

Wall Street Perspective: The PBM Sector - Rx for Growth

Healthcare Technology & Distribution

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Agenda

- Rx Industry Drivers
- Competitive landscape - Stand-alone vs. Captives
- What are PBM customers saying
- PBM fundamental drivers
 - (1) Generics
 - (2) Specialty
 - (3) Mail
 - (4) Medicare Part D
- Where do the stocks trade?
- Summary

Strong Industry Fundamentals: Solid Investment Rx

Industry Background

- I. Rx is the fastest-growing component of healthcare expenditures

National Health Expenditures, By Category

Total Market: \$2.2 trillion

	1980	%	2007	%	CAGRs
Hospital Care	101.0	39.9%	696.5	31.1%	7.4%
Physician/Clinical Services	47.1	18.6%	478.8	21.4%	9.0%
Prescription Drugs	12.0	4.7%	227.5	10.2%	11.5%
Nursing Home Care	18.5	7.3%	131.3	5.9%	7.5%
Dental Services	13.3	5.2%	95.2	4.2%	7.6%
Other	61.5	24.3%	611.9	27.3%	8.9%
Total	253.4		2241.2		8.4%

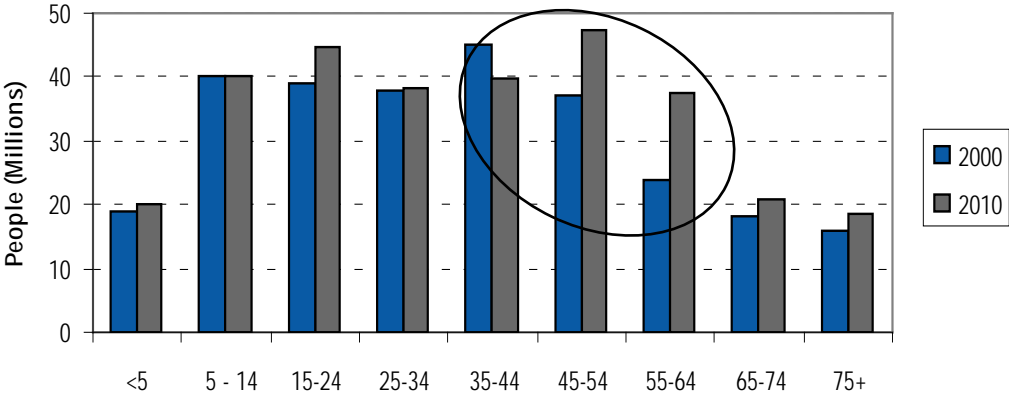
Source: CMS.

CMS projects spending on prescription drugs to grow by a compound annual growth rate of 6.5% per year through 2018, the fastest growth of any category

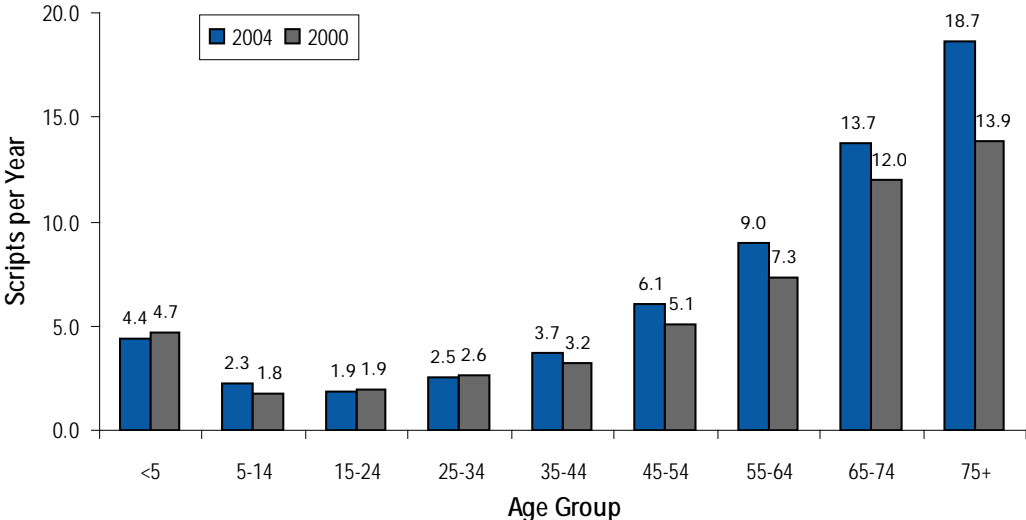
Strong Industry Fundamentals: Solid Investment Rx

Industry Background

II. Aging baby boomer population: driving utilization



Source: U.S. Census Bureau.



Source: National Ambulatory Medical Care Survey, NACDS Economics Department.

PBMs: The Solution to Rising Drug Costs

- 1) Plan design consultation
- 2) Formulary development and compliance
- 3) Rebate management
- 4) Retail network management
- 5) Electronic claims processing
- 6) Mail pharmacy
- 7) Disease management
- 8) Specialty pharmacy

Who Are the PBMs?

