

Financial Analysis of CVS Caremark Pharmacies and Pharmacy Benefit Manager

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Overview

The four major pharmacy chains in the U.S. are Walgreens, CVS Caremark, Express Scripts and Rite Aid. Together, these four pharmacy chains sold over 50% of the prescription drugs purchased in the U.S. in 2016. Walgreen corporation was expected to merge with Rite Aid in 2015, but that merger was cancelled a year later.

Walgreens pharmacies sell prescription medications almost entirely via retail pharmacy stores. CVS Caremark provides prescription drugs through both retail pharmacies and its pharmacy benefits manager service (Caremark) and Rite Aid is a retail pharmacy outlet that also recently began offering pharmacy benefit manager services. Express Scripts is solely a pharmacy benefit manager with a mail order prescription drug service.

All other prescription drugs in the U.S. are sold either by small independent pharmacies, large retail stores for whom prescription drugs sales are a small portion of their overall revenue (like Walmart) or pharmacy benefit managers that act as subdivisions of major health insurance companies.

CVS Caremark

In 2007 CVS pharmacies merged with the pharmacy benefits manager Caremark to form CVS Caremark; the largest single supplier of prescription medications in the U.S. CVS retail prescription drug sales are roughly equivalent to those of Walgreens pharmacies. Both CVS and Walgreens each sold about \$60 billion in retail prescription medications in 2017.

In addition to their retail sales, though, CVS Caremark also has more than \$30 billion in mail order prescription drug revenue each year. As a pharmacy benefits manager, they also mediate more than \$70 billion in prescription drug sales through other retail pharmacies.

The combined total revenue for CVS Caremark in 2017 was nearly \$185 billion. For the entire health care industry CVS's revenue was second only to that of United Health Group which is the largest Health insurance company in the U.S. CVS's revenue was more than double that of the largest pharmaceutical corporation (Johnson and Johnson) and was more than four times the revenue of the largest hospital corporation in the US (Hospital Corporation of America). CVS Caremark is big and, if their merger with the health insurance company Aetna goes through, they'll be much bigger still.

Pharmacy benefit managers (PBMs) were created in the late nineties to help insurance companies select cost effective medications for their formularies. At that time, the majority of prescriptions filled in the U.S. were for expensive brand name medications so PBMs could be helpful in reducing the overall cost of these drugs.

Now, nearly all prescriptions filled in the U.S. are for inexpensive generic medications. The PBMs determine the copays people pay for these medications, but usually pay nothing since

generic medications cost so little. What's more, PBMs often split your copay with the pharmacy so, instead of helping you purchase your generic prescription medication, PBMs actually raise your out-of-pocket cost for these medications in order to get a kickback from your pharmacy.

To make matters worse, PBMs also get tens of billions of dollars each year in rebates from pharmaceutical companies to help them "select" which brand name medications to put on their formularies. So, instead of selecting the most cost effective medications, PBMs are encouraged to select medications that yield higher rebates. PBMs get away with all of this mostly because very few people know anything about them or what they do.

The total executive compensation for CVS Caremark executives in 2016 was \$42.7 million with \$18.4 million going to their CEO Larry J. Merlo.

Sources: <http://truecostofhealthcare.net/pharmacy-financial-index/>

<http://truecostofhealthcare.org/wp-content/uploads/2018/02/LargestPharmcies2016.pdf>

<http://insiders.morningstar.com/trading/executive-compensation.action?t=CVS>

<http://www.usatoday.com/story/money/personalfinance/2014/03/03/pharmacy-benefit-managers-healthcare-costs-savings/5495317/>

