

CVS Health

WBA commentary incrementally positive for CVS' new reimbursement model

Reiterate Rating: BUY | PO: 95.00 USD | Price: 80.88 USD

The News: WBA addresses new reimbursement model

This morning, during Walgreens FY1Q'24 earnings call the company provided commentary addressing recent shifts to pharmacy reimbursement models. Walgreens noted that the company would welcome and will work with payer and PBM partners on any model that recognizes and reimburses pharmacies for the value provided for patients, including pharmacy services, as well as those models that can ensure more transparency and predictability in reimbursement. Additionally, WBA cited that it "could move to a cost plus model overnight".

Why It Matters: WBA support a + for new model odds

Comments by new CEO Tim Wentworth seem to indicate support for CVS' newly proposed reimbursement model. In our view, Walgreens support of CVS' new model would make it more difficult for PBM partners to push back and make it less likely PBMs could react by removing these pharmacies from its networks. For example, it would appear very difficult for a PBM to cut out both CVS and Walgreens pharmacies from networks given potential pushback by members. CVS and Walgreens represent about 25% of all pharmacies in the country. Importantly, PBMs have historically had substantial leverage against retail pharmacies. Recall that Walgreens left Express Scripts' network in 2012 after a dispute over reimbursement rates. This resulted in significant share losses for Walgreens and the pharmacy ultimately re-entered the network after only a few months. More than a decade later, we believe it would be materially more difficult for PBMs to threaten to remove both CVS and Walgreens from its networks given the combined market share of these two large pharmacies. Additionally, the growing problem of "pharmacy deserts" in parts of the country adds another challenge for PBMs that would create headline risk in the event major pharmacies were removed from networks. Furthermore, we see less likelihood that smaller pharmacies would go against a new model as it could help improve reimbursement rates (although this represents the biggest risk to broader adoption at this time). Net net, we view Walgreens commentary as incrementally positive for CVS' new reimbursement model. We reiterate our Buy rating on CVS.

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Stock Data

Price	80.88 USD
Price Objective	95.00 USD
Date Established	2-Jan-2024
Investment Opinion	B-1-7
52-Week Range	64.41 USD - 93.41 USD
Mkt Val (mn) / Shares Out (mn)	104,084 USD / 1,286.9
Free Float	99.8%
Average Daily Value (mn)	648.35 USD
BofA Ticker / Exchange	CVS / NYS
Bloomberg / Reuters	CVS US / CVS.N
ROE (2023E)	15.0%
Net Dbt to Eqty (Dec-2022A)	55.1%
ESGMeter™	High

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PBM – pharmacy benefit manager

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Timestamp: 04 January 2024 10:28AM EST

Price objective basis & risk

CVS Health (CVS)

Our \$95 price objective is based on about 11x our CY24 EPS estimate. This multiple is below the five-year average on an absolute basis and near the lower end of the historical range of 10.0x-17.5x. This also represents a bigger discount to the S&P500 vs. the last five years. The discount reflects margin pressure across CVS's core Pharmacy Services and Retail Pharmacy segments and uncertainty around drug prices.

Downside risks to our PO are failure to generate expected benefits from the Aetna combination (or have any regulatory issues in a highly regulated business), growing competitive risks in the pharmacy benefit market (including competitive pricing around rebates), business disruption tied to Covid any potential impact from ongoing opioid-related investigations, any issues with the closing and integration of the pending Signify Health/Oak Street transactions, costs and mitigation efforts needed to address the lost Stars ratings for CVS' MA plans, potential regulatory risk across the HCB and Pharmacy Services businesses, a slowdown in 340B, and slowing prescription/insurance trends. Upside risks to our PO are any potential prescription volume pickup, faster and stronger than expected synergies from Aetna, biosimilar contributions, and improving front-end performance (including better attach rates post-Covid).

Walgreens Boots Alliance (WBA;B-3-7;\$22.89)

Our \$22 price objective is based on about 6.5x our CY24E EPS. This multiple is below its five-year average on an absolute basis of around 11x. The discount to the five-year average reflects our view that Walgreens' core retail pharmacy business is under long-term structural pressure and must diversify into stable business lines to improve the growth outlook.

Upside risks are better-than-expected generic savings from new partnerships in healthcare and other areas that support long-term growth, contributions from additional new partnerships and strategic investments for Walgreens Health (including Summit Health), and faster recovery in overall script trends.

