

CVS Caremark Corp
Ticker: CVS
Sector: Consumer Staples
Industry: Drug Retail

Intrinsic Value: \$87.61
Current Price: \$63.74
Stop Loss: \$54.18
Upside Review: \$76.49

TTM P/E: 17.77
Forward P/E: 14.31
FV Imp. P/E: 17.70
Beta: 0.81

Market Cap: \$76.82B
Dividend Yield: 1.5%
52 Wk Range: \$44.33-\$64.44

Industry Trends:

Drug Retail industry has a positive outlook. Due to implementation of the Affordable Care Act in January 2014, the prescription volume will increase dramatically since about 25 million people will benefit the health care coverage. Further development of loyalty card program could trigger the sales volume by raising the consumption behavior, and improve the marketing and advertising spending more efficient. The baby boomer generation impact results in around 10,000 people turning into 65 years old every year, which leads to the increased demand of prescription drug. Due to the economic downturn, patients transit from branded drugs to generic drugs, the low price of generic drugs slow down the revenue growth but improve the profitability.

Business Summary:

CVS Caremark is one of the largest pharmacy retailer chains and one of the largest pharmacy benefit managers (PBM) in the United States, and has about 600 retail health clinics under the MinuteClinic brand. It has about 7,500 stores, manages over 1 billion prescriptions per year, and serves more than 60 million plan members. Drug stores offer prescription drugs and a wide range of general goods. PBM offer the services such as mail order, specialty pharmacies, Medicare Part D services, formulary management and discounted drug purchase agreements. Retail health care clinics diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions and deliver vaccinations.

Investment Thesis:

CVS has leading market position, combined strategy of operating as pharmacy retailer, PBM and retail health clinics, healthy cash flow generation ability, high price stability and high earnings predictability, which make it an attractive investment in the long run. Leading player image gives CVS has a strong competitive posture in the market. Combined strategy does create synergies. CVS generates sufficient cash flow to support the business expansion in the future and reward shareholders by distribution of dividends and share repurchase program.

CVS 5 year stock performance:



Competitive Analysis:

CVS's biggest competitor is Walgreens, which also has both retailer chains and PBM. However, according to the market capitalization, sales and earnings, consistent growth of sales and earnings, return on equity and price stability, etc., CVS outperforms WAG. CVS also competes with Wal-Mart as discount store, but Wal-Mart only has small portion of market share in prescription drug market. Other competitors include Express Scripts and Rite Aid.

Pros:

- Over 7,500 pharmacy retail stores across the U.S.
- Expected demand increase since more customers gain medical insurance coverage after implementation of the Patient Protection and Affordable Care Act in Jan, 2014
- Fast increase in aging population, due to baby-boomer generation, brings increased customer drug utilization
- As one of largest PBMs, CVS has strong bargain power to get favorable drug price for payers and patients
- Economies of scale obtained from growing client base
- As specialty drug spending increase, more payers and patients look for PBM to control cost
- Shares repurchase program every year rewards investors
- Continue to develop approaches to improve health and lower costs for patients, such as Maintenance Choice program and Pharmacy Advisor program, which improve the brand image and strengthen customers' trust

Risk Factors:

- The trend of transition from branded drug to generic drug will limit the revenue growth, but profit margin of generic drug is higher than branded drug. It gives both threat and opportunity
- Increased consolidations of suppliers weaken the negotiating power of CVS
- Reimbursements pressure from federal and state governments
- Narrowed pharmacy networks is risky if clients require more choices

Total Return Estimates:

3 Yr FV Reversion*: 13.56%
 5 Yr FV Reversion*: 8.79%
 (* - From limit order price of \$00.00)

Key Valuation Assumptions:

Est. Revenue Growth 5%
 WACC 6.76%
 Expected Inflation 3%
 Terminal Growth Rate 2%
 10 yr. Risk Free Rate 2.6%
 Equity Risk Premium 5.9%
 Tax Rate 38.78%

Key Financial Data:

Est. 2013 EPS 3.64
 Est. 2014 EPS 3.94
 3-5 Yr. Est. EPS Growth 7.95%
 Credit Quality A+
 ROE 11.8%
 ROA 6.7%
 Price/Book 1.99
 Price/Cash Flow 13.1
 Debt/Equity 26.1%
 Current Ratio 1.4
 Quick Ratio 0.6
CVS / Ind. Avg.
 Human Rights 1/0
 Business Ethics Policy 1/1
 ESG Disclosure Score 41.74/19.42
 Equal Opportunity Score 1/1
 Emission Reduction 1/0
 Environmental Disclosure Score 34.11/14.97

Direct Competitor Comparison

	CVS	ESRX	WAG	WMT	Industry
Market Cap:	76.82B	52.49B	56.38B	255.79B	5.50B
Employees:	203,000	30,215	173,000	2,200,000	14,50K
Qtrly Rev Growth (yoy):	0.06	-0.03	0.05	0.02	0.74
Revenue (ttm):	125.37B	105.83B	72.22B	473.00B	2.58B
Gross Margin (ttm):	0.19	0.08	0.29	0.25	0.33
EBITDA (ttm):	9.93B	6.55B	4.92B	36.65B	512.58M
Operating Margin (ttm):	0.06	0.04	0.05	0.06	0.06
Net Income (ttm):	4.47B	1.90B	2.45B	17.09B	N/A
EPS (ttm):	3.59	2.22	2.56	5.14	2.56
P/E (ttm):	17.77	29.22	23.23	15.35	21.52
PEG (5 yr expected):	1.12	0.99	1.30	1.72	1.12
P/S (ttm):	0.61	0.49	0.78	0.54	0.78

Sources:

Bloomberg, Value Line Investment Survey, S&P Net Advantage, Morningstar, Yahoo! Finance, sec.gov

Prepared By: Keira (Xin) Wang on Nov 5, 2013