

03-Aug-2022

# CVS Health Corp. (CVS)

Q2 2022 Earnings Call

# **CORPORATE PARTICIPANTS**

### Laurence McGrath

Senior Vice President, Business Development & Investor Relations, CVS Health Corp.

#### Karen S. Lynch

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

#### Shawn M. Guertin

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

#### Daniel P. Finke

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

### Alan M. Lotvin

Executive Vice President, CVS Health, and President, CVS Caremark., CVS Health Corp.

#### Michelle A. Peluso

Chief Customer Officer, EVP & Co-President-Retail, CVS Health Corp.

#### **Prem Shah**

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

# OTHER PARTICIPANTS

### Ricky R. Goldwasser

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### Lisa C. Gill

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#### A.J. Rice

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### Michael Cherny

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#### **Justin Lake**

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### **Eric Percher**

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Ladies and gentlemen, good morning and welcome to the CVS Health Second 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 a question. As a reminder, today's conference is being recorded.

I would now like to turn the call over to Larry McGrath, Senior Vice President of Business Development and Investor Relations for CVS Health. Please go ahead.

### Laurence McGrath

Senior Vice President, Business Development & Investor Relations, CVS Health Corp.

Good morning and welcome to the CVS Health second quarter 2022 earnings call and webcast. I'm Larry McGrath, Senior Vice President of Business Development and Investor Relations. 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'll host a question-and-answer session that will include Dr. Alan Lotvin, President of Pharmacy Services; Dan Finke, President, Health Care Benefits; Michelle Peluso, Chief Customer Officer and co-President of Retail; and Prem Shah, Chief Pharmacy Officer and co-President of Retail; as well as Tom Cowhey, Senior Vice President, Capital Markets.

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

During this call, we'll make certain forward-looking statements reflecting current views related to our future financial performance, future events including potential impacts related to COVID-19 and 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, this morning's earnings press release and our Form 10-Q.

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

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

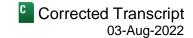
### Karen S. Lynch

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

Thank you, Larry, and welcome to the team. Good morning, everyone, and thanks for joining our call today.



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CVS Health delivered another outstanding quarter. We grew revenue by 11% versus the prior year to over \$80 billion with strong results across all business segments. We delivered adjusted operating income of \$4.8 billion and generated adjusted earnings per share of \$2.40. This morning we raised our full year 2022 adjusted earnings per share guidance range to \$8.40 to \$8.60, an increase of \$0.20.

We are also increasing our full year outlook for cash flow from operations to \$12.5 billion to \$13.5 billion. These guidance increases reflect the continued positive momentum across all of our businesses. We remain well-positioned and confident in our ability to achieve our near-term and longer-term growth goals.

Our increasingly integrated foundational businesses delivered exceptional results for the quarter. The Health Care Benefits segment had a strong quarter with revenue growth of nearly 11% year-over-year. We achieved adjusted operating income of \$1.8 billion. Our medical benefit ratio of 82.9% improved by 120 basis points versus the prior year as medical cost trends remained favorable.

We generated membership growth across all product lines versus the prior year. These results reflect the end-toend value of our assets, increasingly working together, one customer at a time, at national scale.

Our Medicare business remains one of our strongest growth segments, and we increased membership year-over-year across all Medicare products. Our individual Medicare Advantage membership continues to grow at a double-digit pace and faster than the overall market. This quarter, we achieved a major milestone with more than 2 million individual Medicare Advantage members, including dual eligibles.

Our PDP portfolio also maintains its momentum with healthy growth that is well-ahead of industry trends, providing us future conversion and upsell opportunities.

Looking ahead to 2023, we're maintaining a nearly 98% client retention rate in national accounts. Additionally, we are having a successful group Medicare Advantage selling season and expect to show positive membership growth next year. As we continue to build our individual exchange business, we're on track to expand coverage where we currently have individual exchange offerings and are obtaining final approvals to add four new states to our portfolio, bringing our total to 12 states.

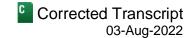
In Pharmacy Services, revenue grew nearly 12% compared to the prior year and delivered adjusted operating income of \$1.9 billion. Specialty pharmacy revenue is up nearly 21% year-over-year. We are a leader in specialty pharmacy with programs that drive value in the marketplace, provide substantive savings to customers and differentiate us as we pair programs with digital assets.

Looking ahead, we're maintaining a 98% client retention rate for the 2023 selling season with more than 75% of renewals complete. We drove \$3.1 billion of gross new business, providing evidence of our market-leading trend management, transparency and integrated offerings.

Turning to our Retail/Long-Term Care segment, we continued our momentum from the first quarter. Our deep customer relationships, high-quality patient interactions, resilient supply chain and agile operating model, all contributed to the strong quarterly performance. Nearly 4.8 million customers engage with us every day at CVS locations, making us a powerful community health destination.

In the quarter, we delivered over 6% revenue growth versus the prior year and \$1.9 billion in adjusted operating income. Our front store sales grew more than 9%, driven by strength in consumer health sales, including strong COVID over-the-counter tests and sales of cough, cold and flu products.

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Our pharmacy grew prescriptions 1.6%, or 4.6%, excluding the impact of the COVID-19 vaccinations, which declined versus the prior year. Our retail script growth trend is remarkable as we have consistently increased market share year-over-year since the first quarter of 2020.

