Bank of America Healthcare Conference ***(Corrected version)***

⌵ Event Details

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Company: CVS Health Corp.
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⌵ Company Participants

Shawn M. Guertin - CVS Health Corp., Chief Financial Officer & Executive Vice President

⌵ Other Participants

Michael Cherny - Analyst

MANAGEMENT DISCUSSION SECTION

Michael Cherny

Everyone, thanks for joining us for this session of Day 3 of the BofA Healthcare Conference. I'm Mike Cherny, the healthcare tech and distribution analyst. It's my pleasure to have CVS Health. With us today are Shawn Guertin, CFO; Tom Cowhey, who runs Capital Markets, also is here as well. We have no slides, so we're going to try and keep this as an informal conversation.

I don't know, if – at least you just reported earnings, anything that stood out that you want to make sure we got across before we jumped in?

Shawn M. Guertin

Yeah. I would say it was really a very – it was a very good quarter, really good start to the year. All of our businesses were largely in line with where we expected them to be. We understood whatever variations were there. So, obviously, still a lot to play out for 2022. And, obviously, just like everyone, you know, we're all still trying to sort of navigate the COVID trajectory of things and the ups and downs around that. But, overall, it was really an excellent start to the year. We continue to have really good top line growth and really, really good momentum in the business.

QUESTION AND ANSWER SECTION

Analyst: Michael Cherny

Question – Michael Cherny: So, I'm going to start on the COVID topic with maybe a bit of a catch-all question, and I apologize, I'm probably going to go beyond that after. But your business is unique relative to your peers and the fact that you have offsetting parts tied to COVID. You have some areas that are performing well, vaccines, some of the dynamics on immunization, some areas thy have had challenges (00:01:25) the COVID costs. Where do we sit right now in terms of where you think we are in return to normalization on some of those key metrics across your overall enterprise relative to COVID and the various macro moving pieces?

Answer – Shawn M. Guertin: Yeah. So I think there's, like you said, there's really two things that have tended to move in opposite directions pretty consistently throughout all of this. And so, in our Health Care Benefits business, obviously, the cost of treating COVID, some of the temporal effects we had around revenue have been a negative. And those largely have been offset by the vaccines and testing revenue that we got on the Retail side. So, on that insurance business, what I'd say in the first quarter, despite the fact that Omicron, so higher kind of levels of case counts that we'd seen, that did mitigate pretty quickly. We didn't see all the severity, for example, that we saw in Delta.

And when you looked at our – that business, the commercial business itself, when you put it all in there, which includes pricing now, right? For the first time, we have a meaningful amount where we've tried to price for COVID. When you put all that together, it was pretty much consistent with what I call its baseline trend expectation. So think about that to where we've price for that business. And so that one felt like it was pretty much on the mark even with some of that COVID in there.

The government business continues to still lag behind that in a bit of a favorable way, where the costs still seem like they're a little bit suppressed from what you would think would be sort of a trended baseline. And so, as we think through the rest of the year, we can still think that's going to continue to trend back towards a baseline. But there certainly could be some periods where we continue to experience some of that as it sort of makes its move back. I feel like I need to always caveat this, right, that every – going back to 2019 and trying to trend forward, it's getting harder and harder to draw the fine points on this. But I think in the broad construct, that's pretty clear it behave that way.

On the Retail side, we continue to have a benefit from vaccines and testing, both over-the-counter and the traditional testing that we had been doing. We had a very good quarter in front of the store. Some of that might be COVID-driven, some of it isn't. And so that continued to be a positive. It was actually better than last year, but that had more to do with sort of the anomalies in the first quarter of last year. We were just starting the vaccine initiatives then. We didn't really have the expense model down. We did a lot of the long-term care vaccines in the first quarter. So, that like last quarter was an anomaly.

When you look at big picture, though, right, we're looking, I think, we still are forecasting around 18 million vaccines, which would be down pretty significantly from 59 million that we did last year. We do think there'll be a fatter tail on testing and treatment. So, we will have a contribution this year for sure in Retail. And the question will be how much does our pricing sort of match? What we see on the HCB side, and that will largely be how the year would play out.

