Health. Bringing down costs

CVS eyes care 'hubs' with Aetna tie-up

US drugstore chain hopes to win business by passing on savings to insurer's clients

DAVID CROW — NEW YORK

CVS Health, the largest drugstore chain in the US, has said its $69bn acquisition of health insurer Aetna will create a powerful company with enough heft to bring down the spiralling cost of healthcare in America.

CVS says it will turn its network of 9,000 stores into "healthcare hubs", where pharmacists and other trained specialists such as nutritionists will offer medical advice and services rather than just dispensing prescription drugs.

By encouraging patients to access these "lower-cost sites of care", CVS predicts it can reduce the rate at which people use more expensive services such as hospitals and urgent care centres, leading to savings for Aetna and its clients.

Larry Merlo, CVS chief executive, says billions of dollars are being wasted on healthcare, especially on chronic conditions such as diabetes, because patients do not following instructions given by their doctors.

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"We can help [patients] achieve their best health, and at the same time, reduce the cost of care that we're incurring today," says Mr Merlo.

One person briefed on the deal says owning an insurer would change the incentives for CVS. Whereas a standalone drugstore profits by serving as many customers as quickly as possible, an insurance company would want pharmacists and other staff to spend more time with patients so they do not end up accessing more expensive services, they add.

CVS believes the new model will also lead to efficiencies for the combined company, which will have annual revenues of more than $221.4bn and roughly $18.5bn in adjusted earnings before interest, tax, depreciation and amortisation. It is predicting $750m in cost savings in the first full year after the deal, announced on Sunday, closes.

CVS hopes to win business by passing on some savings to Aetna's clients — the companies that pay a large proportion of their workers' health costs, and the US government, which foots the bill for retirees and the poor. Healthcare costs in the US hit $3.3tn last year, a figure that is expected to rise to $5.5tn by 2025.

It also says the deal will lower prices for consumers, who are being asked to contribute an increasing share to the cost of healthcare out of their own pockets. Some analysts have interpreted the move as a defensive measure amid rumours that Amazon is planning to bring its low-cost model to healthcare by selling prescription drugs online.

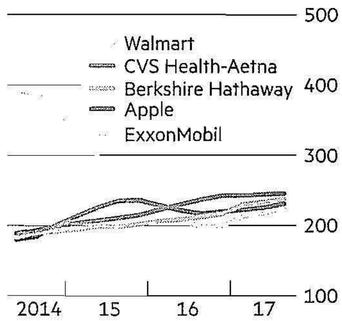
"CVS needs to overcome . . . the threat of Amazon's entry into pharmacy," says Ana Gupte, a healthcare analyst at Leerink.

However, the person briefed on the deal says CVS first considered making an offer for Aetna several years ago, long before any suggestion that Amazon would disrupt the pharmacy market.

That person says CVS shelved its earlier plans after health insurers tried to implement consolidation in 2015 that would have seen Aetna buy smaller rival Humana. Aetna and its rivals abandoned those deals following opposition from government regulators worried about the impact on competition.

Sales at CVS-Aetna would match US heavyweights

Trailing sales, past 4 quarters ($bn)



Analysts say the CVS transaction and the spectre of Amazon's entry into the market is likely to prompt other groups to explore similar cost-cutting deals.

Ms Gupte suggests Walmart, the grocery giant that has pharmacies in many of its stores, could follow suit by offering to buy Humana, and that drugstore chain Walgreens might make a bid for WellCare Health, an insurer.

Express Scripts, a pharmacy benefits manager that negotiates drug prices on behalf of insurers, said last week it was open to a deal with a health insurer or some kind of partnership with Amazon.

CVS said it was confident of securing approval for the deal, which bankers describe as "vertical" because it involves combining two different types of company. However, some observers note that the US Department of Justice has been taking a tougher line on such deals, pointing to its recent decision to try to block the takeover of broadcaster Time Warner by telecoms group AT&T.

"CVS wants to get more control over the flow of prescriptions from insurers, and that is why the government is likely to oppose a merger," says Erik Gordon, a University of Michigan academic.

"The companies will argue that a merger is vertical and will cut costs," he adds, "but the government has shown in its opposition to the AT&T-Time Warner merger that it will challenge vertical combinations that could impair competition, and it will be doubly vigilant in healthcare mergers."

One person briefed on the deal says there is some nervousness inside CVS and Aetna that President Donald Trump could also oppose the takeover on competition grounds.

