committed to maintaining our current investment-grade rating. The transaction is subject to approval by Oak Street shareholders, regulatory approvals and other customary closing conditions. We expect this transaction to close in 2023.

We are now targeting 2024 adjusted EPS of approximately $9, growing to approximately $10 in 2025, with the potential for upside in 2025 based on the successful resolution of our Medicare star ratings mitigation efforts. The 2024 and 2025 adjusted EPS trajectories reflect the impact of the previously disclosed 2024 Medicare star ratings headwind and Centene contract loss, closing of the Oak Street Health transaction in 2023 as well as projected contributions from the Signify Health transaction in 2024 and beyond.

Consistent with past practice, CVS Health expects to exclude integration and transaction costs from its adjusted EPS presentation. With the close of these transactions, we expect that our adjusted debt-to-EBITDA will peak in the mid 3 times level in 2024, well within leverage ranges aligned to our current investment-grade rating.

Our current projections assume modest discretionary repurchase activity in 2024. This is consistent with our 2021 Investor Day projections, which contemplated 1% to 2% adjusted EPS growth from repurchases in addition to offsetting dilution. As leverage begins to subside in 2025, we will have potential for additional repurchases.

In summary, we are excited to announce the acquisition of Oak Street and to incorporate them into our expanding portfolio of capabilities. Oak Street's best-in-class clinics will serve as the focal point of high-quality care for seniors across America. The strategic rationale for this combination is sound and the growth opportunity is vast. Together, CVS Health's foundational businesses, Signify's home assessment and provider enablement capabilities and Oak Street's clinics and care model, create the premier multi-payer Medicare value-based care platform. We could not be more pleased to join with Oak Street as we take the next step in our journey to build a differentiated health services organization and transform how care is delivered.

To conclude, we delivered excellent performance in 2022, creating strong momentum as we continue to execute our strategy in 2023. We are building on our achievements, expanding our portfolio of capabilities and continuing on our path to become the leading health care solution company.

With that, we will now open the line for your questions. Operator?

QUESTION AND ANSWER SECTION

Operator

Thank you. We'll take our first question from Lisa Gill with JPMorgan. Your line is open.

Analyst: Lisa C. Gill

Question – Lisa C. Gill: All right. Thanks very much and congratulations on the transaction and congratulations on the strategy overall. I know every quarter I've asked about the strategy around value-based care and what you're going to do in this area, so I'm happy that that you finally have done this.

So really just two things I want to better understand. One, following Oak Street, they did slow the growth of the number of centers they were opening last year due to cash constraints. Shawn, it sounds like you're laying out that you're going to keep that strategy the same at roughly 35 centers per year. One, is there a reason why you wouldn't reaccelerate that growth when we think about Oak Street?

And then secondly, as we think about some of the changes that have come with RADV, the MA rates that have come out, can you maybe just talk about the impact, not just on the MA side but also on the provider side? And did you take that into account when you were thinking about buying a primary care asset?

Answer – Karen S. Lynch: Hey, Lisa, I'll turn it to Shawn in a second, but I just wanted to acknowledge your point about we did layout a very bold vision at December 2021 to really expand into health services. And I really believe this transaction is a clear win for both patients and providers. And as we said in our prepared remarks, this really does create the premier multi-payer Medicare value-based platform. And you and I have talked a lot about value-based care, not just being a contract but being a platform where we really drive engagement and connect patients to care. And this transaction, combined with Signify Health, really does demonstrate that we are executing on our long-term strategy to drive long-term growth for the company.

Let me turn it over to Shawn to answer your specific questions.

Answer – Shawn M. Guertin: Hi, Lisa. So on the first one about kind of clinic expansion. To be clear, the numbers we cited today in our model are premised on maintaining a trajectory of 35 to 40 clinics a year expansion. As I

mentioned in my prepared remarks, one of the things that we will be doing over the coming months is exploring alternative avenues of both accelerating synergy realization but potentially looking at the growth aspect of that. And in particular, avenues that would help us manage sort of the greater clinic growth but also sort of manage kind of inside the dilution framework that we've talked about with this transaction. And we will be looking at those avenues because it's a very important point because when you look at the long-term returns of this model, that accelerated growth has some real long-term kind of return benefits to doing that, so again, that will be something that we continue to work on and explore the best way to do that within the framework that we've discussed with you today.