As COVID-19 continues to move towards an endemic phase, we will continue to play a critical role in communities across the country. Millions of Americans depend on us for COVID-19 testing, vaccine administration and dispensing antiviral medications for treatment. We administered more than 4 million COVID-19 tests and approximately 6 million COVID-19 vaccinations nationwide in the second quarter. The demand for antiviral medications to treat COVID-19 continues to increase as the national positivity rate remains in the double-digits.

Overall, we continue to successfully navigate a challenging retail environment while expanding services and increasing share of wallet by bringing new customers to CVS Health. Of the approximately 43 million new customers who have chosen CVS Health for COVID-19 health services, nearly 15% have engaged with us for additional services. Our omni-channel approach connects consumer health experiences, driving high satisfaction levels and continuously enabling CVS Health to attract and retain customers. Our leadership on this omni-channel experience is a competitive advantage and one we are committed to investing in, enhancing over time.

Turning to our strategic imperatives. Let me give you a few updates. We are a leading provider of retail health services nationally and we continue to advance our care delivery capabilities. Our CVS Health Care teams and our MinuteClinic's have supported more than 2.8 million patient visits year-to-date, representing a 12% increase from the prior year. We are further enhancing our services and making them more relevant for our customers.

We are working closely with the administration, offering the test-to-treat program in our MinuteClinic's and pharmacies and will be implementing pharmacist prescribing under certain conditions to even more seamlessly serve customers with COVID-19. This furthers our strategy to expand access to health services and helps consumers to navigate to the best site of care.

As we evaluate complementary health services and care delivery capabilities to enhance our overall portfolio, we continue to take a disciplined approach. Inorganic growth is part of our strategy, and we look forward to updating you on our progress.

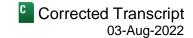
Relative to store optimization, we've closed 198 stores to-date and remain on track to close 300 stores this year. We are successfully minimizing disruption to our customers and maintaining high levels of satisfaction as we maintain our store and pharmacy hours across our locations to meet consumer health needs.

We are retaining over 70% of prescription volume within our network and have redeployed over 90% of impacted colleagues to our other CVS locations. Our technology-forward digital-first approach is reducing complexity for our customers and creating new digital health solutions that are convenient.

CVS Health now serves more than 45 million unique digital customers, up 1.5 million since last quarter. This increase is driven by our omni-channel pharmacy strategy focused on simplifying how consumers fill and receive prescriptions. Over 60% of our newly acquired digital users are customers of our specialty, mail order and retail pharmacies.

We are expanding our digital health services and deepening engagement through personalization to drive convenience for customers. We launched our individualized Health Dashboard earlier this year and already have 6 million active users, up 20% from the prior quarter.

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As we successfully execute our strategy, our unified health model grows in relevance and importance every day for the consumers, customers, and the communities we serve, and you can see this in our results.

And finally, as part of our ongoing commitment to sustainability, we entered into an agreement to purchase renewable energy with one of the nation's largest producers of carbon-free energy. This is the latest step on our path to sourcing 50% renewable energy by 2040.

We are positioned to continue our momentum through the second half of this year. None of this would be possible without our talented colleagues who serve America's health needs every day. We recently added two proven leaders to the executive team. Tilak Mandadi has joined CVS Health as our first Chief Data, Digital and Technology Officer; and Violetta Ostafin has joined CVS Health as our Chief Strategy Officer. Both bring deep, unique expertise to our diverse leadership team.

I will now turn it over to Shawn for a deeper look into our operational and financial results and our outlook.

### Shawn M. Guertin

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

Thank you, Karen, and good morning, everyone. Our second quarter results reflect the continuation of outstanding performance from each of our core business segments as we exceeded our expectations for revenue, cash flow generation and adjusted earnings per share. These results are driven by our steadfast focus on growth, operational execution and supporting the communities we serve. This momentum positions us to raise our 2022 adjusted EPS guidance to a range of \$8.40 to \$8.60 per share.

A few highlights regarding total company performance. Second quarter revenues of \$80.6 billion increased by 11% year-over-year, reflecting robust growth across each of our operating segments. We delivered adjusted operating income of \$4.8 billion and adjusted EPS of \$2.40. Importantly, these superb results were produced despite the impact of about \$100 million of net realized capital losses inside the quarter, which lowered adjusted EPS performance by \$0.06.

These net realized capital losses are reported primarily in the HCB segment, but also impact the retail and corporate segment results in the second quarter.

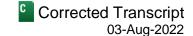
Looking at performance by business segment. In Health Care Benefits, we delivered strong revenue and adjusted operating income growth versus the prior year. Second quarter revenue of \$22.8 billion increased by 10.9% year-over-year. Membership grew 4% year-over-year despite the loss of 266,000 lives from the completed divestiture of Aetna International's business in Thailand.

Excluding the divested business, we delivered sequential membership growth of 176,000 members reflecting growth across all product lines. Our Medicare franchise remains a key growth opportunity for us, adding approximately 70,000 members sequentially across our portfolio of solutions for individuals and employers.

Excluding the divestiture of our international business in Thailand, we continue to deliver sequential membership growth in our Commercial business. We also continue to build out our individual exchange business, which will include 12 states as of January 1, 2023, pending regulatory approval.

Sequential growth in Medicaid membership is largely driven by the ongoing suspension of redeterminations. Adjusted operating income of \$1.8 billion grew 13.4% year-over-year, reflecting improved underlying performance

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and membership growth, partially offset by incremental investments to support growth in the business and net realized capital losses of \$67 million.

