



# McKesson Corporation (MCK)

Updated August 3<sup>rd</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b> \$126	<b>5 Year CAGR Estimate:</b> 16.5%	<b>Volatility Percentile:</b> 77.4%
<b>Fair Value Price:</b> \$190	<b>5 Year Growth Estimate:</b> 6.9%	<b>Momentum Percentile:</b> 7.3%
<b>% Fair Value:</b> 66%	<b>5 Year Valuation Multiple Estimate:</b> 8.5%	<b>Valuation Percentile:</b> 96.8%
<b>Dividend Yield:</b> 1.1%	<b>5 Year Price Target:</b> \$266	<b>Total Return Percentile:</b> 94.6%

## 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 generates \$215 billion in annual revenue and trades with a \$25 billion market capitalization.

McKesson issued Q1 earnings results on 7/26/18 and results were as expected. Revenue was up 3% and adjusted earnings-per-share came in at \$2.90, an 18% increase over the comparable quarter last year. Results were buoyed by lower interest expense, a much lower tax rate, better operating leverage and a lower share count. McKesson is doing a lot of little things correctly to boost margins in order to make up for low rates of revenue growth, and it is clearly working. The quarter was good enough for management to reaffirm its guidance for this year of \$13.00 to \$13.80; our estimate of \$13.60 is unchanged for this year based on the strong results of Q2 and guidance affirmation.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$4.58	\$5.00	\$5.83	\$6.33	\$8.35	\$11.11	\$9.84	\$11.61	\$12.62	\$12.62	<b>\$13.60</b>	<b>\$19.00</b>
<b>DPS</b>	\$0.48	\$0.72	\$0.80	\$0.80	\$0.92	\$0.96	\$1.08	\$1.12	\$1.30	\$1.30	<b>\$1.36</b>	<b>\$2.00</b>

McKesson'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 McKesson has managed to average 13.5% earnings-per-share growth annually over this time frame through organic revenue growth and many acquisitions. We do not believe that sort of growth is likely for the longer term as McKesson has grown much larger. As a result, it seems to have neared a plateau on operating margins and revenue growth, but we do see 6.9% in annual earnings-per-share growth moving forward.

McKesson will achieve this result largely via revenue gains, which we forecast will be in the 3% to 5% range for the foreseeable future. It continues to acquire growth in bolt-on acquisitions and in companies that supplement its current offerings, and that strategy should not 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. With that said, Q2 did see some operating leverage contribute to earnings growth; the company's still-new operations review seems to be bearing some early fruit. In addition, management 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 McKesson 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/E</b>	11.2	11.8	13.6	13.8	14.9	16.8	17.9	20.1	14.1	12.0	<b>9.3</b>	<b>14.0</b>
<b>Avg. Yld.</b>	1.0%	0.9%	1.1%	1.0%	0.8%	0.7%	0.5%	0.5%	0.7%	0.5%	<b>1.1%</b>	<b>0.8%</b>

The stock'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, McKesson offers good value here to prospective

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

shareholders. That should provide a meaningful 8.5% tailwind to total returns over the next five years as the stock's valuation reverts to more normalized levels from today's trough. The yield should move back 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%

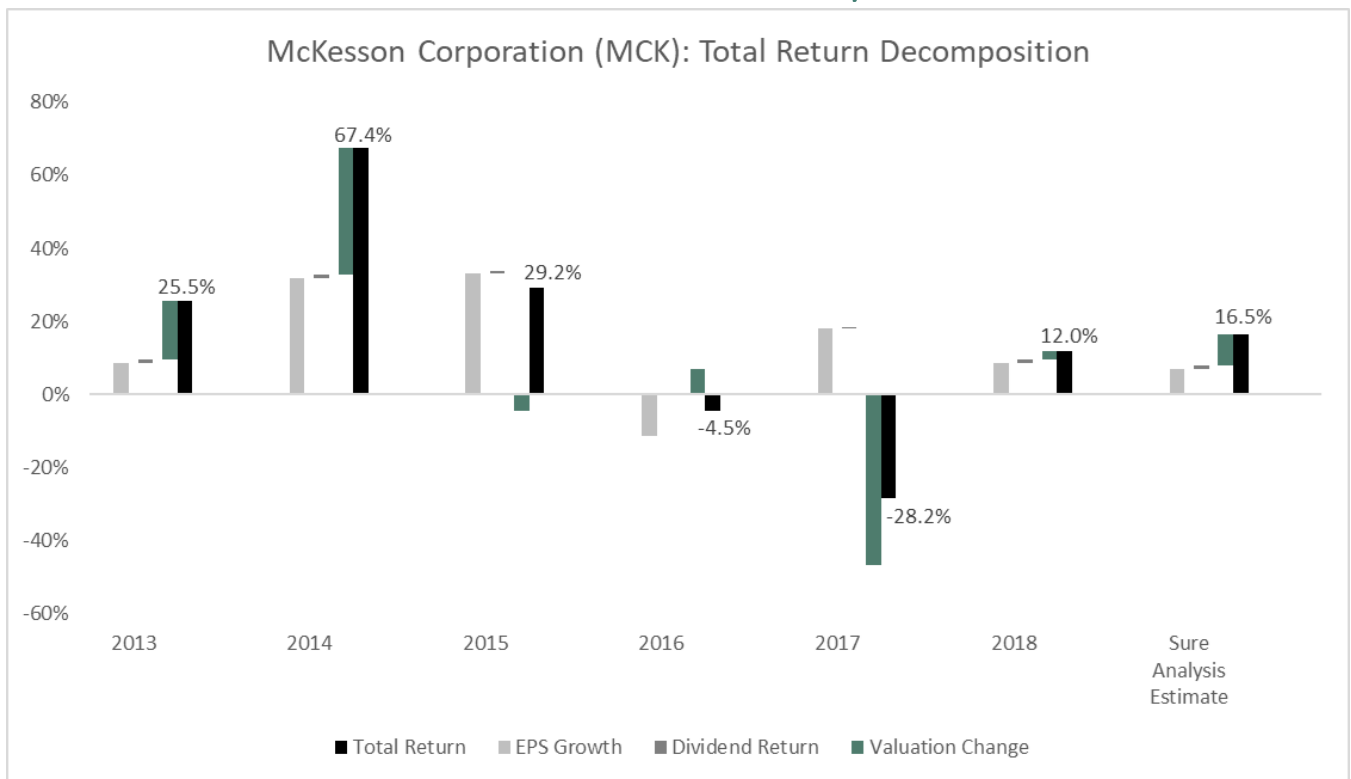
McKesson's quality metrics have been very stable for the past decade, having not moved much in one direction or the other. Margins have flattened out after slight deterioration a few years ago and we see a bit of potential for gains there over the long term given the company's operating review. Its balance 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 material strategic shift, which we certainly are not forecasting. Overall, McKesson is in terrific shape financially.

Its 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 purchasing 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 16.5% annual total returns going forward, consisting of the current 1.1% yield, 6.9% earnings-per-share growth and an 8.5% 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 earns a buy recommendation at current prices.

### Total Return Breakdown by Year



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