

McKesson Corp. Ticker: MCK Sector: Healthcare Industry: Healthcare Distributors	Intrinsic Value: \$251.90 Current Price: \$191.23 Stop Loss: \$162.00 Upside Review: \$332.51	TTM P/E: 27.78 Forward P/E: 18.82 Beta: 1.05	Market Cap: \$44.71B Dividend Yield: \$1.04 (0.50%) 52 Week Range: \$135.68 – 200.92
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**Business Summary:** McKesson Corp distributes pharmaceuticals, medical-surgical supplies, and health and beauty care products throughout North America. The company also develops, implements, and supports software that facilitates the integration of data throughout the health enterprise. In addition, McKesson offers analytic, care management, and patient solutions for payers (Bloomberg)

**Industry Trends:** This health care distribution industry's positive outlook is based mainly on the healthy profit growth seen for the drug supply segment, which comprises 98% of the MCK's. U.S. drug sales are expected to rise modestly in 2014, lifted by price increases and volume gains in specialty and generic drugs. Over the longer term, it is expected that large distributors realize high single to low double digit annual EPS gains, benefiting from generic drug penetration, an aging population, and drug price inflation. (S&P)

**Investment Thesis:** MCK's large footprints in drugs, medical supplies and information technology provide important cross-selling opportunities, while its leading positions in drug and medical products distribution and pharmacy systems reinforce cost-competitiveness. MCK's acquisition of a 76% interest in Celesio in February 2014 will allow the realization of scale and sourcing benefits, by the end of calendar 2014. These factors combined with positive economic indicators and projections make MCK an attractive investment.

**Competitive Analysis:** MCK is the largest healthcare distributor by a factor of two. This creates a high amount of purchasing power, very large geographic reach, and efficiencies of size and scale. Combined, MCK has a distinct advantage to maximize margins in a very competitive industry, one that is expected to significantly grow over the next ten years.

**Pros:**

- Well positioned to benefit from aging population, trends show shift to generic prescriptions, and increases healthcare availability through ACA.
- Completed acquisition of distributor Celesio in which broadens distribution reach and increases purchasing power. Will realize savings through restructuring.
- Signed exclusive agreement with RiteAid to supply generic drugs.

**Risk Factors:**

- Inaccurate projections about prescription drug growth will have large effect on revenue projections.
- Consolidated industry with three large companies. ABC and CAH have exclusive rights to distribute generics to Walgreens and CVS, respectively.

**5 Year Stock Performance:**



**Total Return Estimates**

3 Yr FV Reversion: 10.06%  
5 Yr FV Reversion: 6.12%

**Key Valuation Assumptions**

Est Revenue Growth: 8%  
WACC: 4.4%  
Expected Inflation: 1.7%  
Terminal Growth Rate: 3.8%  
10 Yr Risk Free Rate: 2.4%  
Equity Risk Premium: 7.2%  
Tax Rate: 34.3%

**Key Financial Data**

Est 2014 EPS: 8.76  
Est 2015 EPS: 10.82  
3-5 Yr Est EPS Growth: 15.10%  
PEG (TTM): 1.12

Credit Quality: BBB+

ROE: 15.16%

ROA: 2.81%

Price/Book: 2.87

Price/Cash Flow: 16.69

Debt/Equity: 1.189

Current Ratio: 1.1

Quick Ratio: 0.6

**CSR Characteristics**

Human Rights: 0/0

Business Ethics Policy: 1/1

ESG Disclosure: 35.95/20.19

Equal Opportunity: 1/1

Emission Reduction: 1/0

Environment Disclosure Score: 26.36/15.92

**Prepared by Doug Bova (October 19, 2014)**

**Competitor Comparison:**

Direct Competitor Comparison					
	MCK	ABC	CAH	OMI	Industry
Market Cap:	44.29B	17.02B	24.78B	2.00B	24.78B
Employees:	71,400	12,000	34,000	6,700	34,00K
Qtrly Rev Growth (yoy):	0.37	0.39	-0.10	0.03	0.07
Revenue (ttm):	149.43B	112.45B	91.08B	9.15B	112.45B
Gross Margin (ttm):	0.06	0.02	0.06	0.12	0.06
EBITDA (ttm):	3.35B	1.17B	2.37B	238.12M	2.37B
Operating Margin (ttm):	0.02	0.01	0.02	0.02	0.02
Net Income (ttm):	1.35B	266.79M	1.16B	100.54M	N/A
EPS (ttm):	5.32	1.11	3.38	1.61	3.38
P/E (ttm):	35.94	68.32	21.79	19.70	35.94
PEG (5 yr expected):	1.12	1.30	1.68	2.89	1.30
P/S (ttm):	0.29	0.15	0.27	0.22	0.27

Information from: Bloomberg, Value Line, S&P Net Advantage, Yahoo

This health care distribution industry's positive outlook is based mainly on the healthy profit growth seen for the drug supply segment, which comprises 98% of the MCK's. U.S. drug sales are expected to rise modestly in 2014, lifted by price increases and volume gains in specialty and generic drugs. Over the longer term, it is expected that large distributors realize high single to low double digit annual EPS gains, benefiting from generic drug penetration, an aging population, and drug price inflation. In addition, we expect up to 26-28 million additional Americans to eventually be covered by health insurance under the Affordable Care Act and, therefore, better able to afford pharmaceuticals. However, we do not expect robust growth in distributors' top lines over the next few years, owing to patent losses on several blockbuster drugs and mergers among major drugmakers that might put pressure on the fees the distributors receive from their suppliers. Other contributors to margin expansion should be cost controls, divestitures of underperforming units, and profitable peripheral health care services. We also see these stocks benefiting from acquisitions and common share buybacks. Boosted by positive trends, the Health Care Distributors Index has been one of the market's stronger sectors, rising 57.9% in 2013, versus a gain of 30.1% for the broader S&P 1500 Composite Index. Year to date through September 19, the Distributor Index was up 13.2%, versus a gain of 8.2% for the S&P 1500.

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