

Market Intelligence Report for Q1 2016

March 29, 2016

*Sources:

- EverCore ISI Research Analyst Reports
- MedImpact Marketplace Monitor Reports
- Drug Benefit News
- Cleveland Research
- JP Morgan Investor Relations
- Goldman Sachs Investor Relations
- Kaiser Health News
- Drug Channels Blog
- Modern Healthcare
- Various newswire services



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Upcoming Industry Events

AMCP Annual Meeting

April 19-22, 2016 in San Francisco, CA

[Conference Website](#)

Women's Health Leadership TRUST Forum

April 25, 2016 in Minneapolis, MN

[Conference Website](#)

NCPDP Annual Conference

May 2-4, 2016 in Scottsdale, AZ

[Conference Website](#)

Armada Specialty Pharmacy Summit

May 2-6, 2016 in Las Vegas, NV

[Conference Website](#)

Twin Cities Heart Walk

May 14, 2016 in Minneapolis, MN

[Conference Website](#)

Sharp Women's Health Conference

May 21, 2016 in San Diego, CA

[Conference Website](#)

ACAP CEO Summit

June 28-29, 2016 in Washington, D.C.

[Conference Website](#)

January, 2016

12/1/15 – New OIG Report Shows Hospitals' Huge 340B Profits From Medicare-Paid Cancer Drugs

The Office of Inspector General (OIG) has just released another eye-opening report on the 340B drug discount program: [Part B Payments For 340B-Purchased Drugs](#). The report documents how 340B-eligible hospital outpatient departments earn tremendous profits from the Medicare Part B program. Physician offices, which also receive Part B reimbursements, are not as fortunate. The OIG focuses on how the Medicare program could save money by sharing in these mega-profits, however Medicare appears to be providing incentives for shifts in cancer care treatment locations.

Medicare is the largest payer of provider-administered specialty drugs. Its Part B program covers provider-administered injectable and certain other drugs. In looking only at Medicare Part B program spending, the new OIG study, Part B Payments For 340B-Purchased Drugs, found that hospital outpatient settings received discounted 340B pricing on an astounding 48% of all drugs. By comparison, physician offices received 340B pricing on only 2% of drugs.

Source: <http://www.drugchannels.net/2015/12/new-oig-report-shows-hospitals-huge.html>

1/4 – MTM benefits best realized through retail pharmacy, Congress leaders say

Per Drug Store News, the National Association of Chain Drug Stores in December lauded a letter to Secretary of Health and Human Services Sylvia Burwell from 44 members of the U.S. House of Representatives, urging the participation of retail pharmacists in a new initiative designed to improve the use of medication therapy management in Medicare. Signing the letter were 24 Republicans and 20 Democrats, including a total of 11 members of the House Energy and Commerce Committee.

"We believe the proposed enhanced MTM model to be a positive step forward in improving the Part D MTM program. However, we also believe that without participation of retail community pharmacists, the testing of enhanced MTM models will fall short of achieving the maximum potential in terms of positive outcomes and impact on beneficiary health," the House members wrote. "Therefore, we are writing today to encourage CMS and the Center for Medicare and Medicaid Innovation to take steps to ensure that retail community pharmacists are incorporated into the enhanced MTM models to be tested. MTM provided by retail pharmacists improves patient health, reduces healthcare costs through lower hospitalizations and readmissions, and allows beneficiaries to be more involved in their medication management.

Source: <http://www.drugstorenews.com/article/mtm-benefits-best-realized-through-retail-pharmacy-congress-leaders-say>

1/5 – Willis Towers Watson Merger Successfully Completed

Combination creates leading global advisory, broking and solutions company serving 80% of the world's 1,000 largest companies in more than 120 countries. Willis Towers Watson Public Limited Company (NASDAQ: WLTW) began operating today following the successful completion of the merger of Willis Group Holdings and Towers Watson. The company, which will do business as Willis Towers Watson, is a leading global advisory, broking, and solutions company with 39,000 employees in more than 120 countries.

Source: www.businesswire.com/news/home/20160104006634/en/Willis-Towers-Watson-Merger-Successfully-Completed

1/6 – Aetna Pulls Out Of Insurance Industry's Lobbying Group AHIP

Another top-five health insurer is ditching the industry lobbying group America's Health Insurance Plans (AHIP), which is struggling with revenue problems as a new CEO attempts to right the ship. Aetna Inc., which in the process of buying competitor Humana Inc., is not renewing its membership in AHIP for 2016, a spokeswoman for the Hartford, Conn.-based health insurer confirmed Tuesday. This comes several months after UnitedHealth Group Inc., the nation's largest insurer, made the same announcement and said its interests "are no longer best represented by AHIP."

Source: modernhealthcare.com/article/20160105/NEWS/160109953/aetna-departure-delivers-second-big-blow-to-ahip

1/8 – Cleveland Research Key Takeaways/insights from WBA 1Q16 results

Here are a few key take ways/insights from WAG 1Q call yesterday

1. Rx gross margin pressure is consistent with expectations – pressured by growing Med D mix, 90-day scripts and specialty.
2. WAG indicates they are gaining access to more Med D networks, one of their key initiatives is improving access and getting in more networks – working with major payers to improve access to WAG stores.
3. Rx comp up 9.7% on scripts up 4.7% - despite weak flu (down 10-11%). Growth from Med D offsetting this.
4. Open to vertical integration/partnerships – key way to drive out costs out of the system.
5. Valeant deal is low risk as we get a set fee per script (do not deal with reimbursement). Would be open to additional deals if presented, but not going to seek them out.
6. Rite Aid acquisition
 - a. Received second FTC request for additional information is normal process
 - b. Looking for \$1bb in synergies over 2-3 years
 - c. A lot of best practices that can be shared and leveraged between two companies:
 - i. WAG can benefit from Rite Aid loyalty card and Wellness store remodels
 - ii. WAG can provide Rite Aid with additional capital for investment and global sourcing

Full Notes for WBA 1Q16 Earnings Conference Call on 1/7/16

1Q Results

- Ongoing work to control costs and grow adjusted operating margin leading to growth in EPS
 - EPS up 32% year/year in 1Q
- Solid organic results from all three divisions
- Taken a significant step forward with agreement to acquire RAD
- Announced agreement with Valeant, which will allow consumers to access those drugs at lower costs
- Sales of \$29bb, up 48.5% year/year on inclusion of Alliance-Boots
- Adjusted operating profit of \$1.7bb, up 53.8%
- Net earnings of \$1.03/share, up 32% year/year
- Results not directly comparable due to changes in reporting
- Synergy savings
 - Halfway through store closures, reduced open hours, systems, centralizing Rx operations (more care to patients at counter and lowers cost to fill).
 - Not short of ideas, have a strong team. Working to reduce workload throughout the company and in the stores.
 - Believe we are making sustainable changes. Customer service numbers we evaluate are improving.
 - Will drive more people to our stores over time.

1Q Retail Pharmacy USA Results

- Sales of \$20.4bb, up 4.2% year/year
- Comps up 5.8% on Rx volume and mix
 - Gap on sale of infusion business and store closures in last 12 months
- Adjusted gross margin down 30bps year/year on Rx margin pressure
 - \$5.5bb of adjusted gross profit, up 2.7% year/year
- Adjusted SG&A down 2.1% year/year reflecting progress on cost savings program while maintaining customer experience
- Operating income of \$1.2bb, margin of 6.1% was up 40bps
 - Profit up 23% excluding Alliance-Boots contribution last year

Rx Pharmacy

- Rx sales up 6.7%, 31mm 30-day scripts, including immunizations, up 4.2%
- Rx comp up 9.7% on scripts up 4.7% - pleased with top-line given soft cough/cold/flu
 - Flu incidences down 10.7% year/year
 - Growth on Med D market share gains and greater focus on customer care
 - Market share up 20bps year/year to 19.2%

- December Rx sales remain impacted by soft cough/cold/flu market

Rx Margins

- Pressure on Rx gross margin was consistent with expectations – reimbursement, Med D mix, 90-day, specialty mix
 - Partially offset by generic conversions
 - Anticipate gross margin pressure, but can grow Rx business over time
 - Grow access through Med D, innovative partnerships/relationships (such as Valeant)
- Network contracts
 - Can't comment on the timelines
 - Our strategy is to improve access and gain share. Working hard with our major partners to improve access.
 - Med D has been a successful strategy, well set up for this season. Also paid for services provided within these.
 - Feeling more confident in our relationships with PBMs, as we provide better access and care, we will be compensated

Front-End

- Front-end down 0.6% year/year on fewer promotions, focus on health and beauty
- Transitioned seasonal away from decorating to giftable items to sell through the holiday season.
- Gross margin was essentially flat year/year, overall profitability increased due to lower costs
- December comps flat (improved versus 4Q) with shift in health/beauty and seasonal categories offset by weak cough/cold/flu
- Excited by positive results in 400 reset stores – especially No7 and Soap & Glory
 - Expanding rollout beginning in summer 2016 to 2,000 total stores
- Retail Pharmacy USA gross margin
 - Gross margin in 1Q was as-expected
 - Generic inflation for us was not material – feeling good about that going forward
 - Ongoing reimbursement pressure, more or less as-expected (used to this trend from EU).
 - Front-end margin was flat year/year – pleased with profitability as we take out décor products for more giftable items.
 - More plans to shift that mix next Christmas
 - Also launching more branded products from our Wholesale business into 2,000 stores

PBM acquisition

- Couldn't have been clearer since the beginning – convinced vertical integration is part of what we have to do in US to control costs
- Any kind of vertical integration is good – will depend on opportunities presented to us
- Merger is the perfect way, or you can have commercial agreements to get there – always open to that
- Does not have to be an acquisition, could be a agreement/partnership with PBM
- Have to digest deal we have done, look around. At the right time, we will tell you which kind of deal and when.

