Express Scripts (ESRX) Earnings Report: Q2 2015 Conference Call Transcript

The following Express Scripts conference call took place on July 29, 2015, 08:30 AM ET. This is a transcript of that earnings call:

Company Participants

- Chris McGinnis; Express Scripts Holding Co; Vice President Investor Relations
- George Paz; Express Scripts Holding Co; Chairman and Chief Executive Officer
- Jim Havel; Express Scripts Holding Co; Executive Vice President & Interim Chief Financial Officer
- Timothy C. Wentworth; Express Scripts Holding Co; President

Other Participants

- Lisa Christine Gill; JPMorgan Securities LLC; Analyst
- Elizabeth Mary Blake; Bank of America Merrill Lynch; Analyst
- Garen Sarafian; Citigroup Global Markets; Analyst
- Eric R. Percher; Barclays Capital Inc; Analyst
- Ricky Goldwasser; Morgan Stanley & Co. LLC; Analyst
- Glen Santangelo; Credit Suisse Securities; Analyst
- Robert Patrick Jones; Goldman Sachs & Co; Analyst
- John C. Kreger; William Blair & Co. LLC; Analyst
- George R. Hill; Deutsche Bank Securities; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to Express Scripts Second Quarter 2015 Earnings Release Conference Call. All lines have been placed in listen-only mode until the question and answer session. Today's call is being recorded. If anyone has any objections you may disconnect at this time.

I would now like to turn the call over to Mr. Chris McGinnis, Vice President of Investor Relations. Sir, you may begin.

Chris McGinnis (Vice President Investor Relations):

Thank you and good morning everyone. Welcome to our second quarter 2015's earnings call.

With me today are George Paz, Chairman and CEO; Tim Wentworth, President; Jim Havel, Interim Chief Financial Officer; and other members of senior management. Before we begin I need to read the following Safe Harbor statement.

Statements or comments made on this call may be forward-looking statements and may include financial projections or other statements of the company's plans, objectives, expectations, or intentions. These matters involve certain risks and uncertainties. The company's actual results may differ significantly from those projected or suggested in any forward-looking statement due to a variety of factors, which are discussed in detail in the company's most recent Form 10-K filed with the Securities and Exchange Commission. We do not undertake any obligation to update or otherwise release publicly any revisions to
our forward-looking statements.

For clarity purposes all financial numbers, except where indicated, that we talk about today will be on an adjusted basis and are attributable to Express Scripts, excluding non-controlling interest representing the share allocated to members of our consolidated affiliates. This presentation will be posted on our website and includes an appendix with footnotes and the reconciliation of GAAP to adjusted numbers, including EBITDA to net income.

Please also refer to the tables included in our earnings press release for a reconciliation of GAAP to the adjusted numbers that we will be discussing. The reconciliation of EBITDA to net income can also be found in our press release. The press release is posted on the Investor Relations section of our website at www.express-scripts.com.

At this point I will turn the call over to George to review the agenda for this morning.

George Paz (Chairman and Chief Executive Officer):

Thank you, Chris, and good morning everyone. Today we'll cover three topics, our second quarter performance and updated 2015 guidance, an update on our business, and key opportunities in the marketplace.

Before Jim reviews the second quarter results, I’d like to share my thoughts in the current environment. The changing landscape validates the need for size and scale. However it’s how size and scale is leveraged that matters. We have designed our business model to align the needs of our clients and patients to optimize our size and scale, allowing us to take bold actions that control client costs and improve patient outcomes.

Today in health care specialized care matters to patients and clients. We offer it at every turn. Our pharmacists have specialized training in specific disease states. Our specialized pharmacy, Accredo, offers the best care for complex Specialty patients. Our Home Delivery experience is specialized for patients. And our solutions are tailored for specialized clients and patient needs.

Clients and patients have an independent, fully-aligned partner to help them successfully navigate the complex landscape. Our business model assures a completely shared agenda with clients. With their trust we can leverage our size and scale to change health care. Our strong performance this quarter demonstrates that we are built to win.

I'll now turn it over to Jim to review our second quarter results and discuss our updated guidance.

Jim Havel (Executive Vice President &amp; Interim Chief Financial Officer):

Thanks, George. Good morning everyone. We reported EPS of $1.44, which represents an increase of 17% year-over-year. Overall we exceeded our quarterly EPS guidance by $0.03 at the midpoint, half from core business operating income and half from capital structure. Consistent with recent years this quarter reflects $147.1 million incremental revenue related to a client contract payment.

Other key metric highlights include adjusted claims worth $321.2 million, slightly above the midpoint of our guidance range. Excluding the impact from the previously mentioned client contract payment, EBITDA per adjusted script would have been $5.15, also up 4% over last year. We are realizing an improvement in EBITDA per adjusted script attributable to managing Specialty, Formulary Management, and an increase in the aggregate generic fill rate. All of which result in a significant cost savings for our patients and our clients.

In addition we generated $899.9 million of cash flow during the quarter, up 22% year over year. We
generated -- or I should say, a strong performance in Q2 cash flow positions us to deliver cash flow from operations at $4.5 billion to $5 billion for 2015.

During the quarter we repurchased 55.1 million shares under a $5.5 billion accelerated share repurchase program, which represents 85% of the estimated shares (sic) [$5.5 billion purchase price]. We expect a settlement of the remaining portion of shares (sic) [of the ASR program] to occur in the first half of 2016.

Our model of alignment and focused scale is driving improved operating and financial results. As a result of these improvements and the impact of the accelerated share repurchases during the second quarter, we are increasing our full-year EPS guidance by $0.08 to a range of $5.46 to $5.54 or growth of 12% to 14% over 2014. The ASR contributes $0.05 to the increase in the EPS range with the remaining increase largely due to our improved operating results.

With respect to the third quarter of 2015 we expect EPS to be in the range of $1.41 to $1.45, up 9% to 12% year over year. Throughout the remainder of 2015 we will execute on our model of alignment, which will drive value for our patients and clients, while generating strong returns for our shareholders.

At this point I will turn the call over to Tim.

Timothy C. Wentworth (President):

Thanks, Jim. And good morning everyone. As Jim stated we delivered a solid financial performance in is strongly resonating with clients and patients who value our solutions.

We’re providing a preliminary estimate of our 2016 adjusted claims volume in the range of 1.255 million to -- sorry, 1,255,000,000 to 1,295,000,000. There are many factors that impact this estimate, including the completion of our 2015 renewal and selling season, loss of acquired scripts, client, and other organic growth and utilization.

Regarding our renewal season, we are updating our retention rate to a range of 95% to 97%. We have largely completed the renewal season for our health plan book of business and we are very pleased with our performance. This reflects the value our health plan clients place in our account teams, our expertise, and our unique solutions.