On your second question, it was important to us to both understand the positioning on RADV and at least be able to see the MA advance rate notice for 2024 and frankly work in conjunction with Oak on what we thought that meant to them. And we've had the ability to do that and obviously, as you all know, much of that still leaves many questions to be answered in the future. It does provide a little bit more clarity than we had in the past, but I think we do understand the dynamics and some of the mitigation efforts that we could put in place if certain things stand or certain things get modified.

In many ways though what I would say is what we saw come out of those notices, I think, is exactly why you want high-quality Medicare Advantage value-based care assets. In its most simplest sense, when you have a year, for example, when reimbursements get squeezed what's one of the things you want to do? You want to look at your cost control levers. And certainly Oak is a demonstrable asset that has proven to improve outcomes and reduce costs. And so I think as we think about navigating the future of Medicare Advantage and maybe even a broader opportunity in Medicare value-based care in the fee-for-service population, I think both signify and Oak are exactly the kind of assets that you would like to have at your side as you do that.

Answer – Karen S. Lynch: And, Lisa, just adding to that point. I think we all recognize the importance of Medicare Advantage and the popularity and we are very encouraged by the political statements that were made last night to support Medicare and this fits really nicely into that picture as well.

Question – Lisa C. Gill: Great. Thanks so much.

Operator

Thank you. Our next question will come from Michael Cherny with Bank of America. Your line is open.

Analyst: Michael Cherny

Question – Michael Cherny: Good morning. Thanks for taking the question. Congratulations on the deal. I'm sure there are going to be a number of other questions there so I want to hone in on Health Care Benefits and particularly the work you're doing around stars. I know last month, Karen, you outlined the waiver and the requirements to push forward on the 2024 mitigation plans. Can you just give us a sense of where you stand on the various different work streams tied to achieving the 2025 mitigation and the planned throughput you have in order to get there and reestablish your stars presence?

Answer – Karen S. Lynch: Yeah, Mike, thanks for the question and you're right. We did make progress on the regulatory approvals to move our contracts forward. And we are continuing to make investments in stars so that we can mitigate the risk. As you might remember, we narrowly missed in our CAHPS scores and the team has been working very diligently over the course of the last couple months to make sure that we're improving our results.

I'm going to ask Dan to talk about the specifics.

Answer – Daniel P. Finke: Yeah, thanks, Karen. So in 2022, we really took a look at the opportunity around CAHPS and member experience and we launched some additional campaigns related to that that frankly are still ongoing. Things like assisting our members to understand their benefits, expanding our concierge services to really maximize the member experience overall. We also have the opportunity to impact other domains as well. Our patient safety domain that worked really hard with our retail colleagues on in the fourth quarter related to patient medication adherence and then of course on the HEDIS front closing as many gaps in care as possible in the fourth quarter. And now currently focused on really optimizing our record collection during the hybrid season. So we're committed to improving our stars rating. We believe we have the right actions and the right team to really improve the ratings overall.

Question – Michael Cherny: Great. Thank you.

Operator

Thank you. Our next question will come from A.J. Rice with Credit Suisse. Your line is open.

Analyst:A.J. Rice

Question – A.J. Rice: Hi, everybody. Congratulations on the transaction as well. I wondered since we had Mike on the call, obviously this has played out a little bit in the public domain, so there's been speculation that something might be up with Oak Street for a while. I wonder if he could comment on what kind of feedback he's gotten from his doctors, how are they reacting to this. And I wondered, do they have to approve in any way this transaction. Is there anything in their agreements that require approval?

And then lots of questions around the deal but I might just ask Shawn and Karen, you think you're going to close this at the end of the year or sometime this year. I know the regulatory process is a little less certain than it was a few years ago, I guess the way to describe it. If it were to slip into some point in 2024 would that materially change your $9 and $10 target or are you – does that have some flexibility around timing of the deal?

Answer – Karen S. Lynch: Hi, A.J. We do. We do expect to have the transaction close. I'll let Shawn comment on the financials but I don't think that we would have material changes in those numbers.