Competitive Landscape

Still many players, however, dominated by the Top 3

We will focus our discussion on the “Big Three” independent PBMs

PBM Market Share Based on Adjusted Prescription Volume (2007)

2007 total adjusted scripts: 4.0 billion

Rank	Company	Adj. Claims (E)	Mkt. Share (E)	Affiliation
1	Medco Health Solutions	748.2	18.7%	Independent; publicly traded
2	CVS Caremark (includes PharmaCare)	742.3	18.6%	Independent; publicly traded
3	Express Scripts	506.9	12.7%	Independent; publicly traded
4	SXC Health Solutions (includes NMHC Rx)	324.3	8.1%	Independent; publicly traded
5	Prescription Solutions	310.2	7.8%	Owned by UnitedHealth Group (publicly traded MCO)
6	WellPoint NextRx	309.5	7.7%	Owned by WellPoint, Inc. (publicly traded MCO)
7	Argus Health Systems	267.5	6.7%	Owned by DST Systems (publicly traded) and Financial Holding Corp.
8	ACS State Healthcare (Consultec)	266.0	6.7%	Owned by Affiliated Computer Services (publicly traded)
9	MedImpact	170.4	4.3%	Independent; privately held
10	First Health Services Corp.	149.9	3.7%	Owned by Coventry Health Care (publicly traded MCO)
11	Prime Therapeutics	116.0	2.9%	Owned by a group of Blue Cross Blue Shield plans; privately held
12	Aetna Pharmacy Management	102.9	2.6%	Owned by Aetna, Inc. (publicly traded MCO)
13	Walgreens Health Initiatives	101.7	2.5%	Owned by Walgreen Co. (publicly traded retail pharmacy)
14	Health Trans	94.8	2.4%	Independent; privately held
15	CIGNA Pharmacy Management	85.0	2.1%	Owned by CIGNA Healthcare (publicly traded MCO)
16	Member Health	60.0	1.5%	Owned by Universal American Corp. (publicly traded insurance co.)
17	RxAmerica	57.7	1.4%	Owned by Longs Drug Stores (publicly traded retail pharmacy)
18	Catalyst Rx (HealthExtras)	44.4	1.1%	Independent; publicly traded
19	RESTAT	27.0	0.7%	Owned by F. Dohmen Co. (privately held pharmaceutical distributor)
20	ScriptSave	17.0	0.4%	Independent; privately held

Source: Atlantic Information Services, IMS Health, NACDS, company reports and JPMorgan estimates.

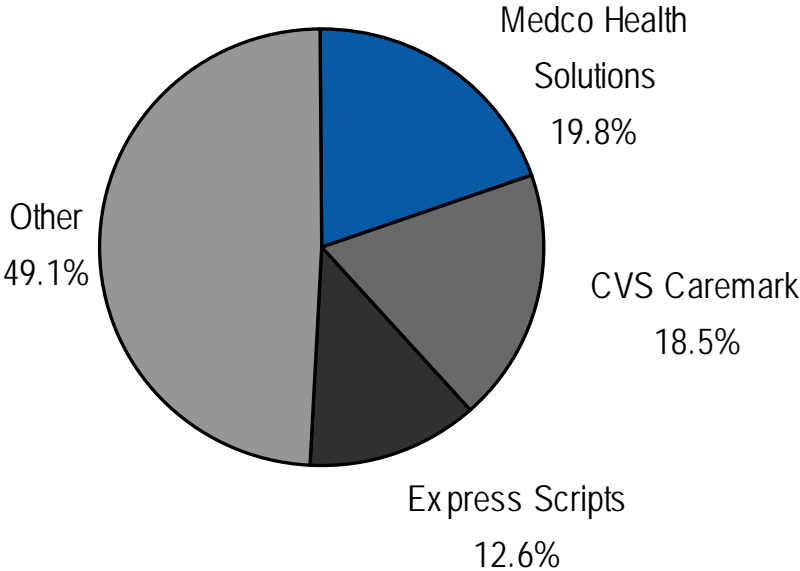
Note: Some potential double counting may exist for PBMs that utilize a claims processing system provided by another PBM on an ASP basis.

Who Are the PBMs? Big 3 Control Over 50% of Market

Competitive Landscape

Medco, CVS Caremark, and Express Scripts control 51% of the market

PBM Market Share Based on Adjusted Script Volume (2008)

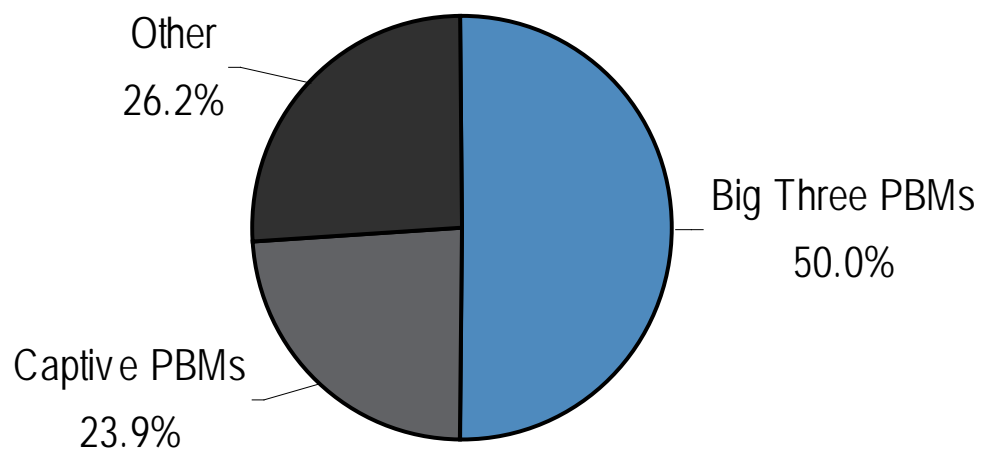


Source: IMS Health, NACDS, Company reports.