For our commercial book of business we enter an important stretch over the next few months as mid-market clients make their decisions. Our performance to date and the positive feedback we continue to receive gives us confidence that we will have strong retention across the board.

As we have previously discussed we will lose approximately 40 million to 45 million scripts due to client acquisitions.

As expected we have seen good activity in new sales across our book. While we do not discuss specific client wins, we are encouraged as our new clients tell us they believe in our model of alignment, appreciate our laser focus on the pharmacy benefit, and value the way we uniquely drive out inappropriate costs, while providing superior care for patients. The result is that our business outlook remains strong and our momentum continues.

Importantly our model is also focused on development of innovative solutions built in close collaboration with our clients. These solutions, which spring from our unique, focused, clinical, and behaviorally focused model, begin with the fundamental premise that each member is either a patient or a prospective patient, rather than simply a consumer. Our ability to coordinate care drives better health outcomes for patients and drives down costs for our clients. This model is clearly different from that of our competitors.

And our solutions are in great demand. For example as more high cost drugs come to market, Specialty is
the number one focus for our clients and is a top focus for us as well. With Accredo, our therapeutic resource centers, specialist pharmacists, UBC, and our Specialty distribution business, we generate value from new medicines for both patients and clients alike.

As you saw last week the first of a new class of cholesterol lowering drugs, PCSK9 inhibitors, was approved. While these drugs are being viewed as breakthrough, they also have the potential to wreak financial havoc on clients who do not proactively manage their Specialty trend and spend. Our clinical programs for PCSK9 inhibitors and for all other Specialty drugs uniquely ensure that the right patients get the right drugs through the right channel at the right price, and that they use them effectively.

Only Express Scripts combines a robust collection of solutions with the size, scale, and client alignment to truly change the market. This is how we move more value to clients, better care to patients, and continued growth for Express Scripts. I'll now hand it back to George.

George Paz (Chairman and Chief Executive Officer):

Thank you, Tim. We are excited about our future for many reasons, but today I want to highlight three of these reasons, Home Delivery, Specialty, and Formulary Management.

First, some thoughts about Home Delivery. Our model of alignment drives a higher Mail penetration over the long term. However over the past two years we have had lower than expected retention levels of our existing clients, resulting in a loss of disproportionate number of Home Delivery scripts.

Notwithstanding these losses we continue to believe in the overall benefit and long-term growth of Home Delivery. Our Home Delivery offers greater safety, more convenience and continuous access to expert pharmacists from the privacy of their home.

Patients who utilize the Mail channel exhibit stronger adherence rates and better Formulary Management when compared to retail. Of course this results in better health outcomes.

Ultimately we are focused on continuing to improve the patient experience in Home Delivery. As consumers take a greater role in their health care, they will have a larger influence on the delivery of prescription drugs. We are transforming Home Delivery from its origin as a payer solution to a consumer centric model that grows as a result of patient demand. Therefore we are continuing to invest in Home Delivery, taking the steps necessary to improve the overall patient experience and to position us for growth.

With respect to Formulary Management we provide flexible offerings that achieve industry-leading drug trend. We have saved clients billions of dollars over the past few years through smarter Formulary Management, while ensuring patients have access to the most effective, lowest cost drugs. Later this week we'll announce our 2016 National Preferred Formulary. Once again it will deliver additional value with minimum disruption.

Finally, a few words about Specialty. Specialty drugs are expected to account for half of the total drug spend by 2018. And this is an opportunity we are focused on and investing in. The landscape constantly changes, and we are best positioned to help clients manage it. We combine our Accredo Specialty pharmacy, the expertise of specialist pharmacists, and our therapeutic resource centers to deliver excellent care to complex patients, while controlling costs for our clients.

We have great opportunities to provide the highest quality care at the best price to patients and clients. We align the interest of our clients to take advantage of these opportunities, which will result in more savings to them, better health outcomes for our patients, and higher returns for our shareholders.

Thank you for your time today. And we will now take your questions. Operator?
QUESTIONS & ANSWERS

Operator:

Thank you. We will now begin the question and answer session. Our first question comes from Lisa Gill with JPMorgan. You may ask your question.

Lisa Christine Gill (Analyst - JPMorgan Securities LLC):

Great. Thanks very much and good morning everyone. George, if I back into the claims number that Tim talked about, it looks like you might have won $3 billion-plus in the selling season, maybe somewhere between $3 billion and $5 billion, depending on what your assumption were for utilization.

Can you talk about the Home Delivery, Specialty, Formulary Management? What do plan design look like for 2015? So you talked about alignment and why people selected you because of alignment. But can you give us a little more color, one, around some of the clients that you won? Obviously without naming them. And then, two, if you could just give us some of that color around how do we think about plan design and some of the things that they're going to implement for 2015? Both retention as -- or renewals as well as new business.

George Paz (Chairman and Chief Executive Officer):

Sure. And good morning, Lisa, and thanks for the question. You know we -- I'll certainly talk some about this, but I'm also going to ask Tim to chime in here.

With respect to our model of alignment, to us a client has never been just a client. We really are focused on clients who share our interest in driving down costs. So what we look for is clients who want to be part of our National Preferred Formulary that have -- that want to be part of our Specialty programs.

These are really important to us, because when we deal with clients on one side, we're servicing patients on another, and on the other side we are dealing with pharma. And it's important that when we go to pharma that we have a focused book of business that allows us to drive the best discounts possible. And that has always been our model. And throughout the process of integration with the Medco business, we have refined that focus even further and aligned both of our businesses together to now the new Express Scripts, which continues that process.

With respect to Mail unfortunately over the last couple years -- not this year. This year has been a very strong year for us, good sales as you pointed out, a lot of the clients have been both in health plans and in the commercial area.

The sales season is still taking place, so we still have -- it's a couple of the large employers that are still outstanding. But mostly it's the middle market that it still needs to be decided. And as you know this can go on all the way into -- actually into early January for the very smaller of the group. But for the most part by the middle of November to the end of November decisions are being made, which can ultimately affect our numbers. But we are very optimistic.

After coming off the integration over the last few years, the team under David Queller is truly focused. What Chris Houston has done with respect to operations is truly remarkable, as we've turned the corner and got all of our business processes aligned to service the patients. And what David Norton is doing with respect to supply chain management really leads us to have a coordinated approach to how we work together to deliver our patients, and it's resonating. And sales are strong.

Give it a little more color, I'll just turn it over to Tim.
Timothy C. Wentworth (President):

Sure. Thanks for the question, Lisa. Obviously each client you win is a fairly customized experience. But the things I would draw from the significant success we've had this year relative to the last three particularly are a couple things.

I would start with leadership. The fact of the matter is we are at the table now because of the fact we have taken a leadership position on a number of issues and delivered on the words that we actually put out there.

