

**Magellan Health, Inc. at Stephens Nashville Conference  
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Corporate Speakers

- Scott Fidel; Stephens Inc.; Analyst
- Jon Rubin; Magellan Health, Inc; CFO

Participants

- Unidentified Participant; Analyst

**PRESENTATION**

Scott Fidel: -- welcome to day three of the Stephens Nashville Conference. I'm Scott Fidel, I'm the Healthcare Services Analyst with Stephens. Thanks for joining us here today.

So we're pleased to have our first healthcare services panel this morning with Magellan Health. Here from Magellan, we have Jon Rubin. Jon is the Chief Financial Officer of the company. We also got [Matt Perry]. Matt is with Investor Relations.

So, Jon, first of all, thanks for joining us, for coming to the Stephens Conference. We very much appreciate it.

Jon Rubin: It's great to be here.

Scott Fidel: So maybe we just want to table set and you recently just reported 3Q earnings. Earnings itself right now is only one of the number of things that are playing out with Magellan. Obviously, we have a new CEO, Ken Fasola, that just started -- it's day two, right, for Ken?

Jon Rubin: Yes.

Scott Fidel: So I'm sure you'll be able to tell us all of Ken's plans, right, for the future at this point. But maybe, Jon, if you want to start with just some introductory comments, maybe you want to just highlight a couple of the key messages that you'd want to extend to investors just coming out of the third quarter report?

Jon Rubin: Sure. And good morning, everyone. And I didn't realize it's day three, so you guys are the survivors. And I appreciate you being up bright and early in the morning to see us.

I don't have prepared remarks here because I definitely want to respond questions, but I'll just note a few things. One, very exciting time for us at the company; lots going on. Over the past several years, we've really transformed the business and made really good progress this year on a number of areas, including cost of care improvement in Virginia, which was one of the top priorities we had coming into the year as well as in pharmacy, where we had a number of cost of goods sold initiatives.

And as Scott mentioned, we have a new CEO, Ken Fasola, who just started yesterday. I actually spent time with him in one of our operations yesterday. He'll be leading us through the next phase of our growth.

In terms of key messages from the quarter, a few things I'd note. One, given the progress I just described, the results in both our pharmacy management business and Magellan Complete Care, our newest, fastest growing segments, we're really quite solid in the quarter, and we're very pleased about that.

We did, as we noted in the quarter, have some pressure in cost of care in the behavioral specialty side, but we believe the pressure is short-term. That's a longstanding business. We've had longstanding customers, and we're confident in being able to mitigate that as we go into next year.

So just in terms of high-level themes, Scott, those are the things I'd note.

Scott Fidel: All right, great. Thanks, Jon. Why don't we just start with -- I'm not going to ask you what you and Ken talked about yesterday and what his vision is for Magellan obviously. I'm sure we'll hear plenty about that in due course.

Just interested, maybe if you could talk to us what you think maybe the timing might be around how Ken and the team start to discuss the thoughts on any type of strategic or operational changes that may play out. You've got the guidance call that you always do in December. But maybe help us just think about how we can think about expectations on timing of how we'll start to learn the new expectations.

Jon Rubin: Yes. And it will evolve over time. You know, Ken just being onboard this week has really emphasized a few things with the team. One, first and foremost, execution. We've got a number of commitments that we made and delivering on the commitments, and having a stable business platform as we go forward are first and foremost. So that scenario, that he certainly will stress, and stress that in doing so, that will give us the opportunity then to think about strategy and also to continue to evolve the culture of the company. So those are really the key things.

So I think -- Scott, I'm not sure there will be a bright line, but I would expect we'll do the guidance call. Ken can give some, his preliminary thinking on priorities and timing. But I'd expect -- he's very diligent and fast learner. And spending a lot of time in his first few weeks meeting with employees, customers, and other stakeholders to really both learn the business and build the relationships he needs to be most effective in his role. And then as we go to next year, I'm sure we'll hear a lot more from Ken about his thoughts on where he'd like to take the business.

Scott Fidel: Okay. So last Friday was actually a nice 8-K at the end of the day with the new business win from Magellan, where the company announced having won a new pharmacy benefit contract to serve the state of California. Jon, interested if you could maybe give us just some more details to the extent you can on, first, what are the specific services, what type of -- was this competitive RFP?