Stand-Alone vs. Captive PBMs

- We estimate captive PBMs represented approximately 24% of the market based on total adjusted scripts in 2007

Market Share as a Percent of Total Adjusted Scripts (2007)



Source: Atlantic Information Services, Inc. (AISHealth).

Survey Says: Opportunities Remain for Carve-outs, Mail, Generics, and Specialty

- Clients with captive PBMs more willing to consider carve-out model
- Generic profitability not currently at risk, as all respondents satisfied with savings and believe PBM economics are fair
- Benefit design changes more likely in current economic environment, driving incremental benefit to the PBM business model
- Plan sponsors continue to seek ways to control specialty pharmacy costs
- Subsidy is still the market choice for Medicare Part D

PBM Fundamental Drivers

- 1) Shift to generics
- 2) Mail growth
- 3) Specialty pharmacy
- 4) Medicare Part D

Fundamental Drivers

Shift to Generics

Tidal wave of generics began in mid-2006

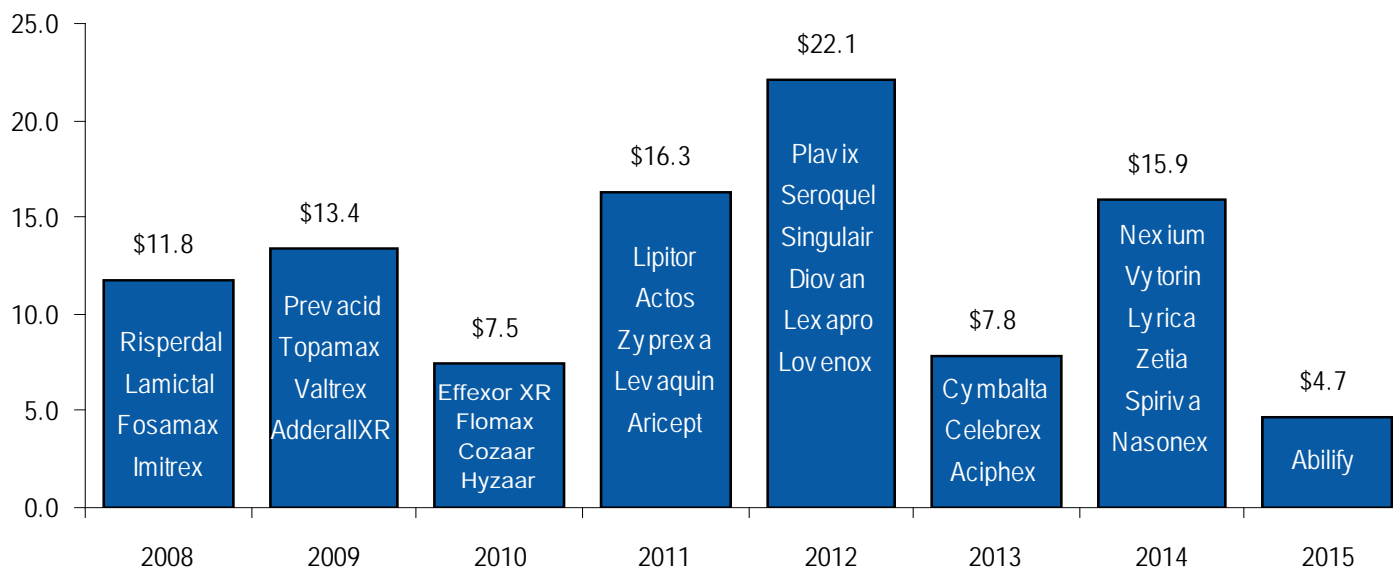
- Generics are expected to be a key driver of profitability over the next few years
- Generics via mail order are 9-10 times more profitable for a PBM on an absolute dollar basis
- Aligned incentives: Clients save and PBMs drive profitability

Fundamental Drivers

Shift to Generics

- Through 2015, branded drugs with sales of nearly \$100 billion are expected to lose patent protection

Generic Drug Opportunity (\$ billions)



Source: Medco Health Solutions.