If I go a little below that you've got to win on a number of things. And I would say the things that have mattered this year, and George hit on several of them, Formulary, driving value. And so we talk about pricing, but really pricing is increasingly a function of what are we going to do to help drive down costs and manage those appropriately.

The second piece I would say is this notion of alignment. Several places in the health plan space where our wins were driven in part with the notion that we were going to help those health plans in their market shoulder to shoulder to win new business for themselves.

The third is clearly the management of patients through Specialty in particular and being able to demonstrate strong commitments there and as well assure certain outcomes.

And I'd say the fourth is service commitment. And I would say our -- a big thing for us this year is references. And so our book of business has seen what George just talked about in terms of our complete service recovery. And they are speaking to the marketplace about it. And it's very important as you know when you're bidding new business to provide references. And those references are done. And our references have been strong.

I think the last piece as part of service has been -- almost every large case we've won have spent time in our lab. Have come in and shoulder to shoulder with us, with their leadership, seen the way that we attack new challenges and how we collaborate in order to do it. And I think all of that together produces a fairly compelling result for the right prospective client.

Lisa Christine Gill (Analyst - JPMorgan Securities LLC):

And I appreciate all that. Is there any way though just to kind of help us to frame those from a numbers perspective? Meaning for the new business that you won, did it -- everybody take Formulary Management? Was it 50%? Like how do we think about it when we think about plan design in the bucket George talked about, Home Delivery, Specialty, Formulary Management for both renewals as well as new business? Is there a way, Tim, that you can frame that to say, the majority of clients who signed with us went with our Formulary? Or just anything that can quantify this in some way, as we think about 2016?

George Paz (Chairman and Chief Executive Officer):

Yeah. So a couple things. And, Tim, feel free to chime in here. But so when we're out selling, there's a far different market in large employer groups versus medium to small employer groups and health plans. One of our challenges with health plans is that they often use multiple suppliers for Specialty. So although we may get the exclusive on doing the oral solids in the Mail, they still have -- often have their own P&T committee. And they have -- and they may choose different vendors as kind of an open hunting ground for Specialty.

So the idea is to get in and to secure it. Make sure that -- and we have on all of our sales, have won a position at the table on Specialty. And now it's a question of our team working the doctor's offices, where we really again turned around our reputation and built our level of expertise, so that they're calling on
the docs. They know that they're already -- we're already servicing a bunch of their clients through many
other clients that we currently have. And now we got -- we tell them we just signed up with ABC
corporation, and they are now a new client of ours. And so we're open to take their transfers and that for
those patients as well. And that's mostly the way it works with health plans.

And we've had a very good success in that area, but we're never satisfied. We're going to continue to
drive more and more as a percentage of those scripts to us. And so it's on day one, it's more of a
challenge than it is on two years or three years into the contract, as we got to increase our penetration
levels.

With respect to Formulary Management, there it's a little different with the -- mostly with the large
employer groups. They're buying into our Formulary Management processes and programs. Clearly with
small employers that's the case. They sign up and they join in.

With the health plans again, they have their own P&amp;T committees. And we're looking for -- is
alignment on key therapeutic classes. So you don't have to have 100% compliance with our Formulary
Management. But what we do, with Steve Miller and Dr. [Glen] Stettin do is they line up with our clients to
make sure that we're informing them about our Formulary Management programs. And then Everett
Neville and David Norton go out and try to secure through economics the ability to align us together.

So I would say again on the employer side, it's mostly aligned in there. On the health plan side for us to
win, just to be totally frank, it has to be mostly aligned. And that's what's really important to us.

And then over time as we drive greater and greater economics, our teams show up at the table. We show
them the information that we have regarding the drugs that we're not aligned on. And we over time
secure that and move it closer to our Formularies.

The other thing we do is provide a lot of detail behind the scenes -- or I guess it's in front of the scenes --
to their P&amp;T committees to show the process we use to make those decisions. Dr. Miller runs that part
for us. And so he's out in front of the clients on a regular basis talking that through. I don't know if, Tim, if
you got anything else to add?

Timothy C. Wentworth (President):

No. I think that to sum it up I think George nailed it, which is on the employer side this year and the public
sector side, pretty much 100% Formulary. Very heavy Specialty, us managing,

Interestingly we won one very significant health plan this year, and that was a client we had had through
Accredo. And they saw what we were able to do with Accredo and have moved to much more strongly
prefer Accredo. That's actually one of 17 installation. And what I would say is, except for Formulary, Mail,
and Specialty, where we're actually working with them for one of 16, because those three areas they
were compelled by what we could do for them, and they were motivated to actually move those more
quickly. So I think again it's an N of one, but it's a good leading indicator for I think the way things are
progressing.

George Paz (Chairman and Chief Executive Officer):

And, Lisa, I hear your comments and let us -- we'll get with Chris McGinnis, and we'll see how we can give
better transparency to this as we go forward. It's I understand your comments. And let us just see if there's
something we can do here.

Lisa Christine Gill (Analyst - JPMorgan Securities LLC):

Yeah, no. I appreciate that, George. It sounds like things are lining up well for 2016. I think all of us sitting
on the other side of the phone today are just trying to figure out exactly what the wins and the retention mean as we start thinking about building out the financial model. So again I appreciate the comments, and we look forward to incremental detail.

George Paz (Chairman and Chief Executive Officer):

Yeah. Okay. Thank you.

Operator:

Thank you. Our next question comes from Robert Willoughby with Bank of America Merrill Lynch. You may ask your question.

Elizabeth Mary Blake (Analyst - Bank of America Merrill Lynch):

Hi, good morning. This is Elizabeth in for Bob Willoughby today. Growth in revenues per claim for the Mail business suggests further gains for Specialty. How do we think about the components there? What was the market growth? How much was share gain? And what was inflation?

Jim Havel (Executive Vice President & Interim Chief Financial Officer):

We don't give specific details about the component parts. But let's just talk a little bit about some of what we incurred this year. We did have some high quality growth in terms of our Rx. Our Specialty business is doing quite well. And that helps drive like you say those quality scripts, so give you some good numbers.

Our revenue was generally in line. And again our overall scripts were absolutely in line as well. And we do feel we have strong growth in quality scripts, which is absolutely the key to drive our businesses. And as both George and Tim have indicated, Specialty, Home Delivery are two of our -- are just key components in terms of driving our growth. And both performed very well in the quarter and have performed well in the first half.

Elizabeth Mary Blake (Analyst - Bank of America Merrill Lynch):

Okay. And any color around what therapeutic categories were the big drivers?

Timothy C. Wentworth (President):

What I'd say is we've seen strength across the board. We have a very, very good super rare disease business that's the legacy, sort of a long-time Accredo business as well as some of the CuraScript business. That has continued to do well, as our service is just so detailed there and the payers completely value it. And the pharma companies have been very strongly supportive as new products have come out. But I would say it has been across the board.

