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CI.N - Q2 2020 Cigna Corp Earnings Call

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OVERVIEW:

Co. reported 2Q20 consolidated revenue of \$39.2b, consolidated after-tax earnings of \$2.2b and consolidated EPS of \$5.81. Expects 2020 consolidated adjusted revenues to be \$154-156b, consolidated adjusted EPS to be \$18.00-18.60 and 2021 EPS to be \$20-21.



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by for Cigna's Second Quarter 2020 Results Review. (Operator Instructions). As a reminder, ladies and gentlemen, this conference, including the question-and-answer session is being recorded. We'll begin by turning the conference over to Mr. Will McDowell. Please go ahead, Mr. McDowell.

William McDowell - *Cigna Corporation - VP of IR*

Good morning, everyone, and thank you for joining today's call. I am Will McDowell, Vice President of Investor Relations. With me on the line this morning are David Cordani, our President and Chief Executive Officer; and Eric Palmer, Cigna's Chief Financial Officer. In our remarks today, David and Eric will cover a number of topics, including Cigna's second quarter 2020 financial results as well as an update on our financial outlook for 2020. As noted in our earnings release, when describing our financial results, Cigna uses certain financial measures, adjusted income from operations and adjusted revenues, which are not determined in accordance with accounting principles generally accepted in the United States, otherwise known as GAAP. A reconciliation of these measures to the most directly comparable GAAP measures, shareholders net income and total revenues, respectively, is contained in today's earnings release, which is posted in the Investor Relations section of cigna.com. We use the term labeled, adjusted income from operations and adjusted earnings per share on the same basis as our principal measures of financial performance. In our remarks today, we will be making some forward-looking statements including statements regarding our outlook for 2020 and future performance.



These statements are subject to risks and uncertainties that could cause actual results to differ materially from our current expectations. A description of these risks and uncertainties is contained in the cautionary note to today's earnings release and in our most recent reports filed with the SEC.

Before turning the call over to David, I will cover a few items pertaining to our financial results and disclosures. Regarding our results, in the second quarter, we recorded an after-tax special item charge of \$99 million or \$0.27 per share for integration and transaction-related costs. We also recorded a special item charge of \$11 million after-tax or \$0.03 per share for costs associated with the early extinguishment of debt. As described in today's earnings release, special items are excluded from adjusted income from operations in our discussion of financial results. Also, as we've previously noted, prior year development is now disclosed on a gross basis, consistent with industry practice. Our financial supplement now includes a roll forward of year-to-date unpaid medical claims liability for the 6 months ended June 30, 2020 and 2019 as well as for full year 2019.

Additionally, please note that when we make prospective comments regarding financial performance, including our full year 2020 outlook, we will do so on a basis that excludes the impact of any future share repurchases. Finally, our outlook for 2020 assumes a full year of earnings from Cigna's Group Disability and Life business, we continue to expect our divestiture of that business to be completed in the third quarter of 2020. With that, I will turn the call over to David.

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Thanks, Will, and good morning, everyone. Thank you for joining our call today. The current environment that we all live in and work in is more dynamic, more unsettled and more complex than any time in recent history, and Cigna's mission to improve the health, well-being and peace of mind of those we serve has never been more important, and it continues to guide the actions as we move forward. In recent weeks and months, we have taken decisive steps to support employers, who are the driving force of a thriving economy, to withstand and emerge from the COVID-19 pandemic, and to support our communities, customers and patients, including our efforts to combat systemic racism, which we view as a critical health issue as well. Today, I'll offer several recent examples of how we continue to differentiate ourselves in the marketplace and with our key stakeholders, by delivering on our promises and working to make health care more affordable, predictable and simple, by creating innovative solutions to solve for health care's most complex challenges, and by partnering with our clients, some of whom are viewed as competitors, but who we see as strategic partners capable of extending our reach to make an even greater impact for customers around the globe. We do all of this with the goal of maintaining and improving the health and vibrancy of our clients, communities and customers.

I'll also give you an update on our financial results that we delivered for the quarter and how these results provide a further testament to the strength of our businesses and the value we create for our customers and clients as well as a few comments on our growth path forward. And then I'll conclude with a brief update on our outlook before turning the call over to Eric.

Cigna's long-standing commitment to our clients, communities and customers is fundamental to who we are as a global health service company and has been critical in shaping our ongoing response to the COVID-19 crisis. This response begins with our more than 70,000 colleagues around the globe who have worked tirelessly and with great empathy throughout this pandemic. They wake up each and every day with the sole focus to serve the needs of our customers, patients and clients around the globe. And I am proud to be teamed up with such a talented group of coworkers, and I thank them for what they do to positively impact millions of lives each and every day. Nowhere is their commitment more evident than in our deep support of our employer clients, large, small, public, private. These businesses have always been critical to a robust economy and today more than ever, companies will play an essential role in serving individuals, reenergizing our communities and returning economies around the world to economic vibrancy.

From the outset of the COVID-19 crisis, Cigna has leveraged our breadth of solutions, strength of our team and our consultative approach and our broad data and analytical capabilities to support our employer clients and their employees in numerous ways. From taking rapid and decisive steps to eliminate cost as a barrier to testing and treatment, to expanding access to care, to helping them safely work to return their employees to work sites, most recently, for example, with the launch of our COVID-19 high-risk dashboard. This new suite of innovative analytical tools, combined with the power of data, predictive models and clinical expertise to help clients project how COVID-19 might impact the health and safety of their employee populations and to model forward impacts of different pandemic scenarios going forward.

For example, the dashboard compiles and analyzes COVID-19 case data on the health of that client's specific employees at national, state and county levels, giving them essential insights to guide their decision making for bringing employees back to work safely. In cases where employers see concerning trends in the reports, Cigna is prepared to help them take action. For instance, through on-site COVID-19 testing and triage services delivered from our Cigna Onsite health solutions. Our COVID-19 high risk dashboard represents just one powerful example of how Cigna is helping employers navigate the complexities of the pandemic and serves as a reinforcement of why employers rank Cigna highest amongst its competitors for driving health care quality and value as reported in a recent study conducted by the Leapfrog group, an independent national organization representing employers.