Our medical benefit ratio of 82.9% improved 120 basis points year-over-year, reflecting medical cost trends that remain modestly favorable to our pricing assumptions. Consistent with last quarter, medical cost trends in our Commercial business remain generally 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 54.3, up 2.6 days sequentially as reserves grew at a modestly higher rate than premium growth, displaying a pattern similar to what we experienced in the second quarter of 2021. 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 outstanding customer service levels continued to drive growth. During the second quarter, revenue of \$42.8 billion increased by 11.7% 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.

Revenue in specialty pharmacy grew nearly 21% versus prior year, reflecting new business wins and pharmacy claims growth. Total pharmacy claims processed increased by 3.9% above prior year and 5.7% when excluding COVID-19 vaccinations primarily attributable to new business in 2022. Increased utilization and the impact of an extended cough, cold and flu season.

Total pharmacy membership grew sequentially exceeding 110 million members as growth in commercial and government lives more than offset significant membership losses from the California Medicaid carve-out that started this year. Adjusted operating income of \$1.9 billion grew 5.7% year-over-year, driven by improved purchasing economics, reflecting increased contribution from the products and services of our group purchasing organization and membership growth.

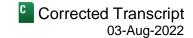
These favorable items were partially tempered by ongoing client price improvements as well as \$55 million of restructuring and integration costs. Year-over-year contributions from our 340B product lines declined inside the quarter as covered entities were slower to agree to manufacturer conditions than we had previously estimated.

In our Retail/Long-Term Care Segment, higher than projected COVID-related volume combined with strength in pharmacy and front store sales helped to drive strong results. Specifically, during the second quarter, revenue of \$26.3 billion grew 6.3% year-over-year reflecting increased prescription and front store volume, including increased sales of COVID over-the-counter test kits and cough, cold and flu products.

Adjusted operating income of \$1.9 billion declined 9.1% versus prior-year partially due to a \$125 million gain from an anti-trust legal settlement recognized in the second quarter of 2021 as well as lower COVID-19 vaccine volumes. Additional drivers include strength in pharmacy and front store sales, improved generic drug purchasing and the favorable impact of business initiatives during the quarter. These positive factors were offset by ongoing but stable reimbursement pressure, and business investments including the minimum wage increase and store improvements.

Pharmacy prescription volume grew 1.6% year-over-year reflecting increased utilization and cough/cold and flu volume extending later into the spring. Excluding the impact of COVID, pharmacy prescription volume increased by 4.6% year-over-year.

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Turning to the balance sheet. Our liquidity and capital position remain excellent. Year-to-date we generated cash flow from operations of \$9 billion and ended the quarter with \$5.8 billion of cash at the parent and unrestricted subsidiaries. During the quarter, we repaid \$1.5 billion of long-term debt. Further, in July, we announced that we will be executing a par call redemption on \$1 billion of November 2022 notes.

Yesterday, we also announced the par call on all of our notes due in December of 2022 for a combined total amount of \$1.65 billion of debt, representing the last of our outstanding maturities for this calendar year. Through our quarterly dividend we returned \$740 million to shareholders. We remain committed to maintaining our investment-grade ratings while also having the flexibility to deploy capital strategically for capability-focused M&A.

A few other items worth highlighting for investors. Adjusted EPS in the second quarter was impacted by reserve strengthening of \$108 million in our legacy long-term care insurance business. This adjustment, which represented the first time we have significantly adjusted this reserve since the Aetna acquisition, is included in adjusted operating income for our corporate other segment and lowers total company adjusted EPS by \$0.06 in the quarter.

From a GAAP reporting perspective, in June, we also completed the previously announced sale of PayFlex, which resulted in a pre-tax gain of \$225 million in our second quarter financials. Consistent with past practice, this gain has been excluded from our adjusted operating metrics.

Turning to our 2022 outlook. We are raising our adjusted earnings per share guidance by \$0.20 to a range of \$8.40 to \$8.60. This increase reflects both the second quarter performance and an improved outlook for the Retail/LTC segment, as well as strong second quarter underwriting results in the HCB segment, tempered by \$140 million to \$180 million of lower net investment income contributions over the remainder of 2022 given the uncertainty and volatility of the current capital markets.

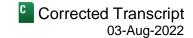
As such, we are maintaining our full year adjusted operating income guidance in Health Care Benefits of \$5.94 billion to \$6.04 billion. This reflects the aforementioned strong underlying fundamental performance, offset by \$110 million to \$145 million of lower net investment income contributions over the remainder of 2022, as the vast majority of our net investment income is generated in our Health Care Benefits segment.

Our updated outlook also contemplates the extension of the public health emergency through the end of 2022. We are raising full year Retail/LTC guidance as follows. Revenue increases to a range of \$101 billion to \$102.7 billion, adjusted operating income guidance increases by \$575 million at the midpoint to a range of \$6.54 billion to \$6.64 billion. We now forecast that we will administer nearly 20 million COVID-19 vaccinations in 2022 with approximately 75% already administered in the first half of 2022. We expect full year diagnostic testing volumes of approximately 19 million and sales of over-the-counter test kits to more than double compared to prior year exceeding 50 million units.

In aggregate, we expect these three categories of COVID-driven items to now produce nearly \$3 billion of revenue in 2022. A decline of approximately 33% versus 2021 but indicative of the endemic tail of COVID on our retail business.