Retail Pharmacy International

- Sales of \$3.5bb
- Comps up 2.2% in constant currency
 - Comp Rx sales up 3.8%
 - Comp retail sales up 1.3%
- Adjusted gross profit margin of 42.6%
- Adjusted SG&A of \$1.2bb
 - Depreciation was a benefit to SG&A within the quarter
- Adjusted operating margin of 8.9% higher than 4Q, as expected due to seasonality
- Boots UK comp Rx up 3.5% on hospital pharmacy, better volume, and flu shots
- Boots UK retail comp up 0.8% due to boots.com
 - Online growth was at lower rate in prior quarters as we cycled pickup in-store rollout in August
 - Cosmetics were the best-performing retail category in UK

- Added Sleek, will expand from 100 Boots stores that sell it currently
- Mexico is a lower operating margin business, but key priority for expansion
 - Working to accelerate store opening program
- Boots UK retail sales better in December with online sales and exclusive range of seasonal gifts driving strength
- Progress driving sales at Boots UK
 - Not shifting strategy – pursuing both sales growth and margin
 - From time to time there will be prevalence of sales over margin and vice versa
 - Very loyal customer base, now able to achieve growth with an omnichannel strategy
- Retail Pharmacy International comps stepped lower, margin in 1Q much higher than it had been
 - Boots UK performing well, with omnichannel growth. Step down includes impact of anniversary pickup in-store.
 - December improvement means we've had good Christmas in what has been a competitive environment
 - This benefit will come through on the next call
 - Differentiated offer, augmented by omnichannel is the key to Boots UK growth
 - Clear that Boots UK has been a winner relative to peers
 - Margin cadence always has a seasonal impact – Christmas shopping starts earlier in UK than in US
 - Also got some benefit from finalizing purchase price adjustments on A-B acquisition – one-time benefit

Pharmaceutical Wholesale

- In-line with expectations during the quarter
- Sales of \$5.8bb
- Constant currency comp growth up 3.1% in 1Q
 - Slightly ahead of estimated market growth
- Strength in Norway. Good growth in Germany and Turkey.
- Adjusted operating income of \$166mm, 2.9% margin

Synergy Program

- Combined A-B synergies of \$288mm, very much on track for at least \$1bb in FY16
 - Continue to look at many other synergies which are not practical to quantify
- Good progress for \$1.5bb cost savings program through FY17

Cash Flow

- Operating cash flow of \$722mm reflecting seasonal build in inventory
- Looking for working capital efficiencies in the US
- Capex of \$340mm – invest in key areas that develop customer proposition, including IT
- Free cash of \$392mm

RiteAid

- Good progress with funding - \$5bb term loan, \$7.8bb bridge facility
 - Replaced \$12.8bb bridge facility prior
- Not assuming any accretion from RAD, but it's progressing as expected and on track to close 2H16
 - RAD has issued proxy, vote scheduled for 2/4
 - Second FTC request for additional information is normal process
 - Integration team
- RAD accretion
 - \$1bb of synergies over 2-3 years, stand behind that number. Will build over time following closing.
 - Don't want to be more precise because we don't know the details of pharmacies to divest/consolidate.
- Potential to turnaround RAD long-term
 - Feeling good about RiteAid given their recent results
 - Idea is to bring them on and import best practices from all over our business
 - RAD has a good investment in 2,000+ of their stores already
 - Believe we can get the right sales and margin mix in RAD stores over time
 - Already investing a lot of capital to transform Walgreens, RAD will be just an extension of this work

- If we had done this in 3 years' time, it would be starting from scratch
- RAD learnings for WAG store base
 - Opportunity to execute store remodels where they have been strapped
 - They are investing in their best stores, doing "Well Experience" better than we had. We are improving lifts here.
 - Global sourcing organization in beauty, healthcare, seasonal is also an opportunity
 - Balance Rewards has 85mm active customers, 28mm everyday points
 - Interested in how their card works in the marketplace

Valeant Agreement

- Valeant agreement announced in December – brings to US market similarities with how we work in Europe
 - Good example of bringing best practices from one market to another
 - Give Valeant opportunity to serve customers at lower cost – improve distribution and convenience/service
 - Also reduces costs to the healthcare system
 - We offer patients the medications they want, utilize our core capabilities, deliver cost savings to system and financial rewards for both partners
- Partnership is a characteristic by which our company can be known – close alignment
- Why is Valeant the right partner given their perception in the market
 - When someone takes a new approach, it is relatively common for people to think differently
 - We are determined to execute this well and evaluate the real costs saved to the system (outside agency to address that).
 - Not trying to bypass PBMs, trying to help them lower costs.
 - Remember they agreed to lower their prices
 - Why Valeant? Because they came to us.
 - We did appropriate due diligence and saw opportunity to leverage best practice from Europe with manufacturers going direct to retail.
 - We are both global companies. The benefits are not only here. There are also potential opportunities in EU/other markets.
 - They have good expertise and an efficient R&D model – connection to skin care where Boots is market leader.
 - Have to execute this deal properly, show we can manage this kind of relationship in US (have done many times in EU)
 - Then will evaluate other potential partnerships
 - Guidance does include this deal – only shortly will commence the Valeant program, will be startup costs in FY16
- Financial implications and mechanics of Valeant deal
 - Low risk opportunity to help drive incremental volume
 - Good economics
 - Low amount of volume vs the 900mm scripts filled last year
 - Nice to have, but not a needle mover
 - Direct relationship with no wholesaler. Valeant gets the drugs to WAG and WAG dispenses.
 - Get a fixed fee for each script filled
 - We are not involved with pricing or reimbursement which eliminates risk
 - Filled just like every other script. We will not fill the script if it is not covered.
 - If model works over time, great and we could potentially expand further with Valeant or other manufacturers
 - Not a way to eliminate wholesalers and it would not make sense to actively look for these deals because we have an equity stake in Amerisource, not in best interest to ditch this model
- Will test this model in the US to make sure it works
- Many manufacturers are looking for more efficient ways to get to the market
 - Others may or may not come with that request
- Want to do something that creates a long-term sustainable bond.
 - Never do a deal wanting to control the whole company.
- When you merge a company into one, you select the best people for the jobs, coming from either side.
- Would be open to any deal that creates substantial and sustainable value – both immediately and in the future for WBA

- Can imagine many different kinds of partnerships – Valeant is a good example, but there are more you can do
 - Synergies can be shared to improve costs and margin – have to figure out best way to share value
- Valeant is an agreement that takes friction out for patients, physicians, pharmacies – so they can focus on improving care
 - Over time, we will independently monitor whether we are lowering costs to the system

FY16 Guidance

- Raised low end of FY16 guidance, range now \$4.30-4.55
 - No accretion from RAD, suspension of \$3bb buyback program, no FX rate changes
- Currency exposure of GBP versus USD – can cause quarterly volatility in gross margin and SG&A lines
 - Guidance now factors in headwind of \$0.03 since initial FY16 guidance in October

1/10 – Five top trends for health-system pharmacies in 2016 from McKesson

Health-system pharmacy leaders are now looking at the value their pharmacy departments can bring to their organizations – not just to control costs, but to grow revenue. The McKesson Pharmacy Optimization team, headed by Mark Eastham, senior vice president and general manager, discussed five health-system pharmacy trends for 2016, during the ASHP Midyear meeting in New Orleans last month. These included 1) the continued growth in the specialty pharmaceutical market, 2) revenue-generation opportunities in health-system pharmacy, 3) the need for supply chain efficiency, 4) more oversight of the 340B program, and 5) the need to leverage pharmacy analytics to make better financial, clinical, and operational decisions.

Source: <http://drugtopics.modernmedicine.com/drug-topics/news/five-top-trends-health-system-pharmacies-2016>

1/11 – Appeals Court Sides with Express Scripts in Compound Claim Blocking Suit

A U.S. appeals court sided with Express Scripts Holding Co. in a lawsuit filed by three pharmacies claiming the PBM violated federal law when it began blocking claims for compounded medications. The U.S. Appeals Court for the Eighth Circuit on Jan. 11 issued its decision to not grant an injunction sought by the pharmacies in order to stop Express Scripts from denying the claims. The suit was filed in November 2014 in the U.S. District Court for the Eastern District of Missouri by pharmacies in Houston and Boeme, Texas, and West Monroe, La. (*OBN 11/21/14, p. 8*). According to the *St. Louis Business Journal*, the court's decision affirmed an earlier ruling from a lower court and stated that the plaintiffs "failed to meet the well-established standards for preliminary injunctive relief."

