

CVS Health (CVS)

\$71.37 (As of 02/14/20)

Price Target (6-12 Months): **\$75.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/22/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: B

Momentum: D

Summary

CVS Health ended the fourth quarter with better-than-expected numbers. The year-over-year improvement in the top line was fueled by strong growth in the Pharmacy Services segment, which benefited from the upside in specialty services. The company's recently-introduced Health Care Benefits segment, following the Aetna acquisition, also holds immense promise. Additionally, solid year-over-year Retail/LTC comparisons were impressive. Strong expansion of both margins further buoys optimism on the stock. The expansions of MinuteClinics and HealthHUBs during the quarter are also encouraging. Over the past six months, CVS Health has outperformed its industry. However, the LTC business is facing some industry-wide challenges. Reimbursement risk continues to be a dampener.

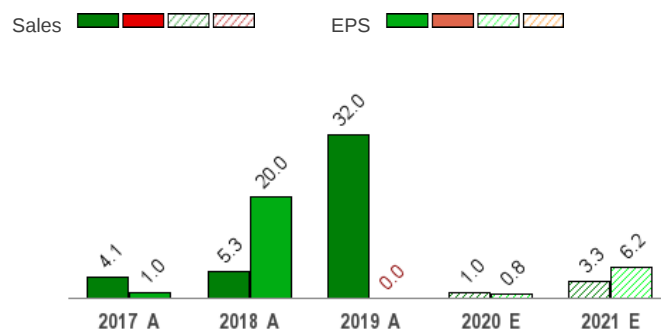
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$77.03 - \$51.72
20 Day Average Volume (sh)	7,341,151
Market Cap	\$92.8 B
YTD Price Change	-3.9%
Beta	0.93
Dividend / Div Yld	\$2.00 / 2.8%
Industry	Retail - Pharmacies and Drug Stores
Zacks Industry Rank	Top 23% (58 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	3.0%
Last Sales Surprise	4.2%
EPS F1 Est- 4 week change	-0.5%
Expected Report Date	NA
Earnings ESP	-0.7%
P/E TTM	10.1
P/E F1	10.0
PEG F1	1.4
P/S TTM	0.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	65,523 E	66,998 E	67,921 E	68,486 E	268,049 E
2020	63,293 E	64,737 E	65,621 E	66,346 E	259,369 E
2019	61,646 A	63,431 A	64,810 A	66,889 A	256,776 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.76 E	\$1.96 E	\$1.93 E	\$1.92 E	\$7.58 E
2020	\$1.62 E	\$1.86 E	\$1.84 E	\$1.83 E	\$7.14 E
2019	\$1.62 A	\$1.89 A	\$1.84 A	\$1.73 A	\$7.08 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/14/2020. The reports text is as of 02/18/2020.

Overview

Headquartered in Woonsocket, RI, CVS Health Corporation (formerly known as CVS Caremark Corporation) is a pharmacy innovation company with integrated offerings across the entire spectrum of pharmacy care. On Sep 3, 2014, CVS Caremark Corporation announced a change of its corporate name to CVS Health to reflect its broader health care commitment.

In Nov 2018, CVS Health completed the \$70-billion consolidation of insurance-giant Aetna. With the acquisition, the segments of CVS Health have been realigned.

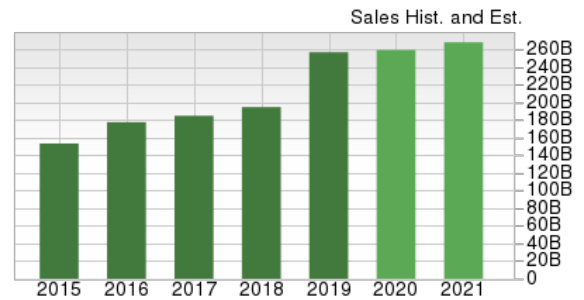
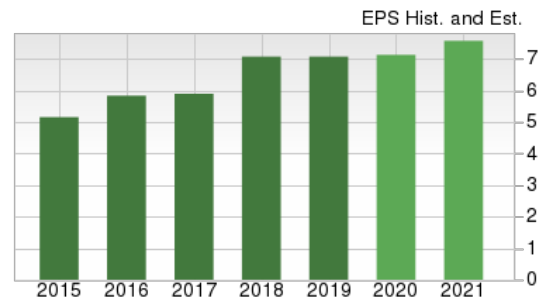
Effective first-quarter 2019, the company's SilverScript Medicare Part D prescription drug plan (PDP) has shifted from the Pharmacy Services segment to the Health Care Benefits segment. In addition, the mail order and specialty pharmacy operations of Aetna have been transitioned from the Health Care Benefits segment to the Pharmacy Services segment.