Our updated outlook also includes a provision for higher levels of investment spending in the back half of the year as we prepare for a potential late year increase in COVID cases and includes continued investments in our workforce and to enhance our customer experience.

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In Pharmacy Services, we now expect to be at the low-end of our full year adjusted operating income guidance range of \$7.31 billion to \$7.45 billion based on the following factors. The continued strength from our core capabilities including purchasing economics and strong network volumes where we have increased the midpoint of our range by 50 million scripts, being pressured by the restructuring and integration costs I previously mentioned and a reduced outlook for our 340B business resulting in a contribution that will be down compared to prior year.

Looking at the enterprise as a whole, due to our sustained operating momentum, we anticipate continued strong cash from operations in 2022 and have raised our guidance to a range of \$12.5 billion to \$13.5 billion with capital expenditures unchanged at a range of \$2.8 billion to \$3 billion. We are raising our full year adjusted effective tax rate guidance from 25.6% to 25.7%, primarily a result of the discussed changes to our investment income outlook.

Finally, as we evaluate the progression of earnings for the remainder of the year, we continue to remind investors that we project that earnings per share will be fairly evenly split between the third and the fourth quarters. All other guidance shared during our first quarter earnings call remains unchanged. You will find additional details regarding our updated guidance in the slide presentation we posted to our website this morning.

To conclude, our second quarter results reflect continued strength from all of our core business segments and we are pleased to raise our full year 2022 adjusted EPS guidance. Our focus on growth and operational execution continues and we continue to progress on our long-term strategy. We remain committed to the EPS targets implicit in our long-term model, including as we look to 2023.

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

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] Thank you. We'll take our first question from Ricky Goldwasser with Morgan Stanley. Your line is now open.

#### Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Yeah. Hey. Good morning and congrats on a great quarter. So my question, Karen and Shawn, is how are you thinking about your primary care strategy on the heels of the recent M&A news and sort of really hit on the balance between organic and sort of the inorganic comments that you referred to, Karen, in your prepared remarks.

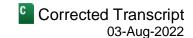
### Karen S. Lynch

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

Hi, Ricky. First of all, let me say congratulations and it has been a pleasure working with you and we want to on behalf of the entire CVS leadership team wish you all the best in your future endeavors.

Relative to your question, first, let me remind you that we are the largest provider of retail health services in the nation and having said that, we have a strategy that is, we are expecting to enhance our health services in three categories, as you mentioned, primary care, provider enablement and home health. And as we've talked about in the past, there are multiple pathways for us to make a mark on our community health care and our ability to

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achieve our strategic goals. And as we've talked about before, Ricky, we have very specific criteria that we look at as we're evaluating our many options.

We look to see if there's a strong management team which we're looking to see if there's a very strong tech stack. Obviously, the ability to scale, given the size of the company that we are, and a pathway to profitability. And as you know, Ricky, M&A can be very fluid. You don't necessarily design exactly how these deals and what gets announced. We are committed to extending our health services in categories, and we are very encouraged and confident that we'll take the next step on this journey by the end of this year.

As you would expect, we are being very disciplined both strategically and financially as we pursue kind of our M&A strategy. We can't be in the primary care without M&A. We've been very clear about that and let me ask Shawn to talk a little bit more about the specific market dynamics.

#### Shawn M. Guertin

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

Yeah, thanks, Ricky, for the question. So we've been very active in evaluating a wide range of assets in and around the care delivery space. And what I would reiterate is that our priority areas remain primary care, provider enablement and home health. It's really of paramount importance and a capability-based play that we fully evaluate their defining characteristics, which would include their capabilities to drive real and lasting value. The financial dynamics of these different business models and the optionality and growth levers that they provide us with, including our own ability to deploy our existing assets and create value in these entities.

And as Karen mentioned, we've consistently stated that there are multiple pathways to follow to achieve our vision. Our vision is something new and differentiated as you know, and thus, there is no one and done asset there. And so, while certainly no asset is perfect, there are differences, as Karen highlighted, when you look at the criteria amongst the available assets particularly in terms of financial performance, the opportunities for future growth and our ability to drive value.

I continue to believe that we can execute on our strategic vision via M&A and begin to execute on that vision in 2022. And the strength of our capital generation is part of what makes this possible, but also provides a powerful lever to supplement our core earnings via share repurchase, and I think we can still – it still remains our goal to commit to the targets that we talked about at Investor Day for 2023 and 2024.

#### Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

So, let me just ask a quick follow-up here. Thinking about your existing asset base and footprint in access point, as you sort of evaluate additional assets to add to your portfolio that will really sort of enable that perfect long-term strategy. Maybe you can share with us sort of kind of how are you thinking about sort of...

### Karen S. Lynch

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

Ricky, we're having a hard time hearing you.

### Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Oh, sorry, can you hear me now?



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Corrected Transcript 03-Aug-2022

Karen S. Lynch

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

Yeah, a little bit better. Thank you.

Ricky R. Goldwasser

Analyst, Morgan Stanley & Co. LLC

Great. So, as we think about your existing assets driving the footprint in the access points, how are you thinking about kind of like what will really kind of like move your long-term strategy? Is it sort of owning or acquiring a primary care provider, [ph] is it versus (31:43) that kind of like enabling technology that can connect it all together?

Karen S. Lynch President, Chief Executive Officer & Director, CVS Health Corp.