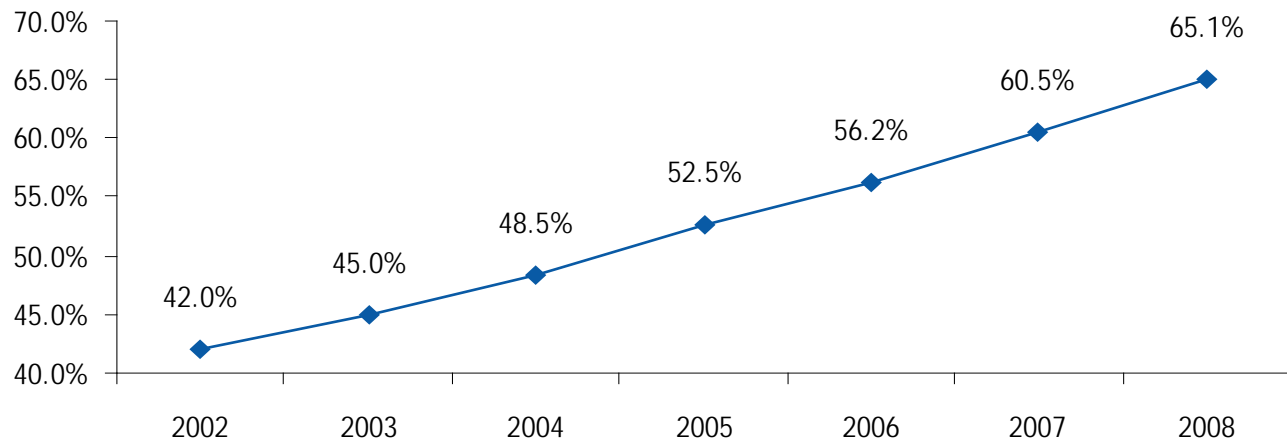
Note: U.S. drug spend estimates are based on IMS Health data for 2007.

Fundamental Drivers

Shift to Generics

- Generic dispensing rates at the Big Three PBMs have risen substantially over the past few years
- Today, 70-75% of all prescriptions could be dispensed as generics

Average Generic Dispensing Rate at Big Three PBMs (% of total scripts)

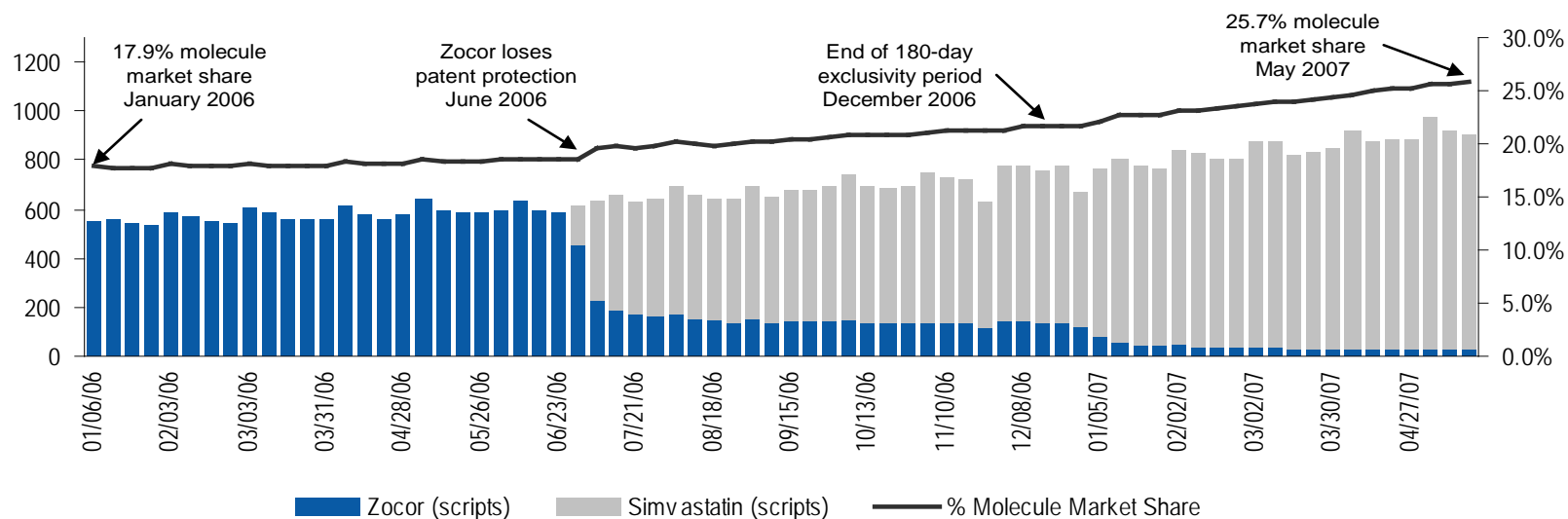


Source: IMS Health, Company reports, J.P. Morgan estimates.

Fundamental Drivers

Shift to Generics

- Therapeutic substitution involves replacing one active chemical with another designed to treat ailments in the same class
- This can lead to a significant earnings benefit for the PBMs, as seen with the simvastatin molecule following the generic launch



Source: IMS Health.

Fundamental Drivers

Mail Growth

Mail order has grown faster relative to all other channels

Retail Channel Scripts vs. Adjusted Mail Scripts, 1992-2007

	1992	% of Total	2007	% of Total	CAGR
Traditional Chain	756	36.5%	1,660	41.5%	5.4%
Independent	769	37.1%	745	18.6%	-0.2%
Mass Merchant	186	9.0%	390	9.8%	5.1%
Food/Drug	173	8.3%	478	12.0%	7.0%
Mail Order	189	9.1%	726	18.2%	9.4%
<i>Total</i>	<i>2,073</i>		<i>3,999</i>		<i>4.5%</i>

Source: IMS Health, NACDS, J.P. Morgan. Note: Mail scripts have been converted to retail equivalents.