Source: <http://www.bizjournals.com/stlouis/blog/2016/01/appeals-court-supports-express-scripts-denial-of.html>

1/11 – State attorneys general joining probe of health insurer mergers

About 15 state attorneys general have joined the Justice Department's probe of two big insurance mergers, according to people familiar with the matter, increasing the scrutiny on proposed deals that would reduce the number of nationwide health insurers to three from five.

The formation of a large group to scrutinize Aetna Inc's plan to buy Humana Inc and Anthem Inc's bid for Cigna Corp complicate what is already expected to be a tough and lengthy review by federal antitrust enforcers. Connecticut, Florida, Iowa, Massachusetts and Tennessee are among the states that have joined forces to investigate the proposed deals, according to sources close to the states, who spoke to Reuters over recent days.

Source: <http://www.reuters.com/article/us-insurance-usa-antitrust-idUSKCN0UP2JL20160112>

1/11 – McKesson will serve CVS Health's newly acquired Target pharmacies

McKesson announced it will source pharmaceuticals for the Target pharmacies acquired by CVS Health after narrowing its outlook for adjusted earnings per diluted share for the fiscal year ending March 31, 2016, from the previous range of \$12.50 to \$13.00 to a new range of \$12.60 to \$12.90. The updated outlook for fiscal 2016 reflects McKesson's expectation that operating profit derived as a result of generic pharmaceutical pricing trends will be weaker in the second half of the fiscal year compared to previous expectations.

"While we continue to drive growth across our broad and diverse businesses, we now expect the operating performance in our U.S. Pharmaceutical distribution business in the second half of Fiscal 2016 will be below our previous expectations,"

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stated John Hambergren, chairman and CEO. "Despite our revised assumptions related to generic pharmaceutical pricing trends and the impact of recent customer consolidation, our company is performing well, both domestically and internationally, and we continue to focus on our customers' success in this dynamic environment," he said. "In fact, I am pleased to report that in late December, we signed a new agreement with CVS Health to serve as the distribution partner for their recently acquired Target in-store pharmacies. We also continue to prepare for the implementation of our new sourcing and distribution agreement with Albertsons, which begins on April 1, 2016."

Source: <http://www.drugstorenews.com/article/mckesson-will-serve-cvs-healths-newly-acquired-target-pharmacies>

1/14 – Solving the Mystery of Employer-PBM Rebate Pass-Through

Manufacturers pay billions in rebates to pharmacy benefit managers (PBMs). How much of that money do PBMs share with their plan sponsor clients? As far as I know, the only public answer comes from the Pharmacy Benefit Management Institute's (PBMI) new [2015-2016 Prescription Drug Benefit Cost and Plan Design Report](#). According to the PBMI's survey data, only three-quarters of employers directly receive a piece of manufacturer rebates. Some employers get 100% of the rebates. Others get a portion, sometimes with a guaranteed minimum amount. Below, I also highlight PBMI data about the prevalence of spread pricing (as opposed to pass-through pricing) as a means for employers to compensate PBMs. Despite what you may have heard, many employers still seem to prefer spread pricing models.

Source: <http://www.drugchannels.net/2016/01/solving-mystery-of-employer-pbm-rebate.html>

1/19 – OptumRx Financial Results for 2015

Reporting full-year 2015 financial results, UnitedHealth Group on Jan. 19 said revenues for its OptumRx PBM unit increased 51% year-over-year to \$48.3 billion, while fourth-quarter 2015 revenues nearly doubled, reaching \$16.7 billion for the three months ending Dec. 31. The company primarily attributed that increase to the acquisition of Catamaran Corp., which was completed in July, as well as strong organic growth. OptumRx processed 778 adjusted prescriptions in 2015, up 36% from 570 million in 2014. For the fourth quarter, OptumRx fulfilled 258 million scripts. UnitedHealth reiterated that it expects OptumRx to fill 1 billion adjusted prescriptions in 2016 (*OBN 12/18/15, p. 2*). OptumRx is part of the Optum health care services conglomerate, which generated \$67.6 billion in revenues for the year and is expected to contribute more than 40% of UnitedHealth's operating earnings in 2016.

Source: Drug Benefit News, Vol. 17, No. 2

1/20 – Medicare Part D 2016: 75% of Seniors in a Preferred Pharmacy Network

Medicare Part D Prescription Drug Plans with pharmacy networks that feature preferred cost-sharing arrangements continue to dominate the PDP landscape, with preliminary enrollment figures posted this month by CMS indicating that three out of four PDP enrollees opted for plans with preferred cost-sharing networks, estimates Pembroke Consulting, Inc. According to the new analysis posted to the Drug Channels blog on Jan. 20, there are now 62 plans with preferred cost-sharing networks that enrolled 14.9 million people, or 75% of total PDP enrollment, through Dec. 4, 2015. These plans operate 754 regional PDPs, which account for 86% of the total regional PDPs for 2016. By comparison, 66 plans with preferred cost-sharing networks captured 81% of total PDP enrollment in 2015 (*OBN 2/6/15, p. 6*).

Source: <http://www.drugchannels.net/2016/01/medicare-part-d-2016-75-of-seniors-in.html>

1/22 – Truveris Report Reveals Double-digit Price Increase for Common Drugs

Prices for commonly used brand-name, generic and specialty drugs continued to increase by double-digit rates last year, according to a new report from Truveris. Reporting the second full year of calculations from its OneRx National Drug Index (NDI), the health information technology and auditing services firm said prescription drug prices climbed 10.43% in 2015, which is roughly in line with the 10.9% increase Truveris observed the previous year. Specifically, from January to December 2015, Truveris saw prices for brand drugs go up 14.77%, specialty drugs jump 9.21% and generic drugs rise 2.93%. Calculated monthly, the OneRx NDI measures the average price of prescription drugs, driven by the most commonly utilized medications, and provides a holistic measurement of the prices paid by private insurers, self-insured organizations, government, unions and uninsured patients, explained Truveris.

Source: <http://truveris.com/insights.html>

1/22 – Cigna Banned By CMS From Medicare Sales for 'Systemic Failures'

Cigna Corp. was banned from marketing its Medicare products to new customers after the U.S. found deficiencies in how the health insurer ran its plans, citing widespread violations that the government said threatened patients' health.

"Cigna has experienced widespread and systemic failures impacting Cigna enrollees' ability to access medical services and prescription medications," the U.S. said in a Jan. 21 letter to the insurer outlining the sanctions. "Cigna has had a longstanding history of non-compliance" with requirements from CMS. Cigna won't be allowed to market or sell Medicare Advantage policies or Part D drug plans to new clients until it fixes the problems. Shares of Cigna, which is being bought by Anthem Inc. for about \$48 billion, fell 1.2 percent to \$138.46 at 12:39 p.m. in New York. Anthem remains committed to the deal, spokeswoman Jill Becher said in an e-mail.

Source: www.bloomberg.com/news/articles/2016-01-22/cigna-banned-from-selling-medicare-plans-by-u-s-stock-falls

1/28 – New York Requires PBM Contracts to Include Generic Drug Pricing Appeals

On December 11, 2015, Senate Bill 3346-B[1] was signed into law by New York State Governor Andrew Cuomo. The new bill requires contracts between pharmacy benefit managers ("PBMs") and pharmacies (or pharmacies' contracting agents) to include a mechanism for appeals of contract disputes related to generic drug pricing. Codified as new Section 280-a of the New York Public Health Law, the new law will take effect on March 10, 2016.

Source: <http://www.jdsupra.com/legalnews/new-york-state-requires-pbm-contracts-29641/>

1/29 – Express Scripts Blocks Valeant Diabetes Drug in Cost Fight

Express Scripts is sharpening its fight against drugmaker Valeant Pharmaceuticals International Inc., in the latest turn between the two key protagonists in an ongoing U.S. debate over the price of pharmaceuticals. The pharmacy benefit manager plans to block reimbursements for Valeant's diabetes drug Glumetza as soon as a generic version is introduced on Feb. 1, according to a post on its website Friday. Valeant raised the price of Glumetza by 800 percent in 2015, said Express Scripts. The drug now retails for about \$1,500 a month, according to GoodRx, a drug price database. The pill is an extended-release, brand-name version of metformin, a generic drug commonly used to treat diabetes.

Source: <http://www.bloomberg.com/news/articles/2016-01-29/express-scripts-blocks-valeant-diabetes-drug-in-cost-fight>

February, 2016

2/9 – CVS Reports Record Revenue Growth of \$41.1B in Q4 2015

CVS Health Corp. on Feb. 9 reported overall revenue growth of 11% to a record \$41.1 billion in the fourth quarter of 2015. For the full year, net revenues rose 10% to a record \$153.3 billion. Revenues in the pharmacy services segment for the fourth quarter were \$26.5 billion, up 11% from the year-ago quarter due in large part to growth in specialty pharmacy, which includes the impact of the Omnicare, Inc. acquisition (*DBN 5/22/15, p. 8*), and pharmacy network claims, which increased 7.2% to 237.4 million. CVS mainly attributed the jump in claims to net new business. The company also confirmed its previous full year 2016 guidance, expecting to deliver earnings per share in the range of \$5.28 to \$5.43.

