

CIGNA CORPORATION (CI)

A Closer Look: Cigna/ESI Makes Waves with Ascent Contracting & Econdisc Sourcing GPOs

One year following the combination of Cigna and Express Scripts, the combined company is shifting the organizational structure of the pharma supply chain by expanding the Ascent Health contracting entity (brand drug rebate negotiation) in collaboration with Prime Therapeutics and withdrawing the Econdisc Solutions GPO (generic drug discount negotiation) from its partnership with Walgreen's WBAD sourcing entity. Taken together, these moves suggest that Cigna is working to leverage its increased scale and global footprint to lower drug costs and achieve tax savings. Cigna's moves suggest a harder road ahead for BCBS plan focused Anthem and generic sourcing leader Walgreens.

Expanding Brand Negotiation Power with Prime. On the brand side, Cigna/ESI announced a collaboration with Prime Therapeutics in December to expand manufacturer discounts and reduce pharmacy network cost. We believe that Prime will take an equity position in the Ascent Health contracting entity alongside long term ESI partner Kroger. **Our discussions with manufacturers evidenced concern that the alignment will increase ESI's negotiating leverage and admin fees, suggesting a material benefit for Cigna and Prime.**

Taking Back Generic Negotiation from WBAD. On the generic side, we have learned that Cigna/ESI has informed manufacturers it will withdraw its Econdisc GPO from Walgreen's WBAD sourcing entity on 4/1/2020. **Generic manufacturers are concerned that Econdisc will attempt to revert to more onerous contract terms than they were subject to via WBAD. We expect Econdisc will ultimately hold discounts relatively steady post departure and are on the lookout for any signs of a move to Switzerland (none as of yet).**

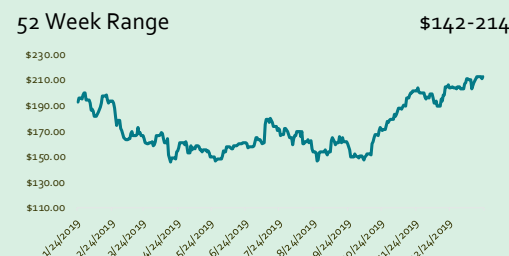
Establishing a Counterweight to Anthem + CVS/Aetna. It is our view that the strategic value of Cigna's alignment with Prime could ultimately exceed the sourcing benefit. Most important, the alignment preempts Anthem's vision of greater unification and coordination among blues plans, a vision that could have threatened ESI's significant BCBS book over time. **From Anthem's perspective, its single biggest opportunity for expanding scale will now meaningfully benefit a competitor.**

The WBA/Prime Specialty JV Could be at Risk. Having solved its cost of goods issue, we expect Prime will turn to specialty where AllianceRx Walgreens Prime has lagged ESI, CVS and OptumRx in terms of capabilities, growth and manufacturer profit capture. **Closer alignment with ESI could provide an opening for Accredo as Prime seeks to improve its competitive position (in tandem with WBA or with other partners).**

We reiterate our Buy rating on CI and 12-mo target price of \$264, based on 14.4x our 2020 EPS of \$18.30

Stock Rating	Buy
Price Target	\$264
Current Price	\$212.70
Upside/Downside	24%

Price Chart



Source: FactSet

Market Cap. (bn)	\$78.9
Enterprise Value (bn)	\$105.6
Dividend Yield	0.03%
CF Yield	9.45%
P/E (NTM)	11.3x
EV/EBITDA (NTM)	9.0x
Debt to Cap	43%