And oncology has been very strong for us. Obviously hep C, I know people are trying to read through to see sort of what's happening. We've continued to see hep C, although certainly it's lapping numbers that were very high. And I would say the hep C contribution is probably marginally less as a percentage. I don't have the exact numbers, nor would we probably give it. But what I'd say is it continues to be an important part of our overall offering.

But no. The good news has been from our perspective, as clients want us to put these programs in place that manage these things, they are directing the volume to us. And so we've seen sort of the natural effects that are happening in Specialty with the pipeline and inflation. But we're also seeing increasing claims due to clients moving more of their business to us.

George Paz (Chairman and Chief Executive Officer):
I think the important point there is twofold. One is we have to -- we're focused on unit growth. But we're also focused on the alignment side of it.

So as clients -- when a new client comes on board, especially a health plan as we talked about earlier, their formulary management may not be as aligned to ours as it will be over time. And so what our account management team does is, is they align it. The client savings go down, because we get better discounts from the manufacturers as we drive into the formulary management areas that we manage.

And then in addition to that the patient cost typically comes down. And of course then our values go up for our shareholders. So that's an important component.

So it's both things. It's not only getting unit volume, but it's also moving in -- the other thing that happens of course is as generic drugs go -- come to the market that actually drives down the revenue line. So the revenue line is always a little misleading, because it's not as much as it was three years, four years ago. But there's still a lot of generics coming to market, which has downward pressure on revenues but upward profits on profitability.

The same thing happens with Formulary Management. As we move from a non-preferred product to a preferred product, our discounts go up, so our revenues come down. But our profit margins increase, client savings increase, patient savings increase, and shareholder value increases. So the revenues are a little tricky in our business for that reason and aren't necessarily a good indicator of where profitability is headed.

Elizabeth Mary Blake (Analyst - Bank of America Merrill Lynch):

Okay. And then finally, how do we think about your competitive advantages in Specialty relative to other models that are out there? I guess why is this opportunity unique to Express Scripts?

George Paz (Chairman and Chief Executive Officer):

Well I'd say I think because of our focus again. We're not just here to fill scripts. We're not just here to take whatever the doctor gives us. It would cost us less money if we only took the script that came in the door, put it in a package, and mailed it out to the patient.

That's really not our approach. It's everything from helping that patient find whatever economic assistance can be had through PAP programs or through any other kinds of patient assistance programs that are out there. It's helping get people aligned to the right formulary.

When you're talking about a drug that somebody is going to be on for multiple years, it's really important that you get them started on the right product, because that's an annuity for the rest of their life. So if we can save somebody hundreds or hundreds or thousands of dollars a year, that's a lifetime annuity to that person. It's a lifetime annuity to that client. Because of our discounts it's a lifetime annuity to our shareholders, that person's lifetime, as we move people to the right drugs.

I think that's what differentiates us and makes us special in this space is because we have that focus on that patient and on our clients and driving shareholder returns through our model.

Elizabeth Mary Blake (Analyst - Bank of America Merrill Lynch):

Okay great. Thank you very much.

Operator:

Thank you. Our next question comes from Eric Percher with Barclays. You may ask your question.
Eric R. Percher (Analyst - Barclays Capital Inc):

Thank you. Over the last two years you've touted the benefit from exclusion, $700 million two years ago, $1 billion last year before hep C. At this point you've demonstrated your ability to impact access. As we think about the 2016 Formulary what type of role does exclusion have? And do you see the benefits of exclusion or your willingness to even in the areas where you're not excluding?

George Paz (Chairman and Chief Executive Officer):

Well that's a great question. And quite frankly we're still in the process. We're going to roll this out next quarter. And this will be a focal subject of ours on the third quarter.

You've made a couple of very interesting points. One is access. When drugs get extremely expensive, they can be life sustaining or make for a better quality of life. At the higher prices they're out of reach for many, many individuals through high deductible plans, doughnut holes, other odd things. There's just -- it's harder for our patients to stay adherent and to stay in the programs.

And that's part of our Specialty offering. It's part of what we do every day in our Mail delivery and other areas, where we actually touch and feel the client or the patient. It's to try to make sure that we assist them in staying adherent or helping them reach out to opportunities that exist in the marketplace to secure financing if it's outside of their means. So when we do that we improve the access.

So although costs are going up significantly in certain therapy classes, our focus on that patient allows us to maintain access levels and drive better health outcomes for those patients.

With respect to our -- with our Formularies like I said, we're still working them. We'll be rolling them out here shortly. And when we do that we will talk about that on our next quarter.

But the idea is to find those therapy classes where the competition is uniquely strong, and there's tremendous opportunity to move share. And we can do it with minimal patient disruption.

And when we combine those things together, it works wonders for our clients. A lot of HR departments have been scaled back, and so they don't have the resources they have, so they don't want a lot of noise. And we can manage these things with minimal noise, better patient outcomes, better client savings, and again better shareholder value. Tim, you have anything you want to add?

Timothy C. Wentworth (President):

No. I think the only thing I'd add is we've clearly demonstrated to our clients and to pharma that we will make tough choices that minimally disrupt but maximally create value. And by virtue of having that track record of doing that and the scale and leverage to execute and the service and patient care to actually make it work for the client and the member, it gives us a very strong position as we come into 2016 to -- the goal is always the same for us, which is to have every drug possible in the Formulary but at the right price.

And from that perspective you don't have to exclude a drug, because the manufacturers in that class have made it worth your while to let them compete in the physician's office. We'll do it that way. If on the other hand we've got an opportunity to drive down costs significantly without impacting care, by virtue of an exclusion, we will -- and particularly with minimum disruption, we will do that. Those same principles apply to what we're going to be doing in 2016.

Eric R. Percher (Analyst - Barclays Capital Inc):

And will -- so we're just seeing what you have in store for 2016. Jim, one quick question, mechanic
question here. The home conversion ratio increased this quarter. I know Mail was a little weaker than we had seen a year ago. Could you speak to what impacted that dynamic?

**Jim Havel** (Executive Vice President & Interim Chief Financial Officer):

Sure. As we went into this year we knew we had had some tough retention issues. And so we had some clients that -- we had some losses that came into 2015. And as we reviewed those losses there was a bit of a disproportionate lean towards the Home Delivery.

And so we have been working hard to make up that hole. But that starts you out -- again you've got to fill that hole. And it gives you a little bit of headwind as you begin to start out. So that's really what has affected the Home Delivery more than anything else. We have had -- we've held our penetration rates really strongly. But again we started out in a little bit of a hole, and we just have to work our way through that as the year goes on.

**Eric R. Percher** (Analyst - Barclays Capital Inc):

Okay.

**George Paz** (Chairman and Chief Executive Officer):

That's an important area for us. And in my mind if you look across the retail horizon, more and more people are taking advantage of Home Delivery, Internet sales. And I just think that is the future.