Source: Drug Benefit News, Vol. 17, No. 4

2/9 – Novartis sets heart-drug price with two insurers based on health outcomes

Cigna Corp and Aetna Inc have struck deals with Novartis AG for a performance-based price for the Swiss drugmaker's new heart drug, Entresto, the companies said on Monday. The agreements are among the few performance-based deals that have been made public by drugmakers and U.S. managed-care companies, which say they have been having more discussions about linking price to health outcomes in order to cut unneeded drug spending.

Under the agreement, Cigna said its payments to Novartis will be linked to how well the drug improves the relative health of Cigna customers. Specifically, Cigna said payments will be based on a reduction in the proportion of customers who are admitted to hospital for heart failure. The agreement applies to Cigna's commercial business and does not apply to its Medicaid or Medicare plans.

Aetna, in an emailed statement, said it signed a value-based agreement with Novartis that is based on the drug replicating results that it achieved during clinical trials. In trials, Entresto cut hospitalizations and the rate of cardiovascular death related to heart failure. Aetna did not provide further information about the terms of the agreement.

Source: <http://www.reuters.com/article/us-cigna-novartis-drugpricing-idUSKCN0VH25K>

2/15 – Final CMS Rule Provides Clarity on Reporting and Returning Medicare Overpayments

On February 12, 2016, CMS published its long-anticipated Final Rule implementing Section 6402(a) of the Patient Protection and Affordable Care Act (ACA). Section 1128J(d), entitled "Reporting and Returning of Overpayments," requires healthcare providers and suppliers to report and return Medicare and Medicaid overpayments no later than 60 days after the overpayment was "identified" or the date a corresponding cost report is due. Providers and suppliers who fail to comply with these requirements risk liability under the federal False Claims Act, administrative penalties under the Civil Monetary Penalties Law and exclusion from federal health programs. The Final Rule takes effect on March 13, 2016. Until that date, providers and suppliers confronted with potential Medicare overpayments may rely on their "good faith and reasonable interpretation" of Section 1128J of the Act.

Source: <http://www.jdsupra.com/legalnews/final-cms-rule-provides-long-awaited-43712/>

2/19 – Express Scripts Reports Q4 2015 Net Income Increase to \$773.5M

Express Scripts Holding Co. on Feb. 16 posted fourth-quarter 2015 net income of \$773.5 million, or \$1.13 per share, up from \$581.8 million, or 79 cents per share, in the prior year quarter. For full-year 2015, the company reported \$2.5 billion in net income, up from \$2 billion for 2014. For the three months ending Dec. 31, 2015, Express Scripts also recorded revenues of \$26.1 billion, down slightly from \$26.3 billion for the prior-year quarter. Moreover, the PBM processed 341.5 million total adjusted claims, up 1% from the year-ago quarter. The company also narrowed its adjusted earnings per diluted share guidance for 2016 from a range of \$6.08 to \$6.28 to a range of \$6.10 to \$6.28, which raises the mid-point to \$6.19. The guidance range represents growth of 10% to 14% over 2015, explained Express Scripts.

Source: Drug Benefit News, Vol. 17, No. 4

2/23 – CVS Releases 2015 Drug Spend Trend Figures

CVS Health Corp (CVS.N) said on Tuesday its pharmacy benefit customers spent about 5 percent more on prescription drugs in 2015 than in 2014, a year when drug spending jumped nearly 12 percent. The No. 2 U.S. drugstore chain attributed the lower increase to careful management of its coverage plans, saying it negotiated with pharmaceutical makers for rebates and discounts and had more selective coverage that excluded pricey drugs. It also said fewer new high-priced specialty drugs hit the market in 2015 and that inflation in branded drugs for high volume disorders like diabetes had one of the biggest impacts on spending.

Source: <http://www.reuters.com/article/us-cvs-health-pricing-idUSKCN0VWOAS>

Link to CVS 2015 Trend Report:

https://na2.salesforce.com/sfc/p/30000000062Y/a/40000000XZv8/CibuO4npir675EMGIFr_47G9jCeb5.0RR9Nqei65Wl4

2/23 – 340B Purchases Hit \$12 Billion in 2015...and Almost Half of the Hospital Market

According to new data that Apexus has made available to Drug Channels, discounted purchases made under the 340B Drug Pricing Program hit \$12 billion in 2015. That's a whopping 67% higher than the 2013 figure. Dr. Fein estimates that the undiscounted value of these purchases exceeds \$17 billion. His analysis also reveals that hospitals now receive 340B discounts on more than 44% of their drug purchases.

Source: <http://www.drugchannels.net/2016/02/340b-purchases-hit-12-billion-in.html>

2/24 – Critics question claims by CVS Caremark saying it slowed drug cost growth

Clients of the pharmacy benefit management company Caremark saw their prescription drug costs rise only 5% last year a drop from an almost 12% increase in 2014, Caremark's parent company CVS Health said this week.

That, CVS Health said, was proof of the efficiency of pharmacy benefit management companies (PBMs), but those claims are being doubted by health care analysts and some members of Congress who say the managers hide the details of their contracts and make determining actual savings virtually impossible.

Source: usatoday.com/.../cvs-caremark-says-slowed-drug-cost-growth-but-critics-question-claims/80801870/

2/26 – Cleveland Research Announcement of MCK acquiring Vantage Specialty Pharmacy:

McKesson announced today that they are acquiring Biologics and Vantage Oncology. For both companies, they paid \$1.2bb. Combined the companies will be \$0.11 accretive to MCK's FY15 earnings.

Below are additional details on the acquired companies and some thoughts on how these assets will benefit MCK.

- Biologics is one of the fastest growing and the largest independent oncology focused specialty pharmacy. They also offer HUB/patient support service to pharma.
 - Through this acquisition MCK will now be one of the largest oncology specialty pharmacies and will have access to most oncology limited distribution drugs.
 - In addition, this acquisition significantly strengthens MCK's patient support services for oncology patients.
- Vantage is a provider of radiation oncology services
 - They operate 50 cancer centers across 13 states
 - Vantage operates a practice management model where they have JVs/profit sharing with their partner physicians and hospitals
 - This acquisition further builds out MCK's presence with community based oncology.

March, 2016

3/1 – PBMI Reports on Drug Benefits and Costs Release

The following PBMI reports were released at their 2016 conference:

- [Trends in Specialty Drug Benefits](#)
- [Drug Benefit Cost and Plan Design](#)

3/1 – Drug Channels 2016 Economic Report on Retail, Mail, and Specialty Pharmacies

The 2016 Economic Report on Retail, Mail, and Specialty Pharmacies is the most comprehensive, fact-based analysis of the pharmacy channel and its interactions with other participants in our healthcare system. The report was written by Adam J. Fein, Ph.D., a leading expert on the industry and author of the Drug Channels website. The 2016 report analyzes the industry in 10 chapters, organized into three major sections. The first three chapters examine the U.S. pharmacy industry's current structure, distinguish among the different dispensing formats for prescription pharmaceuticals, and identify the largest participants. We also examine pharmacy markets for specialty drugs. The two other major sections of report explain and analyze the key channel flows in the U.S. pharmacy distribution and reimbursement system for patient-administered, outpatient brand-name drugs.

Link to full report:

<https://na2.salesforce.com/sfc/p/30000000062Y/a/40000000XZoc/S8lz7psSIWynMvXyfpMR5nnSxEuXiy7w3oTuUNDgTls>

(Note that since it is a rather large PDF, the preview function may not be available so download the report in order to view)

3/1– Cleveland Research Highlights from ESRX presentation at PBMI

The following notes originated from a presentation given by Dr. Steve Miller, SVP & CMO at Express Scripts, during the PBMI 2016 Conference.