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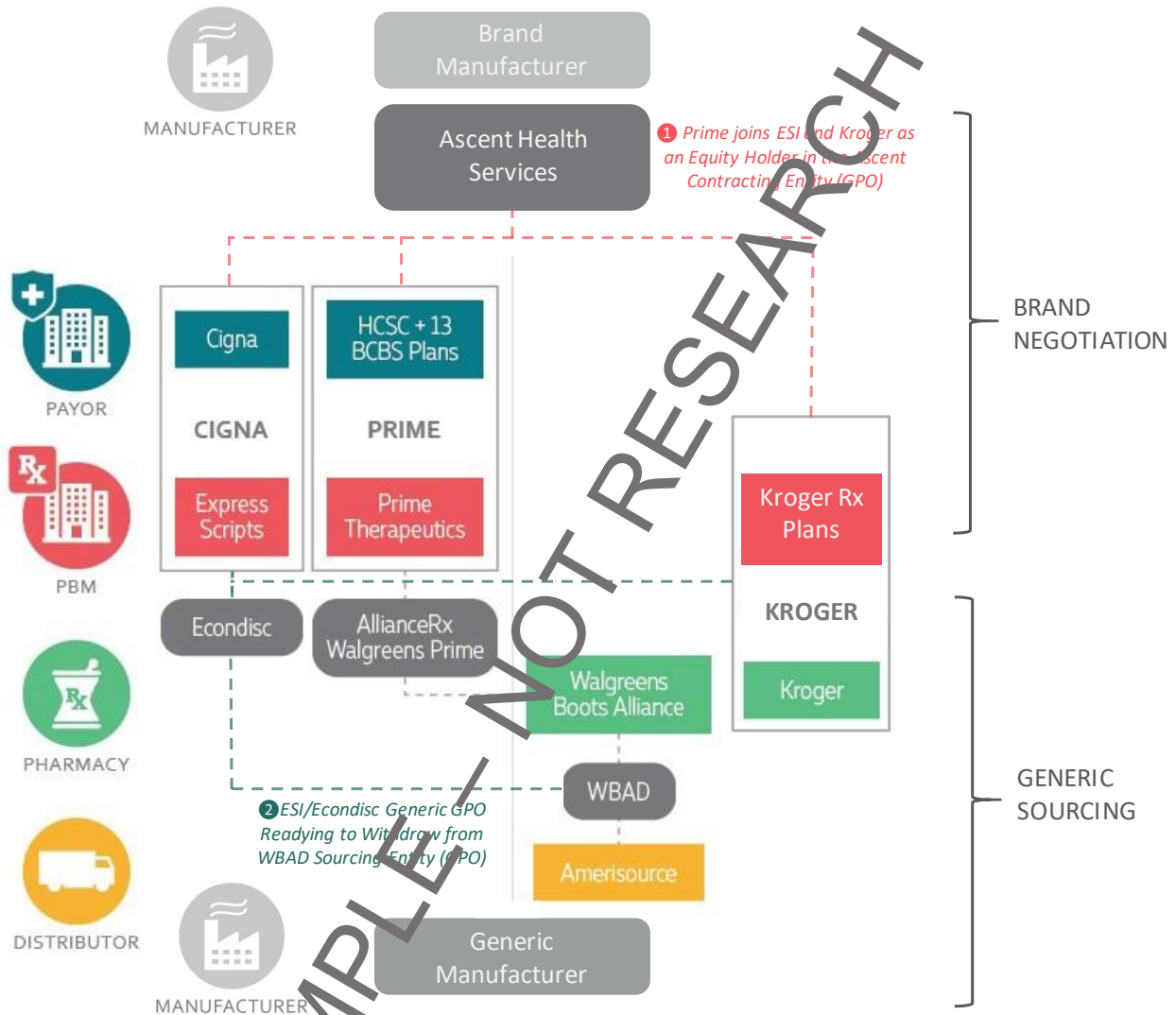
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A Closer Look: CI/ESI Ascent Contracting & Econdisc Sourcing

One year following the combination of Cigna and Express Scripts, the combined entity is shifting its brand negotiation and generic sourcing strategies in ways that will impact the organizational structure of the pharma supply chain, increasing pressure on both brand and generic manufacturers. Let's take a closer look.

Fig. 1: Cigna announced a collaboration with Prime for Ascent and began making plans to withdraw Econdisc from WBAD



Source: Nephron Research

Cigna & Express Scripts Are Making Significant Moves

In December, we learned that ESI will take on negotiation for Prime via the Ascent Health contracting entity

December 20th, Cigna/Express Scripts (CI/ESI) and Prime Therapeutics (Prime) announced a three-year collaboration combining their already significant scale to increase manufacturer discounts and reduce pharmacy network costs. **Given the mechanics of GPO financials, we expect that Prime will become an equity owner of CI/ESI's Switzerland-based Ascent Health Services group purchasing organization (GPO), or 'contracting entity' as CI/ESI prefers to refer to it, alongside long-time ESI partner Kroger.**

- **The combined contracting entity will benefit from:** 1) Equalizing contracted manufacturer rebates and discounts between CI/ESI and Prime in 2020 (a significant source of incremental