Turning to our support of communities where we live, work and play each and every day. Our commitment is reflected in our efforts to increase understanding of the impacts of, and to drive positive changes to combat systemic racism. And not only is systemic racism an issue of human rights, we also view it as a critical health issue, contributing to well documented disparities in health treatment and outcomes that disproportionately impact communities of color. Two weeks ago, we launched our new 5-year initiative, our Building Equity and Equality Program, which commits a mix of local community grants, scholarship funds and employee volunteer hours to continue to drive Cigna's efforts to eliminate racism, bias, and health and economic disparities for people of color. This new initiative is another important part of Cigna's ongoing commitment to partner with our communities and government leaders to affect positive sustainable change, and we will continue to expand and evolve our engagement programs going forward.

All of Cigna's efforts that partner with our clients and communities is ultimately rooted in our mission to improve the health, well-being and peace of mind of those we serve, specifically focused on customers and patients. Today, more than ever, they are looking for us to make health care more affordable, predictable and simple. We continue to introduce new innovative programs and solutions designed to deliver on this promise. For example, our Customer Protection Program, which safeguards our customers from unexpected costs from COVID-19 through surprise or balance bills from out of network providers. In addition, our pharmacy solutions leverage existing and newly created tools to put resources and medicines and treatments in the hands of those who need them most. For example, we help Americans who lose their prescription coverage from recent job loss to secure their medications at affordable, predictable prices through our Express Scripts Parachute Rx program.

Further, as demonstrated by our most recent drug trend report, we also deliver affordability and predictability to our health service customers and clients who in 2019 experienced an overall rate of increase of drug spending of just 2.3%, a result that is in line with the consumer price index. And important to note, more than 1/3 of our commercial plans experienced a decrease in overall spending in 2019.

Taken all together, these examples I've shared with you today are reflective of how Cigna is and will continue to deliver on our promises, create innovative solutions, and partner effectively to further reach and drive impact. Now turning briefly to our results. We once again delivered strong financial performance in this quarter, and we remain on track to complete our integration and reach our deleveraging objectives by year-end. Our consolidated revenue of \$39.2 billion and after-tax earnings of \$2.2 billion reflect continued strong execution of our strategy and the fundamental strength of our four well-positioned diversified growth platforms. In particular, the continued strong performance of our Health Services segment demonstrates the range of services and value we provide to diverse health plan, employer, Federal and state government clients.

Our Integrated Medical segment results reflect lower consumption of medical services as individuals have deferred some services during the COVID-19 pandemic. Additionally, Integrated Medical customers continue to track much better than the national unemployment figures as many employers have maintained benefits through this disruptive time. And importantly because our client mix is less weighted to industries that have been most impacted by COVID-19.

As our employer clients have continued to support their employees' health and wellness needs, we have provided hundreds of millions of dollars in assistance to our employer clients, both through direct financial support and by leveraging our flexibility of our full suite of funding alternatives, all of which are already reflected in our second quarter results. I would also note that our self-funded medical clients have directly benefited from well in excess of \$2 billion of reduced spending this year.

Overall, I am pleased that by maintaining the strength of -- and health of our franchise, we have effectively balanced and responded to the needs of our stakeholders in this challenging environment. Now to bring my comments to a close. The current environment we live in and work in is highly dynamic, unsettled and complex, and as I noted, more than any time in recent history. Cigna's strong second quarter results reflect the



continued strong execution of our strategy and the underlying strength of our four well positioned diverse growth platforms. We have confidence that we will continue to effectively support our clients, communities, customers and patients, all while working to deliver on our EPS and revenue outlook for 2020 as well as our 2021 EPS target of \$20 to \$21 per share. This is driven by our sustained culture of innovation in our organization, the value we deliver to the marketplace each and every day and aided by the financial strength and flexibility of our franchise. And with that, I'll turn the call over to Eric.

Eric Paul Palmer - Cigna Corporation - Executive VP & CFO

Thanks, David. Good morning, everyone. First, we recognize that the current environment is even more dynamic, disrupted and complex than usual as we navigate the ongoing COVID-19 pandemic. And I'm proud of the many ways that Cigna has responded, as we drive to be the champions for affordable, predictable and simple health care.

Today, I will review key aspects of Cigna's second quarter results, including the impact of COVID-19 on our business and discuss our outlook for the full year. Regarding our second quarter consolidated results, a few key financial highlights include adjusted revenue of \$39.2 billion, adjusted earnings of \$2.2 billion after tax, adjusted earnings per share of \$5.81 and continued strong operating cash flow of \$3.3 billion. Within the second quarter, we continued to execute on the fundamentals of our businesses as we delivered value for customers and clients.

Regarding our segments, I'll first comment on Health Services. Second quarter adjusted revenues grew 22% to \$29 billion and adjusted pretax earnings grew 7% to \$1.2 billion. These results were driven by growth in customers and script volumes, favorable impacts from supply chain initiatives, strong specialty performance as our leading Accredo Specialty Pharmacy proactively worked with patients with complex and chronic conditions to maintain continuity of care for their medications, partly offset by an increase in operating expenses to support growth.

We fulfilled 364 million adjusted pharmacy scripts in the second quarter of 2020, an increase of 24% over second quarter 2019, driven by the in-sourcing of Integrated Medical script volumes and strong organic growth, partially offset by somewhat lower retail network scripts related to acute needs due to the COVID-19 pandemic.

Overall, Health Services delivered another strong quarter, as we continue to deliver value for our customers and clients.

