CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Tough Quarter for CVS as Solid Revenue Gains Are Offset by Profit Pressure

See Page 2 for the full Analyst Note from 04 Aug 2015

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The primary analyst covering this company does not own its stock.

Research as of 04 Aug 2015
Estimates as of 15 Jun 2015
Pricing data through 20 Aug 2015
Rating updated as of 20 Aug 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 12 Mar 2015

CVS Health has pursued a two-prong strategy to try and capture as much value as possible from the retail pharmacy industry. The firm has established itself as one of the largest U.S. pharmacy retailers and also as a top-tier pharmacy benefit manager. Its strong competitive advantages have churned out excellent returns on invested capital and have given it a wide economic moat. We anticipate robust growth for the pharmaceutical industry over the long term, which should provide CVS with a solid platform for continued success.

CVS' core PBM service assists pharmaceutical benefit payers with the fulfillment of member prescriptions. This entails processing prescription claims made by a client's members and ensuring the claims comply with benefit plan parameters. Additionally, the PBM is responsible for paying the retail pharmacy on behalf of the client. Larger PBMs usually can negotiate large enough discounts to keep a portion of the discount and still provide clients with highly advantageous drug pricing.

CVS is unique because it has integrated its operations vertically; it processes claims as an independent PBM and also runs one of the largest retail pharmacy chains. The firm operates more than 7,800 pharmacy retail stores across the United States, with about a third of the stores' revenue derived from convenience goods. The overall top-line contribution from total nonprescription retail operations is approximately 16%. While the operating margins from this segment are in the solid high single digits, the material amount of capital needed to run these operations curbs economic profits.

The combination of these two businesses does create some synergies, but we believe the true driver of CVS' moat rests with PBM services. The firm's 1.1 billion adjusted claims processed annually gives it significant scale advantages and the ability to leverage the asset-light nature of a PBM into solid economic profits. CVS has some of the lowest selling, general, and administrative costs and highest operating profit per claim, and these metrics have translated into ROICs well above its weighted average cost of capital.

Vital Statistics

Market Cap (USD Mil)	118,158
52-Week High (USD)	113.65
52-Week Low (USD)	77.40
52-Week Total Return %	34.8
YTD Total Return %	11.2
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	11.0
5-Yr Forward EPS CAGR %	17.1
Price/Fair Value	1.02

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Price/Earnings	17.9	22.8	*20.4*	*18.2*
EV/EBITDA	9.4	11.9	*11.0*	*9.4*
EV/EBIT	11.6	13.8	*13.1*	*11.6*
Free Cash Flow Yield %	4.5	5.5	*3.5*	*5.1*
Dividend Yield %	1.3	1.2	*1.0*	*1.0*

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Revenue	126,761	139,367	*151,049*	*186,433*
Revenue YoY %	3.0	9.9	*8.4*	*23.4*
EBIT	8,037	8,799	*9,879*	*11,222*
EBIT YoY %	11.5	9.5	*12.3*	*13.6*
Net Income, Adjusted	4,902	4,944	*5,576*	*6,036*
Net Income YoY %	20.0	0.9	*12.8*	*8.2*
Diluted EPS	4.00	4.22	*5.19*	*5.84*
Diluted EPS YoY %	25.3	5.5	*22.9*	*12.7*
Free Cash Flow	4,208	4,286	*4,271*	*-8,593*
Free Cash Flow YoY %	-16.4	1.9	*-0.4*	*-301.2*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

CVS Health combines one of the largest retail pharmacy chains in the United States with one of the largest pharmacy benefit managers. The company manages more than 1.1 billion prescriptions per year. It operates more than 7,800 retail pharmacies and more than 500 retail health clinics under the MinuteClinic brand.

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Morningstar Analysis

Tough Quarter for CVS as Solid Revenue Gains Are Offset by Profit Pressure 04 Aug 2015

It was a mixed second quarter for CVS as strong year-over-year top-line growth was offset by significant profit pressure. These results are in line with our expectations, and we are reiterating our $104 fair value estimate. Both the pharmacy benefit management and retail pharmacy operations produced material profit margin declines, which we believe were driven by a few different factors.

CVS has been aggressive in trying to win new PBM clients, given the Medco integration issues Express Scripts has faced over the past few years. This may have led CVS to bring on several new clients at lower profit levels than expected in order to build its PBM book. The PBM revenue mix shift toward lower-margin specialty prescription claims also played a role, in our opinion. We do not necessarily view this dynamic as a negative, as gross profit dollars are significantly higher for these claims. This factor should drive gross profit dollars per claim materially higher over time and become a positive for returns on invested capital.

The firm has faced significant prescription reimbursement pressure in its retail segment, which is no surprise to us. We believe all retail pharmacy players will have to contend with tough long-term headwinds as payers are layering on material reimbursement pressure. The U.S. health-care market has drastically changed, with costs becoming the central driver for most major players. Accordingly, as a top supplier of pharmaceuticals, CVS' retail pharmacy operations will face some stiff headwinds as PBMs, other than its own PBM division, will try to extract as much savings as possible from the drug supply chain.

CVS also faces more competition from many mass and regional retailer/grocer establishments, as these firms have collectively established significant pharmacy operations. This leaves CVS' retail operations with the strategy of trying to emphasize its value-based front-end products and puts it in even more direct competition with retailers and convenience store operators. This factor was highlighted over the quarter as this division reported a 54-basis-point decrease in gross margins and a 36-basis-point decrease in operating margins. Decreasing customer traffic numbers and flat same-store-sales are also very concerning and mean that consumers have many more options for retail pharmacy services.