Key Points:

1. Oncology is the next focus area where ESRX will be rolling out new programs to control costs
2. Despite making up <5% of the global population; ESRX believes that the U.S. represents more than 50% of profits for some manufacturers.
3. ESRX believes the net price they are paying to treat Hep C patients is now below several major Western European countries.
4. Indication based management programs will likely become more prevalent in the near-term; risk-based contracts are much more complicated to structure and monitor

ESRX Presentation Notes

1. Specialty
 - a. Overall drug spend is \$350bb today
 - i. 30% Specialty
 - ii. 70% Traditional
 - b. 2018: drug spend expected to be \$500bb
 - i. 50% Specialty
 - ii. 50% traditional
 - c. In both cases only 1-2% of the patient population is driving the majority of the specialty trend
2. Drug manufacturers will argue back saying that they are currently only 10% of overall healthcare spend
 - a. If this is the case than overall healthcare spending will rise from \$3trillion to \$5trillion in the next several years
 - b. Either way, specialty spend is the fastest growing input in all of healthcare
 - c. Drugs better add the value they claim
3. Specialty drug pipeline: 7k drugs currently in the pipeline
 - a. 25%+ are oncology drugs

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- b. Other key classes are neurology and infectious disease
 - c. In 2010 the number of drugs getting approved flipped from being led by traditional drug classes to specialty
 - d. The reason why it flipped is drug manufacturers figured out that even for small patient populations that you could have a block buster drug given the pricing power
4. Problem with current drug trend
- a. Over last 7 years CPI has been near flat
 - b. Generic drugs have deflated more than 50% over the past 7 years
 - c. The brand and specialty pie has more than doubled
 - d. When you add the high brand and specialty inflation with growing utilization for these products you have a huge problem
 - e. Several examples
 - i. Hep C: 3.2mm population, list price to treat is >\$100k
 - ii. High Cholesterol: 71mm population: \$14k list price to treat
 - iii. Cancer: 14mm population, >\$100k to treat
 - iv. Alzheimer's: 5.4mm and \$35+ to treat
 - f. BIIB has new drug that slows mental deterioration. Huge pricing power for this drug. Not only for the 5.4mm with Alzheimer's, but also for patients who want to prevent it.
5. Hep C lives breakdown: 3.2mm total
- a. 1.1 state Medicaid
 - b. 500k prisons
 - c. 500k VA
 - d. 1.1 commercial
 - e. 2mm being supported by US tax dollars
6. U.S. bearing too much of the cost burden in Hep C and in Rx spending overall
- a. Sovaldi launched in the US for \$84k
 - b. Price in India and Egypt were \$900. The cost to make Sovaldi is \$150, so still getting 6x their money.
 - c. German price was \$68k
 - d. UK price was \$57k
 - e. Why is the U.S. paying 35% more when those two economies are equally developed?
 - f. On top of that, the U.S. system has more lives that need to be treated, should not there be leverage when you have more lives?
7. ESRX's HCV Value Program
- a. Negotiated low price that actually ended up being \$10k lower than the two European markets above
 - b. Provide Hep C TRC and specialized care
 - c. We guaranteed adherence to overcome concern of V-Pak being 2x per day vs. 1x per day for Harvoni
 - d. We capped the total PMPY costs for each patient that went on therapy
 - e. The FDA black box warning had no impact on our business, we already had these patients using Harvoni
 - f. Results of program:
 - i. 25mm lived on national preferred formulary
 - ii. 96% cure rate
 - iii. 95% adherence rate
 - iv. 100% of patients had access to the drugs, no F-score restrictions
 - v. Saved clients \$1bb
 - vi. Saved U.S. healthcare system multiples of this as we initiated the price competition
 - vii. U.S. price is now below several Western European markets
8. PCSK9s
- a. \$14k per year list
 - b. Heavy controls and PAs introduced by most plans

- c. These drugs have impressive results
 - i. Current statin therapy can lower LDL levels by 25%
 - d. PCSK9s can lower LDL by 60-70%, great data to show this
 - e. Of the 70mm high cholesterol patients, only 35mm are currently being treated of which only 7-10mm would qualify to get treatment based on current indication
 - f. We are expecting AMGN and SNY to potentially release new data that would expand the treatable population
 - g. We have told them that if the indication expands that we would have to renegotiate our contract with them. This data could come out as soon as Nov-16 at a big industry conference
9. Turing/Daraprin
- a. Drug cost \$13.5 before it was bought, Turing raised the price to \$750
 - b. In Europe the drug was selling for \$1
 - c. We created a solution where we contracted with Imprimis to compound the drug by mixing it with vitamin Folate which allow us to get around FDA restrictions to compound a drug that was already on the market
10. Generic Inflation
- a. Historically the market was self-correcting
 - b. One of the biggest issues over the last 5+ years is FDA has been very slow to approve products
 - c. Now can take up to 3-5 years to get generic license reactivated
 - d. Historically if a manufacturer took up price, it would be short lived because other mfg would reenter the market. Given how slow the FDA is, this is allowing generic inflation to be higher than what it would normally be
11. Cancer is our next focus
- a. Can cost \$10k per month to treat a cancer patient
 - b. Despite the increase in drugs approved, Kettering Institute data shows that it is now more expensive to add an additional month of life for a cancer patient. We are paying more for less/the same results.
 - c. Rolling out indication based management program in April
 - d. Tarceva is a drug that treats lung cancer. Very effective drug and increased life expectancy by 5.2 months
 - i. Then they go approved for pancreatic cancer
 - ii. This drug only improved life expectancy by 12 days, yet we are paying the same price for the drug
 - e. We can now adjudicate claims through Accredo at the indication level
 - i. Our goal is to be able to do this as well at the retail level
 - f. There are currently restrictions in how a manufacturer could price based on indication. Could not have two separate prices so we would have to negotiate a blended price that would incorporate all utilization on the product.
 - g. We have used outside third parties to assemble our indication based management program
 - h. Year-one the indication based management programs will save no money
 - i. Advantage over value based is you get to a set price, versus having to negotiate what the price/discount should be based on performance
 - i. You are putting in place a math model
 - ii. Starting in oncology and will roll out to other classes next year
 - iii. Will also look to expand outside of Accredo
12. Risk based contracting
- a. Over 70 value based programs have been introduced over the past 10 years
 - i. Problem is the info is not robust and the admin costs are too high due to the inefficiency of data
 - ii. The other issue is whose fault is it if patient does not reach goal – was it patient compliance, side effects,
 - b. Huge need for efficient data to manage

- c. Harvard Pilgrim has a program for PCSK9s
 - d. Will be an active player in risk based contracts, but at this point the admin costs are too high and absorb and savings that would be realized
13. What the payor industry needs to do better
- a. Show better judgment
 - i. Good judgment: Merck's pricing for Zepatier
 - ii. We have told manufacturers that we can help them know what payers are able to absorb
 - iii. Regularly meeting with CEOs and Boards in giving them perspective on pricing
 - b. Support biosimilars
 - i. Have been available in Europe for 6 years
 - ii. Savings on average are 30-40%
 - iii. In TNF class savings in Netherlands are 70%
 - c. Get rid of pay for delay – this has to end. Keeps costs elevated, adds no value, and inhibits competition
 - d. U.S can't support the worlds Rx spend
 - i. We only make up 4.6% of population, but 33% of Rx spend
 - ii. From a profit perspective, we believe US makes up more than 50% of profits for a significant number of the drug companies
 - e. Boost NIH funding
 - f. Adjust malpractice laws
 - g. Accept payment perform

3/7 – Medicare Plans Score Higher Ratings And Millions In Bonuses

Many Medicare plans undertook similar initiatives to improve their 2016 ratings, leading more to qualify for bonuses than ever before, according to the latest ratings released in October. Actions included offering members more preventive care, helping them better manage chronic conditions and handling complaints and appeals in more consumer-friendly ways.]

Since the bonus payments began in 2012, the percentage of Medicare plans earning 4 stars or more has doubled to 40 percent, reports the Kaiser Family Foundation (KHN is an editorially independent part of the foundation). About 71 percent of seniors in 2016 are in a plan with at least 4 stars, up from 60 percent in 2015, 50 percent in 2014 and 38 percent in 2013, according to the Centers for Medicare & Medicaid Services.

Source: <http://khn.org/news/medicare-plans-score-higher-ratings-and-millions-in-bonuses/>

3/8 – JP Morgan Report “Managed Care: Initiating Coverage; Navigating Act II of the ACA”

We are initiating coverage of the managed care sector. We are broadly bullish on the managed care sector and our long-term healthcare services thesis favors payors over providers. We believe the managed care sector has multiple new enrollment growth opportunities and the transition of reimbursement and delivery models will contribute to lower volatility of cost trends, medical loss ratio (MLR) and earnings, resulting in higher sustainable equity valuations. Our top picks are Cigna (CI) and Anthem (ANTM) due to perceived risk/reward from our view of stand-alone value combined with potential upside if DOJ approves the merger transaction. We see both ANTM/CI and AET/HUM as more likely to be approved than not. Our industry thesis over the next 12 months is more balanced between payors and providers: We have a favorable near-term view for payors driven by our expectation for subdued healthcare cost trends and attractive enrollment growth in Medicaid, Medicare Advantage and exchanges.

Link to full report:

<https://na2.salesforce.com/sfc/p/30000000062Y/a/40000000XZuy/ug0MtCYeXZx40QUOpy4ojPvVxHShrRwOIZ1zagHM0m0>

3/11 – Cardinal Health Buys Raintree Oncology

Cardinal Health just acquired RainTree Oncology Services, the largest independent group purchasing organization (GPO) for community oncology practices and clinics. Cardinal did not issue a press release because it was a small tuck-in acquisition. Since RainTree is a major player in oral oncology, the deal also features some of the same strategic motivations as [McKesson's acquisition of Biologics](#).

Source: <http://www.drugchannels.net/2016/03/another-significant-specialty-deal.html>

3/14 – Express Scripts Releases 2015 Drug Spend Trend Figures

U.S. spending on prescription drugs rose 5.2 percent in 2015, including the impact of rebates, driven by an 18 percent increase in specialty drugs, Express Scripts Holding Co said on Monday.