Yeah, Ricky, I think there's a number of ways for us to think about kind of our overall strategy and I'd just go back to, we're looking at capabilities, obviously, in the primary care space, in the home space, and in the provider enablement space. So, it's a combination of all those, and as Shawn said, it's not a kind of one and done activity. We'll continue to evaluate a number of these options.

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

Yeah. And I think, Ricky, it is both, right. We do need both, and I think part of this is because it goes back to this sort of achieving sort of a new and differentiated vision. You need a platform to do that from, right. So, it is a set of extant businesses and assets that you can begin to work with, but it's also the platform and the technology and what that - you can then use that to springboard to do new and better things. And I think that's why we really need to move on both fronts with equal importance, really.

Karen S. Lynch President, Chief Executive Officer & Director, CVS Health Corp.

Yeah. And I think, Ricky, the important point to make here is that we have a very strong foundation with the assets that we have, and that's evidenced by the strength that we're seeing in our retail health operation. We had

12% increase in MinuteClinic visits just this quarter (sic) [year to date], so a lot of opportunity from the strong foundation that we already have.

Ricky R. Goldwasser Analyst, Morgan Stanley & Co. LLC

Thank you, and for the best wishes as well.

**Operator**: Thank you. Our next question will come from Lisa Gill with JPMorgan. Your line is now open.

Lisa C. Gill Analyst, JPMorgan Securities LLC

Great. Good morning and thank you. Karen, I want to start with the current economic environment and how you're thinking about the overall 2023 selling season. So, you talked about a strong selling season on the PBM side. But maybe if you or Alan could maybe talk a little bit about what are commercial employers looking for. How are you thinking about employment trends?

You talk about the different assets that you have. I know you have a new Virtual Primary Care offering that you have in the marketplace. It's almost been four years since Aetna and CVS came together. So, can you maybe just talk about where you see different plan design going in 2023 and what you're hearing from employers in the marketplace today as we think about really bringing all of these assets together as a whole entity?

Karen S. Lynch

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

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Yeah. So, hi, Lisa. I would say what we're seeing, and I said in the prepared remarks, we're having very strong retention results in all of our businesses, through our national accounts and through Alan's businesses as well. What we're seeing is continued focus on access, lower sites of care, continue to look at cost where obviously employers are still interested in making sure that they're low-cost, flexibility, and really strong service, and that's really consistent across kind of the entire portfolio.

What we're seeing is we continue to see very strong results with our integrated offerings. We've had very good results. I think we've benefited from having a integrated sales team out in the market selling our products and capabilities. So, we're pleased with kind of what we're seeing in the market. Obviously, it's been a somewhat dampened pipeline across both businesses, so we've been, as I mentioned, having very strong retention. But let me ask Dan and Alan to give you a little more color on what they're seeing specifically as they're in the markets and selling business, and I'll start with Dan.

Daniel P. Finke

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



Yeah, thanks, Karen. I think you said it well. Look, we're having really good conversations and the top of the house is all about controlling cost, access and consumer experience. As you think about how that value shows up in those conversations, it shows up in some of our integrated benefit designs and cross-sell opportunities. You can see that we're solving some of those access points with the no-cost/low-cost MinuteClinic benefit.

We're also seeing it show up in new products and services, like our Transform diabetes and oncology program. And then, Lisa, you mentioned our Virtual Primary Care. It's not just about Virtual Primary Care. It's about total virtual care, and so offering solutions across the enterprise for virtual care, and then really lastly, good conversations about how we're using our local resources like MinuteClinic, like the pharmacists for access points as well.

Alan M. Lotvin

А

Executive Vice President, CVS Health, and President, CVS Caremark., CVS Health Corp.

Yeah. So, Lisa, it's Alan. I'll just add two things. One, we've certainly seen at the larger ends of the market, the benefit managers focusing on bringing people back into the office post-COVID. And so we have seen contracts that we thought might go out in 2023 and pushing out to 2024 and sometimes 2025. So I think that's the first thing.

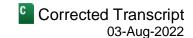
I think the second part would be, we see a continued desire for transparency, for cost controls particularly in specialty and for kind of digital connectivity and the ability to interact with members sort of in that really critical moment when they are renewing a prescription, they are thinking about their health. So, all those things are resonating particularly in those areas of the market that are still very active.

Lisa C. Gill

Analyst, JPMorgan Securities LLC



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Alan, you touched on specialty, and I think you guys are the biggest player, obviously, Humira will have biosimilars come to the market next year. Is that a conversation you're having with planned sponsors and how do we think about that? Is that going to be a big driver say 2024 as you think about the PBM?

Alan M. Lotvin

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Executive Vice President, CVS Health, and President, CVS Caremark., CVS Health Corp.

Yeah. So two things, Lisa. One, as you look out, it's more than just – everyone's focused on 2023 and Humira, but if you look out over the next seven or eight years, there's about \$100 billion of product that's going to lose market exclusivity. We've started talking with our clients about biosimilars back in the Basaglar day, so three, four years ago. So, we've both prepared the market for, we've articulated the strategies around lowest net cost and are continuing to work with our clients.

So, I do think that as we create – as more competition comes into the market historically, that's always been very, very good for our customers, and generally when, as I've said many times before, when we create value for our customers, they generally are happy to pay us for it. So, I do think this is going to be a substantial impact in the PBM industry over the next seven, eight years.

Lisa C. Gill

Analyst, JPMorgan Securities LLC

Great. Thank you.