Turning to our Integrated Medical segment. Second quarter adjusted revenues were \$9 billion, and adjusted pretax earnings were \$1.5 billion. In the quarter, we experienced significantly lower utilization of medical services in both Commercial and Government as individuals deferred care due to the pandemic. By month, compared to baseline expectations, utilization was 30% to 35% lower in April, 20% to 25% lower in May and closer to normal in June at approximately 0% to 5% lower. We also experienced strong customer retention as our clients maintained coverage for furloughed employees, and our Commercial book of business is less weighted to the most economically impacted industries.

In response to the pandemic and the tremendous burden it is placing on those we serve, we are financially supporting our customers and clients through a series of actions, including early on, waiving all cost sharing for COVID-19 testing and treatment and for Medicare Advantage and individual and family plans, additionally waiving cost sharing for in-office and telehealth visits for primary care, specialty care and behavioral health. Additionally, we've provided premium relief programs for clients and financial assistance programs to support providers. All in, our results for the quarter include approximately \$270 million of charges related to these initiatives. It's also important to note that we serve 85% of Cigna's U.S. Commercial customers through self-funded arrangements. And as such, our medical cost performance is highly aligned with our clients who have seen savings well in excess of \$2 billion year-to-date related to deferred medical costs.

Turning to our International Markets business. Second quarter adjusted revenues were \$1.4 billion, and adjusted pretax earnings was \$319 million, reflecting deferred medical utilization, primarily in our Global Health Benefits business. Claims volumes as well as sales activities increased throughout the quarter as global economies reopened.

For our Group Disability and Other operations segment, second quarter adjusted revenues were \$1.3 billion. Second quarter adjusted pretax earnings for this segment were \$132 million, reflecting elevated life claims, primarily due to the pandemic, partially offset by favorable performance in disability.

Overall, our businesses remained focused and delivered strong performance in the second quarter, as we worked to rapidly innovate to serve our customers and patients in this disrupted environment.

Now looking forward to our outlook for the full year. We continue to focus on driving strong performance across our businesses to continue to be able to improve the health, well-being and peace of mind of those we serve. Aided by our strong and diverse portfolio of businesses, we continue to expect full year 2020 consolidated adjusted revenues in the range of \$154 billion to \$156 billion, and we continue to expect to deliver full year adjusted earnings per share in the range of \$18 to \$18.60.

As we look to the balance of the year, we expect medical utilization to increase. We expect additional COVID-19 treatment costs, and we expect lower enrollment as well as continued lower net investment income due to recessionary pressures.

In setting our guidance, we considered a range of scenarios regarding the rate and pace of the return of medical utilization as well as the rate and pace of the reopening of the U.S. and global economies and subsequent impact on employment and customer levels. Our ability to deliver in a range of scenarios underscores the strength and diversity of our portfolio of businesses, which continue to deliver solutions directly aligned with marketplace needs. We will continue to dynamically manage our businesses, ensuring that we are delivering on the fundamentals and meeting our customers' needs while also continuing to provide financial support to our customers and clients in a thoughtful and deliberate manner. Taken as a whole, we continue to expect full year consolidated adjusted earnings per share in the range of \$18 to \$18.60.

I would remind you that our financial outlook excludes the impact of future share repurchases and assumes a full year of contributions from our Group Disability and Life business, although we continue to expect our divestiture of that business to close in the third quarter. Overall, these expected results are driven by strong underlying fundamentals and disciplined expense management and deployment of capital.

Now moving to our 2020 capital and liquidity position and outlook. Our capital-efficient businesses generate a substantial amount of cash flow, which provides us with significant capital and financial flexibility. In the second quarter, we generated \$3.3 billion of cash flows from operations due to strong fundamentals as well as the timing impact of approximately \$900 million of delayed tax payments permitted under the CARES Act. Through the end of the second quarter, we also deployed \$1.1 billion to debt repayment. And on a year-to-date basis, we have repurchased 8.3 million shares of stock for \$1.5 billion.

For 2020, we continue to expect greater than \$7.5 billion of cash flow from operations, reflecting the strong capital efficiency of our well-performing businesses. And as of June 30, we had \$1.7 billion of cash available at the parent.

Finally, we remain on track to close the sale of our Group Disability and Life Business in the third quarter, generating \$5.3 billion in net proceeds, which we expect to deploy to share repurchase and debt repayment in 2020. Our debt to capitalization ratio was 43.5% as of June 30, an improvement of 170 basis points from December 31, 2019, and we remain on track to return our debt to capitalization ratio to the upper 30s by the end of 2020.

Our balance sheet and cash flow outlook remain strong, benefiting from our highly efficient service-based orientation that drives strategic flexibility, strong margins and returns on capital.

Now to recap, through the exceptionally dynamic and disrupted environment associated with COVID-19, Cigna has remained intensely focused on delivering affordability, predictability and simplicity for the benefit of our customers, patients and all of our stakeholders. We are fully committed to helping create vibrant, diverse, high-performing communities, whether through partnerships with our employer, health plan, or government clients, with our provider partners or with our customers directly. We've delivered strong fundamental performance this year while also seeing lower medical costs from deferred care, and we continue to provide financial support to our clients and customers. We expect our strong fundamentals across our diverse portfolio of growth businesses to enable us to manage through the various impacts of the current environment.

And as such, we continue to expect 2020 full year adjusted EPS of \$18 to \$18.60 per share and remain on track to deliver on our target of \$20 to \$21 of adjusted earnings per share in 2021. And with that, we'll turn it over to the operator for the Q&A portion of the call.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ralph Giacobbe with Citi.

Ralph Giacobbe - *Citigroup Inc., Research Division - Director and Co-Head of Americas Healthcare Research*

I guess, can you just give us a sense of your conversations with existing employer customers and appetite, if any, for sort of revisiting funding scenarios? I think in the past, you've talked about shared return models. Any of that resonating? And then ASO enrollment was down slightly, but you had a more pronounced decline in fees, can you just help reconcile that? And if that's at all related to some of those changing in those funding scenarios would be helpful.