The last thing I would say on this is, and I said it on the call, I think as some people have thought about 2023, we have this discussion about, well, what if it goes to zero? And I get that mathematically, but I got to tell you, that's not what it feels like it's going to happen, right, as you sort of watch it. And I'm not saying it's going to be severe, but rather the more endemic nature of this, I could continue to see that there could be testing, treatment, booster, seasonal – I mean, it's – no one could predict that with certainty. But I think there'll be something there.

But the other thing is, I think we've also started to see the potential power that we might have in broader testing and treatment cycles, whether it just be regular flu and other things, where we can use the MinuteClinic, do the tests there, get the – have somebody walk out of that store with the script that they need. So, I think there are some tailing effects as we go towards 2023, and I actually think there are some opportunistic things that we might be able to do better going forward that we've learned, frankly, from the experience.

Question – Michael Cherny: And that's an interesting question, debating the pivot to either benefits or retail, but starting on the retail side, in terms of that future state of your care assets now against the backdrop of what you've discussed in terms of care assets going forward. As you think about that infrastructure, and as we all sit and ponder and discuss what could be that primary care strategy, both organic and inorganic growth, how are you positioning the assets that you have now to make sure that you're capitalizing on the momentum you received, by so many more people coming in for vaccines, for testing that maybe didn't use CVS – CVS, the store or the MinuteClinic or HealthHUB, whatever it is in the same way before COVID?

Answer – Shawn M. Guertin: Right. Yeah. There's a lot of fingers in that question, but a lot of that activity today, you can sort of see centering around the MinuteClinic and the sort of HealthHUB infrastructure. If you step back and you thought about the assets we have, whether it'd be the MinuteClinics and HealthHUBs, whether it be the pharmacy operations, whether it be the home infusion business, you can sort of see all these fulfillment assets sort of circling around what – kind of a nucleus, which would be sort of the care delivery. And that's largely something as we've talked about we think could be very powerful, but likely we're going to need to jumpstart with an acquisition as opposed to de novo.

But to the point of your question, I think there are things we're doing now with the assets to prepare for that. And I think the MinueClinics and the HealthHUBs are a great example where those heretofore had largely been in a very, kind of, wide catch basin, if you will, to take care of episodic care that people have generally lower acuity. They'll always play potentially that role.

But as we think about that sort of connected delivery system, I think there's two other really important roles they could play. One is, as a physical outlet and connectivity point for virtual care. I think the need for people to transition easily from a virtual or digital visit, when they do need something physical, whether that'd be a script, a simple test, the ability to have that kind of connectivity is, I think, going to be very powerful. The role that those could play in helping manage risk-based payment, I also think it's something we've thought a lot about and it could be very powerful.

And on the more sort of day-to-day thing, we've spent a lot of time thinking about how to make that experience more convenient for people. And we've recently launched for the MinuteClinic sort of the ability to schedule sort of through the Google search. And that I think – it's early, but I think we've already scheduled 30,000 visits, which is an incredible number in the short time. It's there and it's all from convenience to your point. And so, I think the key for us, right, the key that will be unique I think to our offering is really to be – to really give the consumer a true differentiated consumer experience in healthcare, one that's really sort of focused on the convenience. And I think that's figuring out what those things are the people value and how we can build that now, I think will really help us. It'll help us now in the business, but it will really help us in the long run.

Question – Michael Cherny: And obviously, it's hard to put a fine point in terms of understanding the strategy without that kick start acquisition that you...

Answer – Shawn M. Guertin: Right.

Question – Michael Cherny: ...mentioned could come along. That being said, you mentioned the convenience factor. And I think convenience comes a number of different factors, but also has that quasi omni-channel approach to healthcare.

Answer – Shawn M. Guertin: Right.

Question – Michael Cherny: How do you think about the marrying of the physical assets with also your digital partnerships, your virtual partnerships to make sure that that convenience factor can continue to be your members, your customers where they are?