Shawn M. Guertin



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

Yeah, Lisa, the one thing I would add, you did ask specifically about some of the componentry on 2023 and I think it makes sense to just offer some high-level comments on sort of the broader context I think that we see for 2023. And obviously, I'm not providing specific 2023 guidance here. But I'd expect the construct of 2023 to be one of higher adjusted operating income in PSS and HCB given some of the things that Dan and Alan were just talking about. And then given a 2020 retail COVID-19 outlook that's nearly double our initial expectations, I'd expect that we'd see lower earnings year-over-year in retail.

Below operating income, given the activity we'd expect lower interest expense and a flat share count, but I would say overall at this stage, again, I'd reiterate that we remain committed to the delivering on the adjusted EPS targets for 2023 and 2024 that are implied by our December Investor Day guidance and as reflected in current consensus estimates.

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

A.J. Rice

Analyst, Credit Suisse Securities (USA) LLC

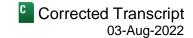
Hi, everybody. Maybe first, just to ask about your experience with the front-end store and the retail side. That continues to be quite strong even though I think there had been an expectation it would moderate this year. And I assume at home test is a part of that. Can you parse that out and then also just say anything you will about sort of the underlying growth and where you're seeing the strength?

Shawn M. Guertin

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

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Yeah, A.J., I'll – let me just offer some kind of a frame for the quarter's performance, which you are absolutely right. We've continued to see underlying strength in both the front and the back of the store beyond COVID. In the quarter itself, I would say about 60% of our outperformance in retail was really driven by those kind of COVID categories that we talk about.

But the remainder which is still a substantial amount is actually sort of the core strength in sort of the front store and the retail pharmacy operations. And obviously, OTC kits are a big part of the story, as I mentioned in my remarks, but I'll turn it to Michelle to add more detail on what's going on in the retail operation.

#### Michelle A. Peluso

Chief Customer Officer, EVP & Co-President-Retail, CVS Health Corp.

Yeah, we're really proud of the strength we've seen in the front store. That's come from a mid-single-digit increase in trips and also, a mid-single-digit increase in average basket size. And as Shawn said, while sort of cough/cold COVID was part of that and a strong part of that, we did see strength across all categories. I would just say two things. We think the momentum is the result of our continual pivot to fulfill the strategy we laid out at Investor Day to serve as local community health and wellness destinations. And secondly that our investments are paying off.

We're uniquely positioned in an omni-channel world and so our strong digital assets plus our community presence and our investments in things like Buy Online, Pick Up in Store, Omni pharmacy, they're accelerating or helping to fuel our growth.

We've also redesigned cvs.com which is driving much stronger engagement. We're modernizing our fleet and investing in smart supply chain infrastructure, so smart automation is helping us fuel our in-stock position which we feel good about. And then finally, really doubling down on service to ensure we're most trusted in the community. That trust is a core part of our enterprise strategy as you know, and just a small note, we were happy to see Morning Consult's recognition of CVS Pharmacy as the most trusted brand in retail and actually one of the most trusted brands across every industry. So, solid performance and we think we're well-positioned as we head into next year.

#### A.J. Rice

Analyst, Credit Suisse Securities (USA) LLC

Great. Thanks. And on the – maybe just quickly on Medicaid re-verifications, updated thoughts there about the timing on when that may go into effect, what your exposure might be and have you done any analysis about your ability to recapture either through the marketplace or the commercial market, some of those members that may lose coverage via Medicaid.

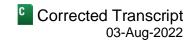
#### Shawn M. Guertin

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

Yeah, A.J., so now, we're assuming obviously that the redeterminations really won't happen until next year of any kind of magnitude, obviously with the extension of the PHE assumption in our guidance. We estimate we've added about 400,000 to 500,000 members as a result of that. And this is a, I put a caveat, it's a difficult thing to estimate on the retention side, but we might retain 25% plus or minus of that membership.

Obviously, our individual exchange footprint is expanding but still limited in the scope of our overall Medicaid block. So, some of that will help, but still, obviously, a lot to play out. And then obviously – so this activity, obviously, will be more of a 2023 activity now than 2022, which we had talked about a quarter ago.

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#### A.J. Rice

Analyst, Credit Suisse Securities (USA) LLC

Okay, great. Thanks a lot.

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

Michael Cherny

Analyst, BofA Securities, Inc.

Good morning, and congratulations on a nice quarter. Shawn, I appreciate the early color that you provided on 2023. I just wanted to maybe take a step back real quick. Any changes to think about relative to the baseline in terms of what you've reported and how to think through the dynamics of where you sit right now? And I guess along those lines, as you think about the implied guidance into the end of the year, how do the moving pieces on COVID potential for increased costs in Health Care Benefits versus potential upside as boosters and vaccines and testing continue in the store. How do those factor into where we should be considering the jumping off points next year?

Shawn M. Guertin

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

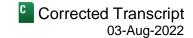
Yeah, so there's a lot – there's a lot in there in terms of moving parts, right. The classic sort of baseline adjustments that we would make, the prior-year's development, that's probably in the neighborhood of I think about \$0.12 right now on a year-to-date basis. The big driver here, right, is the thing that last year was realized capital gains, this year it's realized capital losses. And we have about \$175 million recognized losses year-to-date, and obviously, year-over-year investment income, so that's a story that will play out through the second half of the year, and one that we're going to need to refine expectations on a net investment income for 2023 just with all of the moving parts.