We would note that CVS' decision to remove all tobacco-related products from its retail stores did produce some pressure over the quarter. While this dynamic will provide near-term headwinds, we believe the long-term strategy of eliminating tobacco sales is positive. CVS has made a strong push to become an all-encompassing health-care service firm and to de-emphasize its retail operations, which is the correct course from our perspective. While the firm's storefronts do provide a robust distribution network, we believe the true value emanates from its PBM services. From our perspective, the headwinds the firm faced this quarter are just a blip, and we believe CVS' current long-term strategy will increase economic profits over the next several decades.

Valuation, Growth and Profitability 15 Jun 2015

We are increasing our fair value estimate to $104 from $93 per share. We have factored in CVS' latest acquisitions of Omnicare and Target's retail pharmacy into our valuation. Both transactions are expected to close around the end of 2015 or beginning of 2016. While we believe there will be a slight negative effect on near-term operating margins as a result of a revenue mix shift, long-term returns on invested capital will be affected positively, given the confluence of enhanced capital efficiency, increased pharmaceutical purchasing volume, and positive synergies the firm will gain for its wide-moat pharmacy benefit manager segment. We believe the firm will be able to process a greater mix of specialty pharmaceutical claims over our explicit forecast period, driving solid profit expansion.

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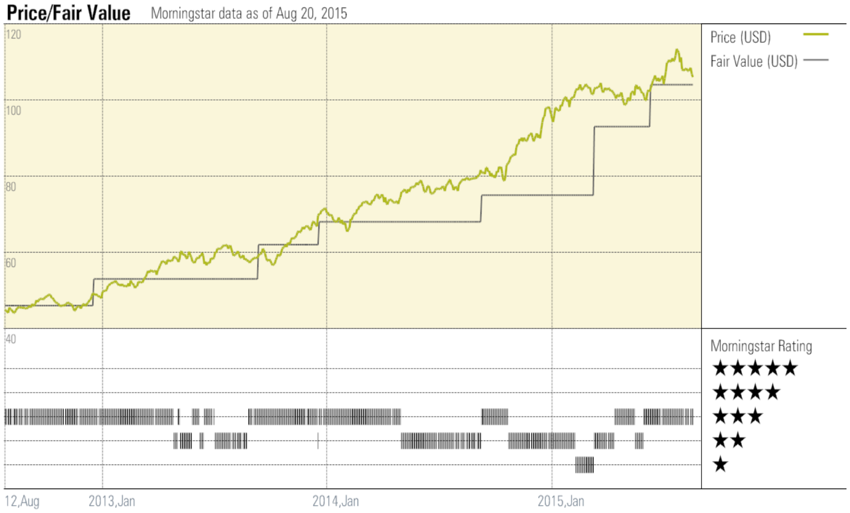
Price/Fair Value Morningstar data as of Aug 20, 2015



For the PBM segment, we forecast adjusted claim volume to increase at a 5.7% five-year compound annual growth rate and operating profit per adjusted claim to increase at an 11.2% five-year CAGR over our explicit forecast period. Built into these assumptions is client growth, increasing claim volume per client, and expanding centralized cost scale. For the retail pharmacy segment, we forecast revenue to increase at a 6.0% revenue CAGR and operating margins to average 10.38%. These variables combine for an 11.0% revenue CAGR and 6.6% average operating margins over our five-year explicit forecast period.

Scenario Analysis

Our scenario analysis takes into consideration the effects of generic pricing, supplier pricing power, and claims volume for CVS' PBM operations. Additionally, we factor in the effect of consumer discretionary spending upon its retail operations. In our bull case, we have factored in less pricing and profit pressure due to the generic wave and assume CVS is able to exert even more negotiating leverage as its suppliers try to contend with growing competition. Correspondingly, we factor in high-single-digit claim volume growth as the firm is able to increase its client base beyond our base assumptions and clients steer more benefit spending toward pharmacy benefits. For its retail operations, we assume the economy grows at a materially greater rate than the recent 2.0%-2.5%, driving sales into the high single digits. Under this scenario, our fair value estimate increases to $120.

In our bear case, we assume the consolidation among suppliers gives greater leverage to these players. Additionally, we assume the generic wave pressures pricing and profits to a greater degree than we anticipate in our base case. The firm's retail operations also suffer greatly under this scenario as we assume GDP growth in the negative territory. Our fair value estimate decreases to $80 under these assumptions.

Economic Moat

We believe CVS is a top-tier pharmaceutical supply chain player and possesses a wide economic moat as a result. The firm's substantial claim volume gives it the opportunity to take advantage of two key industry drivers: supplier pricing leverage and centralized cost scale. With total adjusted claims at approximately 1.1 billion, the PBM is able to negotiate favorable drug pricing with suppliers. This factor gives it the advantage of expanding its client base and preserving its gross margins. Scale is also a source of competitive advantage as each additional claim processed is more profitable than the previous. Centralized and technology system costs are able to be spread across the entire level of claims, which gives an advantage to larger PBMs. Because of these factors, CVS is able to produce gross and operating profits per adjusted claim that are top tier. The firm's significant advantages have historically produced returns on invested capital above its weighted average cost of capital, and we believe this trend will remain over an extended period.