Answer – Shawn M. Guertin: Yeah. So, in that – one aspect of that is actually an answer to your last question too like what are we doing now, right? So, some of these scheduling things that we've done, are (00:09:21). We've completely overhauled cvshealth.com. We're really thinking about convenience capabilities. So, for example, we've launched buy online pickup in store, which in and of itself isn't a novel concept broadly, but not something we've been doing. The ability, for example, to integrate that purchase experience between the back of the store and the front of the store, the ability to add over the counter, right. There's digital capabilities that I think you can easily see can kind of gain momentum in sort of a more robust care delivery operation. And I think, the nice thing about these investments is we can see some of the impact just in today's world, right? We know digital customers kind of make more trips to the store. We know that digital customers in our loyalty program buy sort of certain products that have higher margin. There's just a lot that we've already been able to see and we have – it's early but we have good momentum.

So the other side of that is when we think about sort of what's out there and who the right partner is, I would say – so we can debate whether it's one, two or three. But one of those is that technology and that consumer-driven, that consumer-facing technology to really make that experience better and that can be scheduling. That can be a lot of things. But that's really important. It's one of the things that we don't necessarily have in a state, where I think we could hit the ground running. So every asset we talk to, the state of their technology and, in particular, its ability to scale and its ability to be consumer-facing is really one of the top two or three things on our list right away. It's really a gating item in many ways.

Question – Michael Cherny: And I know that you've talked about the strategy tied to be a multi-payer approach, but then again, you have one of the greatest test labs possible with your HCB and the member base. So how do you think about the build-out of the strategy against making it captive within that and making sure you get it right versus making sure that it's ubiquitous to broader market?

Answer – Shawn M. Guertin: Yeah. I think where that would manifest itself most clearly is in how we might decide where to go first geographically. It just – it will make sense, right, to sort of do some of that, to your point, where we can take advantage of the test lab and we can provide incentives that way. And so, I think we will do this in a way that it makes the most sense that whether it's our Caremark membership or whether it's our Aetna membership that that we can expose them to these things. And I think we all think of that.

But to your point, in many ways, that's a temporal benefit only, because we really want and need these things to be all-payer. So to some extent, right, that will depend on the state of our discussions with other payers, and that could be from the big guys everybody knows to local Blues players, right, potentially. And we could think about how we might sort of partner and that will also be sort of a by-product of this as well. So, I do think that that business in the short term is a real asset, to your point, to learn from, one, where we I think we can kind of accelerate development because of it. But in the long run, it's got to work for a broad population.

Question – Michael Cherny: Turning to healthcare benefits a bit, in particular, the government business. You have two quasi divergent paths and the fact that you've an MA business that's been seeing strong momentum for a number of years versus Medicaid, which is in this quasi-odd periods, we wait to see what happens in the public health emergency and what that means for a potential falloff in redeterminations. How do you think about positioning both of those businesses for 2023 and 2024, in particular, against the backdrop of your guidance, given both the PHE dynamic, as well as what's obviously a higher MA rate environment for this year?

Answer – Shawn M. Guertin: Yeah. So I think on MA, right, that's one I feel very positive about as a business. Like you said, it's got a long-term track record of success. I think the good news for us is we're not – we're operating in a target margin range. So, we don't have a problem one way or the other to swing back and forth on, which is always good. We're in good position this year, as you mentioned, positive reimbursement environment. And we'll do what we always do in terms of thinking about how that product has to be designed against, frankly, its local market competition.

We've been a big believer in zero-premium products and have fought hard to maintain those positions and have one of the better positions in zero-premium and in the market. We'll continue to do that. We still have opportunities for geographic expansion. We're a little bit under market right now in dual eligible, and so we've seen rapid growth there. So there's a number of levers we can go on.