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Ralph, it's David. I'll take the first part. I'll ask Eric to take the second part of your question. At a macro level, yes, to the way you stated the first part of your question. So a lot of dynamic interaction back and forth with employer clients is a regular part of our business, even more elevated in the current environment, a lot of proactive engagement and exchange relative to maximizing value for them through using our broad array of alternative funding mechanisms. And even the intra-year conversation, given the uniqueness of how this year is playing out, bringing more choice to clients. So yes, continuation of -- we see it as a strength and continue to see movement in the use of funding mechanisms to best align ourselves with employers and that plays to a strength of our company.

I'll ask Eric to comment on the second piece relative to the fee dynamic.

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Yes, Ralph, it's Eric. I would note 2 items as it relates to the fee dynamics. First and most significantly, we had a reclassification of certain revenues that we implemented actually back at the beginning of the year, so effective January 1. Didn't have -- that did not have an impact on the P&L, but it reduced revenues and had an exact offset in lower SG&A as well. So that's showing up in the comparison of this year versus last year. And second, as you know, we did see some declines in self-funded enrollment, but just think of that as consistent with the impacts of the COVID-19 and the economic environment overall.

Operator

Our next question comes from Matthew Borsch with BMO Capital Markets.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Research Analyst*

Yes. Maybe if I could ask about the utilization trends that you're seeing. I assume that I know well, I've talked to a fairly steep decline in April. I'm curious how you saw the month of June end and then coming into July, given the surge of cases in the Southeast and West, how that has affected your view of trend?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Yes, Matt, it's Eric. I'll give you a couple of perspectives here. As I noted in my prepared remarks, we saw the decline of 30% to 35% back in April and utilization has upticked since then. You've called out geography and that's a really important dimension here is looking at this play out market by market. And having the local perspective is important, and we're certainly seeing this play out at different rates and paces in different geographies.



As I noted also in the prepared remarks, we saw June at a much closer to normal level of utilization. I'd say our early indicators for July are pretty consistent with June. So still some impact moving through different geographies. But at this point, we'd say July looks an awful lot like June.

Matthew Richard Borsch - *BMO Capital Markets Equity Research - Research Analyst*

And have you seen in the Northeast as things have settled there? Are you seeing evidence of flow-through of deferred electives and pent-up demand... Is there - can you see signs of a temporary period of higher than normal trends coming in the wake of this?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

I wouldn't call anything out on that yet, Matt. I think, again, our outlook for the full year does assume some additional utilization coming in the back half of the year, but I think it'd be too early to say that we've seen anything like that within the second quarter.

Operator

Our next question comes from Justin Lake with Wolfe Research.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

I wanted to focus on the PBM here. Specifically, 2 things. One, your first half growth has been significantly ahead of at least the initial guidance in the -- for the full year. So by my math, it implies about 3% growth in the back half versus about 8% growth in the first half. So just curious, are you -- I know you haven't updated the guide. So are you -- do you expect this first half performance to be indicative of the full year? Or if not, what's the kind of swing factors first half to second half? And then also your script trends are running kind of better than I think a lot of people would have expected, given the slowdown of scripts in the second quarter overall. So can you give us some color there? And maybe any color on kind of mail order mix in the second quarter and the kind of profitability drivers there?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Justin, it's Eric. So on the first part of your question, the health services and kind of the pattern of the earnings, I would just step back. The normal pattern for this business is for income to grow throughout the year, as you know, just reflects the overall utilization patterns and our -- the effects of our efforts to manage the supply chain. And we think that will continue to play out throughout the course of 2020.

Now I'll remind you, in 2019, the pattern was a little bit extra weighted towards the back half of the year, just given the timing of the supply chain initiatives. So when you're comparing 2020 to 2019 that you'll see the impact of that kind of play out through the year. We think of 2020 as being more of a normal pattern this year. We think of 2019 was a little bit back-end weighted. So that would be the biggest dynamic I'd call out as it relates to the pattern.

Now as it relates to the script volumes overall, we're executing very well and very much in line with the pattern that we had expected to play itself out. As I noted back at our call a quarter ago, we did see what we estimated to be about 5 million scripts get refilled a little earlier that moved from the second quarter into the first quarter and since that played out. And additionally, we've seen nice utilization within our home delivery pharmacy. So you know there's a lot of benefits to the mail order pharmacy and such for our customers and clients, and we've seen that adoption continue to be good. But again, nothing else I'd call out in terms of major dynamics.

Operator

Our next question comes from Kevin Fischbeck with Bank of America.



Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

I wanted to ask about the Commercial membership trends, I guess, that you're thinking about for the back half of the year. I appreciate that you mentioned that furloughs have impacted as well as your customer exposure. But if maybe you can drill down into both of those a little bit. Have you had any conversations with clients about membership at risk from furloughs, just to kind of size what that might mean in the back half of the year? And then the comment about being less exposed to the markets most impacted by COVID. Are you seeing a differential in trend? Or are you seeing those customers in the segments you would expect to be impacted seeing larger declines in enrollment already versus the other sectors? Any color there?

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Kevin, it's David. So let me try to paint the 2020 picture and then maybe even bleed in a little bit of comment in terms of how we expect it to unfold beyond that going into 2021. And so first and foremost, a significant amount of interaction with clients, always part of our consultative approach elevated even further in the current environment and the dynamism. So we're looking at this as best we can through a client-by-client framework. As we noted previously, a high percentage of clients have maintained benefits, either through the use of the word that we're talking about as furloughs or layoffs with benefit continuity taking place. And I think that's a testament to how committed employers are to the health, safety and well-being of their employees and the optimism they continue to hold on to, to return employees back to work, to keep their businesses running on a go-forward basis.

As it relates to the second half of the year, we expect the following: we expect to see those employees who are furloughed or with continuity of benefits - we expect to see those furloughs dissipate or go away and 1 of 2 things transpire. Either; a, no benefits for the employee and they transition to COBRA or other alternatives; or b, they return to full employment.

And client by client, we're going through patterning of what the expectations are relative to that. Therefore, we expect to see the effect of lower levels of employment across our book continue throughout the second half of the year, and that's fully factored into the outlook that Eric made reference to.