I want to turn it over to Mike. Mike, can you just respond to A.J.'s question around the clinicians?

Answer – Michael T. Pykosz: Yeah, happy to. So, on the second point, no, we don't require any separate approvals. We just need more of the standard shareholder approvals. On the first question you asked I think is the most important one. At Oak Street Health our mission is to rebuild health care as it should be and the physicians I've talked to and frankly, leaders and team members across Oak Street that I've had a chance to talk to so far I think there's huge amount of excitement that this is kind of the next stage of our journey. And we're really proud of what we've built over the first 10 years of Oak Street but we really believe there's an order of magnitude of more growth out there for us.

We can go to more communities and impact more older adults and I think that CVS Health brings just a huge amount of resources that we can partner with and leverage to help us provide higher-quality care for patients, to help us provide a better patient experience and to help continue to make Oak Street the best place to work in health care. So I think from our physicians and rest of our team members perspective, I think this is a huge positive to continue to help us execute on our mission.

Question – A.J. Rice: Okay. That's great.

Answer – Shawn M. Guertin: And, A.J., I'm not sure if you had a question about more global kind of deal returns but specifically to your question about the timing of close, the answer is no. It would not change those and arguably, it actually adds a little bit of lift, because remember there's an operating loss that's going on for a little bit of time and you're picking that up a little bit deeper into the cycle of moving from kind of loss to break-even to gain. So it actually would not kind of change the $9 to $10, at all, certainly not in a negative way.

Question – A.J. Rice: Okay. Great. That's good. Thanks a lot.

Operator

Thank you. Our next question will come from Justin Lake with Wolfe Research. Your line is open.

Analyst: Justin Lake

Question – Justin Lake: Thanks. Good morning. Wanted to shift back to health benefits for a minute. Wanted to ask if you can walk us through your expectations on membership growth across the businesses in detail. So where do you expect to grow in MA, (48:02) Commercial and the exchanges. And then your MLR looks like it's up about 100 basis points year-over-year, maybe a little less. Just hopeful you could frame how much of that comes from the PYD roll-off that you're not assuming and what other drivers might be impacting that? Appreciate it.

Answer – Karen S. Lynch: Hey, Justin, it's Karen. Let me just comment on the growth. First of all, in our commercial book, we do expect to grow in our commercial book and our value proposition is truly resonating in the marketplace. We announced last month that we closed the State of North Carolina which will bring us about 570,000 members on 1/1/2025 so I think that's a good demonstration of the strong value proposition that we have in our Commercial business.

I mentioned our significant growth in individual exchanges, 900,000 to 1 million members next year. And then in Medicare, as you know, Justin, we are disappointed in our individual Medicare Advantage growth, but we are growing our D-SNP business and our group MA business. So I'll let Dan specifically give you a little bit more details on growth but I'm going to turn it to Shawn to answer your MBR question.

Answer – Shawn M. Guertin: Yeah, so, Justin, the MBR, I think the guidance midpoint is up about 70 basis points year-over-year. There's a number of pieces that are leading to that. The first, to the point of your question, is the removal of prior-year favorable reserve development is about 20 basis points there. Second, the provision we are making for the exchange business and the provision for any adverse deviation there is also worth about 20 basis points. About 10 basis points is driven by Medicaid redeterminations and what we think the MBR impact will be there. The divestiture of our international business in 2022 that was lower MBR so that's adding about 10, so it's three or four items that are building that up.

I would say more broadly behind this that when you looked at the fourth quarter and you looked behind the impacts of flu and respiratory illness, utilization continued to perform very consistent with what we expected to see, and we still feel the pricing environment is very sound and rational going into 2023.

Answer – Daniel P. Finke: And, Karen, I would just add two comments to your remarks. I mean, first, on the Medicare front. A couple of bright spots during AEP were our growth in the duals population as well as our group MA products. And so we expect continued growth in those products through the remainder of the year. And clearly the team's also focused on our individual MA enrollment as it relates to OEP and our lock-in-period. Some of the investments we made at the end of AEP showed some signs of growth that we're looking forward to for the remainder of the year.