I know, at the same time, California has been talking about shifting some of the services in terms of carving out some of the PBM services. That was part of Governor Newsom's healthcare plan. I'm not sure if this relates to that or something different. You disclosed the expected revenue contribution. Interested how you would think about the margin profile overtime of this. Shall we think about this ramping to be, have a margin profile similar to the PBM business overall? Or anything you can give us on margins with that contract as well?

Jon Rubin: Okay. I'm going to try to get all your questions, your specific questions.

Scott Fidel: I'll repeat them if --

Jon Rubin: No, it's okay. No, I think I've got most of it. First, yes, I mean we were awarded essentially all the pharmacy business for the Medi-Cal program in California, which, at least to my knowledge, is the largest pharmacy benefit management program in the country and certainly the most diverse. I mean it serves over 13 million members and claim volume is roughly 200 million claim transactions per year, so huge in terms of volume.

I mean it was a competitive RFP, and we obviously have the sense for the bidders. But we're -- at least the last I had checked in we hadn't gotten all the debrief yet on how everything played out.

But the services under it, by the way, are claims management adjudication. It's prior authorization utilization management. It's managing the preferred drug list and the whole pooling and invoicing and accounting around rebates, supplemental rebates that the state gets, and customer service in terms of member and provider service. So pretty much the whole scope of pharmacy benefit administration services.

Now, this was in respond to Governor Newsom's Executive Order, so essentially this required -- his Executive Order required to transition of all pharmacy management from the health plans in the disparate group of PBMs serving the individual health plans to one single manager which they've identified as us that they're intending to negotiate with on this.

Basically, it standardizes all the benefits state-wide. It applies, again, consistent state-wide utilization management programs around the drug management. And also in the state -- and a lot of their kind of papers that they use to support the program in the RFP around are public information, so you can see it. They believe they can also save money by strengthening their ability to negotiate state-wide supplemental rebates across the states.

So those are the key areas. In terms of margins, we don't like to talk about margins for specific customers. But think about it this way, if you think about PBM, you're probably in that 3% to 5% pretax margins for a typical PBM customer. For a really large PBM customers, though, it's a small fraction of that.

Scott Fidel: You're right.

Jon Rubin: You're probably talking a fraction of a percent. This would be more in that category. However, with the PBM, the accounting is such that the cost of drug gets included in the revenue where here, we're just talking about fee. So, again, if we were to calculate 13 million members and what the cost of drugs would be, the margins would be very, very thin.

But on fees for the PBA book as you look across our entire government's Medicaid fee-for-service portfolio, typically margins would be in the teens, probably mid-teens or potentially higher. Again, if you were to look at it, compared to the cost of the whole program, it would be that the fraction of a percent. But we're just here to [assist] fees. And here, the fees, we're estimating about \$70 million to \$80 million a year, annually. Does that help?

Scott Fidel: It does. So actually because it's largely fee-based, actually, this would have a margin profile that could potentially be more in that teens profile.

Jon Rubin: It would be more -- we more, again, we -- and in fact we're still working out some of the details of the -- of the operating model but that will be more typical to PBA business.

Scott Fidel: Okay, all right, yes. Because when we -- we had initially done our sensitivity analysis in our note on Friday, just assuming the classic PBM margins. I think we used the 2% to 4% but it sounded that could actually be --

Jon Rubin: It would be higher than that.

Scott Fidel: -- quite conservative.

Jon Rubin: The other thing I just want to note is there will be startup expenses because of the gap accounting, you have to recognize the expenses when you incur them and revenue get spread over the active life of the contract which starts in 2021.

So, there will be some expenses in 2020 to hire people for transition and training and things that we're still working through that would be one-time in nature. So, we'll talk about that when we get to the guidance call but at least I wanted to flag that something that we need to acknowledge as we -- as we complete the guidance this year.

Scott Fidel: Got it, but bottom line, so it sounds like actually over two-, three-year period as it ramps. This could actually be a nice contributor to the bottom line.

Jon Rubin: Yes.

Scott Fidel: Great. And have you gotten any feedback to -- from the state yet in terms of, I don't know, if the scoring has been released yet or -- but just in terms of what about your bid, the state found to be compelling in terms of choosing Magellan.