I do think, though, that a lot of times, these discussions sort of focus on the reimbursement issue when I think an important part of this is also distribution. This is a product, in many ways, that's sold, not bought. And so the importance of distribution, which we've always put at the forefront and it's alignment with your marketing, it's a big part of this. It's a big part of this business. And so, we've had a lot of momentum there. So I think with the different growth avenues, I think with our solid margin position, I think with some of the things we've begun to do like Medicare resource centers in the stores, I feel favorable about this business.

Medicaid is – this is a business that I think is going to be a really good business for us, but, it's also something, to your point, where we need to do better. We hired, I think, a little over a year ago, some new leadership, very experienced Medicaid leadership in the space and have made a number of changes. And, it's a bit of a funny issue to me in the sense that when we have contracts, we do great. We're profitable, we hit high quality metrics, and we can – we do excellent. Our issue has been sort of in the RFP space. As mundane as that sounds, this has been about winning RFPs for us.

And so, obviously, we're spending a ton of time on thinking about how we get better at that. And I'm very optimistic and confident in the leadership we have around this, but this is a space that we need to do better. I don't – this won't be something that pops necessarily in 2023, but we do have a big pipeline we're focused on. And I think over the next few years, it's a place where we can and should see accelerated growth.

The other thing that's interesting here is because we don't talk about this a lot, but the idea of our strategy and the vision of having these sort of conveniently located care delivery centers is actually a topic that a lot of Medicaid administers – that excites them when they think about their population and accessibility in getting to care. There's some excitement about our model. So, I do think there's actually something sort of differentiating that we could potentially bring into some of these RFPs going forward that could really kind of gain some traction. We tend not to talk about Medicaid in this infrastructure a lot, but I do think we have some opportunities. And as you know, with the 9,000 locations that we have, a lot of those are certainly in urban areas where that would be much more accessible for people to get access.

Question – Michael Cherny: I may come back to this, but I want to turn to Pharmacy Services. I feel like virtually every earnings call, it's the yin and the yang of Retail versus...

Answer – Shawn M. Guertin: Yeah.

Question – Michael Cherny: ...Health Care Benefits and the traditional (00:16:49) kind of sits in the middle...

Answer – Shawn M. Guertin: The biggest earner, right?

Question – Michael Cherny: Exactly. You outlined at the Investor Day back in December the biosimilar pipeline, which I know is taking on increasing focus, HUMIRA being obviously the standout on that chart. When do you think you'll, as an organization, have visibility into how HUMIRA will contribute to your overall earnings contribution rate?

Answer – Shawn M. Guertin: Yeah. I think when we've talked about this, I think there's an element of this that I think I would say is, in many ways, as we saw with pills and tablets, right, when the new products create competition in the market and that leads us to be able to lower costs, that's been good for our customers and then good for the PBM. And in many ways, that's the same potential paradigm that we see playing out in specialty generics and specialty biosimilars.

Now, I think the trick, to your point, a little bit in this is not whether that opportunity is there over a multiyear period, but the ability to sort of see the forecasting of the timing is a little bit, I'll call it, clumsy at times, right, because, A, these are really big drugs, right, so when they move, they – things can move hard with them, but there's a lot of variables. Your interchangeability, for example, on HUMIRA will be a big one, right? Exclusivity, which is always part of this, even nuances with what formulations are coming to sort of the market can make a big difference. And if you think about it, I think in the case with HUMIRA, even though it starts with February 1, there's an exclusivity period and until we get interchangeability, that's really going to slow the adoption down on that.

Now, these discussions start early, right? I mean, we talk with these guys all the time. And in many ways, right, the path – what we want to do is get to the lowest net cost for our customer. That could be the new agents, which it often is, but it also could be a heavily rebated brand, too. And that's sort of what we go through with each of these sort of drug-by-drug.

So, I'm – I feel pretty good about the multiyear opportunity. I think the 2023, and in particular with HUMIRA, that one could be a little bit more muted just because of the timing of these other factors. We saw – I mean, we – REMICADE's a good example, right? We saw a significant – the cost of that, I think, was more than 50% degraded, and that's good, right? We're able to get value for us and get paid for that value when we do that. So, I think we've seen the evidence, it can be there. I think, though, as we look at these things, it's really important to understand the specifics of what's coming when to sort of know when we can see that value. And we certainly talk a lot about that with them about how to – how and when to capture that value.