Fundamental Drivers

Mail Growth

Key drivers going forward:

- 65%-70% of all scripts are for chronic conditions that fit the mail model
- Aging baby boomers, the fastest-growing age group, utilize more chronic medications
- Several studies by independent government organizations have validated the cost-effectiveness of mail order
- Clients have demonstrated increasing willingness to implement mandatory mail or other incentive programs
- Mail is cheaper (lower copays) and more convenient for the member
- Medicare Part D could drive penetration rates

Fundamental Drivers

Mail Growth

- Mail penetration as a percentage of total adjusted scripts correlates with profitability per claim metrics
- The Big Three PBMs account for well over three-quarters of total mail volume in the U.S.
- Mail market share impacts negotiating leverage with generics manufacturers

Mail Analysis, Calendar 2008

	% of total adjusted scripts	% of total mail market
CVS Caremark	22.9%	23.7%
Express Scripts	25.0%	17.7%
Medco Health Solutions	39.7%	44.1%

Source: IMS Health, Company Reports, JPMorgan estimates.

Fundamental Drivers

Specialty Pharmacy

What does a specialty pharmacy do?

- Distributes patient-specific specialty pharmaceuticals
- Provides patient support services (clinical, reimbursement, etc.)

What is a specialty pharmaceutical?

- Biotech products, blood products, orphan drugs
- High-cost therapies (typically \$10,000+ per patient per year)
- Special handling requirements (temperature-sensitive)
- Unique routes of administration (injected, infused, inhaled)
- Complex therapies requiring high degree of clinical support

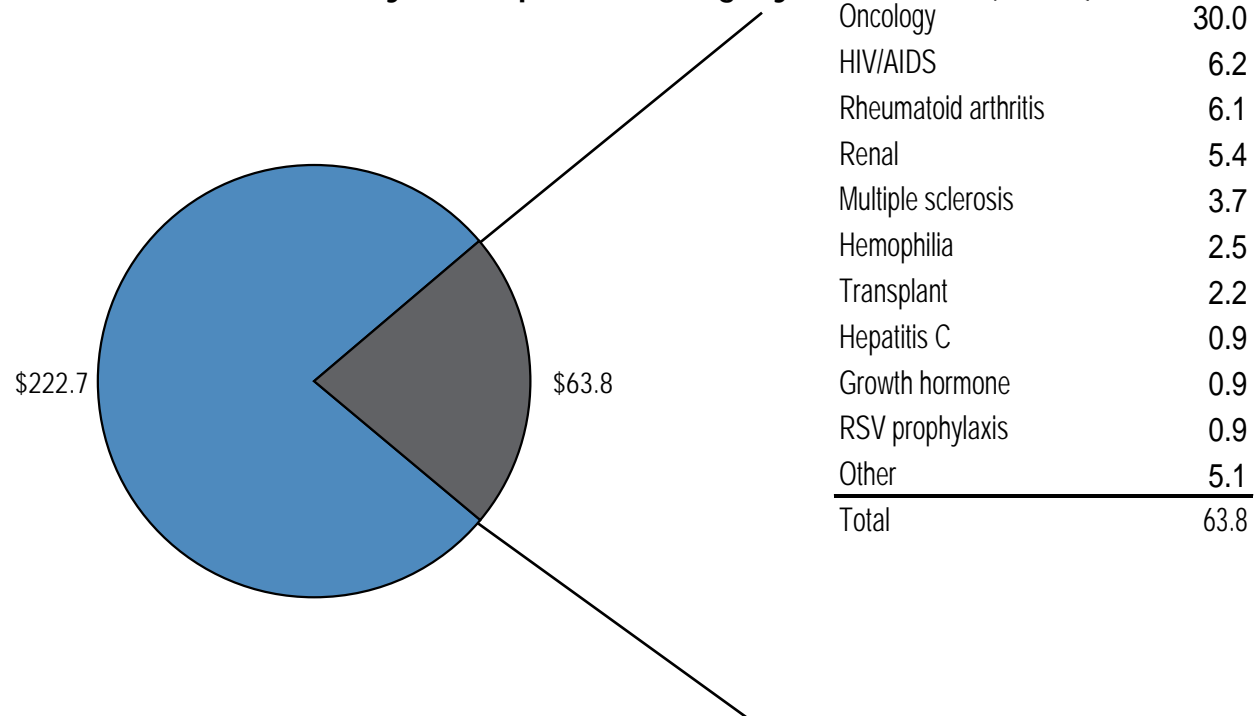
Fundamental Drivers

Specialty Pharmacy

- Specialty pharmaceuticals represent a relatively small portion of total drug expenditures, but are projected to grow 2-3 times faster

Specialty Pharmaceutical Market by Therapeutic Category, \$ billions (2007)