Jon Rubin: No, not that I'm aware of. I know the scoring does get released but the last I had at least check in, we had not seen it yet. What I would say is in this business, it's very interesting,

in this business, we've been in this business for -- well we've been in Magellan's since 2009 when we first -- the company First Health Services.

But First Health -- First Health had been in the business for decades, so we are actually the biggest direct state pharmacy benefit administrator by a wide margin. I mean we're in 20 -- depending on how you count things, 26 states plus Washington D.C., so 27 different regions. And it is interesting because this was largely when we first got into a business, considered a fee-for-service market.

Scott Fidel: Right.

Jon Rubin: Meaning it was -- if things weren't managed by the health plan, they have fee-for-service programs to manage the pharmacy component. It is interesting because California now has -- really the first major state to literally already have gone to managed care and they will be pulling the pharmacy out.

The one thing I will say just quickly is there are a lot of other states that have concerns about the PBM model. It's very fragmented, it's very opaque in many cases. So, we're optimistic now, especially with California being one of the bellwethers that this may help start a trend where more the pharmacy business gets carve out. If so, we're very well-positioned.

I mean we don't know, again, the specifics of the scoring but we've got more experience. We've got the capabilities that are very specific to the segment. There is a lot of compliance, there's a lot of experience in terms of managing the supplemental rebate pools and things where I would project that we scored well because of both the experience and the very targeted capabilities that we're able to bring to the table.

Scott Fidel: Yes, you raised a good point. Actually, it was -- it was going to be my follow-up question and -- because I remember after you guys had bought First Health business and I remember the days of covering First Health before they were required by Coventry, there was that trend, significant trend towards insourcing of pharmacy benefits which I know was a headwind for you guys.

And now -- I mean obviously California did what they did and -- but as you say, I mean a couple of states out would think about would be obviously Ohio, significant scrutiny right now to PBMs and Medicaid. Kentucky is another one, so it sounds like you have a sense that maybe this -- that California may not be just a one-off, that there be -- there could be other states that also look to essentially carve back out the pharmacy benefit service and Medicaid.

Jon Rubin: Yes, we do. I mean they're not the size of California but yes.

Scott Fidel: Okay. All right, well that's going to be a story to watch. Okay, Jon, maybe if we can just -- on 3Q, just drill in to getting, trying to bring sense, the utilization pressure that you saw in the behavioral and specialty book. You know, I think what maybe a little different, but correct if I'm wrong about this as you talked about, it seemed like this was more of a general pickup in trend in the book, right. I mean you guys have had certain issues with certain contracts

in Virginia for example -- so it's -- what I'm -- the question is just that you've seen a pickup in trend and if so, any sense on what actually the catalyst or the driver of why at this point we're seeing a -- some rising trend in the behavioral book and then obviously from the mitigation side of things, I'm sure you're looking at corrective pricing right now, talk about the pricing actions that you're putting in place and how confident you are that you can mitigate this trend issue for 2020?

Jon Rubin: Yes. Good -- all good questions, so behavioral health trend this year, we started to see some uptick in the first half of the year very specific to inpatient behavioral health. So -- not on the outpatient side and not as much in the substance abuse side, it was really psychiatric diagnoses where we were seeing really an increase in demand for inpatient services.

What I mean by that is we also track very closely our own operational metrics, what's the percentage of authorizations that are approved as appropriate, what's the length of stay. Those metrics have actually been stable. The issue has been really across the board. We'd actually seen just more people, presenting themselves to either through the ER or through the inpatient admissions.

It has been widespread. Anecdotally, we're hearing that psych hospitals are also seeing increases -- some increases in volume, so it does seem to be an industry phenomenon, not so much driven by any population changes or things within the book of business.

We're trying to understand root cause as, again, so far it's anecdotal but we think that there just is an increase trend, less stigma associated in some cases with people getting care for psych services which long-term could be good. We also believe that there is a continued issue around availability of psychiatrist and in some cases other behavioral health professionals on an outpatient basis which creates longer wait and sometimes people showing up in the ERs.