Moat Trend

CVS has a stable economic moat trend. Given favorable demographic trends and the expansion of government-sponsored health-care coverage to the uninsured occurring over the next several years, spending on pharmaceutical products will increase at a robust clip. In addition, we expect the percentage of health-care benefit spending that flows through pharmacy benefit plans to increase as pharmaceuticals are looked upon as more of a front-line treatment. Offsetting these favorable trends for CVS is the upcoming patent cliff. The wave of nonexclusive generic drugs is expected to hit over the medium term, which could curb pricing and profit for the entire pharmaceutical industry. Additionally, partnerships among suppliers (manufacturers, distributors, retail pharmacies) could transfer some negotiating leverage from PBMs to other players along the pharmaceutical chain.

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Bulls Say/Bears Say

Bulls Say

- CVS is one of the largest PBMs, with approximately 1.1 billion adjusted claims processed in 2014. This gives the firm top-tier negotiation and scale advantages.

- Pharmaceutical spending will grow at a robust rate over the next several years, given demographic shifts and the expansion of medical insurance coverage to the currently uninsured.

- As specialty drug spending continues to increase, we believe payers will look to PBMs to help control spending on these products.

Bears Say

- The gross dollar amount of branded drugs migrating to generic status will decrease over the medium term, which will create a moderate headwind for CVS.

- If suppliers are successful with controlling more product through consolidation, then CVS could lose some of its pricing power.

- In an effort to preserve gross profits, PBMs have narrowed their pharmacy networks. This dynamic could create a headwind if client members demand more choice among retail pharmacies.

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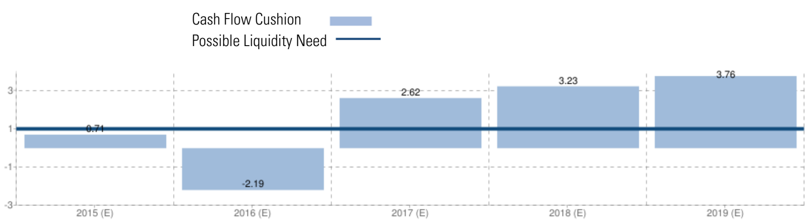
Five Year Adjusted Cash Flow Forecast (USD Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	2,481	228	2,924	4,548	5,465
Adjusted Available Cash Flow	-413	-8,329	7,839	9,027	9,996
Total Cash Available before Debt Service	2,068	-8,100	10,763	13,575	15,461
Principal Payments	-1	-550	-550	-866	-866
Interest Payments	-589	-993	-1,398	-1,350	-1,255
Other Cash Obligations and Commitments	-2,341	-2,164	-2,164	-1,986	-1,986
Total Cash Obligations and Commitments	-2,931	-3,707	-4,111	-4,202	-4,107

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	2,481	13.0
Sum of 5-Year Adjusted Free Cash Flow	18,120	95.1
Sum of Cash and 5-Year Cash Generation	20,601	108.1
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	20,601	108.1
Sum of 5-Year Cash Commitments	-19,058	—

Financial Health

CVS' leverage looks set to rise after the Omnicare and Target acquisitions and continued returns to shareholders. At the end of March, gross debt stood at $13 billion, or 1.2 times gross debt/EBITDA, and including leases, adjusted debt/EBITDAR stood at 2.4 times. To acquire Omnicare, CVS expects to pay $12.7 billion, including $2.3 billion in existing debt. To acquire Target's pharmacy and clinic operations, CVS will pay $1.9 billion. Including both of those transactions, lease-adjusted leverage is expected to rise by only about half a turn, and management aims to return to its long-term target of 2.7 times within a reasonable time frame after the acquisitions close around the end of 2015 or beginning of 2016. Of note, though, the company maintains a very large share-repurchase program ($11 billion authorized as of March) and aims to use $5 billion of that in 2015. The company also plans to pay more than $1 billion in a dividend in 2015. With only $1.6 billion in cash on its balance sheet as of March and the company returning so much cash to shareholders even with these acquisition plans, CVS may choose to issue even more debt than necessary to complete the Omnicare and Target transactions. Beyond these capital-allocation activities, key maturities during the next five years include $500 million in commercial paper borrowings, $1.2 billion due in 2016, $1.1 billion due in 2017, $1.3 billion due in 2018, and $1.2 billion due in 2019.

Enterprise Risk

The main risk facing CVS is the end of the generic wave that is likely to happen over the medium term. Profitability for generic drugs is far greater than for branded drugs, and profit growth could be pressured for the firm as a result. How CVS handles this development will be key. Additionally, consolidation/partnerships among suppliers could pose a risk if these players are successful in shifting some of the pricing power away from CVS. The firm also faces a greater amount of systematic risk than its major rivals as a significant portion of its revenue and profits is tied to consumer discretionary spending.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
LARRY J. MERLO	CEO/Director/President,Director	556,287	01 Apr 2015	—
PER G.H. LOFBERG	Executive VP	223,119	02 Jan 2015	—
MR. DAVID B. RICKARD		207,179	14 Dec 2009	—
DAVID M. DENTON	CFO/CFO, Subsidiary/Executive VP/ Executive VP, Subsidiary	112,187	01 Apr 2015	—
C. DAVID BROWN,II	Director	91,252	01 Jun 2015	10,000
JONATHAN C. ROBERTS	Executive VP/President, Subsidiary	74,313	01 Apr 2015	—
MR. DAVID W. DORMAN	Director	63,607	07 May 2015	—
DR. TROYEN A. BRENNAN,M.D.	Chief Medical Officer/Executive VP	61,841	01 Apr 2015	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Stock Mkt Idx	1.76	0.55	-50	31 Jul 2015
Vanguard Five Hundred Index Fund	1.16	0.68	93	31 Jul 2015
Fidelity® Contrafund® Fund	1.16	1.23	-224	30 Jun 2015
Vanguard Institutional Index Fund	1.07	0.68	27	31 Jul 2015
Vanguard Wellington™	1.07	1.40	-594	30 Jun 2015
Concentrated Holders				
Boston Partners Long/Short Equity Fund	0.01	10.96	—	30 Jun 2015
Fidelity® Select Consumer Staples Port	0.25	10.54	—	30 Jun 2015
ALTA WATER	—	8.70	—	31 Jul 2015
ICON Consumer Staples	—	8.56	—	30 Jun 2015
B+RVUS2	—	8.34	—	31 Jul 2015