And that is our focus. We have the strongest, best assets out there. And the problem we've had that we've talked about on these calls in the past is the fact that for years Home Delivery was a mandatory Mail selling solution for a lot of our clients.

And consumer choice is really important today. And so we are investing heavily to change our model from one that was purely client driven for savings to being patient centric and focusing on patient needs.

We've rolled out changes in our website. We have another massive change coming through in a month or so that's going to really make it much more user friendly and easier to navigate. The whole experience is being worked on and focused on. And I think we're making tremendous strides. But it will continue to be something we think is a very important vehicle for driving down cost while controlling health outcome. So it will remain a big focus of ours.

**Eric R. Percher** (Analyst - Barclays Capital Inc):

Appreciate it. My question was really the ratio. I know 3X is typically what we see, times the Mail scripts. It seemed to tick up this quarter. Is there -- is it as simple as 3X? Or is there a change when you see lower Mail, higher Specialty?

**George Paz** (Chairman and Chief Executive Officer):

Yeah, it really is. It's 3X.

**Jim Havel** (Executive Vice President & Interim Chief Financial Officer):

It's just that simple.

**George Paz** (Chairman and Chief Executive Officer):

It's that simple. It's 3X.

**Eric R. Percher** (Analyst - Barclays Capital Inc):
Okay.

**Timothy C. Wentworth** (President):

Sorry about that, Eric.

**Operator:**

Thank you. Our next question comes from Ricky Goldwasser with Morgan Stanley. You may ask your question.

**Ricky Goldwasser** (Analyst - Morgan Stanley & Co. LLC):

Yeah. Hi good morning and congratulations on the quarter. Have a couple of questions here. First of all I mean obviously we’ve seen significant consolidation on the health plan side. And talk about just kind of optionality as it relates to pharmacy management. So, George, would love to hear kind of like your perspective on industry consolidation.

**George Paz** (Chairman and Chief Executive Officer):

Yeah. It's -- there's -- obviously there's an awful lot going on in our space today. I think we are uniquely positioned for roughly 1.3 billion prescriptions. We have tremendous scale and size.

And I don't -- again I don't know that it matters if you're at 1.3 billion or 1 billion, the idea is it has to be focused. In other words if I had a very disproportionate offering in Formulary Management we wouldn't be able to get the economics that we have. So scale is really important. And so when I look at all the consolidation that's taking place, it both offers us opportunity -- it offers us some opportunity.

I think we've significantly improved our service levels with some of our biggest clients. I think that they have a -- we have an opportunity to help them drive additional savings and value. I mean obviously when they run their own companies, they have to decide where they want to go and what they're going to do. We can't speak for any given client or what their future holds.

But I think our job is to make sure that we are presenting a unique experience with great economics that they really can't get anywhere else. And it's our job to sell that and demonstrate that. And I think we're uniquely positioned to do that.

So we're optimistic about what's taking place in the marketplace. And again we've built our company by aligning our interests with those of our clients. And I think that we can have a tremendous offering for any of the players that are out there that are looking for opportunities to improve their service offering, while lowering their cost.

**Ricky Goldwasser** (Analyst - Morgan Stanley & Co. LLC):

What -- and what are you hearing from -- because obviously we're seeing kind of like the consolidation of kind of like the large health plans. What are you hearing from kind of like your small to mid-size health plan customer?

**George Paz** (Chairman and Chief Executive Officer):

I'm sorry. What? Hearing from whom?

**Ricky Goldwasser** (Analyst - Morgan Stanley & Co. LLC):

From your small and mid-size health plan customers.
George Paz (Chairman and Chief Executive Officer):

Oh I see. Well it really depends. And again not getting into any into client specifics, but there's all different kinds of health plans out there. Some of them are Blues plans that are state owned that have very large shares in any given state with a very good offering.

And I mean obviously that when its competitors merge together, it makes people nervous, because your competitors are getting stronger. But a lot of these state Blue Cross Blue Shield plans are very, very strong and very competitive in their marketplace. So I think they feel good about their position on where they sit.

Other health plans are specialized to given populations. And to the extent they do that, they feel like again any time you see consolidation going on around you, it's a little unnerving. But at the end of the day if you have the right model and the right approach, you just keep sharpening your pencil and make sure you keep refining it and staying on top of it. And a lot of our health plans are specialized in their areas, whether they're part of a university, whether they're part of a doctor's practice. And so they have that focus, and they have their plans. And I think they feel very good about where they sit.

So I think that there's -- you'll continue to see broad-based consolidation in our space. But I think there's always going to be a need for these Specialist players in given markets.

Timothy C. Wentworth (President):

Yeah, Ricky, if I could add. I think a couple very specific things they are looking for, given how they compete typically against the larger ones. They are very focused on the physician experience in working with us, which makes our model very compatible to helping them in their local markets, particularly on Specialty. They're very focused on winning in their markets and keeping their sort of local clients. And again how we work together with them to do that, as well as to take and manage risk. And so increasingly we have conversations with them about how we use data in ways they may not be able to on their own invest in to help better assess and manage risk.

And then for those that are in certainly the regulated markets, they are very focused on Star programs if they're Medicare, and they're focused on the emergence of probable Star programs in other lines of regulated business, and how we can help them stay ahead of the curve there and get the full bonuses that they would want.

Ricky Goldwasser (Analyst - Morgan Stanley & Co. LLC):

Okay. And then one other question really more on kind of like just the 2015 dynamics. So obviously you raise EBITDA guidance, but you also raise kind of like slightly the SG&A range. So what gives you kind of like the enthusiasm? What do you think of the second half of the year? I'm assuming that the moving parts imply that gross profit are going to continue to go higher in the second half. So just can you talk a little bit about the moving parts of what coming from kind of like your GPO purchasing benefits versus other potential drivers?

Jim Havel (Executive Vice President & Interim Chief Financial Officer):

Ricky, I think that's a really good question. And I got to tell you there's lots of moving parts when we take a look at both where we've been this year and then where we're headed. We have -- as you pointed out earlier we have had strong gross margin. And that's really an ability to execute and align with our patients, align with our clients, and just execute our model.

And we've done a terrific job, I would argue, of managing supply chain. We're buying right, we're selling right, we're doing all the right things when it comes to supply chain.
At the same time you take a look at our cost control. And as George pointed out earlier, our operating costs thanks to the leadership of Chris Houston and others has just been in line. And it has been moving in the right direction all year. And we believe it's going to continue to move that direction.

When you take a look at SG&A we are -- we certainly focus on the component parts of our model. And SG&A is a special focus. We're willing to invest though in SG&A when it makes good sense. And as George pointed out earlier, you take a look at Specialty and when it comes to our attention, there's opportunities to invest in Specialty to improve our results, we'll do it. And the same holds true for Home Delivery, and it holds true for other aspects of our business.