A number of potential things that we're evaluating but at the end of the day, we've been in this business for very long time and we've seen cycles where the utilization has been up and we've seen cycles for utilization has been low. So, we've been able to very successfully manage through these cycles in the past and there's really two things that we're looking at.

One, as you mentioned, Scott, the annual rate increase is all -- essentially all of our contracts provide for annual rate updates and the methodologies include the rolling 12 months claim experience and the negotiated trend going forward, so we're in those discussions now.

The biggest element of the negotiation is really the trend, which is essentially the decision on how much of the increase in trend do we expect to persist going forward versus just the one time bump and then trends return to more normal level. That ends up being a negotiation and we're comfortable with, we got great relationship with customers. We're comfortable to get maybe not everything we want but where we need to for the year.

The second thing as we're going to 2020 is, with the knowledge now of the experience and what we're seeing market by market, we're also have some targeted network contracting initiatives where we're looking at some of the higher cost on facilities and either renegotiating or looking at

some network actions and other utilization management programs to manage the appropriate length of stay from a concurrent view -- concurrent review standpoint.

So, we're confident, again, as we go into 2020, we'll mitigate the vast majority of this next year.

Scott Fidel: Okay. Let me just pause here and see any questions at this point.

## QUESTIONS AND ANSWERS

Unidentified Participant: Could you give us a little bit of a background on Ken and (inaudible - microphone inaccessible)?

Jon Rubin: Yes, so I can give you my perspective, obviously, I can't speak for the board. But my perspective on Ken is one, he's got a wealth of experience in the managed care business. So, he started out with the Blues, worked for Humana, worked for United, actually most recently was the CEO of HealthMarkets, which United recently purchased. So, he has experience both on the large company side as well as more entrepreneurial side.

My perspective is he's very focused. I mentioned earlier his -- and he's got good experience on the -- on both business development and operations, very execution-oriented, which is something that's very high priority for us over the next year or two. Good strategic thinker and I know with the board, as I mentioned earlier to Scott, that as he gets up to speed, he'll be able to engage more fully in that and give his perspectives.

And also from at least my vantage point and the experience I had over the last few weeks interacting with him, very strong communicator and good leader, very transparent, very good and pragmatic. So, I think those are the key elements that I know.

Unidentified Participant: California obviously is the largest pharma contract you've ever received, tell us about your view of how Magellan is ready to implement [of that scale], how does that compare to other contracts that [you've scaled]?

Jon Rubin: Yes, it's big. I mean it's big. What I'd say is, again, we've been for a long period of time the industry leader in the space. So, we're as well or better positioned than anyone else to do this. I mean our [claims] system was built for this -- I mean -- that we've got -- again as referenced earlier we bought from First Health.

We've got the expertise to be able to lead and manage it. The biggest lift is -- and really, it starts -- it starts next month is the ramp up of hiring. I mean we've got to bring on -- I think it's 500 or so people next year, not the beginning of the year but through the year to manage the -- both the transition from managed care into the fee-for-service program and ultimately the go live next January.

So, again, we obviously had a plan that we articulated in the RFP process. We've been thinking about it for a while. But now, I had to put that into action as we head into next year. So, it's a big lift.

Again, we know what we need to do and we will make sure we don't [under club]. We're going to get the resources that we need. But from an expertise standpoint, it is essentially what we do in 26 other states. It just happens that this contract is almost as big as the other 25 combined. I mean, it's a big contract.

Unidentified Participant: (Inaudible -- microphone inaccessible).

Jon Rubin: No. I mean -- no. The offering cost will really be 2020 -- I mean by 2021 because we're not taking risk on this, it's not -- it's not a matter of ramping up the care management, utilization management or anything like that. We should pretty much be earning the appropriate margins or the contract margins going to next year.

Unidentified Participant: (Inaudible -- microphone inaccessible).

Jon Rubin: It shouldn't, no, no. Because by 2021, which is when I think we were guiding directionally at least the target, we'll be -- we'll be -- we'll already have those behind us the one-time cost.

## PRESENTATION

Scott Fidel: Jon, maybe we can talk a bit about the set up for 2020. Maybe just a start might be helpful on the 3Q call you have provided some initial framework around how to think about that, maybe just to start that conversation if you just wanted to just update the group on how that framework for 2020 was established initially and then we could add a couple of questions on that.

