# McKesson Corporation (MCK)

*Updated June 16th, 2018 by Josh Arnold*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $150 | **5 Year CAGR Estimate:** | 12.7% | **Quality Percentile:** | N/A |
| **Fair Value Price:** | $190 | **5 Year Growth Estimate:** | 6.9% | **Momentum Percentile:** | N/A |
| **% Fair Value:** | 79% | **5 Year Valuation Multiple Estimate:** | 4.9% | **Total Return Percentile:** | N/A |
| **Dividend Yield:** | 0.9% | **5 Year Price Target** | $266 | **Valuation Percentile:** | N/A |

## Overview & Current Events

McKesson Corporation traces its lineage to 1833 when its founders began to offer wholesale chemicals and pharmaceuticals in New York City. In the nearly 200 years since, McKesson has grown into a powerhouse in an ever-growing industry and today, it enjoys $215B in annual revenue and a $30B market cap.

The company's recent fourth quarter earnings report was mixed as MCK reported adjusted earnings-per-share growth of just 2.3%, but other metrics showed greater improvements. Total revenue was up 6% as the flagship North America pharmaceutical business was up 5.3%, but the International business saw 18.6% top line growth. Medical-Surgical produced an 8.7% gain to round a nice quarter from a revenue perspective and that strength translated into operating earnings growth of 8%. MCK's fourth quarter had many non-cash charges and adjustments impacting earnings but overall, mid-single digit revenue growth and high single digit operating earnings growth is strong, and characteristic of MCK's recent years. Finally, management issued guidance of $13.00 to $13.80 in earnings-per-share for this year.

## Growth on a Per-Share Basis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $4.28 | $4.58 | $5.00 | $5.83 | $6.33 | $8.35 | $11.11 | $9.84 | $11.61 | $12.62 | ***$13.60*** | ***$19.00*** |
| **DPS** | $0.48 | $0.48 | $0.72 | $0.80 | $0.80 | $0.92 | $0.96 | $1.08 | $1.12 | $1.30 | ***$1.36*** | ***$2.00*** |

MCK's earnings-per-share history is quite robust, having grown YoY every year in the past decade with the exception of 2015. Indeed, even with that decline MCK has managed to average 13.5% earnings-per-share growth annually over this time frame through organic revenue growth and many acquisitions. We don't think that sort of growth is likely for the longer term as MCK has grown much larger and seems to have neared a plateau on operating margins, but we do see 6.9% in annual earnings-per-share growth moving forward.

MCK will achieve this result largely via revenue gains, which we forecast will be in the 3% to 5% range for the foreseeable future. MCK continues to acquire growth in bolt-on acquisitions and in companies that supplement its current offerings, and that strategy shouldn't change anytime soon. Margins have been fairly flat for some time so we expect that will continue, which means margins will not be driving any sort of significant earnings growth on their own. To be fair, MCK recently launched a review of its operations to see where efficiencies could be gained to improve margins, but it is still very early and specific targets for savings weren't provided. However, MCK did just recently increase its share repurchase authorization by $4B, bringing the total to $5.1B. That is good for a mid-teens percentage of the float at today's prices to that will certainly have the capability to drive significant earnings-per-share growth via a lower share count over time.

The dividend has never been a priority for MCK and that isn't likely to change anytime soon. We do see the payout rising from today's $1.36 to $2.00 in five years, but the dividend remains just a small fraction of earnings.

## Valuation Analysis

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Now | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 11.2 | 11.8 | 13.6 | 13.8 | 14.9 | 16.8 | 17.9 | 20.1 | 14.1 | 12.0 | ***11.0*** | ***14.0*** |
| **Avg. Yld.** | 1.0% | 0.9% | 1.1% | 1.0% | 0.8% | 0.7% | 0.5% | 0.5% | 0.7% | 0.5% | ***0.9%*** | ***0.8%*** |

MCK's price-to-earnings ratio has ebbed and flowed in the past decade but today, it is actually quite cheap relative to its historical norm. We see fair value as 14 times earnings and thus, MCK offers good value here to prospective shareholders. That should provide a meaningful 4.9% tailwind to total returns over the next five years as the stock's valuation reverts to more normalized levels. The yield should remain below 1% for the foreseeable future given the stock price appreciation we are forecasting and the diminutive payout.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **GP/A** | 4.7% | 4.9% | 5.1% | 4.9% | 5.2% | 5.0% | 4.7% | 6.0% | 5.8% | 5.4% | ***5.4%*** | ***5.5%*** |
| **Debt/A** | 75% | 75% | 73% | 77% | 79% | 80% | 80% | 85% | 84% | 82% | ***82%*** | ***80%*** |
| **Int. Cov.** | 7.5 | 8.4 | 11.0 | 9.1 | 9.2 | 10.0 | 8.7 | 8.6 | 10.8 | 25.8 | ***30.0*** | ***40.0*** |
| **Payout** | 10% | 10% | 13% | 13% | 13% | 11% | 9% | 11% | 10% | 10% | ***10%*** | ***11%*** |
| **Std. Dev.** | 37% | 34% | 19% | 20% | 15% | 20% | 14% | 17% | 32% | 26% | ***25%*** | ***23%*** |

MCK's quality metrics have been very stable for the past decade, having not moved much in one direction or the other. Margins have flattened out after slight deterioration a few years ago and we see a bit of potential for gains there over the long term given the company's operating review. Its balance sheet is reasonably leveraged and the company's strong earnings mean it has more than ample interest coverage. The payout ratio will remain very low barring a huge strategic shift, which we certainly aren't forecasting. Overall, MCK is in terrific shape financially.

MCK's competitive advantage is in its willingness to adapt and shift to the changing needs of its customers, its willingness to buy growth and its immense scale, which affords buying power. It should hold up well to the next recession given its product assortment that offers healthcare consumers things they need, and not discretionary items.

## Final Thoughts & Recommendation

McKesson looks very attractive here as it offers a strong growth outlook, a robust share repurchase program and a valuation that is well under fair value. We are therefore forecasting 12.7% annual total returns going forward, consisting of the current 0.9% yield, 6.9% earnings-per-share growth and a 4.9% tailwind from a rising price-to-earnings multiple. That would make McKesson attractive for investors seeking growth or value, but its low yield would make it unattractive to investors seeking high levels of income. Overall, McKesson looks like a buy here.

## Total Return Breakdown by Year