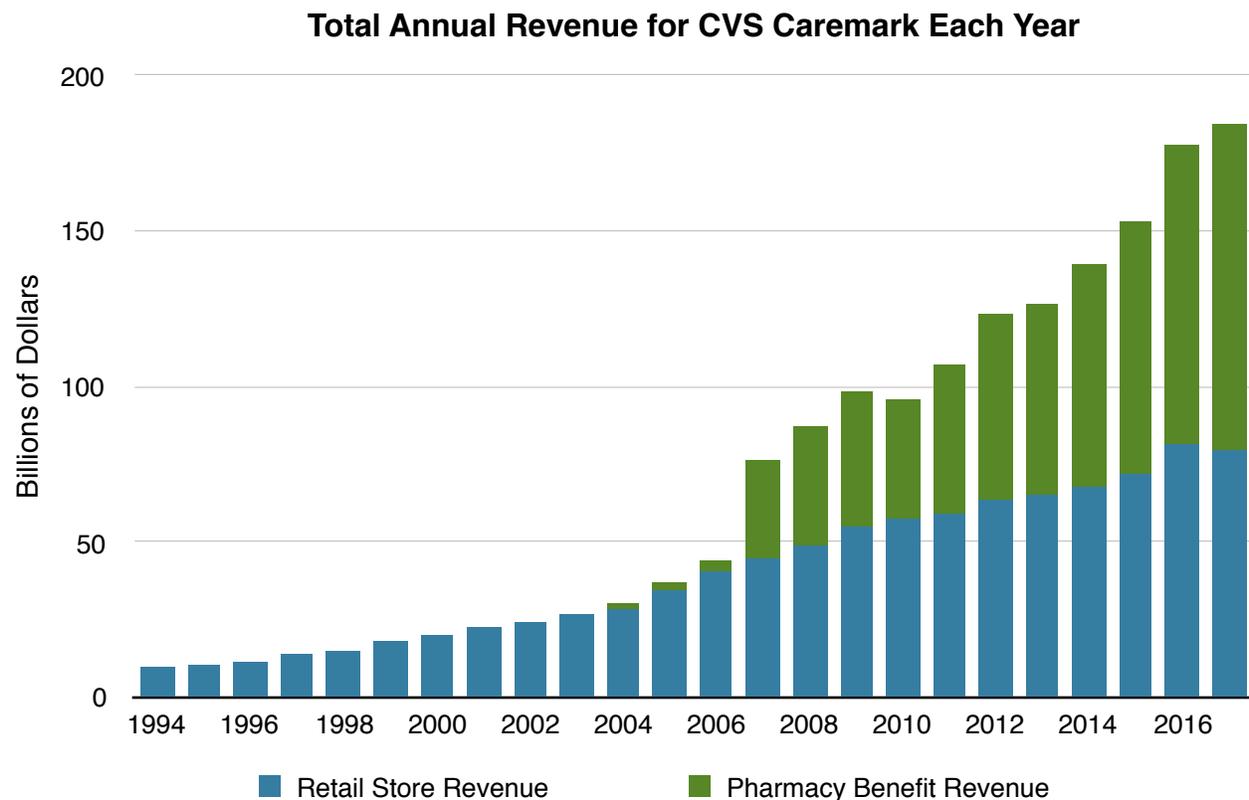


Figure 1: The total revenue for CVS Caremark has gone from less than \$10 billion in 1994 (for CVS alone) to nearly \$185 billion in 2017 for CVS Caremark combined. That's a gain of nearly 2,000% in revenue in 23 years.