And then finally, maybe at the most macro level, the way we're thinking about it is, essentially, over the next 18 months, second half of '20 and 2021, we expect to see a slow recovery to the overall employment marketplace in the United States and that's what's factored into our thinking. Said otherwise, we expect to see pressure through the second half of this year and 2021 to what would otherwise be a normal course of business from a membership standpoint and that's factored into our thinking for 2020 as well as 2021.

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

Do you have any color about the impact on the members who are -- who you believe are in sectors most expect -- impacted by COVID versus those in sectors that you don't see as disrupted? Is there difference in trend there?

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Kevin, stay on the line. Are you asking the question of medical trend or employment dynamic?

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

Sorry, it's employment dynamic. The second part of my question was are you seeing a differential in employment loss or job losses in markets where you said that you had low exposure to those segments that are impacted by COVID. I just wanted to see if you are seeing differential in employment trends.

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

The answer to that is absolutely, yes. So as we parse our business by sector and then employer by employer, there's no doubt there are some employers that are having either de minimis impact to their employee base as a result of COVID or there are some sectors that you're seeing actually the need for more employees given the environment. So there is no doubt that the phenomenon we're talking about is incredibly uneven or unique, not just to sector but to employers within the sector. That's why our approach is a client-by-client approach. So yes, to that portion, unequivocally, high variability there.

Operator

(Operator Instructions) Our next question comes from Ricky Goldwasser from Morgan Stanley.

Rivka Regina Goldwasser - *Morgan Stanley, Research Division - MD*

David, going back to one of the comments in prepared remarks, you talked about partnering with some competitors. Could you just share some details. You have the recent partnership with Oscar, how do you think about this developing? And curious what your appetite is for the exchange market?

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Ricky, so I appreciate your referencing the prepared remarks. My remarks said of what some view as traditional competitors, we view as strategic partners. So stepping back, our philosophy has been, we seek to be the undisputed partner of choice. And our view is that the ability to partner with others and work to create shared value, presents an opportunity for mutual growth, which means more customers to serve and a larger impact. So now stepping back, whether that's through an expanding portfolio of health plan clients through our Health Services portfolio, where we challenge ourselves to continue to bring additional innovations for the benefit of our health plan clients to help them deliver better affordability, better value and continue to grow, or specifically, to come to your question with Oscar, we have an exciting partnership with Oscar, where we're bringing mutual capabilities to the table, to bring some additional innovation to the small employer market, a marketplace that both organizations feel has been underserved as it relates to benefiting from more innovative programs around health engagement, personalization, value-based care, more comprehensive clinical engagement programs. And together, we're going to be able to bring the best of both companies together, and as the latter part of this year, we'll be opening up some additional markets where we're already quoting today jointly. So the philosophy of the corporation is to find mutually aligned organizations where we could create leverage value together and then pursue that. And Oscar is a wonderful example of it. And actually, we had a check in with the team earlier this week, Eric, and the team is working exceptionally well to get there around the innovation here.

Operator

Our next question comes from Frank Morgan with RBC Capital Markets.

Frank George Morgan - *RBC Capital Markets, Research Division - MD of Healthcare Services Equity Research & Analyst*

Yes. Just one question around the deferral. Could you distinguish any difference in what you saw regarding deferrals in the Commercial versus the Medicare book?



Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Frank, it's Eric. We would -- I would say the pattern was similar in terms of how we progress through time. We would note, we saw more of a deferral percentage in the Commercial book than what we saw in the Medicare Advantage book. But again, kind of the progression month-to-month has been pretty consistent, just a more significant impact in the Commercial business.

Operator

Our next question comes from Whit Mayo with UBS.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

Can you maybe -- so I appreciate the question. Can you maybe help us understand the impact of Commercial leakage on the PBM? I'm just trying to cross walk the 2? And think through what percent of your risk members are with your PBM and presumably all the self-funded are, but I'm not sure that this is necessarily a one-to-one relationship. So any help would be great. And then also maybe just on the Medicaid enrollment that we're seeing sort of nationally, I know this isn't really impacting you per se, but maybe just the overall impact on the PBM, given its exposure to Medicaid?

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Whit, it's David. Can you just repeat the first part of your question because Eric and I didn't hear a couple of your words, and we want to make sure we understand the core of your question.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

Yes. No, I'm just trying to sort of crosswalk the impact of Commercial leakage, the decline in Commercial membership across risk and ASO and how that impacts your PBM. And I think that the majority of your risk members are probably with -- not with your -- with your PBM and presumably the self-funded are. So I'm just trying to square the Commercial leakage with the PBM.

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Great. I'll ask Eric to take the first part of your question, and then I'll come back and take the second part of your question on Medicaid.

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

On the leakage, as you termed it, maybe step back, I think the way I'd think about that is we have a kind of spectrum across our different customer segments. So within our Select segment offering, really think about all of our Select segment as having comprehensive bundle of our services. So pharmacy, behavioral, disease and care management, et cetera, all tied together with stop-loss and the administration or in our fully insured product. But to that point, think about the Select segment as being effectively 100% penetrated with our pharmacy offering. As you move into the middle market segment, reasonably high degree of penetration there, but you see more buyers that have some a la carte offerings or purchasing and such. We've provided some statistics on this in the past in some of our past Investor Day materials. But think about a meaningful portion, but not all of the middle market as having purchased an integrated offering, which then flows to the PBM. And then that same dynamic holds true in the National segment. It's even more a la carte, if you will, in terms of the pieces there.

But again, I think about it more along the segment line than I would around just kind of the funding line. It is true that the insured business also carries a high degree of penetration, but I encourage you to think about it by segment.



