

CVS Health Corporation (NYSE: CVS)

Sector: Healthcare



Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Adj.Beta
\$95.24	\$81.41	\$106.10	\$73.53	14.87	\$83.164 B	2.47%	.756

Business Description

CVS Health Corporation is an integrated pharmacy health care provider. The Company's offerings include pharmacy benefit management services, mail order, retail and specialty pharmacy, disease management programs and retail clinics. The company operates Drugstores through the United States and Puerto Rico. The company has three reportable segments. These are the Pharmacy Services segment, the Retail/LTC Segment and the Corporate segment. Revenue is only recorded in the Pharmacy Services and Retail Segments. The pharmacy services segment offers pharmacy benefit management solutions to clients, which consist of employers, insurance companies, unions, etc. They operate a SilverScript subsidiary which is a drug beneficiary for the Medicare Part D Program. In 2016, this segment filled and managed 1.2 billion prescriptions. This business seeks to use innovative tools and quality client service to improve clinical outcomes for health benefit plan members, while assisting their members to better manage costs. PBM services include Maintenance Choice, Pharmacy Advisor, Specialty Connect, Extra Care Health Card program, and MinuteClinic. The Retail/LTC segment dispenses prescriptions and provides services. This segment accounts for two-thirds of the company's revenue. There are 9,709 retail locations, of which 7,890 include a pharmacy, 1,674 are CVS pharmacies within Target stores. In 2015, CVS acquired Omnicare which encompasses their LTC, or Long Term Care programs.

Industry Trends

The pharmacy services outlook is relatively positive. With the expansion in health care coverage, and more people within the United States becoming employed, there is a greater demand from plan sponsors for PBM services. There is also a growing elderly population seeking drug cost savings which is a goal of PBMs. This industry has also been consolidating, giving PBMs more leverage to promote drug as preventative measures rather than costlier forms of care, such as hospital visits. The retail/ltc outlook is characterized by various trends in the consumer. Retail segments are seeking better store location and convenience, higher customer service and satisfaction, better product selection and lower prices. The LTC pharmaceutical services are highly regional or local and nature, and because of this are not too competitive due to specialization.

Investment Thesis

CVS Health Corporation is an attractive investment due to their ability to generate significant cash flow, their focus on shareholder returns and their position as an industry leader in pharmacy providers for long-term care and innovative cost solutions. CVS has a free cash flow yield of 8.98% and a five-year free cash flow growth rate of 14.51%. The company has had 14 consecutive years of dividend increases, has a share buyback program and is in a position, due to their free cash flow, to make an acquisition in a consolidating industry.

Valuation Assumptions

WACC: 7.0%
Growth Rate: 9.7% - 3.0%
Dividend increase 5% based on company reports
CapEx increase of \$10 billion based on position for acquisition

Key Financials

DCF Stock Price: \$90.96
Multiples Stock Price: \$109.74
DDM Stock Price: \$89.30
Weighted 50/25/25
Intrinsic Value: \$95.24

Corporate Social Responsibility

Independent Chairperson: 1.00, Yes (Industry Average: 0.25)
% of Non-Exec Directors on Board: 90.91% (Industry Average: 88.03)
Chief Financial Officer Tenure: 6.00 (Industry Average: 3.06)

5-Year Stock Performance



Competitive Analysis

CVS Health Corporation competes in both the Pharmacy Services segment and the Retail/LTC segment. In the Pharmacy Services segment, main competitors are ExpressScripts and United Health Group. CVS has the largest market share at 28.6% compared to Express Scripts and United Health Group with 23.0% and 13.3% respectively. In the Retail/LTC segment, CVS' biggest competition is Walgreens, RiteAid and Jean Coutu Group PJC Inc (Mexican equivalent).

Competitive Advantages

CVS has various competitive advantages between their two revenue-generating segments. First, they have the ability to generate significant free cash flow, which puts them in a position to make an acquisition in a consolidating industry. Their free cash flow yield is higher than their biggest competitor Walgreens at 8.98% versus 6.66%. Secondly, they are the industry leader in pharmacy services and PBM solutions. In 2016, they won more than 50% of revenue from clients changing PBMs and had a 97% client retention rating, showing their growth and leadership in the industry. Third, with the changing government policies, CVS seeks to gain from the increasing number of individuals requiring health care, as well as a lower corporate tax rate, as they are currently taxed at around 39%, lending to more profit that can be put forth to investments in the business.

Risks

There are some risks that CVS faces. The first is changes in U.S. policy, laws and regulations. Repeal of the Affordable Care act could impact customers however, the company has stated they are ready to pivot to address any policy changes and continue to bring solutions and reduce healthcare costs. Also, the company makes a higher margin on generic drugs compared to brand name. There have been less new generic drugs in recent years. Lastly, it has been speculated that PBMs are causing drug prices to rise, however we find this to be erroneous considering CVS Caremark helped reduce client costs from 11.8% to 3.3% YTD through September, 2016.

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Sources: Bloomberg, Yahoo! Finance, 2016- 2017 CVS Annual Reports, Value Line, IBIS