So we feel that we've got a good handle on our expenses. We have a good handle on our model. And as we look forward to the rest of the year, sure we have challenges, and sure we're going to face some opportunities that will enhance our operating results and really give us a chance to demonstrate even further how strong the model is. But we have confidence that we can deliver. And we have lots of confidence in the way that the selling season has gone and really the way we've executed throughout the year.

So we feel pretty good about all the -- each of the component parts. And therefore feel good about our guidance as we go forward into the rest of the year.

**Ricky Goldwasser** (Analyst - Morgan Stanley & Co. LLC):

Great. Thank you very much.

**Operator:**

Thank you. Our next question comes from Glen Santangelo from Credit Suisse. You may ask your question.

**Glen Santangelo** (Analyst - Credit Suisse Securities):

Oh yeah. Thanks and good morning. Maybe if I could just follow-up on the consolidation theme. George, it kind of feels like when you originally gave your retention guidance back at Analyst Day, I think it was sort of 94% to 97%. And now you kind of upped that a little bit. And you're willing to give fiscal 2016 script guidance. And so it's obvious you're feeling a little bit better about your retention rates.

And I'm wondering if could you comment on maybe what you're seeing in the competitive landscape, given the United [UnitedHealth Group ] sort of Catamaran merger? Obviously you have all the MCO consolidation.

How is all this impacting your competitive landscape and your ability to sort of win new business? And then as you kind of look forward to 2016, does this sort of consolidation sort of make you feel better about your competitive position? Or does it maybe raise some level of uncertainty heading into next year?

**George Paz** (Chairman and Chief Executive Officer):

Yeah. Sure. And I guess the first thing I'll say is the turnaround in our business and the focus on our clients and improving sales really validates the decision I made to elevate Tim to President. I think it really does speak to his expertise and what he's able to bring to the table in getting the company aligned. So I think that was a very first, a very important step in moving us forward, and it's paying dividends.

As we -- when we started the year we've had -- we had some pretty big bruises coming out of the last two years. And obviously we didn't want to overstep our bounds. And so when we gave our original guidance
it was our best guess coming off of a tough year. 1/1 for us this year was a very strong one when -- just to be totally frank it's the best 1/1 Express Scripts ever had. It's also the best 1/1 that Medco ever had as stand-alone companies. And together it was really well executed. And so that really added a lot of value to us going into the year, because clients coming off the previous year were feeling, still feeling some pain.

But 1/1 this year, like all years, had a lot of moving parts, a lot of changes, a lot of Medicare changes coming through. And to the point we were able to execute on that, re-instill confidence in our clients. Plus very importantly it was the stability in our account management teams that service our clients that also allowed us to again build a better rapport and stronger relationships.

As the year has played out and more and more changes have occurred throughout our landscape in the healthcare industry, and new changes have to be implemented, we've done those for the most part flawlessly. And that again builds confidence.

And so with clients that we felt were at risk for renew, we renewed. And through that process we've been able to put the right foot forward and make some significant progress. So we're very excited about where we stand today in our model and how it's being received in the marketplace. And I think our new sales actually validates our position of our model of alignment and what we're doing in the industry.

The bold moves that Tim and I have talked about earlier are really important for our success. Anybody can go out there again and fill a prescription and adjudicate a claim. And we just -- we don't want to be that type of a prescription benefit manager. We want to be somebody that's really affecting health outcomes and driving down costs. And I think us making bold moves, doing things for our clients that minimize disruption but drive economic value is truly important, and it's resonating.

Glen Santangelo (Analyst - Credit Suisse Securities):

And maybe just a follow-up on that. I mean the specific -- the Optima-Catamaran combination, the MCO consolidation. How does that make you feel about the competitive landscape as you look forward over the next 12 months to 18 months?

George Paz (Chairman and Chief Executive Officer):

Well just to be totally frank, Glen, a lot of people picked our pockets over the last couple years as we've gone through integration. To be honest we're going to try to do the same.

And so we feel that there's some great opportunities out there. It's still early on. And so we're aligned and ready to go after them. And we're going to do our best and put our best foot forward. It's a very competitive environment out there. But we feel like our model is good and it resonates. So we're excited about the opportunities that all these consolidations are offering to us.

Glen Santangelo (Analyst - Credit Suisse Securities):

Okay. Maybe if I could just ask Jim one more, then I'll jump off. Jim, given the ASR could you maybe comment on when it's all said and done where that'll leave the leverage on the balance sheet? And what's sort of target leverage you're looking for the balance sheet? And I'm trying to really get a sense for maybe what the company's willingness is to deploy additional capital, whether it be towards acquisitions or a future share repurchase? Thanks.

Jim Havel (Executive Vice President &amp; Interim Chief Financial Officer):

Sure, Glen. You asked a lot of different issues in there. And the ASR was certainly successful for us. And capital structure is important to us, as we give guidance for 2015 and frankly any year. And as we
reported earlier we got shut out of Q1. So that ASR really got us back on track and incrementally will add about a nickel as we talked about in our release. And that's important to us, and that's good, and we acknowledge it.

As we look forward on the capital structure we've got -- we're going to be right now -- as we guided earlier, we're going to be probably a 2.1 times, 2.0 times on our debt. And I think that's a really good place to be. Having said that you also talked about the opportunity for acquisition. And I would tell you we look at acquisitions with frequency.

Every time one will come down the road we're certainly willing to take a look every -- at every opportunity. And where it makes sense we're certainly going to be willing to jump in. We are not in the least bit concerned about raising that ratio if you will in terms of that capital structure, when it will mean good things to us. In other words as when we can take a look and see something that's going to be accretive and shows the returns that fit our model, I think again we will jump in with both feet and be willing to move.

It's important to us to keep our ratings. Don't get me wrong. But at the same time when we go through an acquisition or when we have an acquisition opportunity, and we can demonstrate what that payback is going to be. And it's going to come back within the ranges that are acceptable to us and frankly to the market, then we're certainly not afraid at all to move forward.

So we're going to continue to take a look at our capital structure as we take a look through the remainder of the year. We may look at some refinancing. We may have some adjustments there. But short of an acquisition I think we're going to keep our debt-to-EBITDA ratios about where we have historically been, again around that 2.0 times ratio. I hope that answers most of your question.

**Glen Santangelo** (Analyst - Credit Suisse Securities):

Thank you. Yeah. That's great. Thank you.

**Operator:**

Thank you.

**George Paz** (Chairman and Chief Executive Officer):

And just one -- let me just follow-up by just saying that one of the things I think we've proven over many, many years is that when we have excess capital, we turn it to our shareholders. So whether it be through share repurchases or through accretive acquisitions, our focus is to manage your capital in a diligent manner to maximize returns. So that will always be a focus of ours.