Pharmacy benefit manager Express Scripts said that use of specialty medicines, which includes the new pricier treatments for hepatitis c, as well as older drugs for rheumatoid arthritis and multiple sclerosis, rose 7 percent and was coupled with an 11 percent rise in unit cost.

Express Scripts said it included rebates in its annual drug spending report for the first time, which shaved 2.7 percentage points off spending growth. Last year's drug spending report showed an increase of 13 percent, and did not include the impact of rebates.

Brand name drug average prices rose 16.2 percent in 2015, and one-third of brand-named drugs had price increases greater than 20 percent, Express Scripts said. Specialty medicines accounted for 37 percent of drug spending in 2015.

Source 1: <http://www.reuters.com/article/us-expressscripts-pricing-idUSKCN0WH03T>

Source 2: fiercepharma.com/story/specialty-drug-spending-set-double-digit-leaps-over-next-3-years-express-sc/2016-03-15

Source 3: <http://www.drugchannels.net/2016/03/four-takeaways-on-drug-spending.html>

3/15 – Cleveland Research Top insights from ESI investor presentation

ESI presented at an investor presentation. They spent a lot of the time walking through their new Drug Trend report which was released this week, progress they are making with Safeguard Rx, and new formulary strategies for 2017. If you have not read it yet, the link for the Trend Report is: [ESI 2016 DRUG TREND REPORT](#)

Top Takeaways:

1. Out of the 25mm lives on the national preferred formulary, almost all have signed up for Hep C Value and 15mm have signed up for the oncology indication management program
2. ESI is highly focused on lowering costs in diabetes and anti-inflation drug classes for next year
3. On a PMPY basis, inflammation is now the highest cost disease (overtaking diabetes).
4. ESI will launch new extensions to their Safeguard Rx program at their Outcomes conference
5. The Exclusion list is now generating \$3bb in savings for plan sponsors – ESI feels they no longer have to go after big drugs to drive continued savings.
6. ESI expects a biosimilar insulin product to launch in 2016 and anti-inflammatory biosimilar most likely in 2017. ESI is confident in their ability to drive biosimilar conversion on the pharmacy side (medical conversion will be more difficult).
7. 2017 selling season off to a good start (strong pipeline and retention) – focus is to sell Safeguard Rx into existing book of business.

1. ESI Background

- a. 85mm members
- b. 3k total clients
- c. 1.3bb adjusted scripts per year

2. Selling Season

- a. 97% retention rate in 2015 (excluding Coventry)
- b. Best ever 1/1 implementation

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- c. Have a strong pipeline for 2016 selling season, off to a good start
- d. Have a new set of tools to sell this year – Safeguard RX (4 programs)
 - i. Focused on budget busting categories
 - ii. We get huge discounts and usually we take risk on these programs
 - iii. Drive them through Accredo

3. Exclusion Lists

- a. Early on we took Victoza and Advair off early on and we showed we could move share. This garnered the respect of the market and is what drives the rebates.
- b. Generating \$3bb in savings this year which we are returning to patients and plan sponsors
- c. No longer have to go after big drugs to get these savings

4. Lives Signed Up For SafeGuard Rx Programs

- a. 25mm patients enrolled in national preferred formulary
 - i. Almost 100% of ESI's clients are in the Hep C Value Program
 - ii. Oncology Care Program – plans that represent over 15mm lives have signed up
 - 1. This is the most controversial program and we already have 50%+ of the national preferred lives signed up for this program

5. Drug Class Focuses For 2016

- a. Traditional Drug Focus For 2016
 - i. The number one spend is diabetes (\$78 per member per year)
 - ii. Diabetes spend is going up 14%
 - iii. We are focused on controlling diabetes spend – we believe in 2016 for the first time we are going to be able to do great things in diabetes for our plans
 - 1. Almost every diabetes class now has vigorous competition
 - 2. There will be a biosimilar for insulin by the end of 2016 – this will change the game for insulin
 - iv. Pain and inflammation is #2
 - 1. Biosimilar for anti-inflammatory are likely coming in 2017
 - 2. Continue to see a lot of new introductions for atopic dermatitis, psoriasis, RA, and other inflammatory diseases
 - v. Believes diabetes and inflammation are ripe for new programs
 - vi. 2016 will be the first year where we will do some great things to control diabetes
 - vii. High cholesterol is #3 – we kept in check PCSK9s in 2015 and will continue to do so in 2016
- b. Specialty Drug Focuses For 2016
 - i. For the first time ever, a specialty drug category is the #1 spend category
 - 1. Inflammatory disease increased 25% and is now almost \$90 PMPY (higher than diabetes on a PMPY basis)
 - ii. We are going to see more specialty categories overtake the traditional oral solid categories
 - iii. Cancer spend is going up 23%

6. Drug Class Highlights From Drug Trend Report

- a. Generic price trend is flattening after several years of deflation due to 90% GDR and price inflation within specific generics
- b. Branded drug is the biggest issue for plan sponsors
- c. Key ESI numbers for 2015
 - i. Drug trend growth was 5.2%, less than half of what it was in 2014 (around 11% in 2014)
 - 1. This decline is driven by Hep C and compounds
 - ii. Patient co-pays decreased by 3.2% - ESI is working hard to not shift costs to the members

- iii. Trend for traditional and specialty medications increased 3.3% for clients who implemented 4 or more of ESI's solutions
 - 1. Average drug trend of -1.2% on non-specialty medications
- iv. 30% of ESI's clients saw their drug spend decline in 2015
- d. 37% of total drug spend is specialty; this will grow to 50% by the end of 2018
- e. Total PMPY Cost is \$906
 - i. Traditional PMPY: \$565
 - 1. Up 0.6%
 - 2. Makes up 62% of total trend
 - ii. Specialty PMPY:\$341.21
 - 1. Up 17.8%
 - 2. Makes up 38% of total trend
- f. Traditional 5 Traditional Classes (PMPY Cost) For 2015
 - i. Diabetes
 - 1. PMPY: \$77.50
 - 2. Total trend: 14.0% (utilization up 6.7%, unit cost up 7.4%)
 - ii. Pain/inflation
 - 1. PMPY: \$40.65
 - 2. Total trend: 2.9% (utilization up 0.8%, unit cost up 2.1%)
 - iii. High blood cholesterol
 - 1. PMPY:\$32.66
 - 2. Total trend: -9.2% (utilization down -0.3%, unit cost down -8.8%)
 - iv. Attention Disorders
 - 1. PMPY: \$29.44
 - 2. Total Trend: 8.5% (utilization up 5.9%, unit cost up 2.5%)
 - v. High blood pressure/heart disease
 - 1. PMPY: \$25.70
 - 2. Total trend: -12.5% (utilization up 2.4%, unit cost down -14.9%)
 - vi. Other top classes: heartburn, mental disorders, asthma, compounded drugs, skin conditions
 - vii. Total traditional trend was up 0.6% (utilization was up 1.9%, unit cost was down -1.4%)
- g. Top 5 Specialty Classes (PMPY Cost) for 2015
 - i. Inflammatory conditions
 - 1. PMPY:\$89.10
 - 2. Total Trend up 25% (utilization up 10.3%, unit cost up 14.7%)
 - ii. MS
 - 1. PMPY:\$53.31
 - 2. Total trend up 9.7% (utilization up 3.5%, unit cost up 6.2%)
 - iii. Oncology
 - 1. PMPY: \$49.62
 - 2. Total trend up 23.7% (utilization up 9.3%, unit cost up 14.4%)
 - iv. Hep C
 - 1. PMPY: \$38.44
 - 2. Total trend: up 7.0% (utilization down -2.2%, unit cost up 9.2%)
 - v. HIV
 - 1. PMPY: \$31.53
 - 2. Total trend up 16.6% (utilization up 4.6%, unit cost up 12.0%)

7. **SafeGuard Rx**

- a. Umbrella of tools used to control drug spend. It started with the Hep C Value, but now has 4 programs in it

- b. It drives patients to Accredo so we have better control
- c. ESI gives plan sponsors and patients huge discounts
- d. ESI also takes risk on these programs
 - i. For Hep C, ESI underwrote the risk that the patient would be adherent to the drug. If they weren't adherent, ESI would rebate that back to the plan sponsors
- e. SafeGuard has 4 components
 - i. Hep C Value
 - 1. Lowered the cost to cure by over 50%.
 - ii. Cholesterol Care Value
 - iii. Oncology Care Value – indication based pricing which went into effect this year.
 - 1. We now have discounts on oncology products that we've never had before, but ESI is also making sure that both new generics (Gleevec for example) and biosimilars will be utilized by these members
 - 2. Reimbursing for early treatment discontinuation on select oncology drugs.
 - iv. Price inflation protection
 - 1. Branded drugs –now cap the inflation for plans – gives plan sponsors clarity.
 - v. ESI has seen a lot of interest in SafeGuard Rx this selling season
 - vi. ESI will introduce an expansion of Safeguard Rx at their Outcomes Conference – a lot of clients sign up for SafeGuard while at the conference
 - vii. Plans have to opt out of Safeguard – this drives tremendous adoption
 - 1. Big pain points are diabetes and inflammatory
 - 2. Competition in these classes has increased and you have the introduction of biosimilar (diabetes in 2016 and anti-inflammatory in 2017 most likely)

8. Biosimilars

- a. Will be a continued challenge to get these substituted in, especially on the medical side
- b. Biosimilars will be hard to get substituted in on the medical side
- c. On the pharmacy side, ESI has the tools to switch patients to the biosimilar. For example we took Lipitor off our formulary and we had the tools to communicate with doctors, patients and pharmacies to get those patients moved over to the preferred drug.
 - i. Even on the retail side we have great tools for switching and great communication. During the WAG dispute, they represented 20% of our volume and we were able to move these lives to alternative stores.