Jon Rubin: Yes, sure. So, for 2020 -- and again, it will give a lot more color in a couple of weeks when we give guidance. So -- but we talked about in the third quarter call directionally, there are few key areas that drive year-over-year earnings growth, which we think will be significant as we go into 2020. And these are really continuation of the profitability improvement plan to get us ultimately that 2%.

One is in cost of care -- to drive and continued cost of care improvement particularly at MCC and particularly in Virginia. I mean, there are other MCC markets not going to let you actually performing quite well. Virginia because of the large series of implementations we had over an 18-month period where we quickly ramped up to around \$800 million of revenue and a lot of nuances to the different complex populations we implemented, it took us a while to kind of ramp up to the point where we are now where this year we'll be approaching break even specifically after 2019. After this year, we think there's another \$40 million of cost of care improvement in Virginia. We won't get it all in 2020 and we'll talk more specifically on the guidance call. But between 2020 and 2021 and it will be split between those two years.

Also, we noted that on the call the fact that the \$15 million of pressure we saw this year in behavioral specialties, we think we'll be able to reverse next year as we drive rates better appropriate for the level of utilization and the population that we have. So, we think again the vast majority of that will be able to improve as we go into next year.

And then really the third area is just net growth which is probably smaller than the first two in terms of the initial year of new business. But the net of new business and any churn or contract losses within the period. So, that's the way I kind of think about the key components.

Scott Fidel: Okay. And one or two as a follow up question around as you just think about establishing initial guidance for next year, it's encouraging for sure that you expect a solid growth off of the 2019 adjusted baseline.

At the same time, the couple of years have been challenging in terms of meeting or beating expectations. And just interested as you think about establishing that initial guidance framework for 2020, thoughts around maybe just building in some additional conservatism for all of these unanticipated variables that play out in this business and that clearly you have seen to start to rebuild investor confidence and the ability for you to achieve the targets that you're going to lay out.

Jon Rubin: Yes. No, I think that's very fair. And a few things just in terms of table setting I think there are important to note, one, the last handful of years for us have really signified a major transformation in our business. As I said at the outset, if you went back even five or six years, the vast majority of our revenue and probably even a higher percentage of our segment profit was carved out behavioral health contracts.

We've been at business for a long. We've had many customers for a long time. Again, revenue is much lower than it is today. And growth prospects are much lower than they are today. But it was much more predictable.

As we transform the business and particularly I'd point to MCC -- the Magellan Complete Care business where we're now doing integrated comprehensive management for complex populations under state Medicaid program. That was essentially a series of startups and really a very -- we knew at the time a very ambitious project for us because we knew as states were carving in behavioral health that we had to -- from a strategic standpoint -- kind of morph to the new world.

On the other hand, it wasn't for the faint of heart. It was -- there was a lot of things that were new even to the states not just the Magellan. So, we've talked about that we were the first to launch a specialty plan for the seriously mentally ill in Florida. That had never been done before.

We won the contract in the Virginia in 2017, in between late 2017 and January of 2019, implemented the managed long-term care population, the ABD population. We were awarded the Medallion, the general Medicaid population and Medicaid expansion all rapid fire. So, we're drinking through the proverbial fire hose. And that led to some of the unpredictability in the results in that. While we had very capable people. We were doing things for the first time; again, in some cases, the first time in the whole industry.

If you fast forward to this year, I just wanted to underscore that we're in a much more stable place now. We very consciously didn't implement any large cases in 2019 and 2020 other than the Medicaid expansion in Virginia which was a natural event because of the fact that we needed

to digest what we had really stabilize our operating platform and then have solid bases for future growth.

So, as we go into 2020, inherently, I think we're in a much better place from a predictability standpoint because all of our customers we've now had for at least a year and know the run rate, have worked with the states so understand much better how they're evaluating the renewal rates and everything else and should be subject to much fewer surprises both internal and external, so that's one.

Two, we are, to your point, trying to be very conscious of not just not overreaching and being more conservative but also making sure we're providing for adequate flexibility as maybe we do win business as we go forward.