■ Traditional
■ Specialty



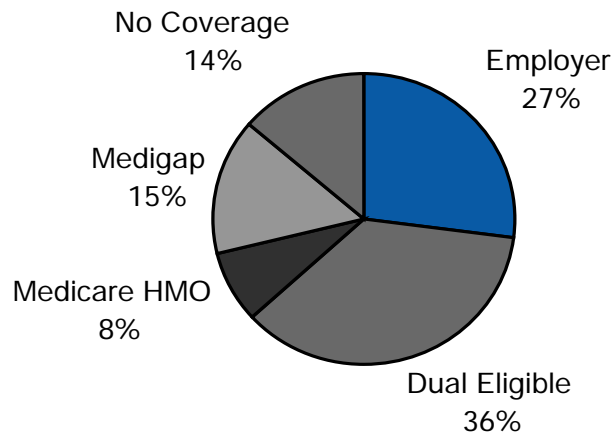
Source: IMS Health, Company reports, J.P. Morgan estimates.

Fundamental Drivers

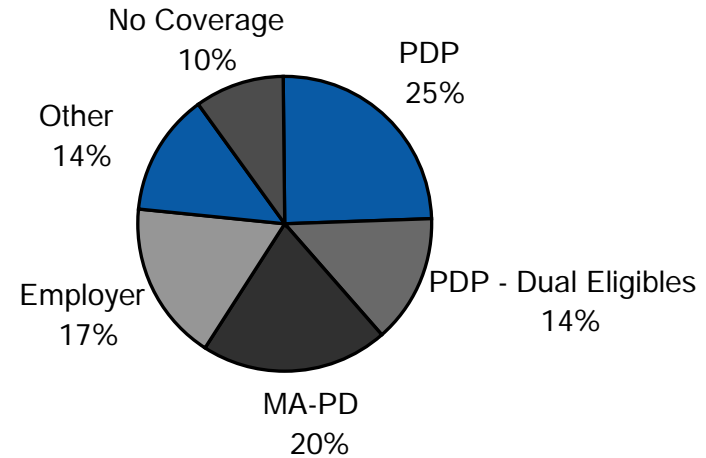
Medicare Part D - A New PBM Frontier

Retiree Market Changes Create New Opportunities

Prior to Part D Implementation



Post Part D Implementation (as of 3/09)



Source: Kaiser Family Foundation Medicare Chartbook, 2005.

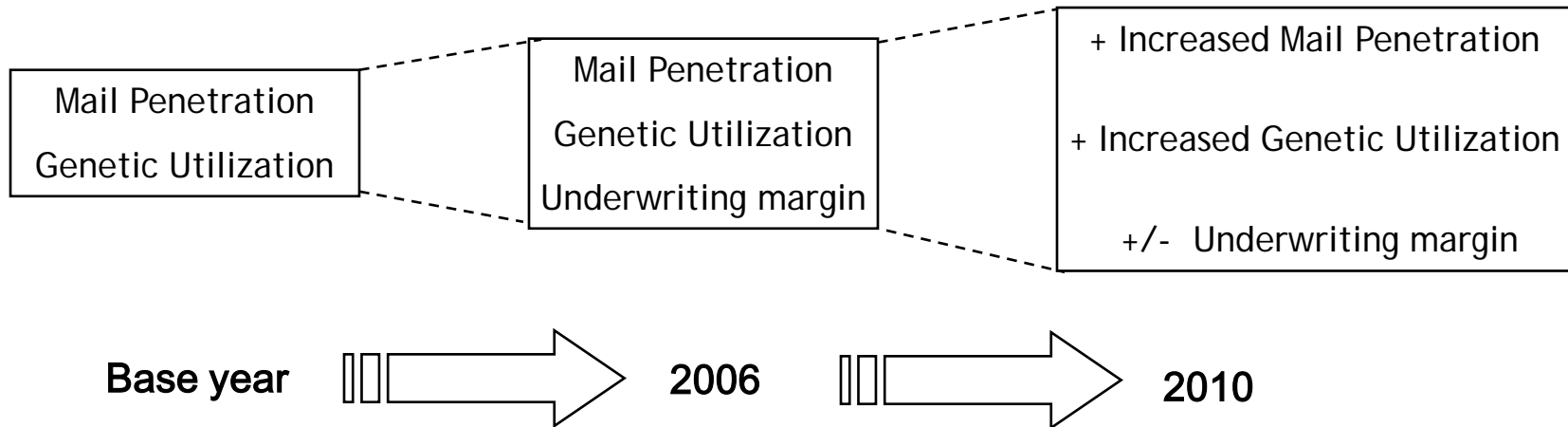
Fundamental Drivers

How Will PBMs Participate?