And then the last comment would just be on Medicaid. We do expect some modest growth in that book of business through the first quarter but as anticipated, at the end of the first quarter, we do expect some of the redetermined members to fall off the roster and so we're working closely with the states around our opportunities to regain that membership.

Operator

Thank you. Our next question will come from Eric Percher with Nephron Research. Your line is open.

Analyst: Eric Percher

Question – Eric Percher: Thank you. Eric Percher and Josh Raskin here at Nephron. Question with respect to the approach of M&A. How important was geographic diversification in your process, or as you're examining assets and making this decision? And then conversely, how important was how much annuity of a model that Oak Street has built? And maybe lastly, how do you think about how this and Signify come together with respect to physician enablement?

Answer – Shawn M. Guertin: I can have Karen talk about that as well at the end, but what I would say is as we talked about, our factors here, Eric, we've conducted a very thorough evaluation over the last 15 months and are confident this is the best asset in the space. It really satisfied all of our criteria. Talented and capable leadership, a leading integrated technology platform, a clear ability to the point of your question to scale and reproduce the model and the results across both geography and for different payers.

It also has, as Mike mentioned, a demonstrable capability to improve clinical outcomes and lower costs and I think a very clear path around the unit economics required for profitability. I'd be remiss if I didn't also mention that it has a fundamentally differentiated patient experience, as evidenced by their 90 NPS and their exclusive AARP endorsement.

So this asset really, we've talked about the list of criteria, we really hit it. And I think to your point, the geography was important. We're a big company. We're going to need a big footprint over time and being in 21 states was important, in and of itself. But is actually, in my mind, the scalability element was the ability to demonstrate the model worked in different geographies. And to the point of your second question about having, I'll call it, the homogeneity of the model, it was the ability to reproduce it, and then make changes to it. I think that that was very, very important, and, frankly, very distinct in what we looked at in the market.

I think the second part of your question, I think, is important, too, because there is a lot of interplay potentially down the road between these two assets. One of, I think, the benefits that we have and I think we've built-in a modest synergy when we talk about the ability to accelerate growth, is the ability of Signify, when they're doing a home visit, to recognize that here is a member that needs to be returned or connected to care. And that doesn't have to be, obviously, through Oak, but it can be now, and it can be our MinuteClinics as well. So the interconnectivity of actually getting these members the care they need, when they need it and where they need it and, to Mike's point, the way it should be provided, I think these two things over time will be able to work powerfully together.

Answer – Karen S. Lynch: Yeah, and, Eric, just to add to that, I think it's really important to think about community and community-based care, as we've talked a lot strategically, being in the community and really having kind of all these assets work together. Shawn made a good example of Signify and Oak, but then you think about our MinuteClinics and we can kind of leverage those MinuteClinics for additional capacity. We can leverage our nurse

practitioners as well and then we can have wrap-around services. So we can have a very much of a holistic approach to care in the community.

I'd also add that it is really critically important for us to be a multi-payer agnostic provider and make sure that we're connecting care for all the patients that we're interacting with in the community.

Question – Eric Percher: Thank you.

Operator

Thank you. Our next question will come from Stephen Baxter with Wells Fargo. Your line is open.

Analyst: Stephen Baxter

Question – Stephen Baxter: Hi. Thanks. Appreciate all the color on the Oak Street acquisition. I was hoping you could help us think a little bit about the timing you'd expect to be required to realize both the greater than $2 billion of earnings power itself and also the $500 million of synergies. And also maybe any insight into where both those figures might be on a reported basis over the next couple of years would be great. Thank you.

Answer – Shawn M. Guertin: Yeah. So let me talk kind of about this in sort of a financial terms and try to get at some of those points. As I mentioned, right, this is – we do think this is a deal that has an attractive long-term return on capital, but it also has the potential to move the needle from an earnings perspective in a company of this size and scale.

Our strategy has been and will continue to be to deploy capital to improve the sustainable earnings growth rate of this company as a whole. When you look at this asset in concert with Signify, we project this could improve our overall long-term earnings company growth rate by at least 100 basis points a year as these investments mature.