So, we talked about California and well between now and we do the guidance call and make sure we've got adequate provision for the implementation there. There's other things again we're going to be certainly erring on the side of caution as we kind of complete the guidance. But, again, a lot of good things happening. We're still very comfortable even having said that that we're going to be able to drive good growth as we go into 2020.

Scott Fidel: Got it. I'll just pause here and see if any questions out there. All right, I'll [Thompson].

## QUESTIONS AND ANSWERS

Unidentified Participant: What are you guys think are the areas in the business unit that still need a lot of (inaudible - microphone inaccessible) and attention going forward and going back to the (multiple speakers) --

Jon Rubin: Yes.

Unidentified Participant: It still feels like there's still some more work to do and the new CEO coming on, a little color.

Jon Rubin: Yes.

Unidentified Participant: (Inaudible -- microphone inaccessible). But what else?

Jon Rubin: Yes. So, let me kind of give you my thoughts. I mean, there's a lot of details in each of the business, but I'll try to call out the critical ones. One, you mentioned California implementation on the pharmacy side, that's front and center for everybody across the company.

We not only need to be successful with the implementation but we really wanted to be flawless because we do believe as Scott referenced earlier that this could be a trend for other states to follow. But we got to make sure we nail this one so that we can position ourselves to be the beneficiary of that, so that's one.

Two, although we've made great progress on MCC operations and costs of care, that is an area that -- and great progress on the organization. I mean the leadership there is fantastic. We've really build a great team. It really is important that we continue to focus on execution just because it's such a large block of revenue in costs that we need to stay on top of and manage. So that's certainly front and center as well.

On the behavioral specialty side, we talked about the short-term areas of cost of care and that's going to be important. In addition, as we think about the future there, it's a very mature business. It's one where we think we can grow but it will be a slower growth. And I think the future that business depends on a -- depends on us continuing to create new products that we can sell into the channel.

So, if you think about over the last several years, we had the behavioral health carve out business. We purchased the company, NIA that did radiology management. We've built other products off that cardiac management, radiation oncology, musculoskeletal management what we call physical medicine which is PT and OT. And we've continued to sell those new products to the customers as everyone of those products has a lifecycle where it becomes penetrated. Then you have to find new opportunities. So that's another.

And the last thing I've mentioned which is more of a strategic decision that we'll contemplate as we go forward as Medicare Part B. We're a Medicare Part B player on the pharmacy side. We really entered that business because at the full service PMB, having Medicare capability is important because when a large employer or a health plan evaluates the program, they may have a small number of retirees that maybe an [equity] program or a series of program to health plan. They can sometimes make the decision based on that small number of employees. And we wanted to make sure we could demonstrate that we could manage Part B, to have compliance with CMS and go through the audits and all that.

However, we're sub-scaling that business into PDP business, the individual Part B. And we've also gotten to the point now where we believe we've demonstrated to the market that we are capable and actually we have employer and health plan programs in place today. So that's something going forward in 2021 and beyond.

We're going to evaluate -- because it does lose money and say do we need to continue that. That will be another strategic decision that we make as we go through the year.

Scott Fidel: Yes, I concur on that. I'd be interested to see what you guys decide to do on the Part B business. I think, so far, in terms of returns on capital, it hasn't been the best use of it, so far, right?

Jon Rubin: Right.

## PRESENTATION

Scott Fidel: Okay. Jon, maybe you can update us because there's been some moving pieces over the course of the year, right, in terms of how things have progressed at the current outlook year. It's now [implies run] an adjusted net margin around 1.3% at the midpoint. You reaffirmed your

target for 2% in that intermediate time zone, which is that 2021-ish, right, type framework back half 2020 into 2021.

Maybe based on the current guidance assumptions, we think about the bridge of the 70 basis points to get there how that's bucketed at this point as you think about at MLR improvement in healthcare, COGS improvement at PBM? The PBM margins have actually been really performing well this year. So, it's been encouraging to see nice turnaround there, how much is left though, and then just SG&A and corporate administrative cost savings?

Jon Rubin: Yes, and that was a good -- a great question. So, as we think about it and your intro was correct. We're projecting about 1.3% this year. So, the 1.3% to 2% is the right way to think about it. So, I'd still look at cost of care in MCC as being the biggest component of that.