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
United Association Pension Fund Local 13 Pension Fund	—	0.18	10,044	31 Dec 2008
New Jersey Division of Pensions and Benefits	0.21	0.14	2,875	30 Jun 2010
ALLEGHANY CAPITAL Corp	0.17	6.99	1,950	30 Jun 2015
T. Rowe Price Associates, Inc.	1.78	0.43	1,692	30 Jun 2015
Montag & Caldwell, LLC	0.13	2.12	1,424	30 Jun 2015
Top 5 Sellers				
J.P. Morgan Investment Management Inc.	0.59	0.30	-4,066	30 Jun 2015
Aberdeen Asset Management PLC	1.09	3.73	-2,939	30 Jun 2015
Dimensional Fund Advisors, Inc.	0.80	0.58	-2,652	30 Jun 2015
State Street Corp	3.92	0.50	-2,623	30 Jun 2015
BlackRock Fund Advisors	3.08	0.53	-2,161	30 Jun 2015

Management 12 Mar 2015

We believe stewardship at CVS has been solid, as management seems to have found its footing after the highly complex CVS-Caremark merger. After the deal closed in 2007, the management team initially had trouble with the combined entity. This was highlighted by lost PBM market share and eroding profitability in the segment. Given the excellent economics underlying the PBM industry, this trend was extremely troubling. However, CVS has increased its claim volume over the past three years to well over 1.1 billion adjusted claims processed. Gross and operating profits per claim also increased from 2011 to 2014. Management has been able to leverage its large retail pharmacy stores into another lucrative channel for claim growth. The firm has been able to expand its mail order claim and retail prescription volume by enabling client members to pick up orders at stores, validating the symbiotic relationship between the two areas of the business.

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Analyst Notes

Increasing Our CVS Fair Value Estimate After Omnicare and Target Pharmacy Acquisitions 15 Jun 2015

On Monday, CVS Health announced it will purchase and rebrand the in-store pharmacy operations of Target for $1.7 billion. After factoring in this transaction along with the recent purchase of institutional pharmaceutical distributor Omnicare, we are increasing our fair value estimate for CVS to $104 per share from $93. While we believe there will be a slight negative effect on near-term operating margins as a result of the revenue mix shift, long-term returns on invested capital should be positive, given the confluence of enhanced capital efficiency, increased pharmaceutical purchasing volume, and synergies for the firm's wide-moat pharmacy benefit manager segment.

Strategically, we believe CVS has done a solid job in obtaining material value with these recent acquisitions, as they enhance the firm's core PBM operations and augment its already sizable pharmaceutical purchasing power. The key value driver of this recent activity is the ability of the firm to offer some of the lowest-cost drugs to providers and payers. This dynamic will allow it to continue to offer top-tier PBM services and drive outsize economic profits.

Omnicare's distribution assets roll up nicely into CVS' already sizable mail-order pharmacy operations, and this dynamic should allow for excellent synergy opportunities. Additionally, the pharmacy benefit manager will be able to expand its specialty distribution operations, giving it a stronger foothold in the fastest-growing segment of the pharmaceutical industry. CVS will also have the opportunity to enhance its PBM offerings, given that it will capture all of the economics from direct drug distribution to a client's members, and it acquires a captive audience for its own SilverScript Medicare Part D plan offerings. Additionally, the firm gains a little over $6 billion in increased dug purchasing dollars--allowing it to gain lower-cost pharmaceuticals.

Through the acquisition of the Target pharmacy assets, CVS enhances its drug-purchasing volume by approximately $6 billion and gains a little over 1,600 retail locations nationwide. We believe these locations add nicely to CVS' retail store count in key metro areas where it did not have a strong presence, highlighted by growth in the Minneapolis/St. Paul/Bloomington, Seattle/Tacoma/Bellevue, and St. Louis geographies. CVS will also be able to build this increased store count into its PBM network offerings, adding to its operational advantages.

CVS Acquires Omnicare, Enhancing Mail-Order and PBM Assets 21 May 2015

On May 21, CVS Health announced the acquisition of Omnicare, a major distributor/wholesaler of pharmaceuticals to long-term care facilities, for $98 per share, or for approximately $12.7 billion. While we are still analyzing the financial details of the deal, we believe it is a positive from an operational standpoint for CVS. Omnicare's distribution assets roll up nicely into CVS' already sizable mail-order pharmacy operations, and this dynamic should allow for excellent synergy opportunities. Additionally, the pharmacy benefit manager will be able to augment its specialty distribution operations, giving it a stronger foothold in the fastest-growing segment of the pharmaceutical industry. CVS will also have the opportunity to enhance its PBM offerings, given that it will capture all of the economics from the direct distribution of drugs to a client's members, and it acquires somewhat of a captive audience for its own SilverScript Medicare Part D plan offerings. The confluence of these factors should drive solid operational benefits and growth over the next several years for CVS. We are leaving our $93 fair value estimate unchanged for now as we analyze the transaction, but we expect the deal will have a minor positive impact on our valuation.