Obviously, there were – we did talk about sort of the one-time adjustment that we had related to the long-term care insurance business that's worth about \$0.06. So those are some of the big baseline pieces and then you sort of now pivot to I think sort of the COVID-moving parts between Retail and HCB.

I think for HCB, as I mentioned, we're at a point where we've priced this. We're three-years away from sort of the last time we had a baseline without COVID and this really, I think, has to kind of come down to the way we've always talked about this business traditionally, right? This is about kind of matching our prudent price increases across all of our products with our expected cost trends and kind of managing the revenue growth and operating margin dynamics and I think we're in a very good place right now for 2022 on that front, and then as we position for 2023.

I think on Retail, while again, it's logical to think that given the level we're at this year that we'll go backwards. I think our thinking is we still have sort of an endemic tail and a contribution in 2023, and I think we still anticipate that that business can perform at a baseline level that's consistent with what we talked about on Investor Day from sort of the jump off point of around \$6 billion, that's still something that we can operate around in that business. So there's still a lot to be played out, obviously here in terms of where we go with future recommendations, obviously, around boosters.

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So – but I do feel good that we've got our – we were in a positive pricing position, I think, right now in HCB as we think about sort of pricing for COVID and obviously, I think we're in a good position in terms of serving the communities and continuing to serve the communities on the COVID front.

Michael Cherny

Analyst, BofA Securities, Inc.

Thanks. I'll leave it there. Appreciate it.

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

Justin Lake

Analyst, Wolfe Research LLC

Thanks. Good morning. First off, let me say congrats on hiring Larry McGrath. He's the best. Congrats, and then second, just on – wanted to ask couple of question on PBM. Specifically, there's a lot of questions in terms of how the drug pricing provisions on the Inflation Reduction Act might impact PBM. I was hoping to get some color there.

And then Shawn, you mentioned the headwind from 340B. Anyway to size that for us, and then thinking about how that might roll into next year, would it fully annualize this year? Or could that be a forward headwind to 2023? Thanks.

Alan M. Lotvin

Executive Vice President, CVS Health, and President, CVS Caremark., CVS Health Corp.

So, Justin, it's Alan. Thank you. So first on the drug pricing provisions. They're sort of limited. If you look at the details, it's 10 drugs in 2026 and 20 by 2029, and if you look at the way the language is structured, it would articulate that these are all products that are unlikely to have material competition, so I think the overall impact is going to be, it'll be positive in the sense that pricing will come down for those products in advance of competition, but I don't think the impact on the overall model is going to be substantial just given the nature of the way the definition of which drugs fall in work. That's the first part.

The second part, with respect to 340B, as you know, there've been a lot of changes to the way that program has operated and essentially, if you boiled it down, there are two critical decisions/actions on behalf of the covered entities. In order to re-access the financial value, which, as I know you know, is critically important to many of those critical access hospitals to maintain their financial viability, they need to start providing a certain level of data on contract pharmacies to the pharmaceutical industry.

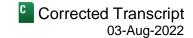
Their decision-making process is somewhat slower than I think people expected, and then the ability to turn that data on is a little bit slower, but we're seeing steady decision-making and steady expansion of the number of hospitals that are doing it, and we expect that that will continue through this year and into next year.

Shawn M. Guertin

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

Yeah. And, Justin, just specifically to give you sort of a sense. I mean, as I mentioned in my remarks, we still think we'll be within the range, but probably in the lower half of that range for PSS, and the width of the midpoint to the bottom is a little more than \$100 million. And so, it's in that sort of ballpark sort of as the year-over-year sort of decrement, some of which by the way we experienced already a little bit in Q2, but about a quarter ago we thought this could come in flat year-over-year and now we think it'll be down a little bit year-over-year.

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

**Eric Percher** 

Analyst, Nephron Research LLC

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Thank you. I'll shift back to the Retail side. And a question really around COVID and the profitability of the vax scripts that you're seeing. I know you held some G&A cost early in the year given some of the increases in demand. Did you see a change in the level of G&A staffing you're able – or have to hold in Q2?

Do you find that the profitability on COVID scripts is moving up as you can staff for it? And then how does that flip as we think about the second half of the year? And I know you mentioned investments.

Shawn M. Guertin

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

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Yeah. So, Eric, I'd say, I mean, like sort of like anything that you do for a while, right, you get more and more efficient at how to do it. So I think on the margin directionally, that's sort of gotten better, but we've kind of taken the opportunity, obviously, with the results to think about how we continue to sort of invest in this business and invest in the customer experience, and make sure that we can provide sort of the staffing and all of the services and capabilities that we need on the Retail side. And so, we've made some provision for that in our thinking for the second-half of the year, and that sort of is incorporated in our outlook.

**Eric Percher** 



Analyst, Nephron Research LLC

And as you look at endemic, if we think about 10 million flu shots a year with relatively minimal change to the P&L during that season, do you get to a point where you're able to staff for this in the pharmacy by moving around what you already have or is there always an incremental? Do you think it becomes even more efficient?

Shawn M. Guertin

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

Yeah. No, I'll turn it to Prem, but I think...

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**Prem Shah** 

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

Yeah, we definitely can plan for it and as part of our modeling, we do that with flu season every year. I would say as we've gotten smarter with COVID, we continue to be very nimble with our models and being able to leverage our staff, whether they're doing prescription-related work or vaccination-related work. So we're continuing to do that really well, and we're also preparing for some of the Test to Treat that's come out from HHS for the back half of this year and a pilot and then going to scale throughout the year, so we feel really good about it.