We talked about \$80 million of improvement in Virginia. About half of which we expected to and are actually getting in 2019, which has driven the improvement I referenced earlier. The second \$40 million will be after 2019. So, think of it as 2020 and 2021. That's a big chunk of it.

Second area would be SG&A. And this will probably be heavier weighted to 2021. But it's continuing to make productivity improvements in our business operations and in corporate. And again, we'll get some improvement in 2020. But many of these initiatives require some investments. So, the near-term improvement is less but that's -- that we believe will be about \$35 million between 2020 and 2021.

And then we talked about the headwinds we're seeing this year in behavioral specialty, the \$15 million of pressure we referenced in the third quarter call. We believe we can reverse most of that in 2020. So, those are the biggest pieces.

Now, the pharmacy cost of goods is all is interesting. We actually did get the benefit of those initiatives mostly in that first/second quarter timeframe this year. So, we're already seeing the benefit of those in second and third quarter of this year, largely in second quarter and third quarter of this year. But that will continue into next year.

We do think there's future opportunity on the pharmacy side both for further improvements as we build scale and also operating expense improvements as we consolidate platform. However, we didn't include that specifically much in addition to what we've gotten this year in the 2% because we're being a little bit cautious about what the competitive market will be and how much of that we'll be able to retain in margins versus how much will help us to compete and continue to grow. And that will play out over time but we're at least not counting on that as further getting to -- further moving towards the 2%.

Scott Fidel: Great. I'm glad you brought up the competitive margin and PBM because actually that's going to be my next question actually on a more of an encouraging at least from my perspective angle on this. And investors to market had gotten very concerned about competitive environment, the regulatory environment, and the PBM market. Obviously, PBM valuation multiples became significantly compressed. A lot of that was focused on concerns about the

rebate proposal which was punted by the administration and doesn't seem like it's coming back anytime soon.

When you actually look at the performance of the PBM market, I thought in the third quarter across the board, we actually saw pretty good performance relative to street expectations if you look at OptumRx, if you look at CVS, Express Scripts or Cigna, you guys. Margins in general came in a bit better I think than street expectation. So, maybe with that as the backdrop, talk about how you see the competitive environment right now. Do you see like things have maybe – we know it's competitive but that intensification of the environment may have started to settle out a little bit and maybe we're getting some stabilization in some of those competitive dynamics at this point?

Jon Rubin: Yes. So, a few things. One, the market does continue to be competitive. I don't want to -- I don't want to sugarcoat that. I mean -- and that's why I say we're all going to need to continue to get better and better at what we do both more efficient and drive up additional savings to continue to compete and drive the margins we're seeing in the industry.

Having said that, last year, if I look at 2018, I'd say we saw competition that was beyond just competitor. I mean it was borderline irrational. And I do think some of that was the large PBMs going through consolidations and acquisitions and trying to renew customers and retain business and stabilize revenues. And I think there was just a little bit of a scramble at that point.

We have seen that subside. And we even referenced, we had lost some specialty customers because PBMs had grab the business at [subterranean] margins, which isn't sustainable. But that was again over a year ago. And we've seen things more return to normal, very competitive.

Scott Fidel: Right.

Jon Rubin: So that's one thing. The other thing that's interesting is and it still will play out is what the impact is of the consolidations. Meaning now we really don't have very many large independent PBMs left. The big guys are all now associated with large health plans. With the win we have in California and there'll be other mid-tiered PBMs that are actually going to lose business in that, we're probably the largest -- going forward the largest independent PBM.

I think it still remains to play out what the impact of all that is. I mean we're certainly seeing customers or potential customers that are coming to us with some concern about whether the small health plans or PPAs or employers that have certain biases that have some concern with the channel conflict of a PBM that's owned potentially by a competitor in the instance of health plan and TPAs.

So, our activity levels and pipelines are very strong right now on the PBM side. Having said that, the large PBMs are going to be very aggressive to retain business and customers. And even if people have certain concerns or biases, it often does come down to dollars and cents. So, we still need to see how that plays up. And at least encouraged that I think that will create some new opportunities for us.

Scott Fidel: Got it. All right. Well, I think we're pretty much wrapped up here in terms of time, so we'll close it here, Jon, thanks very much.

Jon Rubin: You bet. Thanks, Scott.