- National PDP (CVS Caremark and Medco)
 - Auto enrollees
 - CVS Caremark in 28 of 34 regions
 - Express Scripts in 0 of 34 regions
 - Medco in 22 of 34 regions
- Support employers & health plans
 - 95%+ of employers took subsidy in 2008
- Leverage existing relationships to move post retirees of employer groups to PDP product over time (wraparound)

Fundamental Drivers

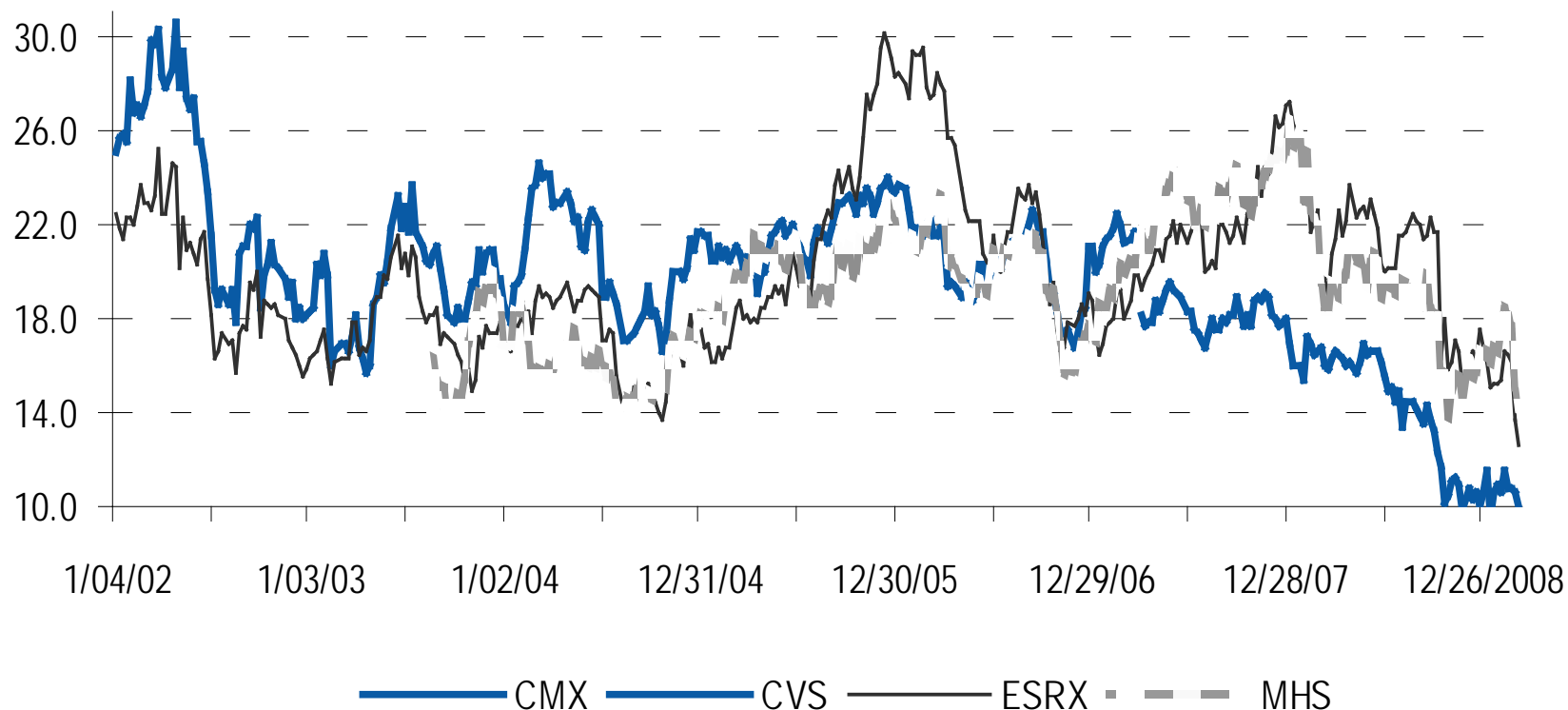
Medicare Part D Should Add Incrementally Over Time



Key for PBMs: Maintain existing retiree base even if they shift to Medicare

Where the Stocks Are Trading: Historical Valuation

Forward 12-Month P/E Multiples: Big Three PBMs



Forward 12-Month P/E Multiples Since 2002

	Caremark Rx	CVS Caremark	Express Scripts	Medco Health Solutions
Average	21.1	15.5	20.0	19.2
High	30.6	19.5	30.1	26.3
Low	15.7	9.6	12.6	13.6

Note: CVS Caremark data includes period following merger with Caremark Rx (March 2007).