From our perspective, the acquisition of Omnicare enhances CVS' wide economic moat, as we believe most payers and

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Analyst Notes

distributors with larger operations are economically advantaged. For a more detailed look at which firm's we believe are economically advantaged in the health-care services space and for our analysis of CVS investment thesis, please see our March Healthcare Observer, "Strengthening Economic Moats Make Health-Care Services Firms Powerful Value Creators."

CVS Produces Strong Top-Line Growth, Offset Once Again by Profit Compression 01 May 2015

It was another mixed quarter for CVS as further profit pressure offset strong year-over-year top-line growth. However, these results are in line with our expectations and we are reiterating our $93 fair value estimate. The number of pharmacy benefit manager, or PBM, prescription claims the firm processed for the quarter increased 11%, which we believe was driven materially by new clients the firm was able to acquire from Express Scripts. From our perspective, CVS performed decently last selling season in taking advantage of its main rival's stumbles. However, the firm may have been willing to take a slightly decreased spread retention rate in order to do so. On a per-claim basis, revenue per claim increased $6.45 while gross profit dollars per claim remained flat. In contrast, Express reported that revenue per claim increased $6.93 while gross profit dollars per claim increased $0.49. This trend is not overly concerning as we expect it to reverse over the coming years. We will watch closely how gross profits trend over the remainder of the year.

CVS' retail segment reported decent results considering the strategic decision last year to remove all tobacco products from its stores. Revenue grew 2.8% while operating margin compressed 43 basis points to 10.19% for the quarter. The firm's pharmacy sales increased 5.3% on a same-store basis as the firm was able to increase unit volume by approximately 5%. However, front-end same-store sales decreased 3.6% largely due to lost tobacco-related revenue. While this dynamic will provide some near-term headwinds, we believe the long-term strategy of eliminating tobacco sales is positive. CVS has made a strong push to become an all-encompassing health care service firm and to de-emphasize its retail operations--the correct course, from our perspective. While the firm's store fronts do provide a robust distribution network, we believe the firm's true value emanates from its PBM services.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2012	2013	2014	*Forecast* 2015	2016	5-Year Proj. CAGR
Revenue	*9.2*	15.0	3.0	9.9	*8.4*	*23.4*	*11.0*
EBIT	*11.6*	13.9	11.5	9.5	*12.3*	*13.6*	*12.5*
EBITDA	*8.9*	13.5	10.5	3.1	*15.7*	*16.8*	*14.2*
Net Income	*9.4*	8.3	20.0	0.9	*12.8*	*8.2*	*12.1*
Diluted EPS	*14.6*	13.9	25.3	5.5	*22.9*	*12.7*	*17.1*
Earnings Before Interest, after Tax	*11.9*	13.7	8.4	13.6	*4.5*	*13.0*	*11.0*
Free Cash Flow	*5.9*	39.3	-16.4	1.9	*-0.4*	*-301.2*	*17.7*

Profitability	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Operating Margin %	*6.2*	5.9	6.3	6.3	*6.5*	*6.0*	*6.6*
EBITDA Margin %	*7.5*	7.3	7.8	7.3	*7.8*	*7.4*	*8.1*
Net Margin %	*3.6*	3.3	3.9	3.6	*3.7*	*3.2*	*3.6*
Free Cash Flow Margin %	*3.5*	4.1	3.3	3.1	*2.8*	*-4.6*	*2.0*
ROIC %	*7.5*	7.0	7.7	7.8	*8.9*	*8.9*	*9.9*
Adjusted ROIC %	*12.4*	11.6	12.7	13.0	*14.9*	*16.3*	*19.1*
Return on Assets %	*6.3*	5.9	6.7	6.4	*7.2*	*6.9*	*7.5*
Return on Equity %	*11.5*	10.2	12.2	12.2	*14.3*	*15.7*	*17.3*

Leverage	3-Year Hist. Avg	2012	2013	2014	2015	2016	5-Year Proj. Avg
Debt/Capital	*0.24*	0.21	0.25	0.25	*0.25*	*0.44*	*0.37*
Total Debt/EBITDA	*1.20*	1.10	1.30	1.21	*1.05*	*2.13*	*1.54*
EBITDA/Interest Expense	*17.52*	16.09	19.46	17.02	*20.05*	*13.88*	*15.09*

Valuation Summary and Forecasts

	2013	2014	2015(E)	2016(E)
Price/Fair Value	1.05	1.28	—	—
Price/Earnings	17.9	22.8	*20.4*	*18.2*
EV/EBITDA	9.4	11.9	*11.0*	*9.4*
EV/EBIT	11.6	13.8	*13.1*	*11.6*
Free Cash Flow Yield %	4.5	5.5	*3.5*	*5.1*
Dividend Yield %	1.3	1.2	*1.0*	*1.0*