Question – Michael Cherny: I might be a little early on this but relative to the Pharmacy Services and PBM, 2023 selling seasons kicked off, especially as both payers and employers that you're participating RFPs with come to market in this post-COVID world. Anything changing about the bid structure that you're seeing or what they're looking for as you're going to try and continue what's been a fairly robust streak of wins?

Answer – Shawn M. Guertin: Yeah, I would say, this year, 2022, is just an incredible year, right, with, 1 billion plus sort of net growth. It's I think unlikely we recreate that where we had some jumbo wins in there, right? So it's just been an incredible year this year. I'd say on the renewal season, it's not – it's certainly not an oversized year for us to think about mid-30s in revenue, which is typical similar to I think what we had in 2022 and we're about 60% through that. And, I think, the sort of the core retention around that's like 98%. So that feels fine.

The new business sale process, I mean, after – there's – of course, there's always a price element. But if you asked, the team, the same answer is, one, two and three, it's all about specialty and it's all about specialty cost management, specialty capabilities, which is an area we do pretty well in because sort of like we do on mail order drugs, we can give people the opportunity to have maybe like a cold storage drug, for example, deliver to a store for pickup instead of waiting for at your house for that to get it.

So people like that. We have a nice digital tool that I think 95% of our specialty patients are sort of connected to where we can sort of exchange information. So, I would say that in specialty, obviously, it's more than 50% of the cost. So this is really the sale in PBM, after you sort of step out of the financial elements. Yeah, there's a basic level of customer service, but almost all the differentiation and dialogue has been around specialty.

Question – Michael Cherny: And are you seeing any changes in the approach or the attempts in RFPs for carve-in versus carve-out on specialty? And how does that factor in, in terms of the ask, given that you do have the largest specialty pharmacy by a pretty wide margin?

Answer – Shawn M. Guertin: Yeah. I mean, I think in some ways we saw it, right, because the – one of the jumbo contract we wrote was the FEP contract, right? And that's a specialty-only contract. We've actually won some. So I mean, we see it – again, we can debate the merits of the economics of sort of carving these things into pieces. I think it's debatable to the payer whether they're really getting value out of that. But, again, in many ways, given our capabilities in specialty, I think it's a good thing for us because I think we can compete very well with sort of both the scale and the capabilities of our specialty pharmacy operation.

Question – Michael Cherny: Turning to the Retail side again, where do we stand on pharmacy reimbursement and how is that contemplated, in particular, into your 2023 and 2024 targets?

Answer – Shawn M. Guertin: Yeah. So, it's a good question. It probably in my mind is the biggest issue in that business in terms of its financial effect. What we've seen in 2022, I would say, there's some positivity directionally, right? It has not accelerated. The early look this year was maybe it's mitigated a little bit, but it's still of a magnitude that it's meaningful.

And so, as we think about the next few years, what I wanted to do is to be able to have that Retail business be at least flat. And so, to combat that kind of margin pressure, we've really done a few things. Obviously, we're going to try to not – to negotiate that to a minimum, right, that goes without saying. But we've done a lot to try to drive scale, right? And we've been taking scale almost every year – we've taken market share, almost every – I'd spend at least eight quarters in a row we have in the Retail Pharmacy business.

And so, we grew scripts, I think, in the high 5s ex-COVID in the first quarter and that was almost like double the market growth in scripts. And we're doing that through a lot of our service elements and things like that. Even the buy-online, pickup in-store would be one more thing, but the omni-channel capability of getting the script to the person the way they want, again, has a volume element. But it also goes to the second where you would push on this, which is sort of reducing your cost of goods sold, reducing your expense structure. And so, figuring out more efficient ways for us to deliver those scripts with sort of new models would also be part of it.