David Michael Cordani - *Cigna Corporation - President, CEO & Director*

And Whit, relative to Medicaid, we currently serve a very attractive portfolio of Medicaid relationships through our Health Service portfolio. As a result of our diverse and high-performing health plan portfolio of businesses, we see that as growing. We've grown that successfully, notwithstanding the COVID-pandemic ramifications. And looking forward, we see that as a continued growing base of an opportunity for us to expand into servicing the Medicaid population, but servicing them through the Health Service platform.

Operator

Our next question comes from Gary Taylor with JPMorgan.

Gary Paul Taylor - *JPMorgan Chase & Co, Research Division - Analyst*

I have a 2-part question about your MLR expectations and your, I think, relatively appropriate conservatism or caution as we head into the back half. But the question is, as you anticipate higher MLR in the back half, is that explicitly from an expectation around deferred electives coming through? Or around an expectation about higher acuity care being required because of necessary deferred care during the pandemic? And do you have any evidence around those? That's the first part. The second is just given where you stand on your 3-year rolling Commercial MLR minimum positions, if we don't see this pickup in MLR transpire, should we still -- should we assume that in the second half, there's still pretty substantial flow through of MLR to EPS?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Gary, it's Eric. So I'll take that one. A couple of different dimensions that you talked about there. First of all, stepping back, we expect the loss ratio to be somewhat elevated in the back half of the year, think about that as 150 to 200 basis points increase over what we've previously would have expected for the second half of the year. I'd dimension that off a couple of things. One, we do think that there will be some deferred care utilization and the potential for higher acuity coming back in. And then 2, the ongoing effect of the programs we've put in place to reduce copayments or make care more accessible and affordable, we think will also drive some additional utilization. I don't have a precise kind of identification of each of those components, but think about those as the biggest drivers for our outlook over the course of the back half of the year.

On the minimum MLRs. As you know, it's a 3-year calculation for the minimum MLRs for the Commercial business. So again, we, generally speaking, do have a margin between where we're at and the minimums. Now I would note that we increased our accrual in the second quarter by \$95 million. We've got \$175 million on the balance sheet for this as a provision at this point. And so it's something we watch, but I would still note that there's, across the board, still a margin there before we'd not see the impact kind of flow through to the bottom line.

Operator

Our next question comes from Josh Raskin with Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

It's Josh here with Eric Percher as well. What do you see as more permanent changes as a result of the COVID pandemic? And what are you doing to make sure that Cigna is positioned to take advantage or capture those opportunities going forward?

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Josh, it's David. I'd identify 2. One, in terms of access; two, in terms of programmatic. As it relates to access, the -- it's indisputable that the COVID pandemic has either required, caused or pushed more utilization of technology as a mechanism to access care, coordinate care, et cetera. You

recall that our view has been for some time that we believe a meaningful amount of care can be delivered through a combination of technology, you call it "tele", you call it "virtual", et cetera, but it needs to be highly coordinated care. And then further augmented by in-home care that is also aided by technology. So one, we believe that the rate and pace of adoption and acceleration of reformatting care access, utilizing technology to coordinate care and deliver care in a personalized, high-quality basis and then augmenting it with reenvisioning what could take place in the home is mission-critical and accelerated by COVID. That's on strategy for us, and we are aggressively investing in and innovating in those categories off of a variety of our platforms.

Secondly, a lot of what we talked about before, it's a little back to the future, but COVID rehighlights for all societies around the globe that as challenging as COVID is, it's exponentially more challenging for individuals who have chronic conditions or who are polychronic, so it presents another opportunity to engage with employers, with health policymakers and from a public health policy standpoint to make sure we are investing in and innovating programs with physicians and individuals to lower health risks or increase health quality for those who are chronic or polychronic. Because all things remaining equal, if you have a better health status, you're more likely to withstand COVID-19 or the next iteration a decade from now and beyond. And that's an area where Cigna excels on our current state basis in terms of what we're able to bring to bear from that standpoint as well as with our Health Service portfolio. And then putting a bow around that, COVID-19 highlights the mental health dimension that is highlighted in societies around the globe where the mental health and the physical health needs to come together to best manage overall well-being.

So reformatting, utilizing technology, chronic condition management and improving overall health risk and then taking the mental health and the physical health together are all areas we see as being accelerated because of COVID and additional opportunities and areas that Cigna is heavily investing in.

Operator

Our next question comes from Lance Wilkes with Bernstein.

Lance Arthur Wilkes - Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst

Just wanted to get your updated views on your strategic capital deployment priorities, and in particular, I was interested in how you're prioritizing buybacks given the Group sale, and then if you've had any change in perspective or evolution and thought in Medicaid, owning physicians or other aspects of value-based care and how you're looking at global now.

David Michael Cordani - Cigna Corporation - President, CEO & Director

Lance, it's David. I'm going to ask Eric to comment on the portion of your question specifically because of the uniqueness of the Group sale, and then I'll come back and talk about M&A priorities more broadly.

Eric Paul Palmer - Cigna Corporation - Executive VP & CFO

Yes, Lance, so just on the Group sale, specifically. So first of all, we do expect that transaction to close within the third quarter. Reminder, we expect \$5.3 billion of after-tax proceeds once that transaction closes. So that is coming in, in the relatively near term. As we've talked about for some time now, we've had a goal of -- and are committed to obtaining -- or achieving a debt-to-capital ratio of under 40% by the end of the year, we're driving towards that. And we've committed to deploying a significant amount of the proceeds from the Group transaction to share repurchase to offset the dilution, the effect of the -- not having the Group insurance business for a portion of the year. So again, at the most macro level, those are the pieces we're navigating. We do continue to fund significant organic growth. We continue to have capital investments to advance our capabilities. But we see share repurchase as a really excellent use of capital to drive shareholder value in the near term. And the last thing I'd note is just at our recent Board meeting, our Board increased the share repurchase authorization, consistent with our expectation of closing the New York Life transaction later this quarter. And as we sit here today, we have \$4.4 billion of share repurchase authority outstanding.