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.8
Weighted Average Cost of Capital %	8.3
Long-Run Tax Rate %	42.0
Stage II EBI Growth Rate %	7.0
Stage II Investment Rate %	53.6
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	15,406	12.8	14.66
Present Value Stage II	38,956	32.5	37.07
Present Value Stage III	65,668	54.7	62.48
Total Firm Value	**120,031**	**100.0**	**114.21**
Cash and Equivalents	2,515	—	2.39
Debt	-12,380	—	-11.78
Preferred Stock	—	—	—
Other Adjustments	-5,000	—	-4.76
Equity Value	**105,166**	**—**	**100.06**
Projected Diluted Shares	1,051		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Morningstar Analyst Forecasts

Income Statement (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	*2015* (Forecast)	*2016* (Forecast)
Revenue	**123,120**	**126,761**	**139,367**	***151,049***	***186,433***
Cost of Goods Sold	100,632	102,978	114,000	*123,650*	*155,226*
Gross Profit	**22,488**	**23,783**	**25,367**	***27,399***	***31,207***
Selling, General & Administrative Expenses	15,278	15,746	16,568	*17,520*	*19,985*
Other Operating Expense (Income)	—	—	—	—	—
Other Operating Expense (Income)	—	—	—	—	—
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**7,210**	**8,037**	**8,799**	***9,879***	***11,222***
Restructuring & Other Cash Charges	—	—	—	*20*	*80*
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	348	—	521	—	—
Operating Income (incl charges)	**6,862**	**8,037**	**8,278**	***9,859***	***11,142***
Interest Expense	557	509	600	*589*	*993*
Interest Income	—	—	—	—	—
Pre-Tax Income	**6,305**	**7,528**	**7,678**	***9,270***	***10,148***
Income Tax Expense	2,436	2,928	3,033	*3,893*	*4,262*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	-7	-8	-1	—	—
(Minority Interest)	2	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**3,864**	**4,592**	**4,644**	***5,376***	***5,886***
Weighted Average Diluted Shares Outstanding	1,280	1,226	1,172	*1,075*	*1,033*
Diluted Earnings Per Share	**3.02**	**3.75**	**3.96**	***5.00***	***5.70***
Adjusted Net Income	4,085	4,902	4,944	*5,576*	*6,036*
Diluted Earnings Per Share (Adjusted)	**3.19**	**4.00**	**4.22**	***5.19***	***5.84***
Dividends Per Common Share	0.65	0.89	1.10	*1.10*	*1.10*
EBITDA	**8,615**	**9,907**	**10,209**	***11,790***	***13,712***
Adjusted EBITDA	**8,963**	**9,907**	**10,209**	***11,810***	***13,792***

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December				*Forecast*	
	2012	2013	2014	*2015*	*2016*
Cash and Equivalents	1,375	4,089	2,481	*228*	*2,924*
Investments	5	88	34	*34*	*34*
Accounts Receivable	6,479	8,729	9,687	*10,499*	*9,960*
Inventory	11,032	11,045	11,930	*12,940*	*16,244*
Deferred Tax Assets (Current)	693	902	985	*985*	*985*
Other Short Term Assets	577	472	866	*866*	*866*
Current Assets	**20,161**	**25,325**	**25,983**	***25,552***	***31,014***
Net Property Plant, and Equipment	8,632	8,615	8,843	*9,480*	*10,079*
Goodwill	26,395	26,542	28,142	*28,142*	*43,142*
Other Intangibles	9,753	9,529	9,774	*9,774*	*9,774*
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	1,280	1,515	1,510	*1,510*	*1,510*
Long-Term Non-Operating Assets	—	—	—	—	—
Total Assets	**66,221**	**71,526**	**74,252**	***74,458***	***95,519***
Accounts Payable	9,044	10,096	11,951	*12,963*	*16,273*
Short-Term Debt	690	—	685	*685*	*685*
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	4,416	5,329	6,391	*6,391*	*6,391*
Current Liabilities	**14,150**	**15,425**	**19,027**	***20,039***	***23,349***
Long-Term Debt	9,133	12,841	11,695	*11,695*	*28,695*
Deferred Tax Liabilities (Long-Term)	3,784	3,901	4,036	*4,036*	*4,036*
Other Long-Term Operating Liabilities	1,501	1,421	1,531	*1,531*	*1,531*
Long-Term Non-Operating Liabilities	—	—	—	—	—
Total Liabilities	**28,568**	**33,588**	**36,289**	***37,301***	***57,611***
Preferred Stock	—	—	—	—	—
Common Stock	17	17	17	*17*	*17*
Additional Paid-in Capital	29,120	29,777	30,418	*30,418*	*30,418*
Retained Earnings (Deficit)	24,998	28,493	31,849	*36,043*	*40,794*
(Treasury Stock)	-16,270	-20,169	-24,078	*-29,078*	*-33,078*
Other Equity	-212	-180	-248	*-248*	*-248*
Shareholder's Equity	**37,653**	**37,938**	**37,958**	***37,152***	***37,903***
Minority Interest	—	—	5	*5*	*5*
Total Equity	**37,653**	**37,938**	**37,963**	***37,157***	***37,908***

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Morningstar Analyst Forecasts

Cash Flow (USD Mil)

