

Express Scripts Holding Company (NASDAQ: ESRX)

Sector: Health Care (NAICS: 446110)

Intrinsic Value	Current Price	52 Week High	52 Week Low	Beta	P/E	Market Cap	Dividend Yield
\$87.57	\$74.35	\$79.37	\$59.20	1.56	24.52	\$55.42B (Large Cap)	N/A

Industry Trends

The Pharmaceutical Benefit Management industry is in the mature phase of its life cycle. As such, the industry is characterized by consolidation, merger and acquisition activity and a shift in focus toward operational efficiency. Macroeconomic trends that will impact the industry include rising drug costs, higher consumer spending on healthcare, and the Affordable Care Act.

Investment Thesis

Express Scripts is a PBM that has seen significant success in the industry. The company has a strong position in the market, with 40% of total PBM market share and 52.3% of home delivery market share. Part of this large market share is attributed to the recent strategic Medco acquisition, which significantly increased the size of the company. While in the past, the company focused on increasing volumes, the focus is changing towards operational efficiency. Demographic changes and an increasing older population create large volumes of scripts and an increasing demand for benefit managers. The company has rewarded shareholders through generous share buybacks over the past few years and expects to continue the program in the future. Overall, investors will continue to receive share price appreciation through these share buybacks, market share, macroeconomic growth, and increased operational efficiency.

Business Summary

Express Scripts is a pharmacy benefit manager (PBM) primarily offering services in the United States and Canada. A PBM's primary role is to provide healthcare and prescription management on behalf of its clients. The company's PBM services operate primarily through a large retail pharmacy network, but also increasingly through a direct mail delivery system. The business also includes drug formulary management, clinical solutions, and other drug interaction studies. Express Scripts makes money by taking spreads between the negotiated and charged price. As there are very low margins, the focus has turned to increasing operational efficiency.

ESRX 5-year stock performance vs. S&P 500:



Corporate Social Responsibility:

ESG Disclosure Rating	14.05
Social Disclosure Score	8.77
Governance Disclosure Score	51.79

Additional information about corporate responsibility is attached

Source: Bloomberg, Value Line, Yahoo Finance, ValuePro

Competition:

- Express Scripts' main competitor is CVS Caremark, but the company also competes with other PBMs such as Catamaran and the PBM business segments of UnitedHealth Group and Cigna. In the future, competition may come from pharmacy retailers as they vie for more leverage within the industry.

Pros:

- Significant market share: 40% of total PBM revenue (CVS, 37%), 52.3% of home delivery revenue (CVS, 47.3%)
- Medco merger has increased the size of the company (used as leverage in negotiations), Part D presence, and mail order network
- High client retention (92%-95% expected in 2015)
- Has stated intentions of continuing share repurchase plan (Recent debt issuance of \$2.5B includes stock buyback in uses)
- New management, Cathy Smith, from Walmart brought on to help increase operational efficiency
- Macroeconomic factors such as demographics and the Affordable Care Act increase script volumes
- Distribution network of 68,000 retail stores (95% of all retail pharmacies)

Cons:

- At the moment, PBMs makes money by being at the center of the supply chain for the healthcare industry. This may shift as other areas of healthcare seek to increase profits
- Political and regulatory changes regarding healthcare affect Express Script's business
- Pricing pressure from competitors, particularly CVS Caremark
- Medco merger has created short term operational inefficiencies as the companies attempt to combine databases and other operations

Value Estimate: \$85-\$115 (2014-2020)

Estimated Real Annual Return: 9%-15%

Key Valuation Data:

Estimated Revenues	-1% in first 2 years, 1% thereafter
WACC	11%
Terminal Growth Rate	4%
Calculated CAGR	9%

Key Financial Data:

Expected inflation	3%
Current EPS	\$4.42 (LTM)
Forecasted EPS Growth	9%
Credit Quality	Baa3/BBB+/BBB
ROE	8.25%
ROA	4.89%
Price/Book	2.71
Debt/Equity	63.9%
Debt/Assets	26.0%
Current Ratio	0.6
Price/Cash Flow	12.2

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