3/15 – Cleveland Research Top insights from CVS investor presentation

CVS presented at an investor conference this week. They provided a lot of good detail on how their unique set of assets is helping them gain share in Specialty and positions them well to continue to gain share with health plans and IDNs as they look to lower costs and improve outcomes. Below are the key takeaways and full notes.

Top 5 Insights from CVS Investor Presentation

1. Currently Omnicare is only capturing 50% of the Rx share in the homes that they cover. CVS is developing tools to better capture this share which would provide significant revenue synergy opportunities over the long-term.
2. The 2016 selling season was largely weighted toward health plan wins. A top priority for this year is getting additional programs sold into these accounts.
3. CVS is currently contracted with 60 IDNs. Currently only 50% of Minute Clinic patients have a primary care doctor which provides a significant referral opportunity for the IDNs CVS is partnered with.
4. CVS Specialty is growing 2x the market. This is being driven by both payer directed contracts and success within the open markets (able to capture a lot of business through retail presence and Specialty connect).
5. Given the cost pressures and consumer preferences healthcare is shifting out of the institutional setting to the home and clinics – CVS assets positions them well to benefit from this trend.

CVS Investor Presentation | March 2016**1. 2016 will be a year of execution and integration**

- a. Through Target can offer CVS programs (maintenance choice, specialty connect etc.) through 1700 additional stores
 - i. Target opened new markets to CVS – Seattle and Portland are two great examples
- b. Omnicare opened new patient populations
 - i. Will now be able to follow the patient into the nursing facility or as they come out of the nursing facility
 - ii. Integrating Omnicare now
 - iii. There are both procurement and operating synergies in the near-term, longer term we believe there is revenue synergies
 1. Omnicare currently has 30% market share, but they only capture 50% of the Rx share in the homes that they cover
 2. Omnicare has largely a B2B company and did not have the consumer programs, CVS has consumer reach and is building programs in this channel to capture more of this share
 - iv. Rx Crossroads (Hub Services) is a nice asset, but a small part of the deal.

2. Selling Season

- a. \$14bb of gross wins (\$12.7bb on a net basis) for 2016
- b. Very successful 1/1 with great service levels
- c. The opportunity this year vs. last is this season was largely represented by several large health plans
 - i. Employers can make a quick decisions to adopt tools
 - ii. Health plans have to sell in the program throughout their book, this takes longer
 1. So there is a lot of opportunity to sell these programs in

3. Ability to impact the cost curve

- a. Consumer perspective – biggest reach to consumers vs. competitors given mobile tools and retail presence. We can make the clinical engagement more effective
- b. Payer perspective – we have been able to structure effective formularies and solutions for payers
- c. Plugging more into the provider community. We are in the early innings of this
 - i. As they are taking on risk, pharmacies are able to lower costs and improve outcomes
 - ii. Minute clinic is a great asset to partner with IDN, now have 60 IDN relationships
 - iii. 50% of the patients that come into Minute Clinics do not have a primary physician. So we are a referral source to IDNs.
 - iv. As hospitals take more risk, we are a high quality and low cost of care
 1. There is a shortage of physicians

4. Specialty

- a. CVS has been growing at 2x the market
- b. Look at it in two markets: payer directed market and patient directed market
 - i. Payer directed market is very focused on what is the right formulary, how do they control trend and cost and drive adherence
 - ii. Patient directed model is the open model (ie Medicare where networks can't be restricted) – through Specialty Connect when a patient presents themselves at a retail location, we can get them on therapy quickly
 1. We have 9k plus access points for specialty care with retail locations
 2. At retail our pharmacists have access to the mail specialty clinical programs
- c. The Coram acquisition is a good example of our ability to serve the health plan community more effectively.

5. Integrated Model

- a. CVS + Caremark came together in 2007, but it took until 2011 until things started to gain traction
- b. We now have had patients and payers on our programs for years and have the data to show the savings and outcomes that are programs will deliver
- c. There continues to be reimbursement pressure and we have more opportunities to continue to expand the reach in both the employer and health plan segment
- d. There are many things we can do as healthcare evolves from an institutional setting to more of a retail or home setting
- e. CVS Assets:
 - i. Largest retail presence
 - ii. Large infusion which gets CVS into the home
 - iii. Specialty business allows CVS to leverage this in retail, mail and in the home
 - iv. 1100 clinics that allow CVS to partner with payers and providers in unique ways

6. Brand Inflation

- a. In 2015 we had 5% trend across our book
 - i. 65% of the trend was from core brand inflation
- b. Inflation in total was pretty immaterial
- c. As brand inflation occurs – we are the largest PDP – we are a payer – so CVS pays more for those drugs. There are other pieces of our business the benefit from inflation, but overall our focus is to lower inflation for our customers.

3/17 – Key Takeaways and Notes from Evercore ISI Expert Call on ANTM/ESRX Row

Key Takeaways from the Call [emphasis from Evercore]

While our expert stated that it is hard for him to imagine ESRX profits on the ANTM contract approaching \$3Bn, he did provide a wealth of data on how rebates, AWP discounts, generic effective rates and other contracting dynamics have shifted from 2009 to today. Based on this we have created a **PROPRIETARY worksheet** (available upon request) to calculate potential contract savings and our base estimate now **VALIDATES ANTM's \$3Bn claim**

- **Generics:** Savings up to **~\$1.9 Bn** stemming from an increase in the AWP discount (from ~73% to ~81% over the past 3 years)
- **Specialty:** **~\$260 MM** in savings given the increase in average specialty rebate since 2012 (from \$140 per Rx to \$200)
- **Brand:** **~\$285 MM** in savings from the rise in average brand rebate from 2012-2015 (from \$26.50 to \$34.50 per Rx)
- **Rebate Capture:** Savings up to **~\$600 MM** for both branded and specialty drugs if ESRX is keeping ~10% of rebates
- **TOTAL:** **~\$3.1 Bn in potential savings to ANTM**

Our consultant is seeing the ESRX-ANTM dispute as a **major disruption to this year's selling season**

- Some clients think that if ESRX is poorly serving its largest customer in ANTM, "imagine what they are doing to us"
- **Expects ESRX's retention rate to go well below 97%**
- **CVS** would be the likely **big winner**, capturing a lot of downfall from this dispute
- Overall, **pricing has materially worsened vs. 2015** and the consultant has seen ESRX come with competitive financials proposals when going after new business (rebates + GER - key to argument they are using ANTM rebates as 'price' to new / existing customer)
 - **Expect many ESRX clients to demand / utilize price check during selling season (NEW)**

Our expert noted that despite the tenor of the current dispute between ESRX and ANTM, he has never seen a case go to litigation. He views ANTM as likely to stay with ESRX, and laid out the below options for ANTM (**we see much greater risk of litigation / termination**)

- Renegotiate with ESRX

- ANTM would likely receive a better discount rate and would not have to switch to a new vendor, especially when the CI deal is going on at the same time
- A renewal could also benefit ESRX as it would retain its largest client and would likely convince ANTM to adopt its incremental clinical and pharma programs
- Switch to a new PBM (easier in 2020 vs. today)
 - Difficult to do if integrating CI at the same time
 - CVS has the ability to manage a client like ANTM, but AET is largest client, and it would have to invest in assets
 - Optum does not have the scale and resources to support ANTM right now (could be helped by WBA relationship)
- Develop in-house PBM
 - Tough in the near-term given the required investments; would take long time

The recently announced **Optum/WBA** deal is **much different** from the previously announced **Smart90 program** (between ESRX and WBA) as Optum more likely to sell the program aggressively (much lower mail penetration vs. ESRX)

- The announcement is also the likely **start of a broader relationship**, with specialty likely to be the next area of increased cooperation
- Optum doesn't typically have CVS in its network and is looking to build relationship with a competitor

Our expert believes **the standalone PBM model is viable** over the long term.