**Glen Santangelo** (Analyst - Credit Suisse Securities):

Okay. Thank you.

**George Paz** (Chairman and Chief Executive Officer):

Thank you.

**Operator:**

Thank you. Our next question comes from Robert Jones with Goldman Sachs. You may ask your question.

**Robert Patrick Jones** (Analyst - Goldman Sachs & Co):

Thanks for the questions. I appreciate you guys already sharing a specific net new number today. But just
looking at the 2016 script guidance and the updated retention, it does seem like you're on pace to at least offset losses from this year. So I guess first, is that directionally the right way to think about net new wins this selling season?

And then, George, I guess more importantly how much more opportunity do you see left at this stage of this year's selling season?

George Paz (Chairman and Chief Executive Officer):

Yes. That's a great question. So if you look at the midpoint of our guidance, the scripts will be down just slightly is our best guess, but it's not done yet. So we can't really tell you where it's going to come in.

There's not big -- so insurance as Tim said, the managed care side is pretty much finished. We did have a large win he referenced earlier. We're picking up the Mail on that, and we're picking up Formulary Management. But moving a lot of scripts takes a lot of time and effort with a lot of plan design changes that have to come through. So that client in particular is going to start on 1/1/17, although we get some benefits this year.

As far as the clients that are still out there in the managed care area side, these are all for 1/1/17, and even that is starting to come more to a close on the larger side. With respect to large employer groups that's really starting to slow down now as well. They're making their decisions, pretty much finishing up.

But the small employer group, which isn't a lot of claims, is what's really hot and heavy right now. So if we could be very successful there, it won't have as big of impact on claim volume, but it'll have a nice impact on EBITDA in the ensuing year. So it's a very big focus of ours. And it's something we really like, because again the smaller clients really do get into our programs in a bigger way. And they're very much aligned with us on trend management, Formulary management, and those types things. So it's -- this is an important aspect for us. Okay?

Robert Patrick Jones (Analyst - Goldman Sachs &amp; Co):

No. That's great. And then I guess, Tim, as a follow-up. I know I think you acknowledged during your prepared remarks we had the first PCSK9 approved recently. Just was curious to check in. Any updated thoughts on your intent to manage this class of drugs both now with just one on the market and then in the future? And I guess any thoughts around the label and price point of this first one to market would be helpful for us.

Timothy C. Wentworth (President):

Sure. Obviously I think we're going to be shipping the first one before the end of this week. We've got programs in place for our clients right now, given that the first product that came out. Given the label, obviously that informs. And we pretty much were prepared for the label as it came out as it relates to managing our clients' appropriate use let's call it.

We're also very focused and very prepared as it relates to helping members use this product appropriately both through our PBM and through our UBC asset. And we obviously are engaged with the innovators, both those that have the product in the market and those that don't yet, to ensure that we can maximize access while ensuring appropriate usage.

And so when the second product comes that'll obviously be something that we are working on this summer to ensure the best result for our clients and our patients. And Glen Stettin is here. Glen, I don't know if there's anything you want to add or not? I know your team has been down very deeply involved in this.
Glenn D. Stettin - Senior VP-Clinical, Research & New Solutions

Yeah. So while this is a drug that's really important to people who have heterozygous familial hypercholesterolemia and haven't been able to get to cholesterol goals with the statins alone, the label is pretty narrow. And our PBM customers as expected wanted us to be sure to have programs in place to manage this drug from the very moment that the first prescription started flowing. And we have the programs in place.

The drug is a very expensive drug. And we are going to manage it so that the utilization is appropriate, the people who need it have access to it. That's what our clients need and want. But not more than that.

And at Accredo we're also prepared between Accredo and UBC for the education that people need to be able to take and use the medication. Our clients overall are going to be very pleased.

Robert Patrick Jones (Analyst - Goldman Sachs & Co):

I appreciate your thoughts. Thank you.

Operator:

Thank you. Our next question from John Kreger with William Blair. You may ask your question.

John C. Kreger (Analyst - William Blair & Co. LLC):

Hi. Thanks very much. A question for Tim, and it relates to Formulary Management and compliance. Tim, when you sit down with a manufacturer, what's the number of members that you can point to that will comply with your Formulary changes? And how has that number sort of changed over the last year or two years?

Timothy C. Wentworth (President):

It's a good question. It varies obviously by class and size of Formulary. What I would tell you is though we get very high formulary compliance as it relates to our book. Particularly by the way -- which is why I'm so bullish on Mail long term -- inside the Mail channel vis-a-vis the retail channel. And so it's not unusual to see 90% plus.

And what's as important for us is our patients taking their meds. Are we keeping patients on an appropriate therapy versus having patients suddenly drop off, because the Formulary was too difficult to navigate? And we are very focused on that. And that's a large part when we talk with pharma, they want to know that not only we're going to move the share, which we -- and demonstrate that we do. They make sure that we do by virtue of how we write our contracts. So believe me pharma holds our feet to a fire, as it relates to delivering on those share movements.

And importantly if you used for example the hepatitis C category, where there was some concern about the ability to keep patients on a regimen that may have appeared for certain patients a bit more complicated, we are seeing identical, for all practical purposes, adherence rates for those patients completing therapy to patients on other therapies that are available. And so we're doing our job well once the patient is on the right therapy. And pharma cares as much about that as they do the share movement.

George Paz (Chairman and Chief Executive Officer):

I think, John, the other point here is that your question is, how has it changed over the years? And when we came out with our first exclusionary list, because big pharma was going around us through coupon programs. And it was really hurting our ability to manage. So when we came out with the exclusion list, it...
really did bring a lot of focus.

And because we were able to execute that in some very expensive therapy classes and drive down costs significantly, that the buy-in into this has really grown.

And when we talk about the health plans having their own P&amp;T committees and Formulary, but it's important to note what Tim said is that just because it may not be that all drugs align, on those that make a huge difference in cost, we can get alignment. And so when we go in, it really depends on the therapy class. When we go in with a significant amount of members in other classes it's not nearly as important, because the differentials aren't as great. So it really is aligning on those therapy classes that matter. And it has improved significantly over the years.

John C. Kreger (Analyst - William Blair &amp; Co. LLC):

Thanks, George. Maybe one quick follow-up, another topic in drug inflation. What are you seeing at this point across your book, sort of list inflation and realized inflation for your clients?

George Paz (Chairman and Chief Executive Officer):

Well the -- so it depends. On oral solids it's 10% to 12% typically. And on the Specialty it's 14%, 15%. That's list.

What we do is we fight through discounts and other means to get it down to single digits, to mid-single digits is our goal. It really depends on population changes for a client. No two clients are the same. So a client with an older demographic may face different challenges than a client that's a professional services firm, where the membership may be lighter, and they don't have retirees. So it really is different.