And we also have tried to think about how we negotiate on the cost of goods sold with not only manufacturers, but even with the PBMs. Are there other sort of value-added services we can provide, whether that's (00:24:27) disease specific? So it's a fight on multiple fronts to get there. And I certainly don't – wouldn't sort of be overly confident that it's something that's left by any stretch of the imagination. But we continue to work on it on multiple fronts, and ultimately, we need to have some stability here. And I do think, it's not really the reason for our broader strategy, but the more attractive and functional and convenient that that store location can be for care delivery broadly, the more bargaining power that gives us, right, when we get down to sort of that discussion. So again, it's not the reason for being of the strategy, but it could be one of the nice sort of ancillary benefits of it.

Question – Michael Cherny: And within the stores as well, I mean, mostly at least, wage inflation has been a big component of discussion. You've been very forthright on $600 million of annualized wage investments. Do you feel at this point in time like you have enough of a feedback loop to know that that's enough for your employee base?

Answer – Shawn M. Guertin: Yeah. I mean, it feels okay at the moment. I mean, it's something that we have to watch really carefully. I think by doing it before all these started helped us. We probably haven't had to play catch-up as much. But it's a tough environment. It's a tough labor environment. We're doing okay. But it is something we think about. I mean, I largely think, as we've thought about what we might have to do this year, that feels okay. I think we're going to have to think longer term, whether it's still a lot to be played out here.

Some of this goes back to the same thing though about finding different ways, right, for us to do – we're really trying to rethink what we can do with the store footprints. If you think about it largely today, every one of them does the same thing in some variation. And we've thought about, could you have some pharmacy-only locations and what's –

is there a more efficient intake of scripts? And there's just – there's some things we could think about using this as a fleet (00:26:31) call it, the air cover that we need sort of in a big operation. And I think we'll also sort of look at that as well as a way to sort of maybe take some of the pressure out of the system that might allow us to sort of deal with that.

Question – Michael Cherny: And I want to make sure I hit on this because I've asked about it in bunch of different ways. But on the longer term targets, CVS has evolved as an enterprise, talks about the puts and takes on COVID and, of course, non-COVID areas of the business as well. As you think about your long-term targets and making sure that you're – the team is staying on track on those goals, how do you balance the dynamics of areas where there could be unexpected or uncontrollable variability? And how you think through the best way to provide visibility for the organization as a whole on whatever offsets you have to make sure that those targets stay on track?

Answer – Shawn M. Guertin: Yeah. Well, I think, if nothing else, probably over the last year, we've made a concerted effort, first and foremost, to be transparent about what those targets are, exactly where we expect to get that from, and then be able to talk about when we are or we're not getting that from, so that there's not a lot of surprise. What I would say is, I think the area that we tried to remain cautious in is around capital generation and capital deployment. I think it's a very underappreciated aspect of our story. I think over time people have confused valuation with capital generation, and they're not obviously the same thing. And last year, $18 billion of cash flow from operations.

So, I think – when I think about what we've built into our guidance for share repurchase as an example, I think we've held some power to that. And I think that becomes a little bit of our safety net, if M&A takes a different timing or if this kind of goes in that direction. Can I say it's going to be foolproof? No, because that money needs to be used for other things, too, right, M&A. But we tried to leave ourselves some flexibility. We're spending a lot of time on this organizationally, making sure we're optimizing that cash flow. And I think that does become one of the things that we can go to, to try to help bridge periods of time, because, inevitably, to your point, we laid out a very discrete plan on Investor Day. Inevitably, reality will not be that plan, because that's just the way the life is, but the question is, it gives us something to sort of navigate around and, two, with the different levers that we can pull.

Question – Michael Cherny: I wish we're all that good at forecasting, but...

Answer – Shawn M. Guertin: Yes. (00:28:54)

Question – Michael Cherny: ...like, it's a two-point buffer is never a bad thing.

Answer – Shawn M. Guertin: Yeah.

I think we're out of time, Shawn. But...

Okay.

...thank you so much for being here. Thank you, everyone, for joining us for the last day of the conference.

Excellent. Thank you, Michael. Thank you, everyone.