It's important, as you think about this, that the dilution, especially the dilution from financing, is temporal and short-term, but the sustainable improvements in growth rate are not. From a return on capital standpoint, we think it earns double-digit returns on capital in year seven and, very importantly, because of the embedded value in that clinic infrastructure, that return on capital continues to grow on the order of 200 basis points a year thereafter.

And I mentioned in my remarks that at the current rate of expansion, we would expect to have 300 clinics in 2026 or by the end of 2026, and using the Oak Street convention around adjusted EBITDA at $7 million per-clinic, we think the embedded EBITDA could cross the $2 billion threshold in the 2026 year. So that's an important sort of data point, but I think it's important to recognize that the way that embedded EBITDA really manifests itself can be in these ongoing returns on capital.

I'd comment that while the return profile might be longer than other deals you've seen in the past, I don't think it's atypical of deals that meaningfully improve your strategic positioning as a company. And I do think it's important. In fact, I think being overly slavish to deals that only satisfy short-term returns are exactly what can lead to long-term growth problems. And I think this is something that has a lot of long-term growth earnings power.

And finally, you had asked about the synergies and some of the kind of accretion/dilution. The synergies are powerful here and I think it's one of the things that we're uniquely positioned to deliver on. I've often, when I've talked to all of these companies, they've often said to me like if I say what do you need to grow faster and they say members and capital, well that's something we can bring to bear here. But most of the synergies, probably about 70% of what we talked about, are tied up really in that accelerated growth and the improved retention of MA members. And so when you think about the model here, the J-curve if you will, this is about moving them along that curve faster. And in that trajectory, that generally gets closer to break-even and positive in that year two to three timeframe, so that it's after that that a lot of these synergies mature.

The way we see that playing out is I think this would be roughly EPS neutral, probably in like year four of our ownership, thereabouts, and begin to be accretive on an EPS line for year five. But make no mistake. It is improving each year, which is going to help our growth rate between then and now, and you're building substantial embedded long-term value in that footprint.

Operator

Thank you. Our next question will come from Ann Hynes with Mizuho Securities. Your line is open.

Analyst: Ann Hynes

Question – Ann Hynes: Hi. Good morning. Maybe we can shift to Retail, your guidance for OP of $5.95 billion to $6 billion. Can you just let us know how much endemic COVID you have in that guidance? And for 2024 and 2025

expectations, are you assuming that stays flat or is there any growth in that base business? Thanks.

Answer – Shawn M. Guertin: No. So, Ann, for 2023, we have about $500 million to $600 million of what I'll call the endemic COVID contribution from the three categories we've been talking about, vaccines, diagnostic testing, and over-the-counter testing. It's important to recognize that that is significantly down from the contribution that we experienced in 2022, nearly $1 billion down from that. So we're targeting producing the $6 billion again despite kind of that headwind.

In our forecasting, I would tell you, the general targeting is we continue to expect Retail to be able to maintain flat and we have a declining COVID contribution in our thinking behind that. That obviously there's other initiatives and I can let Michelle and Prem maybe talk about some of the other things that are going on in both the front of the store and the back of the store that are helping the business broadly, but also helping us sort of manage through the decline in COVID contribution.

Answer – Michelle A. Peluso: Hi, Ann. It's Michelle. So while it's easy to see we had a really strong financial year and gaining share in both front store and pharmacy, there's a lot of underlying trends that I think are driving the momentum even as COVID slows. So if you think about 2022, we grew consumers, we experienced stronger household penetration, and we actually grew service levels and Net Promoter Scores to historically high-levels. And so the foundation and momentum has been strong in the front store.

This is coming about because of things like our investments in omni-channel, modernizing our store fleet, improving our merch mix, improving service and even our pricing promotional strategy. So this is a kind of underlying momentum and foundation that we think will help us continue our growth trajectory. But at the same time, we absolutely recognize there's also opportunity to invest in cost structure and productivity improvements, so we're investing in supply chain, for instance to optimize, modernize and selectively automate. We believe that will bear significant return. We're also finding lots of other opportunities to improve inventory turns and reduce overall product loss. So it's this combination of growth alongside productivity improvements that we think will continue to fuel our performance not just in 2023 but beyond.

So let me turn it over to Prem.