CVS currently has four reportable segments: Pharmacy Services, Retail/Long Term Care (LTC), Health Care Benefits and Corporate/Other.

The Pharmacy Services segment provides a full range of pharmacy benefit management ("PBM") solutions, including plan design offerings and administration, formulary management, retail pharmacy network management services, mail order pharmacy, specialty pharmacy and infusion services, clinical services, disease management services and medical spend management.

The Retail/LTC segment sells prescription drugs and a wide range of general merchandise, including over-the-counter drugs, beauty products, cosmetics and personal care products, health care services through its MinuteClinic walk-in medical clinics and conducts long-term care pharmacy operations, which distribute prescription drugs and provide related pharmacy consulting and other ancillary services to chronic care facilities and other care settings.

The Health Care Benefits segment offers a broad range of traditional, voluntary and consumer-directed health insurance products and related services, including medical, pharmacy, dental, behavioral health, medical management capabilities, Medicare Advantage and Medicare Supplement plans, PDPs, Medicaid health care management services, workers' compensation.



Reasons To Buy:

- ▲ **Share Price Performance:** Over the past six months, CVS Health outperformed its industry. The stock gained 16.3%, in comparison to the 11.5% growth of the industry. The company posted better-than-expected results for the fourth quarter, demonstrating successful execution of its priorities. This led to all three of its segments performing in line with or above its expectations. Going by these priorities, CVS Health is currently on track to make approximately 50 hubs operational by the year-end along with its original plan to have 1,500 hubs by the end of 2021. The company has already started to witness increased customer traffic, and incremental sales in pharmacy front store and MinuteClinics.

In terms of segmental performances, year-over-year growth in the top line was driven by strength in the Pharmacy Services segment, benefiting from the upside in specialty services. The company's recently introduced Health Care Benefits segment, following the Aetna acquisition, is showing strong momentum, particularly in the government product portfolio.

- ▲ **Health Care Benefit shows Potential:** Following the colossal acquisition of health insurance giant Aetna for a colossal sum of \$70 billion, CVS Health has introduced a new business arm called Health Care Benefits. This segment has already started to show strong momentum, particularly in government business.

Revenue growth in the segment during the fourth quarter was driven by strong membership growth in the company's government product portfolio, expansion of its Medicare Advantage business and successful synergy benefit coming from the Aetna integration. In the fourth quarter, revenues were in line with the company's expectations.

In this regard, we note that, CVS Health expects to earn \$750 million from near-term synergies of Aetna integration with low to mid-single digit accretion in the second year post the transaction's closure. Per the company, shareholders can look forward to several outcomes with respect to near-term synergy including enhanced competitive positioning and a new combined platform that might redefine access to high-quality care at low cost, substantially accelerating the consolidated business' growth.

- ▲ **PBM business gaining traction:** With regard to its 2021 PBM selling season, CVS Health has noted that, till the end of the fourth quarter, it has completed approximately 65% of renewals with strong retention. This includes the extension of the FEP contract through 2021, and the renewal of the WellCare contract through 2023.

Meanwhile its 2020 selling has already completed. Since the third-quarter earnings call, net new business improved by \$2.8 billion which includes the retention of a larger portion of the Centene contract as well as additional client wins. CVS Health noted that, it has extended its contract with Centene through 2022.

According to CVS health, service levels and performance metrics are currently remaining at historically high levels and the company expects to return to its historical retention levels in future periods.

- ▲ **Specialty pharmacy – a high-growth avenue:** The soaring demand for specialty pharmacy, especially in the on-going decade, is likely to accelerate growth for the company. Within Pharmacy Services, total revenues increased 6.2% year over year in the fourth quarter, exceeding the company's expectations. The upside can be attributed to increased volume of claims, brand inflation and growth in specialty services like IngenioRx.

Shift of Aetna's mail order and specialty operations to its Pharmacy Services segment during the fourth quarter also benefited the segment.