Total Retail Revenue and Retail Prescription Drug Revenue for CVS Caremark

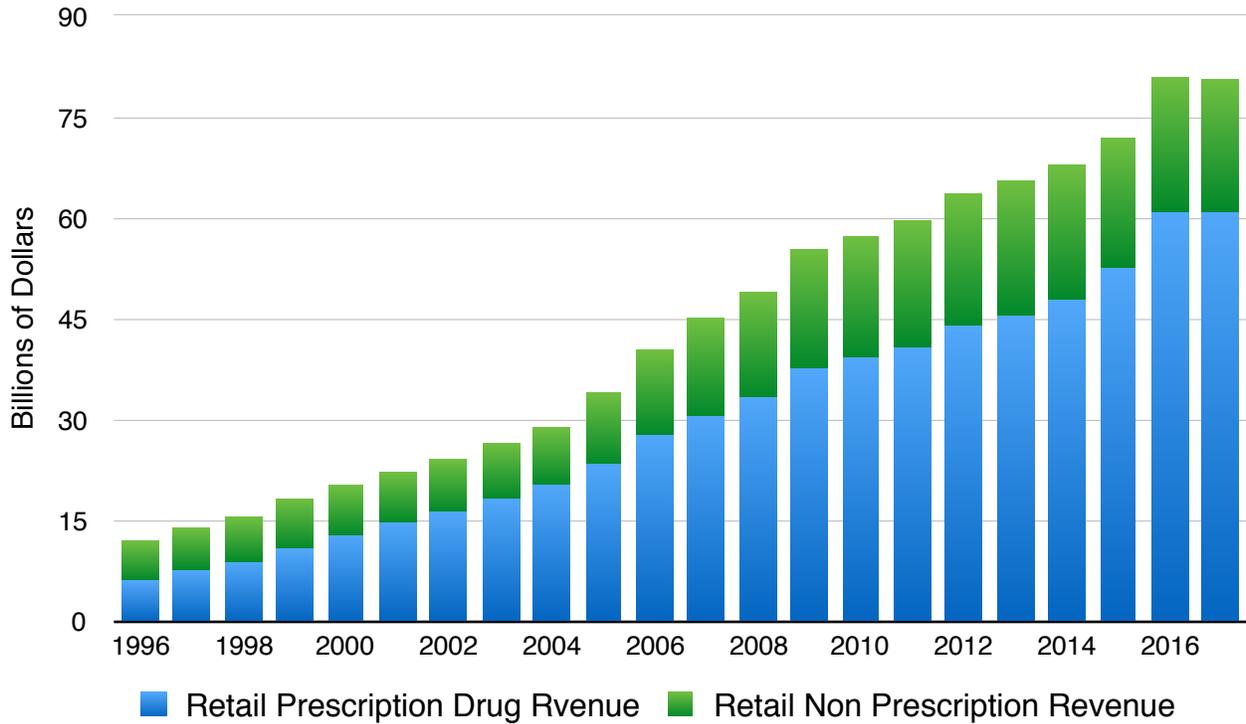


Figure 2: About half of the revenue for CVS’s retail stores was for prescription medications in 1996. In 2017 prescription drugs accounted for about 75% of their retail pharmacy revenue.

Total Number of CVS Retail Pharmacies in the US Each Year

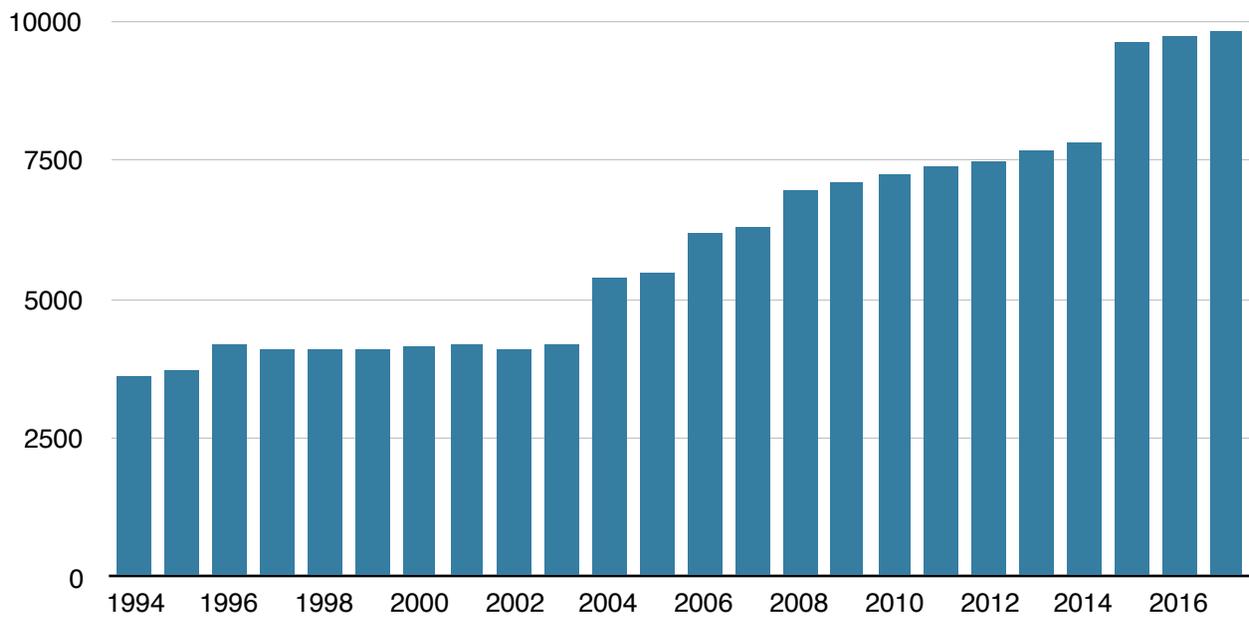


Figure 3: The number of retail pharmacies owned by CVS has more than doubled since 2003 after remaining flat for nearly a decade prior.