Summary: PBMs A Solid Prescription for Growth

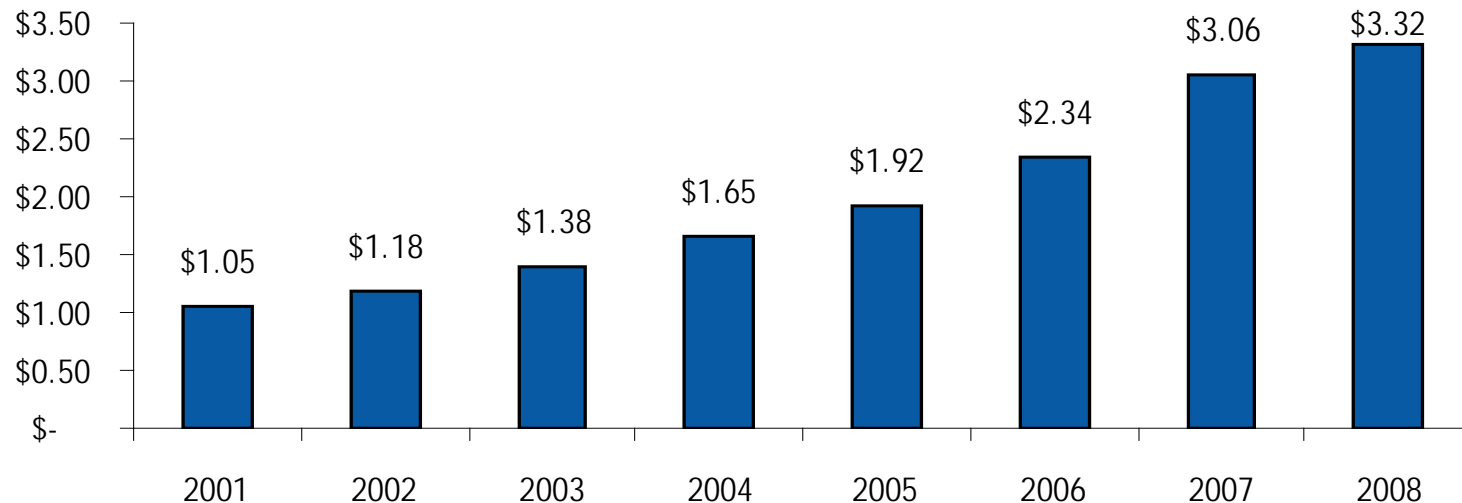
- Longer-term fundamentals - next five years, remain strong thanks to generics and specialty
- Significant patent expirations of chronic medications should continue to drive profitability
- Biotech and specialty drug pipeline remains robust, with the potential for a generic biologic over the next several years
- Medicare Part D continues to be a growth area with opportunity to improve margins
- Shareholders are generally willing to pay for growth - PBM industry should be well positioned

PBM Is a Competitive, But Rational Industry

We view EBITDA per adjusted claim as a reliable profitability metric

- Profitability metrics continue to rise, evidence of a rational pricing environment
- CAGR (2001-2008) = 17.8%

PBM EBITDA/Adjusted Claim Trend, 2001-2008



Note: Data includes AdvancePCS prior to acquisition by Caremark in 2004, and includes PharmaCare beginning in 2007.

Source: Company reports and J.P. Morgan estimates.

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Companies Recommended in This Report (all prices in this report as of market close on 19 March 2009)

CVS Caremark Corp. (CVS/\$26.65/Overweight), Express Scripts, Inc. (ESRX/\$46.48/Neutral), Medco Health Solutions, Inc. (MHS/\$38.77/Overweight)

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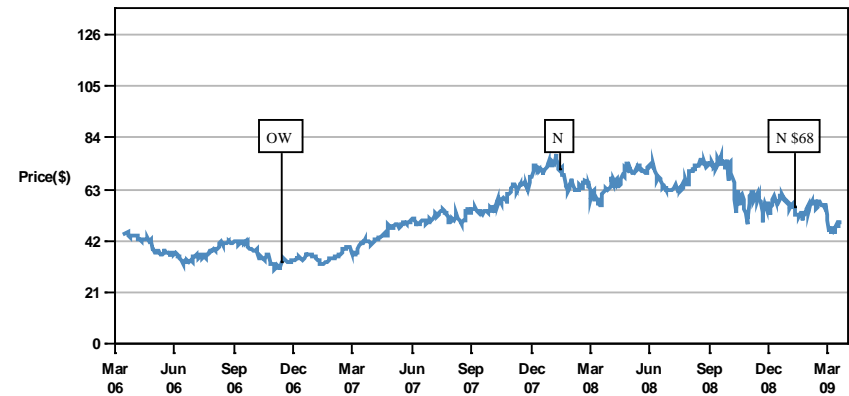
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CVS Caremark Corp. (CVS) Price Chart



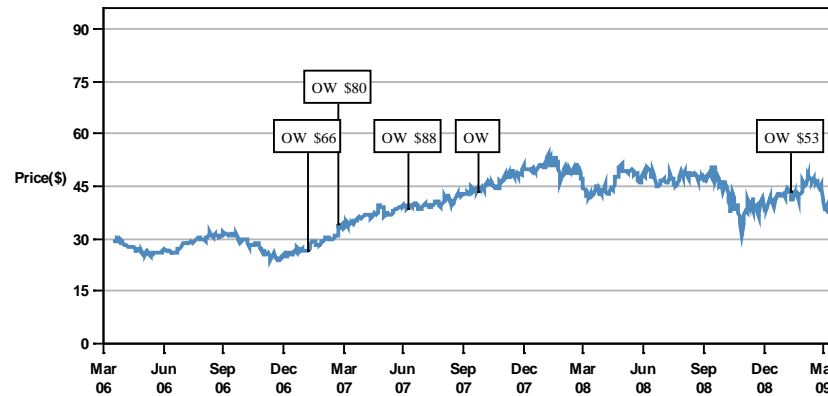
Source: Reuters and J.P. Morgan; price data adjusted for stock splits and div idends.
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Express Scripts, Inc. (ESRX) Price Chart



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Medco Health Solutions, Inc. (MHS) Price Chart



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