We are also positive on the company's newly developed comprehensive set of programs to effectively manage specialty trends, which includes formulary exclusion strategy. According to recent data, 3 million people in the U.S. are currently in need of specialty treatment while the potential cost of treatment tends to be very high. With management's notification that the company's specialty business remains a top priority for customers, we believe CVS Health is well positioned to capitalize on that opportunity based on its broad, differentiated offering which includes the likes of Specialty Connect. Moving forward, management expects drug price inflation, new product launch, higher utilization and new PBM clients to fuel growth. We expect the segment to serve as a stable growth platform going forward.

- ▲ **Retail on a Growth Track:** Over the last few quarters, the retail Long Term Care business registered positive revenue growth after several quarters of drag.

The business witnessed year-over-year growth of 2.5% in the fourth quarter, in line with the company's expectation. Strong growth was primarily driven by higher prescription volume and brand name drug price inflation. Front store revenues within the Retail/LTC segment grew in the fourth quarter, primarily banking on increased sales of health and beauty products. The company delivered strong adjusted script growth of 5.6%, with comp scripts up 6.9%, primarily driven by the consistently strong adoption of patient care programs.

Going forward, Retail is expected to continue to deliver strong adjusted script growth in the range on successful execution of pharmacy clinical care program that drive improved adherence and patient retention. CVS Health is experiencing growth in the Medicare partnerships it formed in recent times, as well as a few new regional preferred relationships in 2019.

- ▲ **Strong Balance Sheet:** CVS exited 2019 with cash and cash equivalents of \$5.68 billion, compared with \$4.05 billion at the end of 2018. Cumulative cash flow from operating activities at the end of 2019 was \$12.84 billion compared with \$8.86 billion at the end of year-ago period.

Increasing demand for PBM and specialty pharmacy along with significant growth observed in the retail business are encouraging.

Reasons To Sell:

- ▼ **Near-term challenges to Impede Growth in 2020:** For CVS Health, the year 2019 was a transition year that primarily focused on the colossal integration of Aetna. This accordingly, had certain adverse impacts on the year's operating income of its Pharmacy Services and Retail/LTC segments compared to 2018.

Ongoing pharmacy reimbursement pressure in the Pharmacy Services and Retail/LTC segments and reductions in the traditional offsets to those pressures, including a declining benefit from the introduction of new multi-source generic prescription drugs and lower benefits from generic dispensing rate increases.

These challenges are expected to persist through 2020 as well.

The reimbursement pressure in the Pharmacy Services segment is projected to be exacerbated by the cumulative effect on rebate guarantees of lower brand name drug price inflation and a modest selling season.

The Retail/LTC segment is projected to be impacted by structural and company specific challenges in the long-term care space as well as the annualization of the company's 2018 investment of a portion of the savings from the Tax Cuts and Job Act in wages and benefits.

- ▼ **Risk Related to Reimbursement Reduction:** A significant portion of CVS Health's net revenue is derived directly from Medicare, Medicaid and other government-sponsored health care programs. The company is therefore subject to federal and state reimbursement laws and regulatory requirements, anti-remuneration laws, the Stark Law and/or federal and state false claims laws. According to the company, the continued efforts of health maintenance organizations, managed care organizations, PBM companies, government entities, and other third party payors to reduce prescription drug costs and pharmacy reimbursement rates may impact its profitability. In particular, increased utilization of generic pharmaceuticals has resulted in pressure to decrease reimbursement payments to retail and mail order pharmacies for generic drugs, causing a reduction in the generic profit rate.
- ▼ **Competitive Landscape:** Despite significant new client wins in the course of a strong selling season, intense competition and tough industry conditions act as major impediments. Major competitors such as Walgreens, Target and Wal-Mart are expanding their pharmacy businesses. Competition is especially tough in the pharmacy segment, as other retail businesses continue to add pharmacy departments and low-cost pharmacy options become available. Discount retailers, in particular, have made substantial inroads in gaining market share.
- ▼ **Poor Macroeconomic Condition:** Although prescriptions and related health care service providers like CVS stay out of general macro-economic turmoil, the recent debt crisis and sluggish economic conditions in U.S. could impact consumer purchasing power. This may also influence preferences and spending patterns and result in low prescription utilization. In the reported quarter, CVS faced pricing pressure and higher operating and remediation expenses for its Medicare Part D prescription drug business.