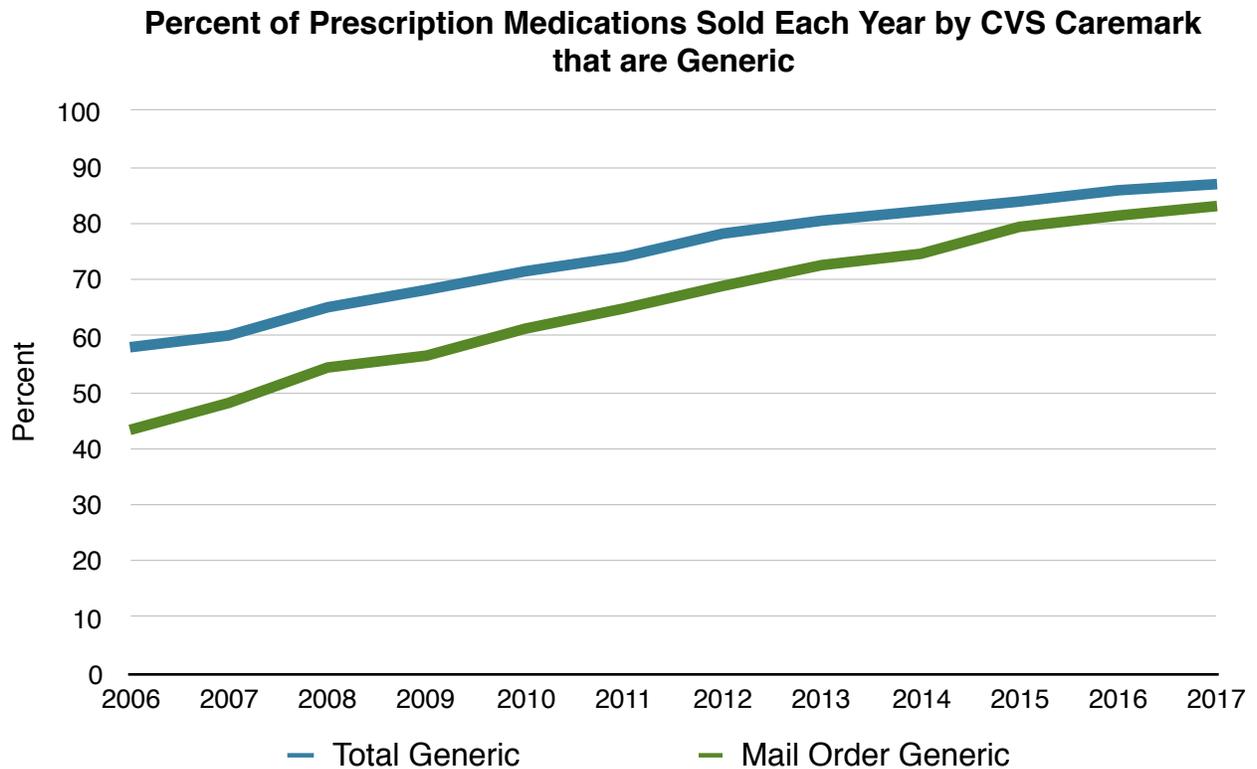


Figure 4: In 2006 fewer than 60% of the total prescription medications sold by CVS were generic and only 43% of their mail order prescriptions were generic. By 2016, about 87% of the total prescriptions filled by CVS Caremark were for generic medications.