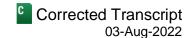
Shawn M. Guertin



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

Just let me go back because I want to make sure I didn't – Eric, since you usually ask about PBM, I'll use you to go back to Justin's question on the PBM. I want to make sure that I was clear and not confusing on something. My commentary about directional contribution on 340B was specific to 2022 in terms of like what was in our guidance. Obviously, as that volume comes back online, we'd expect a different result for 2023 going forward, so.

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Analyst, Nephron Research LLC

Thank you.

Operator: Thank you. Our next question will come from Brian Tanquilut with Jefferies. Your line is now open.

### **Brian Tanquilut**

Analyst, Jefferies LLC

Hey. Good morning, guys, and congrats on the quarter. I guess my question as we think about the front store – front end of the store, I mean, obviously, high inflation rates for product categories across the board. So, how are you thinking about – first, what you're seeing in terms of product inflation right now, where that's trending, and how are you thinking about that as it relates to the guidance? What assumption have you embedded for the revenue guidance going forward? Thanks.

### Michelle A. Peluso

Chief Customer Officer, EVP & Co-President-Retail, CVS Health Corp.

Yeah, let me start with what we're seeing and then turn it to Shawn on guidance. So, for the most part, we're able to pass inflation through to our customers. Having said that, we're super mindful to the environment where we want to make sure there's value on the shelf at all times for our customers, and we think about that in – of course, we think about that in terms of how we price, but it's a great time for our store brands. Our store brands on average are 20% to 40% below our national brands, so it's a great time for consumers to find value in our store brands.

We do have a lot of substitutability across categories, and last but not least, we have a very large lever with ExtraCare and CarePass on the – CarePass is up another 26% year-over-year. We have a great lever with ExtraCare and CarePass to make sure we're providing personalized coupons and deals so that our consumers see value on the shelf. So, while it's a good guide in terms of being able to price in, we're mindful of value and thinking about that really carefully across categories.

### Shawn M. Guertin

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

Yeah. And keep in mind that the significant majority of our revenue in the Retail segment is pharmacy driven, and we're not really seeing sort of the inflationary impacts that you kind of hear about in the headlines ripping through that segment. So, that's still more of the typical levels of pharmacy inflation that would be embedded in our outlook. And even within our front store product mix, sort of the inherent inflation rates in that kind of product mix is different and lower than sort of the big kind of gaudy headline numbers that you hear about in – kind of when they talk about inflation headlines, but again, it's really going to be the pharmacy sort of inflation assumptions that drive our revenue outlook.

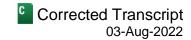
#### **Brian Tanquilut**

Analyst, Jefferies LLC

Awesome. Thank you.

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

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#### **Nathan Rich**

Analyst, Goldman Sachs & Co. LLC

Hi. Good morning. Thanks for the questions. Shawn, you mentioned the favorable cost trend versus expectations in the second quarter. Could you just give a little bit more detail on what drove that? And you didn't change the guidance for MBR for the full year. Is there any change to your thinking for how cost trend plays out in the back half of the year.

And then if I could ask a follow-up just upfront? I just wanted to clarify the new COVID assumptions. I was trying to follow the numbers and it seemed like maybe \$500 million of incremental revenue and \$200 million of incremental earnings, but if you could just clarify that, that would be great.

#### Shawn M. Guertin

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

Yeah, let me do that one first. It's significantly more than that. We're talking about \$3 billion. We've raised Retail revenue about \$2 billion, well more than half of that is related to these COVID categories, so it's a significantly bigger contribution for the full year on that, totaling about \$3 billion of revenue for the year, and as I mentioned, that's nearly double where we started the expectations for the year.

On the MBR front, now that's definitely positive. I'd still think our range is indicative of our performance in there, but obviously just on Q2, we're on the favorable side of that, and so that outlook remains I think very positive from an underlying standpoint. As I mentioned the product, sort of the way this is rolling out by-product has been very similar, commercial really consistent with our baselines and probably a little favorability on Medicare/Medicaid, but I'll ask Dan to comment a little bit on what we're seeing below that.

#### Daniel P. Finke

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

Yeah, let me give you just a little flavor of what we're seeing in some of the service categories. First of all, across all of the lines of business we are seeing the inpatient volume favorable. We're watching preventive care PCP visits and specialists and generally those have returned to normal levels. We've been really focused on making sure our members have access to preventive care throughout the pandemic.

ER is still slightly lower-than-expected and then when you think about the COVID costs overall as well, we did see a steady volume of COVID costs, but that had lower severity, lower length of stay and lower-cost overall, so just to give you a little flavor of the service categories.

#### Nathan Rich

Analyst, Goldman Sachs & Co. LLC

Great. Thank you.

**Operator**: Thank you. This does conclude the Q&A portion of today's conference. I would now like to turn the call back over to Ms. Karen Lynch for her closing remarks.

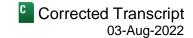
#### Karen S. Lynch

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

Before we conclude today, I just want to leave you with a couple thoughts. Our team is delivering meaningful progress on our strategy as we're striving to become the nation's leading health solutions company. We are



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confident that we'll continue to build on this powerful momentum through 2022 and 2023, and we look forward to continuing to update you on our progress. Thanks for joining the call today.

**Operator:** Thank you. This concludes today's CVS Health second quarter 2022 earnings call and webcast. You may disconnect your line. Have a wonderful day.

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