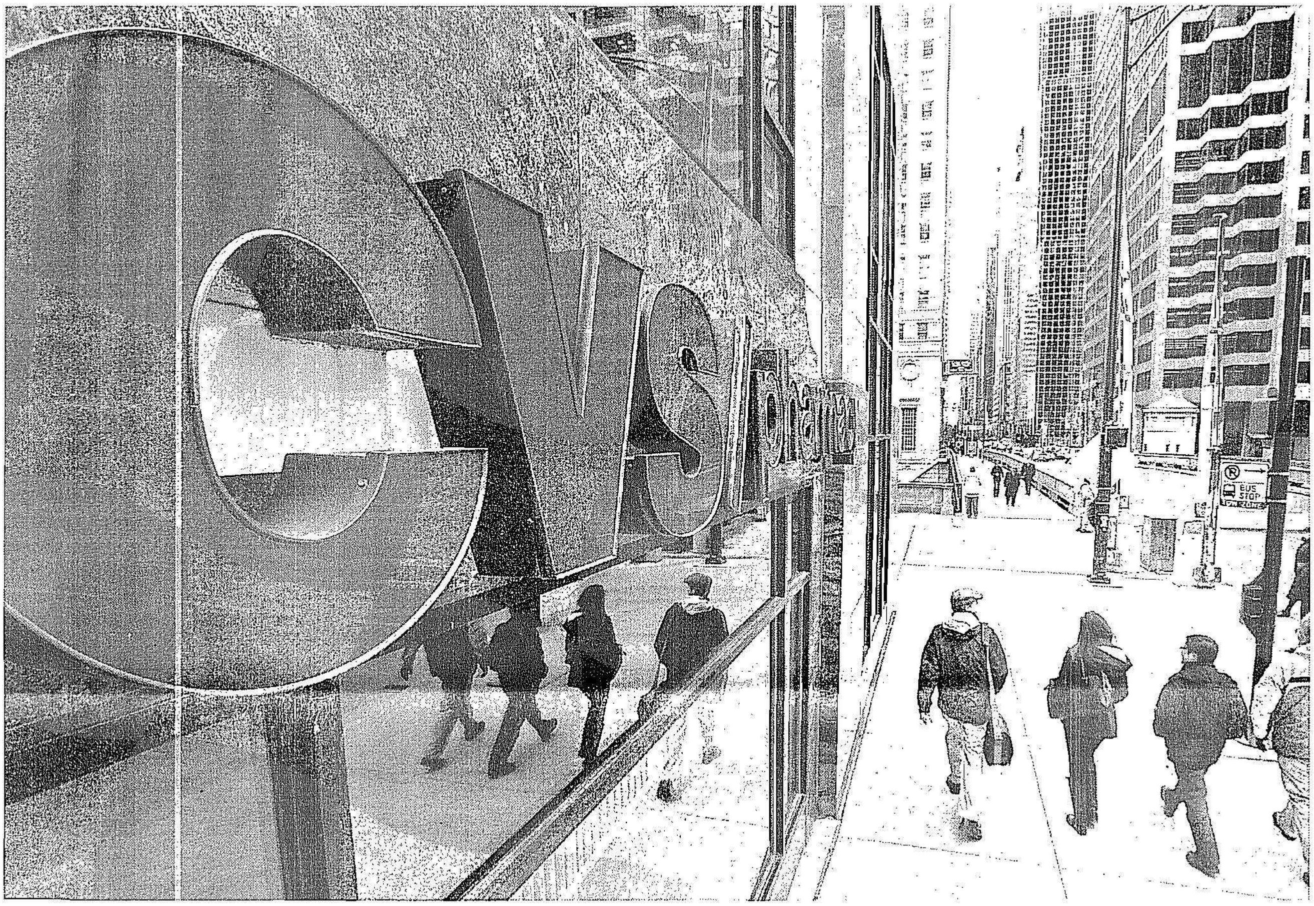
Analysts have also asked whether some of the health insurers who are customers of CVS's PBM division, such as UnitedHealth, might take their business elsewhere if the company were to own a competitor outright.

And while Moody's, the credit rating agency, has hailed the combined company's "potential to reshape the entire health plan market", it also says the $45bn of debt that CVS is taking on to finance the transaction would result in a "significant weakening" of the company's credit metrics.

Given the risks surrounding the deal, some analysts question whether CVS could not have achieved its aims by signing an agreement with Aetna that stopped short of a full takeover.

"We await greater answers as to the rationale and advantages of an outright purchase as opposed to other potential combinations, such as a joint venture or partnership," says Erin Wright, a healthcare analyst at Credit Suisse.

See Lex



CVS says $69bn Aetna deal will create a group with enough heft to curb spiralling costs
M. Spencer Green/AP