Downside risks to our PO are ongoing pricing and reimbursement pressure, higher prescription attrition from Part D relationships, uncertainty on front end and pharmacy sales during the Covid outbreak, ongoing growth and profitability pressure within the Retail International business, incremental spending tied to building out the Walgreens Health platform (including investments in Summit Health), the risk of a disruptive force entering the supply-chain market, a slowdown in 340B, various opioid trials that could include financial penalties, and lack of available/appealing attractive capital deployment opportunities.

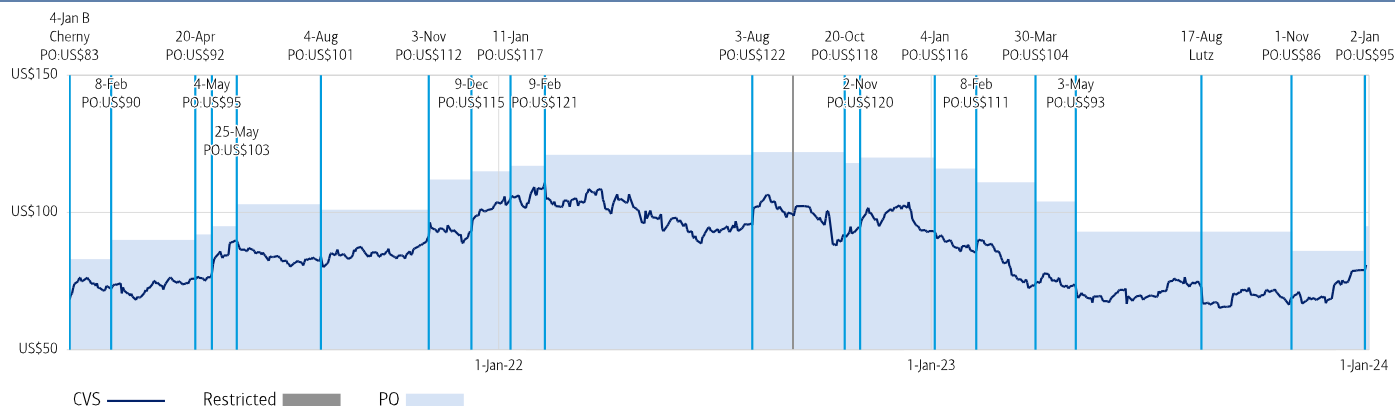
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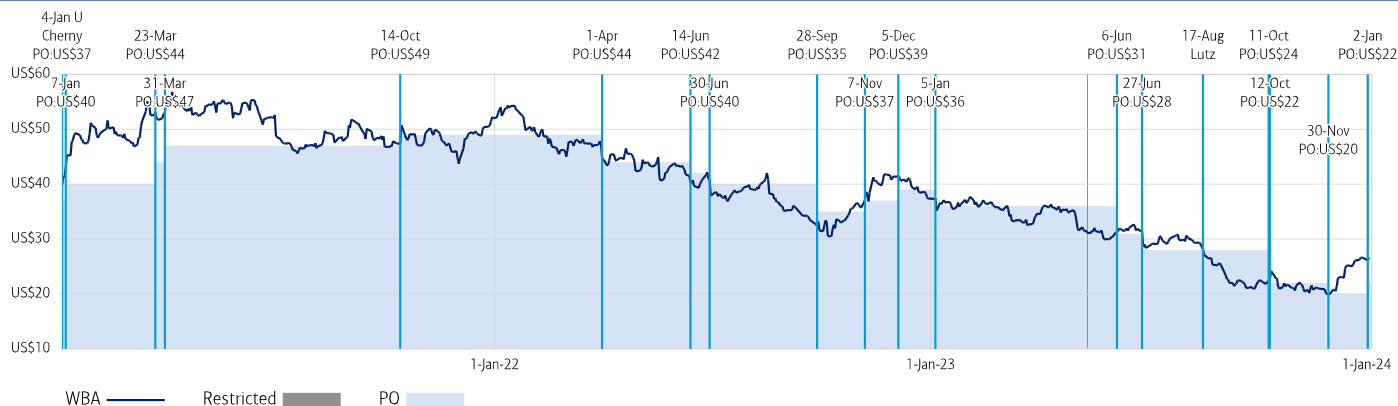
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CVS Health (CVS) Price Chart



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Walgreens (WBA) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
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