Answer – Prem Shah: Yeah, just a couple other points. Our Q4 market share in pharmacy is now approximately 27% and we grew share another 12 basis points and we're about 117 basis points higher than the pre-pandemic share.

And then secondly, I'd say there's two areas we're really focused. One is on our digital approach in our pharmacies and how we continue to be the most convenient retail destination for our patients and consumers and really connecting that with our digital strategies. And the second is really around our clinical programs. We're seeing continued strong adoption of those clinical programs that drive further adherence and retention for our patients and we're starting to see new therapies also arise. So continued strong momentum in retail from a pharmacy perspective. We continue to have extremely strong service levels in our business as well to drive the business forward.

Operator

Thank you. Our next question will come from Nathan Rich with Goldman Sachs. Your line is open.

Analyst: Nathan Rich

Question – Nathan Rich: Hi. Good morning. Thanks for the questions. Oak Street's cohort data paints a pretty compelling path just in terms of the embedded EBITDA that is in the centers. I guess what do you see is the key variables to kind of achieving that kind of J-curve that they've laid out. And you've talked about some of this, but what can CVS do to potentially accelerate that.

And then just as a quick follow up, Shawn, I was wondering if you could just talk a little bit more, in more detail about capital deployment plans in 2024 and 2025. I think you said some modest level of share repurchases in 2024 and more in 2025. Could you also talk about maybe what you see as sort of deleveraging or debt pay down across those years as well? Thank you.

Answer – Shawn M. Guertin: Yeah, so as you mentioned, I think and I can certainly I think Mike can comment as well, right. Really, the variable and it's remarkably consistent, right, over time is the ability to drive membership growth sort of along to your point along that sort of J-curve of cohort financials. And today, I think Oak has done a great job being successful as that and what this deal really opens up is a lot of new potential pools for members.

And I think that will take a lot of different forms, right. There are certainly, well it's very much going to be a multi-payer asset. There's obviously things we can do for plan design offerings to highlight the Oak network or the Oak

clinics. We can do that with the Aetna members. I mentioned Signify before as a potential sort of source of members, but when you just think about the vast array of members that we interact with and the vast array of seniors that we interact with every year, across this company, this is a much wider catch basin if you will for potential growth.

I also think we can strengthen the value of the offering with our other fulfillment assets around pharmacy and MinuteClinics. And frankly, I think that'll make that offering not only more attractive (01:06:13) but all of the payers who contract with Oak. They will all benefit from what we bring to bear with our retail health strategy and our pharmacy strategy. And I think that is sort of – that is an opportunity there.

On capital deployment, I think as I mentioned, what we expect for this to play out is that over the next couple of years, we will likely be in the mid-threes from a debt-to-EBITDA ratio and that's obviously a range which is consistent with our current investment-grade ratings and that is important to us to maintain that rating profile.

Having said that, I still think we have an ample amount of financial flexibility over the next two-to-three-years after this transaction. Our current projections are – or let me step back, as you mentioned we have a modest amount of share repurchase in the 2024/2025. Think about that as maybe a point or two above dilution. That's very consistent with what we told you on Investor Day. So when we think about the flexibility we have, I would say that we would have probably between $4 billion and $8 billion of flexibility over the 2023/2024 window and then that grows more to like the $10 billion to $15 billion of flexibility in the 2024/2025 window. Timing obviously still to be determined, but I think that gives us ample flexibility because this is the capital that we could continue to use to return value to shareholders via the dividend, obviously, incremental share repurchases, deleveraging to your point, or it could be used for other corporate purposes.

So before we conclude, I want to take this opportunity to thank our CVS Health colleagues for their extraordinary work bringing our vision to life, improving the health of our customers and delivering on our financial objectives. As you heard today, CVS Health delivered strong results and we're advancing our strategic initiative. We entered 2023 with great momentum and we are well-positioned for growth in our foundational businesses, and we are making continued progress against our strategy. We are so excited about the opportunities ahead of us including both the Signify and Oak Street Health acquisitions and we look forward to keeping you updated throughout the year. Thank you.

Operator

Ladies and gentlemen this does conclude today's CVS Health Fourth Quarter and Full Year 2022 Earnings Call and Webcast. You may disconnect your line at this time and have a wonderful day.