David Michael Cordani - *Cigna Corporation - President, CEO & Director*

And Lance, relative to the portfolio of businesses today and going forward. First, to be clear, we like our portfolio and the strategic positioning and are pleased with its performance from a growth standpoint, from a service standpoint and from a capital and fiscal flexibility standpoint, and that portfolio is positioned to deliver sustained 6% to 8% revenue growth. As it relates to M&A priorities, we continue to remain focused on 5 specific M&A priorities: one, to further strategically and smartly our global footprint; second, to further enhance our U.S. seniors capabilities; third, to continue to broaden our digital and information capabilities; fourth, looking to continue to expand our care coordination capabilities; and five, as we've talked before, exploring state-based risk program capabilities as we see states who are under budgetary pressure for -- within their Medicaid programs, seek to further subsegment their programs and seek either high cost complex, critical programs to be able to perform on their behalf and deliver more value. So we see opportunity going forward, but building off of a very strong base and well-performing portfolio.

Operator

Our next question comes from Sarah James with Piper Sandler.

Sarah Elizabeth James - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Can you talk about any slowdown that you've seen in the pace of receiving claims from the date of service? And then on your risk business, what impact that's made on your reserving policy or any impact to MLR?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

It's Eric. Broadly, I wouldn't call out any change in terms of impact. So again, nothing that would rise to being notable. With respect to our reserving approaches and policies, been very consistent in the same team and the same approach to working through those calculations for some time and served us really pretty well. So I wouldn't note anything unusual here.

Sarah Elizabeth James - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

But are you seeing a slowdown in claims receipt timing?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

No.

Operator

Our next question comes from A.J. Rice with Crédit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

Just wondering, there's been some discussion about the selling season. I see in your press release you're talking about in the Health Services division, a very high retention rate. I wonder if you could just talk through a little bit what you're seeing for the 2021 selling season related to Integrated Medical and the Health Services division, how the COVID impact is on that process, whether it slows it down or causes people to defer decisions? And if I could just slip in as well on the Healthcare Services division, I know you're not seeing much attrition in the Integrated Medical, but how is the economic slowdown impacting the PBM side of the business, if at all?



David Michael Cordani - *Cigna Corporation - President, CEO & Director*

A.J., it's David. I'll take the selling season. I'll ask Eric to comment briefly on the -- your equivalent of disenrollment on the Integrated Medical and what we're seeing on the Health Service portfolio. First, broadly, on the selling season, I appreciate you asked about multiple segments of the business. Headline is, while we're not guiding for 2021 yet, we will expect another year of attractive revenue growth for the franchise in 2021. For the Health Service portfolio, that will be anchored in a third consecutive year of truly outstanding client retention, where our clients continue to reward us by staying with us and expanding the relationship because of the services we're delivering, because of the continued innovation we're delivering, and because of the outstanding affordability or market trends we're delivering on their behalf.

Before I jump over to Integrated Medical, I'll comment on Medicare Advantage, we would expect another year of attractive customer growth within our Medicare Advantage portfolio. And I will remind you, we set a strategic objective to grow Medicare Advantage customers 10% to 15%. We're tracking well to that objective in 2020, and we would expect another year of contribution in 2021.

And specific to the Integrated Medical, our visibility in 2021 is largely through the national accounts at this point in time. And to remind you, we define that as commercial employers with 5,000 or more employees who are multistate. At this point in time, we expect to see that tracking to a bit higher retention rate than recent past. And while we have some new business wins, we expect the new business wins to be a little less than recent past. Taken as a whole, probably performing a little better as we step into 2021 off of that portfolio. And then the Middle market or regional and Select segment are currently in the throes of their growth trajectories as we look into 2021.

Wrapping it up, we would expect, again, another year of very attractive and profitable revenue growth for 2021. Eric, maybe just a little color on the Health Services dynamic of the equivalent of disenrollment?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Yes. Thanks, David. So on the Health Services business, again, within the segment, as I think we've talked about in the past, we've got a really diversified book of business here with customers through a variety of channels, employers, other health plans, government relationships, some direct programs and the like. We've had a really strong degree of client retention, and we've had a high degree of continuity in terms of enrollment within those clients as well. As I noted in my prepared remarks, we did have a bit of a dip of retail acute scripts, especially earlier in the quarter. But that would be really -- the only thing I would call out as particularly impactful.

Overall, the enrollment levels within our clients and within our health plan clients have held up quite nicely.

Operator

Our next question comes from Stephen Tanal with SVB Leerink.

Stephen Vartan Tanal - *SVB Leerink LLC, Research Division - MD & Senior Research Analyst*

Maybe just one really quick follow-up on strategic M&A and then an actual question. So I just wanted to understand, what would you say we should expect with respect to the size of any future deals you might choose to do and your willingness to do another large deal, just following up on that question earlier. And then I also just wanted to get your latest thoughts. Obviously, an executive order last Friday, ordered HHS to put out the rebate rule again, but it was conditioned on being able to demonstrate no increase in premium or really any kind of cost to any payers, which looks pretty unlikely given the CBO scoring the first time around. But just given the prospect, I guess it would be helpful if you could just remind us how to think about that rule and its potential effect on the economics of the PBM business in Medicare, that would be helpful.

David Michael Cordani - *Cigna Corporation - President, CEO & Director*

Sure. It's David. I'll take both questions. On the first question, as I noted before, we are really pleased with the configuration of our business portfolio today and its performance. I'm not going to comment on size of assets. We've been quite disciplined over a long period of time relative to strategic alignment and financial alignment relative to assets we would pursue. And it would be inappropriate to say that there's an asset of a certain type or size from that standpoint that we would limit ourselves to.

Specific to the executive order, stepping back, first, at the more macro level, we share the administration's objective to further improve affordability of prescription drugs. There's no doubt about that. And concrete examples including we're the first to step into the need to reformat the diabetes and insulin environment with a patient assurance program that caps cost at \$25 for 30-day supply. That truly creates affordable, simple, predictable. Our Embarc program that focuses on high-cost specialty drugs or a recent launch of our Parachute program for our workers who've been displaced.