- PBM integration with managed care companies is problematic (particularly for other health plan clients), and he thinks Optum will be spun out from UNH over time (has said this prior)
- He also expects future consolidations among mid-sized PBM players
- The PBM model will change over time and **pricing will become more transparent** (e.g. move to a PMPM model, PBM takes on risk in certain therapeutic classes)

Ryan Lane's Notes from Evercore ANTM / ESRX Expert Call on 3/17/2016

- Expert has deep knowledge of PBM landscape (first name is Art? Thick New York accent, mentioned that he formerly worked at Mercer)
- Market checks became more common over the past 5 yrs
- ESRX/ANTM has caused a lot of noise amongst consultants
- Small % of time a typical contract leads to better terms for client via price check
- Would absolutely drive savings on any contract circa 2009
- Have seen a massive shift in specialty rebates (from \$75 to now \$200)
- 2012 market check unlikely to have yielded much savings for ANTM
- Escalators should be built into contract negotiation to guarantee financial savings for client YOY
- ANTM likely suffered from mixed contracting at original time of signing
- \$3B target definitely aggressive on procurement
- Thinks it is hard to imagine litigation in this instance
- Health plans have been leaving Optum within consultant's book (former CTRX)
- ANTM did not have robust GER guarantee
- Expert put language in place to say IF generic effective rate not met there is a \$ return to client in many instances
- A lot of blockbuster generic drugs became available since 2009
- Believes 2 big buckets for ANTM savings will be 1) specialty and 2) generics
- Possible that ANTM could renew or adopt incremental clinical programs
- Complex to transition to another vendor during CIGNA integration
- Would be more logical to transition away from ESRX in 2020 vs today

- CVS has the ability to manage client the size of ANTM
- AWP-81% is going rate on generic discount (but GER is also in the 80% rate); GER could be mid 80s by 2020 vs 60s in 2009
- Difficult to understand why resolution has been challenging to come to for ESRX and ANTM
- Has not ever had client litigate against a PBM (only threaten)
- No contracts consultant negotiates have any rebate share kept by PBM (100% to client with minimum guarantee per claim)
- Rebate sharing used to be more customary; common is 10% (but could be as high as 20%)
- ESRX will increase rebate in final offer but require higher % rebate at times
- \$ guarantee rebate per Rx is \$20 higher on brand and specialty is more so
- In less than 10 years we will see a lot more transparent pricing because it will be public information
- ESRX clients who wanted to renew now looking to do full vendor procurement, and looking at 2nd tier PBMs (Envision specifically mentioned by expert)
- Would be surprised if EXRS retention is 97% (likely below)
- Big winner from disruption so far is CVS
- Tough to develop own PBM in house at ANTM; would take a long time
- Tough to see relationship between OptumRx (UHC) and ANTM
- CTRX has had network relationships with WBA for years
- Difference between Optum/WBA and Smart90 is ESRX bias toward mail
- Smart90 pricing still better at mail vs retail (even through discounted – middle road)
- WBA/Optum will offer similar pricing at mail / retail
- Could be first step of larger relationship between WBA and Optum
- Next phase of WBA relationship could be around specialty drugs
- Could Envision be rolled into Optum over time due to this relationship growing?
- Continues to think Optum will be spun out from UHC over time
- Believes stand-alone PBMs business model will exist long-term
- CVS has big winner on health plan side
- Sees further consolidation among mid-sized PBMs, either together or via big PBMs
- Political oversight could also influence business model transition
- Pricing very competitive/robust in 2016 (better than 2015) during selling season
- Not seeing Optum be as price competitive as ESRX and CVS; ESRX being more competitive at BAFOs (GER + rebates)
- Surprised how quiet it has been on RAD/WBA front in terms of deal closing

3/17 – OptumRx and Walgreens Partner to Improve Consumer Convenience, Cost Savings and Outcomes

Includes 90-day prescription options at pharmacies nationwide at home delivery prices, and 24/7 access to pharmacists. Integrating OptumRx's pharmacy care services solutions with Walgreens leading drugstore services will help reduce pharmacy costs and improve health outcomes

OptumRx and Walgreens are partnering to create a new pharmacy solution to meet consumers' changing prescription drug needs and help employers, health plans and their members achieve better health outcomes and greater cost savings. OptumRx is UnitedHealth Group's [NYSE:UNH] free-standing pharmacy care services business, managing more than one billion prescriptions annually. Walgreens is one of the nation's largest drugstore chains and part of the Retail Pharmacy USA Division of Walgreens Boot Alliance, Inc. [Nasdaq:WBA].

Source: businesswire.com/news/.../OptumRx-Walgreens-Partner-Improve-Consumer-Convenience-Cost

3/21 – Goldman Sachs 2016 Healthcare Outlook Report

Report Summary: Becoming more selective after five years of outperformance

While it may not feel like it given the recent rollover in the sector, HC is on track to clock its fifth consecutive year of outperformance in 2015 (XLV +3% ytd vs. S&P down -2%; HC third best S&P sector ytd), a feat achieved for the first time in the last 25 years. In subsectors, managed care fared best, partly on the M&A/consolidation theme, while laggards were spec pharma (on business model risk) and hospitals (as ACA trades reversed, and the high leverage factor theme hurt). Five of the sector's 10 best performers (BSX, REGN, EW, LLY and BMY) were product cycle / pipeline stories, an investable theme that we think will be increasingly important for the forward outlook, irrespective of the direction of the overall HC tape. As we look toward 2016, we see a confluence of macro, political and micro vectors shifting the sands beneath the bull case. On the macro, three factors will be top of mind.

1. **The election.** Performance data going back to 1976 shows that, in election years, (i) HC has outperformed less than 40% of the time and (ii) the median HC stock delivers 200 bp of underperformance. The overlay of the tough pricing rhetoric coming out of DC could keep the bar high for multiple expansion.
2. **Interest rates.** Analogs show HC lags with other defensive/dividend yielding areas a rising rates environment. While we believe the yield component has been only a partial factor in HC's 5 year bout of outperformance – micro themes have mattered equally, if not more – we see rotational risk as generalist PMs re-evaluate sector level allocations as we move into an elongated period of potential interest rate hikes from the Fed for the first time in nearly a decade.
3. **Relative growth.** Part of the bull angle on HC has been its superior sales growth relative to the S&P (11% in 2015 vs. S&P 3%) though it is worth noting that this gap narrows in 2016 – to 7% for HC vs. 6% for the S&P, per GS equity strategy – which could make the sector relatively less compelling. FX is likely to also remain a key swing factor – continuing USD strength could be a headwind. GS currency strategists see USD/EUR rates of 0.95 by year-end 2016 (vs. current 1.1).

Further, the following sector-level/micro themes are likely to remain areas of debate.

1. **Drug pricing.** The risk of legislative changes in 2016 is low, though our Washington DC strategist notes that at some point down the road, discounts/rebates for Medicare (particularly Part B) could get traction even under a Republican Congress. As we enter what could be a multi-year debate on branded pricing vulnerabilities, we believe that market should – and will – place a premium on true innovation (cancer and orphan disease). With regards to generic pricing, we expect the moderation in generic prices experienced in 2H15 could continue into next year, potentially driving a return to single-digit price deflation, driven by a declining GRx FDA backlog and greater government scrutiny on select outsized price increases.
2. **Utilization.** As the ACA-fueled components of recent utilization strength anniversary in 2016, the onus will be on macro /cyclical factors to carry HC utilization higher. While we expect core HC volumes to improve in 2016, we believe uncertainty over the outlook for ACA coverage will result in investors paying a lower multiple across HC services (hospitals, drugstores, labs) for “core utilization” growth vs. the ACA bonanza of the last few years.
3. **M&A.** Despite substantial balance sheet firepower across the sector, we expect the pace of M&A going forward to slow after a record year in 2015. Notably, acquirer stocks have now started to underperform after deals are announced. The net effect of these moving parts create a tougher backdrop for further sector level outperformance, in our view, and an environment in which stock selection will become ever more important. With this outlook piece, we make several changes that now reflect a more Neutral view on Healthcare.

Link to full report:

https://na2.salesforce.com/sfc/p/30000000062Y/a/40000000XZuj/q_ml46RsIM3jbloGGstQRkmeetCV8EHEulqo5h5B1Ho

3/22 – Modern Healthcare: Will the Anthem-Express Scripts battle change the PBM landscape?

Anthem sues Express Scripts for \$15 billion over drug pricing. Anthem Inc.'s legal strike against Express Scripts Holding Co. may spur other health insurance companies to re-evaluate their contracts with pharmacy benefits managers to see if they are getting shortchanged on drug savings. It could also allow Anthem and others to consider integrating drug benefits under their own corporate umbrellas. At a minimum, observers expect more calls for transparency throughout the drug pricing process, which often is shrouded in secrecy in the name of “trade secrets” and has become one of the most divisive issues in health care.

Source: <http://www.modernhealthcare.com/article/20160321/NEWS/160329976>

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3/24 – Centene Completes Acquisition Of Health Net

Centene Corporation (NYSE: CNC) today announced that it has completed its acquisition of Health Net, Inc. The closing of the transaction follows the approval of each company's shareholders and receipt of all required regulatory approvals. Effective today with the closing of the acquisition, Health Net is a wholly owned subsidiary of Centene and no longer a publicly traded company.

In accordance with the terms of the acquisition agreement, Health Net shareholders received 0.622 shares of Centene common stock and \$28.25 in cash for each share of Health Net common stock they held at closing, for a total transaction value of approximately \$6.0 billion, including the assumption of debt.

Source: <http://www.prnewswire.com/news-releases/centene-completes-acquisition-of-health-net-300241037.html>