Fiscal Year Ends in December	2012	2013	2014	*Forecast* 2015	*Forecast* 2016
Net Income	3,862	4,592	4,644	*5,376*	*5,886*
Depreciation	1,753	1,870	1,931	*1,931*	*2,570*
Amortization	—	—	—	—	—
Stock-Based Compensation	132	141	165	*174*	*199*
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	—	—	—	—	—
Other Non-Cash Adjustments	237	-86	463	—	—
(Increase) Decrease in Accounts Receivable	-387	-2,210	-737	*-812*	*539*
(Increase) Decrease in Inventory	-853	12	-770	*-1,010*	*-3,304*
Change in Other Short-Term Assets	3	105	-383	—	—
Increase (Decrease) in Accounts Payable	1,147	1,024	1,742	*1,012*	*3,310*
Change in Other Short-Term Liabilities	777	335	1,082	—	—
Cash From Operations	**6,671**	**5,783**	**8,137**	***6,672***	***9,200***
(Capital Expenditures)	-2,030	-1,984	-2,136	*-2,568*	*-3,169*
Net (Acquisitions), Asset Sales, and Disposals	-378	-415	-2,439	—	*-15,000*
Net Sales (Purchases) of Investments	—	-90	4	—	—
Other Investing Cash Flows	559	654	526	—	—
Cash From Investing	**-1,849**	**-1,835**	**-4,045**	***-2,568***	***-18,169***
Common Stock Issuance (or Repurchase)	-3,494	-3,476	-3,580	*-5,000*	*-4,000*
Common Stock (Dividends)	-829	-1,097	-1,288	*-1,182*	*-1,135*
Short-Term Debt Issuance (or Retirement)	-60	-690	685	—	—
Long-Term Debt Issuance (or Retirement)	-479	3,964	-1,617	—	*17,000*
Other Financing Cash Flows	2	62	106	*-174*	*-199*
Cash From Financing	**-4,860**	**-1,237**	**-5,694**	***-6,356***	***11,666***
Exchange Rates, Discontinued Ops, etc. (net)	—	3	-6	—	—
Net Change in Cash	**-38**	**2,714**	**-1,608**	***-2,253***	***2,696***

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	1.14	17.7	19.0	16.1	9.5	10.6	9.4	14.8	14.4	17.1	3.0	3.5	3.2	0.7	0.7	0.6
Express Scripts Holding Co ESRX USA	0.88	31.6	16.1	14.6	12.9	10.4	9.5	14.9	18.8	12.9	3.1	3.2	3.4	0.6	0.6	0.5
Average		24.7	17.6	15.4	11.2	10.5	9.5	14.9	16.6	15.0	3.1	3.4	3.3	0.7	0.7	0.6
CVS Health Corp CVS US	**1.02**	**22.8**	**20.4**	**18.2**	**11.9**	**11.0**	**9.4**	**18.3**	**28.8**	**19.6**	**2.9**	**3.2**	**3.1**	**0.8**	**0.8**	**0.6**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	86,382 USD	12.1	11.5	11.8	38.1	33.5	32.3	17.4	17.9	19.2	6.7	6.4	6.7	1.4	1.1	1.1
Express Scripts Holding Co ESRX USA	53,799 USD	—	—	—	50.2	93.7	133.4	9.7	13.1	16.2	3.8	4.9	5.8	—	—	—
Average		12.1	11.5	11.8	44.2	63.6	82.9	13.6	15.5	17.7	5.3	5.7	6.3	1.4	1.1	1.1
CVS Health Corp CVS US	**74,252** USD	**7.8**	**8.9**	**8.9**	**13.0**	**14.9**	**16.3**	**12.2**	**14.3**	**15.7**	**6.4**	**7.2**	**6.9**	**1.2**	**1.0**	**1.0**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	129,695 USD	6.5	19.0	14.8	7.0	5.6	15.7	3.6	10.5	17.9	-16.6	-224.6	-220.2	33.8	—	—
Express Scripts Holding Co ESRX USA	100,887 USD	-3.1	3.4	4.4	1.4	29.4	13.0	19.4	103.8	10.2	-8.8	-22.1	42.9	—	—	—
Average		1.7	11.2	9.6	4.2	17.5	14.4	11.5	57.2	14.1	-12.7	-123.4	-88.6	33.8	—	—
CVS Health Corp CVS US	**139,367** USD	**9.9**	**8.4**	**23.4**	**9.5**	**12.3**	**13.6**	**5.5**	**22.9**	**12.7**	**1.9**	**-0.4**	**-301.2**	**22.8**	**—**	**—**

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	5,619 USD	25.2	23.2	21.9	8.5	7.5	7.4	7.3	6.5	6.6	4.3	3.8	3.7	5.0	5.2	3.8
Express Scripts Holding Co ESRX USA	2,035 USD	7.9	8.1	8.1	5.8	6.9	7.3	3.6	4.5	4.8	2.0	3.7	3.6	4.1	3.0	4.3
Average		16.6	15.7	15.0	7.2	7.2	7.4	5.5	5.5	5.7	3.2	3.8	3.7	4.6	4.1	4.1
CVS Health Corp CVS US	**4,944** USD	**18.2**	**18.1**	**16.7**	**7.3**	**7.8**	**7.4**	**6.3**	**6.5**	**6.0**	**3.6**	**3.7**	**3.2**	**4.3**	**2.7**	**3.2**

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	17,406 USD	53.6	85.9	77.9	34.9	46.2	43.8	17.8	17.6	13.1	1.6	2.4	2.1	2.7	2.9	2.8
Express Scripts Holding Co ESRX USA	13,568 USD	67.7	73.0	77.5	40.4	42.2	43.7	10.0	12.6	13.8	2.3	1.9	1.7	2.7	2.7	2.9
Average		60.7	79.5	77.7	37.7	44.2	43.8	13.9	15.1	13.5	2.0	2.2	1.9	2.7	2.8	2.9
CVS Health Corp CVS US	**12,380** USD	**32.6**	**33.3**	**77.5**	**24.6**	**25.0**	**43.7**	**17.0**	**20.0**	**13.9**	**1.2**	**1.0**	**2.1**	**2.0**	**2.0**	**2.5**