Rising pressure to reduce reimbursement rates for generic drugs, disappointing retail performance, highly competitive market and pressure on margins provide stiff challenges to CVS Health.

Last Earnings Report

CVS Health Q4 Earnings Top Estimates, Margins Improve

CVS Health Corporation's fourth-quarter 2019 adjusted earnings per share of \$1.73 dropped 19.2% year over year but exceeded the Zacks Consensus Estimate by 2.9%. The quarter's adjusted earnings considered certain transaction and integration costs pertaining to the buyout of Aetna and asset amortization costs along with other adjustments.

On a reported basis, the company's earnings of \$1.33 per share came in against the year-ago loss of 37 cents.

Full-year adjusted earnings of \$7.08 was unchanged from the year-ago period but topped the Zacks Consensus Estimate by 0.7%.

Total revenues in the fourth quarter rose 22.9% year over year (excluding the impact of certain items that neither relate to the ordinary course of CVS Health's business nor reflect the company's underlying business performance, adjusted revenues increased 23.1% year over year) to \$66.89 billion. The top line also beat the Zacks Consensus Estimate by 4.2%.

The year-over-year revenue rise was primarily driven by the acquisition of Aetna, expanded volume and the brand name drug price inflation in both the Pharmacy Services and Retail/LTC segments, partially offset by a persistent reimbursement pressure in the Retail/LTC, continued price compression in the Pharmacy Services segment and an increased generic dispensing rate.

Full-year total revenues and adjusted revenues surged 32% and 32.3%, respectively, to reach \$256.7 billion. This too exceeded the Zacks Consensus Estimate by 1.1%.

Quarter in Detail

Earlier in 2019, CVS Health realigned the composition of its segments. As a result, the company's SilverScript Medicare Part D prescription drug plan (PDP) was shifted from the Pharmacy Services segment to Health Care Benefits. In addition, the mail order and specialty pharmacy operations of Aetna were transitioned from the Health Care Benefits segment to Pharmacy Services.

Pharmacy Services revenues were up 6.2% to \$37.07 billion in the reported quarter, driven by growth in total pharmacy claims volume and the brand name drug price inflation. This was, however, partially offset by a continued price compression and an increase in generic dispensing rate.

Total pharmacy claims processed rose 10.2% on a 30-day equivalent basis, attributable to net new business and the steady adoption of Maintenance Choice offerings.

Revenues from CVS Health's Retail/LTC were up 2.5% year over year to \$22.58 billion. Per the company, the result was based on higher prescription volume and branded drug price inflation, partially offset by a persistent reimbursement pressure and the impact of an increased generic dispensing rate. Front store revenues represented 22.7% of total Retail/LTC revenues in the reported quarter, primarily banking on improved sales of health and beauty products.

Total prescription volume grew 5.6% on a 30-day equivalent basis, boosted by the steady uptake of patient care programs, collaborations with PBMs and the company's preferred status in a number of Medicare Part D networks.

Within Health Care Benefits segment, the company registered revenues worth \$17.15 billion in the fourth quarter.

Gross profit soared 79.1% to \$24.82 billion. Accordingly, gross margin expanded 1165 bps to 37.1%. Adjusted operating margin in the quarter under review grew 1086 bps to 24.2% on a 123.1% rise in operating profit to \$16.17 billion.

Outlook

CVS Health has provided its 2020 guidance.

Adjusted EPS is expected in the band of \$7.04-\$7.17. The Zacks Consensus Estimate for 2020 earnings is pegged at \$7.15.

This apart, the company's 2020 adjusted operating profit is estimated in the \$15.5-\$15.8 billion range.

Further, the company's full-year cash flow from operations is envisioned in the bracket of \$10.5-\$11 billion.

Quarter Ending **12/2019**

Report Date	Feb 12, 2020
Sales Surprise	4.16%
EPS Surprise	2.98%
Quarterly EPS	1.73
Annual EPS (TTM)	7.08

Recent News

On **Jan 23, 2020**, CVS Health debuted its first HealthHUB locations to serve Greater Philadelphia and South New Jersey Communities.