And our solutions have to be tailored to the demographics of the client. And so the way we measure is we take clients -- when our comp teams meet with a client, we don’t just show them -- well we do show them overall drug trends. But the important point is, is how did that client -- how did their actions and through plan designs, Formulary Management, and other things relate to other businesses in their industry?

And that's a key matter for us is to make sure that we keep our clients competitive relative to the rest of their industry, because that's what they got to compete in. So that's one of our key metrics for our clients.

John C. Kreger (Analyst - William Blair &amp; Co. LLC):

Great. Thank you.

George Paz (Chairman and Chief Executive Officer):

Why don't we do two more questions? And then we'll call it a day.

Operator:

Thank you. Our next question comes from George Hill with Deutsche Bank. You may ask your question.

George R. Hill (Analyst - Deutsche Bank Securities):

Good morning guys. Thanks for taking the question. George, I want to look at industry consolidation on the other side with retail pharmacy consolidation. And I guess you saw the CVS - Target deal, which is interesting. And how much more pharmacy consolidation would have to occur to impact your ability to implement restricted networks and kind of drive pricing and concessions on the retail -- on the fulfillment side?

George Paz (Chairman and Chief Executive Officer):
Yeah. That's a great question. It's interesting. When I started in this business back in the 1990s, half of all the pharmacies were independent. And if you had asked me as a CFO of this company back then, what was going to happen? And I look at what Home Depot and Lowe's have done. I've looked at what Wal-Mart has been able to accomplish. I would have told you that the independent pharmacy is a dying breed. And that they would ultimately vanish.

Today? Half the pharmacies are independent. And I think the reason is, is because you get a lot of entrepreneurial-minded pharmacists that go to work in retail. And when they come out they understand that they have an expertise and a connection to the clients and a following. And so once they get -- make some money and have an opportunity, they quickly look to open their own retail. And although every year a fair amount of independents either get bought out by large retailers or go away through consolidation or whatever, next thing you know a new one opens up. And the numbers stay pretty consistent.

So one of the things that works really well in the pharmacy space is actually the fact that they do these group buying together. So that they join up with different pharmaceutical distribution companies to form buying groups that allow them to stay relatively competitive against the big players. So there's a fair amount out there.

You would think that maybe that consolidation would hurt us. It actually helps us, because the consolidation allows us to give an offering to specialize or to offer a specific chain in a given geographic area, where they have a large share and want more share of course. And be able to feature them to a given client, which allows them to give a very narrow network with better pricing. And try to capture more of the share in that marketplace.

So it actually works to our benefit for the most part through this process, because all of them are still looking for share. So it's a great opportunity.

George R. Hill (Analyst - Deutsche Bank Securities):
Okay. And then maybe just a quick follow-up for Jim. With the preliminary 2016 script guidance, could you kind of put a number on visibility to that number or certainty? And I guess would the remainder of the selling season indicate an upside or downside bias to that figure? Thanks.

Jim Havel (Executive Vice President &amp; Interim Chief Financial Officer):
Yeah. That's a very difficult question, because what we tried to do is give you -- steer you a little bit forward, give you some guidance on 2016 through a script count. And we've tried to stay within a consistent process and a consistent methodology. Last year about this time is when we first gave you a look into 2015. We're trying to give you a look into 2016 with a fairly consistent range in there.

I don't know that there's anything more specific that we can give you with regard to that. All the comments made today will tell you that we have a lot of confidence based on execution for this year and through the selling season this year, both results and frankly the welcoming we've received from both clients and prospects. And so again I don't know that we can give you anything more specific with regard to that. But again we just wanted to make sure you have a first look at least.

George Paz (Chairman and Chief Executive Officer):
Yeah. And the idea of a range of course is looking at probability adjusted downside and probability adjusted upside. And we try to put our midpoint in the middle.

So as we sit here today we feel good about our range with the middle being where we're looking towards.
And we hope to beat it. We’re going to certainly compensate Tim on beating it. And to the extent we don’t, then Tim’s income goes down, and he’ll be a little less happy.

But we feel pretty good about the midpoint. We’re going to try to drive to the higher end. But we can’t give you anything other than the range today. And the midpoint’s our best guesstimate as we sit here today.

**George R. Hill** (Analyst - Deutsche Bank Securities):

All right. Thanks for the question. Good luck, Tim.

**George Paz** (Chairman and Chief Executive Officer):

Let’s do this last question.

**Operator:**

Thank you. Our final question comes from Garen Sarafian with Citi Research. You may ask your question.

**Garen Sarafian** (Analyst - Citigroup Global Markets):

Good morning guys, and thanks for taking the questions. One, a follow-up on a prior question. So could you maybe clarify what the major drivers are around the top end of the claims guidance for example? So is it -- are you assuming an increase in utilization? Any view on what the top end captures regarding exchanges or in-group expansion, contraction, anything from that perspective?

**George Paz** (Chairman and Chief Executive Officer):

Yes. So like I just said what we do is we weight adjust. There’s still clients out for renewal. And so we’ve got to figure out where we stand with those.

Obviously as the year progresses we become more optimistic about the renewal process. And so those are -- our thoughts around that are weighted on every -- each and every account. We do it from a top-down perspective. And then we do it from a bottoms-up perspective by looking at every client that’s out there. And we make assumptions around retention. And then we look at the pipeline and prospects. And we do that as well.

One of the factors out there that are hard to get your arms around is this small employer group. And by that I mean clients that are 1,000 members or larger in that size of a range. Because a lot of those don’t have what you would consider a normal pipeline. They’re being sold through brokers and TPAs. And we don’t have as much visibility there. But we still -- but we know over history that a lot of these come to the market. And we’ve got to be out in front and make sure that we’re working these hard.

And we just -- at this juncture we can’t give any better guidance than what we’ve given today. The top end obviously is driven by a stronger sales in that space.

But keep in mind that even if the numbers aren’t that much stronger in that space, to the extent it’s successful in its growth, the profitability in that space is disproportionately large. So it’s important to us to grow it.

Now obviously if it’s bigger and towards the top end, then it’s going to be stronger and better. So we just got to play out the remainder of the year and see where this unfolds.

**George Paz** (Chairman and Chief Executive Officer):

To the extent that if there’s any other questions out there, if we didn’t get to them all, we sure would -- we
would welcome you to please call Chris McGinnis. And we will certainly make ourselves available to answer any questions or comments or any issues that you might have.

We really look forward to this quarter's results. And we look forward to the turnaround in our business. We're excited about our future. We think with all the things that are going on in our space that our prospects are as good if not better than they've ever been. And so we're excited about where we sit, where we're at, and what we're doing to control costs and improve patient safety and health outcomes.

So I thank you all so much for joining us this morning, and I'll look forward to talking to you all soon. Thank you very much.

**Operator:**

Thank you and this does conclude today's conference. We thank you for your participation.

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