So we will continue to drive innovation, and our clients are benefiting from that relative to our market-leading trends. Specific to the rebate rule, your overall framing, I think is right. Specifically, we do not believe the rebate rule if implemented in its current configuration would have a material effect on Cigna. It focuses on the government programs, and as you know, as designed today, the government-run programs require and are facilitated by full pass-through, full transparent rebate economics to start with. They are designed in the pricing scheme as dictated by government rules that we all comply with as an industry. The result of this rebate rule change as designed would result in increasing costs to all seniors, as an example, and thereby decreasing costs for some, depending on their point-in-time drug utilization. And the rule as written today would create a conflict in terms of what would transpire around that. But from a Cigna perspective, we do not see that as having an impact on our book of business and our overall performance, even if the rebate rule was implemented.

Operator

Our next question comes from Bob Jones with Goldman Sachs.

Robert Patrick Jones - *Goldman Sachs Group, Inc., Research Division - VP*

I guess, Eric, maybe just to go back to one on the PBM, a comment you made earlier in Q&A about not calling out anything major as far as dynamics. I was just wondering how the Prime roll-on has been going? Had that any major impact on the quarter? Is that kind of going according to plan? And then maybe just you haven't spent a lot of time on Accredo, maybe just any kind of parsing out of how volumes of the traditional pharmacy business have trended relative to the Specialty Pharmacy? Have you seen any differential impact there as a result of the COVID environment?

Eric Paul Palmer - *Cigna Corporation - Executive VP & CFO*

Yes, Bob, it's Eric. So with respect to Prime, we announced that our collaboration with Prime last December, worked quite diligently over the end of the year and through the first quarter to get ready for that. We began servicing that collaboration on April 1. It's really performed very well and very much consistent with our expectations, both in terms of services provided, the timing and the volumes and the like. So it's again, off to a great start. We're delighted to have the relationship there.

In terms of Specialty, I appreciate you calling out Accredo. Accredo continues to be industry leading capability here, and it does continue to drive growth as we see more and more Specialty products and as more and more clinical needs of the clients, those we serve, both of those things driving additional growth within Accredo. It's continued strong growth there as well, and that's a real bright spot even in the strong Health Services results.

Operator

Our last question comes from Charles Rhyee with Cowen.

Charles Rhyee - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Maybe I could ask a question about the International segment. David, you kind of said earlier, sort of lower claims volumes benefiting the quarter. But maybe you can give us some sense on what your expectations are sort of maybe for the back half and give a sense of what the trends you're seeing globally related to COVID? And if there's anything that you can take from that as we think about how COVID may progress here in the States?

Eric Paul Palmer - Cigna Corporation - Executive VP & CFO

Yes, it's Eric. I'll start here. With respect to International, as we noted, it was a strong result year-to-date, and the segment overall continues to perform really well. We've got, as I think you know, 2 platforms within the International business, a Global Health Benefits platform that serves employers. And then a more individually oriented platform that serves both kind of health and supplemental needs and such.

Within the employer book of business, I would say, globally, the dynamics are pretty similar to the dynamics that we talked about in our Integrated Medical segment. So we saw a deferral, less utilization, earlier in the quarter, some of that's come back over the balance of the quarter. We continue to expect to see a slower recovery in terms of employment levels and the like within this business. But I think of it as having a lot of parallels with the U.S. medical business. On the individual business, I think here we saw disruption back in first quarter, even in terms of both sales and in terms of claims experience and such. We're really seeing a lot of that come back in Asia, and our Asian markets already and very much kind of back to normal in a lot of our individually oriented businesses at this point. So again, looking forward from here, we would see continued strong performance in the business, continued good trajectory from a growth perspective. David, what else you would like to add here?

David Michael Cordani - Cigna Corporation - President, CEO & Director

I'll just add in the learning category, as we're learning in the United States, state by state, we're seeing around the globe, the imperative of being flexible as the pandemic ebbs and flows from that standpoint, from a community standpoint, from a health access standpoint, from the academic standpoint, from the employer standpoint. And secondly, we've seen, consistently around the globe, a more aggressive adoption of, as I referenced before, technologically enabled health access solutions. Even in environments where they previously were at a really low adoption rate, less desire to go to physical proximity to access care if it could be delivered through technology. And we see an elevation of that, those services being utilized around the globe, and we think that trend will continue.

Operator

At this time, I'll turn the call back over to David Cordani for closing remarks.

David Michael Cordani - Cigna Corporation - President, CEO & Director

Thanks. Just briefly wrap up, I want to, first and foremost, again, acknowledge and thank Cigna's more than 70,000 colleagues around the globe who worked tirelessly with great empathy throughout this pandemic to serve the needs of our customers, our patients, work within our communities and support our clients around the world. At Cigna, our mission to improve health, well-being and peace of mind of those we serve has never been more important, and that continues to guide our actions and will as we go forward. In the recent weeks and months, we've taken decisive actions to support our employers, who we believe are the driving force through a thriving economy to withstand and emerge from the COVID-19 pandemic, as well as to support the communities and customers we work and serve in each and every day, including our efforts to combat systemic racism, which we also view as a critical health issue.

From a results perspective, we once again delivered strong financial performance this quarter, and we remain on track to complete our integration and reach our deleveraging objectives by the end of this year. We continue to expand and innovate our programs and services to support our clients, our customers, our patients and our communities, and we are on track to deliver our revenue and EPS outlook for 2020 as well as our 2021 EPS target of \$20 to \$21 per share.

With that, I thank you for joining our call today, and we look forward to our future discussions.

Operator

Ladies and gentlemen, this concludes Cigna's Second Quarter 2020 Results Review. Cigna Investor Relations will be available to respond to additional questions shortly. A recording of this conference will be available for 10 business days following this call. You may access the recorded conference by dialing (800) 839-1171 or (203) 369-3030. No passcode is required for the replay. Thank you for participating. We will now disconnect.

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