On **Dec 9, 2019**, CVS Pharmacy (the retail division of CVS Health) announced the completion of its rollout of time delay safes in all of its 58 CVS Pharmacy locations in West Virginia, including pharmacies located in Target stores. The safes are expected to help prevent pharmacy robberies and the diversion of controlled substance narcotic medications by keeping them out of the hands of unauthorized individuals.

On **Dec 5, 2019**, CVS Health announced the successful completion of the first year of combined operations following the acquisition of Aetna in late 2018.

On **Dec 3, 2019**, CVS Health joined the U.S. Department of Health and Human Services (HHS) to support the fight against HIV. This coincides with the launch of a new HHS initiative called Ready, Set, PrEP, a critical component of the Ending the HIV Epidemic in America Initiative.

On **Dec 2, 2019**, CVS Health inked a deal with Centene Corporation under which CVS Health will acquire Centene's Illinois health plan subsidiary, IlliniCare Health Plan (IlliniCare). The transaction entails the sale of Centene's Medicaid and Medicare Advantage lines of business in Illinois. This partnership is in connection with the previously announced merger agreement between Centene and WellCare Health Plans.

On **Dec 2, 2019**, CVS Pharmacy, the retail division of CVS Health, announced the completion of the rollout of time delay safes in all of its 375 CVS Pharmacy locations in North Carolina, including pharmacies located in Target stores.

On **Nov 19, 2019**, CVS Health announced that MinuteClinic, the company's retail medical clinic, has rolled out its video visit offering in the states of Colorado, Illinois and New Jersey.

On **Nov 13, 2019**, CVS Health announced that it has developed a Social Isolation Index to estimate each member's risk of social isolation. The Index, which is based on claims data and multi-dimensional information on social determinants of health, will help to identify high-risk Medicare beneficiaries. They will get proactive outreach from specially-trained consultants within our Resources For Living program.

On **Nov 4, 2019**, CVS Health announced entering a three-year corporate collaboration with the Alzheimer's Association aimed at fighting Alzheimer's disease – a disease impacting more than 5 million Americans and 16 million caregivers across the country.

Valuation

CVS Health shares are down 3.9% and up 2.1% in the year-to-date and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry are down 6.7% while the Zacks Medical sector is up 6% in the year-to-date period. Over the past year, the sub-industry is down 11.9% and sector is up 17.7%.

The S&P 500 index is up 4.9% in the year-to-date and up 20.7% in the past year.

The stock is currently trading at 9.9X Forward 12-months earnings, which compares to 9.6X for the Zacks sub-industry, 26.1X for the Zacks sector and 19.4X for the S&P 500 index.

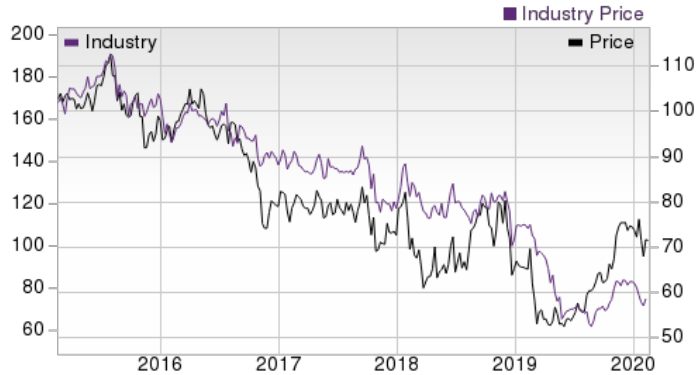
Over the past five years, the stock has traded as high as 20.3X and as low as 7.5X, with a 5-year median 12.7X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$75 price target reflects 10.4X forward 12-months earnings.

The table below shows summary valuation data for CVS.

Valuation Multiples- CVS					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.94	9.57	26.07	19.35
	5-Year High	20.26	20.48	26.20	19.35
	5-Year Low	7.49	7.66	19.07	15.18
	5-Year Median	12.66	13.60	22.99	17.47
P/S F12M	Current	0.36	0.31	1.09	3.58
	5-Year High	0.81	0.79	1.11	3.58
	5-Year Low	0.21	0.24	0.80	2.54
	5-Year Median	0.42	0.47	0.92	3.00
P/B TTM	Current	1.45	1.43	5.40	4.68
	5-Year High	3.45	3.22	5.87	4.68
	5-Year Low	0.91	1.21	3.60	2.85
	5-Year Median	2.28	2.37	4.87	3.62