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
UnitedHealth Group Inc UNH USA	114,227 USD	7.60	6.04	9.77	0.77	0.71	0.81	0.77	0.71	0.81	5.36	3.99	6.16	24.2	21.9	18.6
Express Scripts Holding Co ESRX USA	59,552 USD	2.41	1.29	2.22	0.62	0.60	0.66	0.50	0.47	0.51	0.72	0.35	0.56	—	—	—
Average		5.01	3.67	6.00	0.70	0.66	0.74	0.64	0.59	0.66	3.04	2.17	3.36	24.2	21.9	18.6
CVS Health Corp CVS US	**118,158** USD	**2.12**	**0.21**	**2.83**	**1.37**	**1.28**	**1.33**	**0.74**	**0.63**	**0.63**	**3.62**	**0.33**	**4.27**	**27.7**	**22.0**	**19.3**

Research Methodology for Valuing Companies

Components of Our Methodology

- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

We believe that a company's intrinsic worth results from the future cash flows it can generate.
The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies

Economic Moat
Financial Health
Stewardship
Uncertainty
Moat Trend

Morningstar Fair Value

Margin of Safety
Market Pricing

Morningstar Rating™ For Stocks
★★★★★

Source: Morningstar, Inc.

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

*Please contact a sales representative for more information.

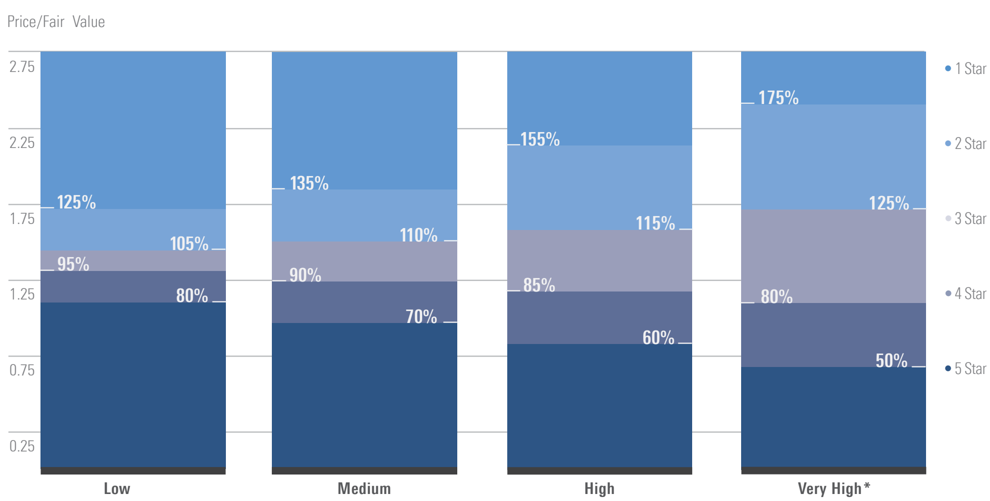
which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts model three scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



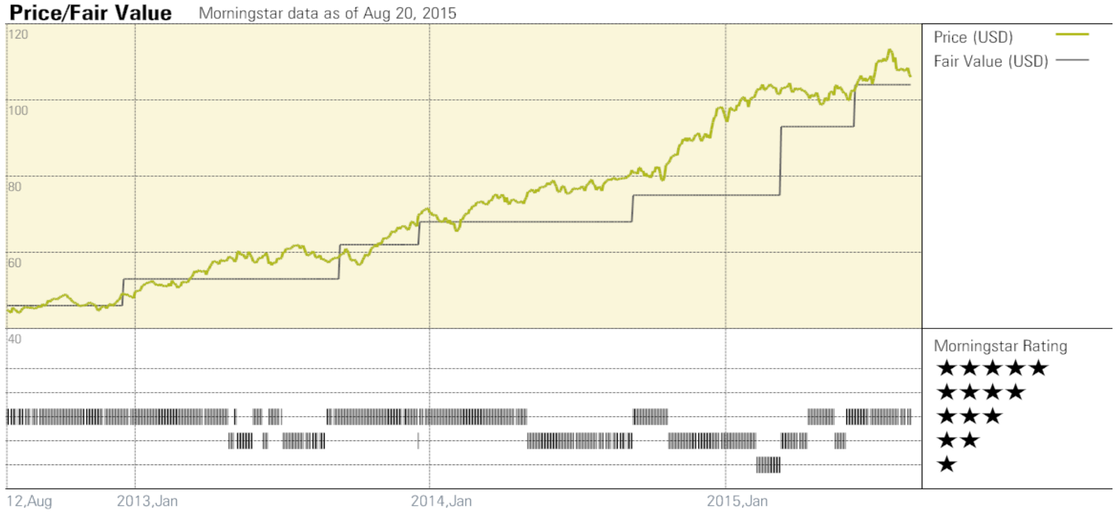
* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Source: Morningstar, Inc.

CVS Health Corp CVS (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
106.02 USD	104.00 USD	72.80 USD	140.40 USD	Medium	Wide	Stable	Standard	Health Care Plans

Price/Fair Value Morningstar data as of Aug 20, 2015



The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value.

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