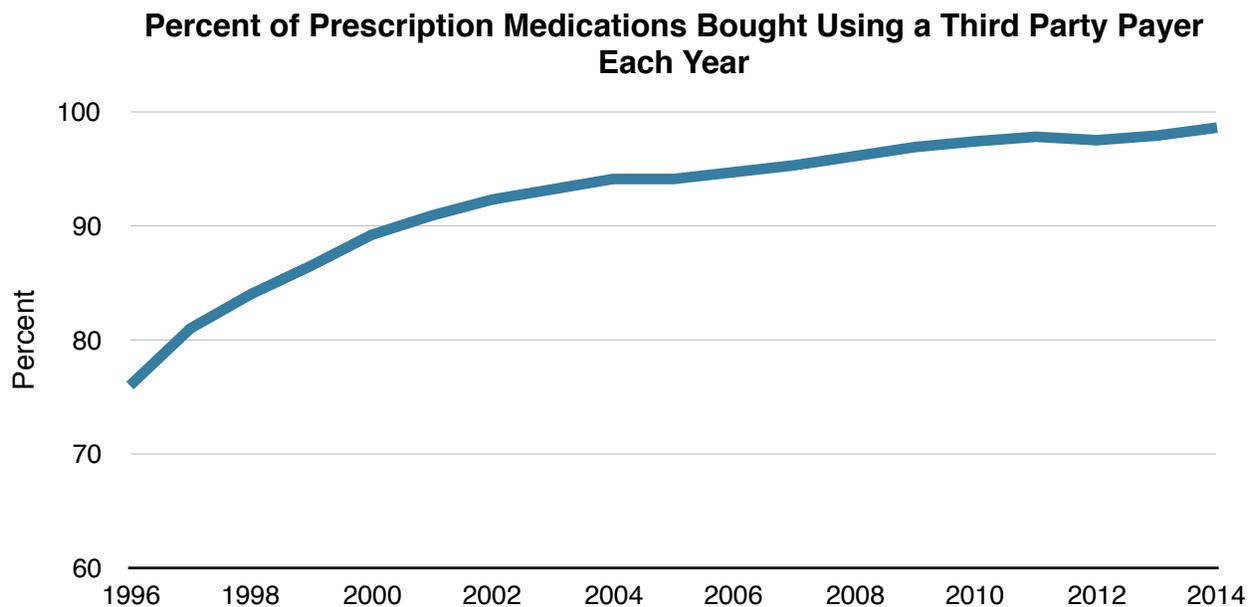


Figure 5: The percentage of purchases for prescription medications that involve a third party (insurance) continues to rise at CVS In spite of the fact that more of these medications each year are generic. In 1996 only 76% of prescriptions sold at CVS involved a third party. By 2014 over 98% of those purchases involved a third party.

Annual Profits for CVS Caremark Pharmacies

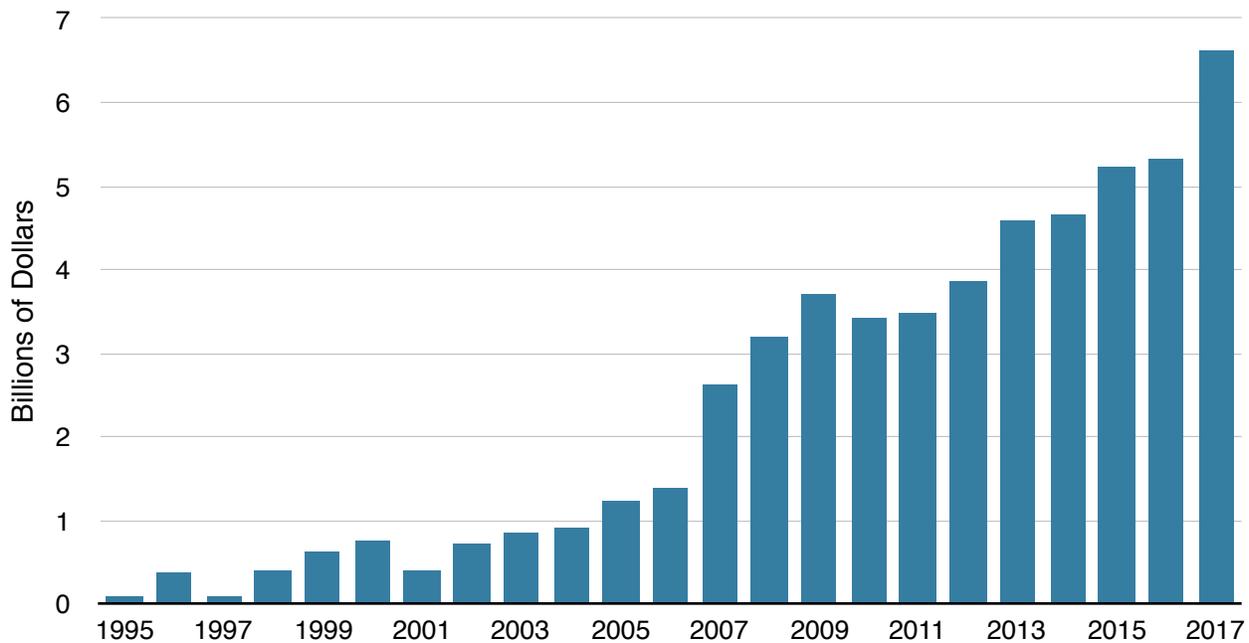


Figure 6: Profits continue to rise each year for CVS Caremark in spite of all of the money they spend each year to expand their business in the US.