As of 2/14/2020

Industry Analysis Zacks Industry Rank: Top 23% (58 out of 255)



Top Peers

Rite Aid Corporation (RAD)	Outperform
Herbalife LTD. (HLF)	Neutral
Humana Inc. (HUM)	Neutral
The Kroger Co. (KR)	Neutral
Target Corporation (TGT)	Neutral
Universal Health Services, Inc. (UHS)	Neutral
Walgreens Boots Alliance, Inc. (WBA)	Neutral
Walmart Inc. (WMT)	Neutral

Industry Comparison Industry: Retail - Pharmacies And Drug Stores				Industry Peers		
	CVS Neutral	X Industry	S&P 500	RAD Outperform	WBA Neutral	WMT Neutral
VGM Score	B	-	-	A	B	C
Market Cap	92.85 B	801.45 M	24.61 B	801.45 M	46.82 B	334.47 B
# of Analysts	22	2	13	1	10	14
Dividend Yield	2.80%	0.00%	1.78%	0.00%	3.46%	1.80%
Value Score	B	-	-	A	B	C
Cash/Price	0.08	0.12	0.04	0.40	0.02	0.03
EV/EBITDA	13.10	10.80	14.06	18.40	10.80	15.95
PEG Ratio	1.38	1.38	2.09	NA	1.38	4.58
Price/Book (P/B)	1.45	1.69	3.29	0.79	1.93	4.27
Price/Cash Flow (P/CF)	6.82	6.56	13.65	1.08	6.31	13.62
P/E (F1)	10.01	10.00	19.21	43.00	9.02	22.68
Price/Sales (P/S)	0.36	0.36	2.70	0.04	0.34	0.64
Earnings Yield	9.99%	9.99%	5.19%	2.33%	11.09%	4.41%
Debt/Equity	1.30	0.55	0.71	6.22	1.34	0.83
Cash Flow (\$/share)	10.47	3.34	6.92	13.52	8.38	8.66
Growth Score	B	-	-	A	B	C
Hist. EPS Growth (3-5 yrs)	11.14%	5.68%	10.85%	NA	12.45%	0.13%
Proj. EPS Growth (F1/F0)	0.77%	14.34%	7.17%	NA	-2.15%	4.43%
Curr. Cash Flow Growth	-16.33%	-16.33%	8.56%	16.33%	-2.42%	5.58%
Hist. Cash Flow Growth (3-5 yrs)	19.17%	-0.39%	8.36%	-0.39%	11.05%	-0.35%
Current Ratio	0.94	1.06	1.23	1.46	0.66	0.81
Debt/Capital	56.58%	56.90%	42.91%	86.15%	57.22%	45.25%
Net Margin	2.58%	2.58%	11.81%	-1.86%	2.69%	2.77%
Return on Equity	14.87%	-5.19%	16.86%	1.40%	21.76%	18.47%
Sales/Assets	1.17	1.70	0.54	2.20	1.85	2.24
Proj. Sales Growth (F1/F0)	0.78%	0.39%	3.85%	-0.05%	2.21%	3.08%
Momentum Score	D	-	-	C	B	C
Daily Price Chg	-0.88%	0.05%	0.06%	2.81%	-1.34%	0.38%
1 Week Price Chg	5.51%	4.70%	2.47%	9.54%	4.70%	1.71%
4 Week Price Chg	-6.15%	-6.15%	0.59%	12.46%	-2.88%	1.72%
12 Week Price Chg	-4.76%	-10.95%	6.98%	52.29%	-12.82%	-1.64%
52 Week Price Chg	5.44%	-24.49%	16.62%	-6.78%	-26.71%	19.66%
20 Day Average Volume	7,341,151	1,078,623	2,020,569	3,874,162	4,522,829	5,287,791
(F1) EPS Est 1 week change	-0.45%	0.00%	0.00%	0.00%	-0.15%	-0.10%
(F1) EPS Est 4 week change	-0.45%	0.00%	-0.05%	13.23%	-0.17%	-0.10%
(F1) EPS Est 12 week change	-0.71%	0.00%	-0.17%	220.83%	-1.23%	0.07%
(Q1) EPS Est Mthly Chg	-0.03%	0.00%	-0.24%	64.93%	-0.82%	-0.02%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	D
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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