



McKesson Corporation (MCK)

Updated February 15th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$168	5 Year CAGR Estimate:	8.0%	Market Cap:	\$29.8B
Fair Value Price:	\$177	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	02/28/20
% Fair Value:	95%	5 Year Valuation Multiple Estimate:	1.0%	Dividend Payment Date:	04/01/20
Dividend Yield:	1.0%	5 Year Price Target	\$237	Years Of Dividend Growth:	12
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	5.1%

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 186 years since, McKesson has grown into a powerhouse in the pharmaceutical and medical distribution industry and today, generates nearly \$230 billion in annual revenue and trades with a \$30 billion market capitalization.

McKesson reported Q3 earnings on February 4th and results beat expectations on the top and bottom lines. Revenue was \$59.2 billion in Q3, up 5% from the year-ago period. Adjusted for forex translation, revenue would have grown 6%, primarily driven by growth in the US Pharmaceutical and Specialty Solutions segment, as the company enjoyed brand pharmaceutical price increases and higher volumes from retail national accounts.

Earnings, excluding one-time charges, came to \$3.81 per share, up 12% year-over-year as revenue growth combined with a lower share count to produce sizable growth. These gains were partially offset by a higher tax rate.

For the first nine months of the fiscal year, McKesson has returned \$2.2 billion of cash to shareholders via \$1.9 billion of share repurchases and \$222 million in dividend payments. Cash flow for the first three quarters was -\$618 million as the company's operating cash flow was -\$280 million and it used a further \$338 million in capital expenditures.

The company also raised guidance from \$14.00 to \$14.60 in earnings-per-share to \$14.60 to \$14.80, causing us to raise our estimates for this year to \$14.75.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$4.58	\$5.00	\$5.83	\$6.33	\$8.35	\$11.11	\$9.84	\$11.61	\$12.62	\$13.57	\$14.75	\$19.74
DPS	\$0.48	\$0.72	\$0.80	\$0.80	\$0.92	\$0.96	\$1.08	\$1.12	\$1.30	\$1.51	\$1.64	\$2.30
Shares¹	271	252	235	227	231	232	225	211	202	191	183	165

McKesson's earnings-per-share history is quite robust, having grown nearly every year in the past decade. Indeed, McKesson has managed to average more than 10% 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 still see 6% annual earnings-per-share growth as sustainable moving forward.

McKesson can achieve this result largely via revenue gains, which we forecast will be in the area of 3% for the foreseeable future. It continues to acquire growth in bolt-on acquisitions and companies that supplement its current offerings, a strategy that is unlikely to change. Margins have been flat for some time, so we expect that will continue. The buyback should continue to meaningfully reduce the float over time, which we see as a key driver of earnings-per-share growth. We remain somewhat cautious due to an increasingly hostile regulatory environment for drug wholesalers like McKesson. In addition, constant pressure on pricing from regulators, as well as strong generic conversion are headwinds. However, recent results have been quite supportive of long-term growth.

¹ Share count in millions

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.



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The dividend has never been a priority for McKesson and that is not likely to change anytime soon. We see the payout rising from today's \$1.64 to \$2.30 in five years, but the dividend remains just a small fraction of earnings.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.8	13.6	13.8	14.9	16.8	17.9	20.1	14.1	12.0	9.7	11.4	12.0
Avg. Yld.	0.9%	1.1%	1.0%	0.8%	0.7%	0.5%	0.5%	0.7%	0.5%	1.1%	1.0%	1.0%

The stock's price-to-earnings ratio has ebbed and flowed in the past decade but today, at 11.4 times earnings, it appears slightly undervalued relative to its historical norm. We see fair value as 12 times earnings and thus, McKesson offers a reasonable value to prospective shareholders in our view. This could provide a very small tailwind to total returns over the next five years if the stock's valuation reverts to more normalized levels from today's level. The yield should remain about where it is for the foreseeable future.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	10%	13%	13%	13%	11%	9%	11%	10%	10%	11%	11%	12%

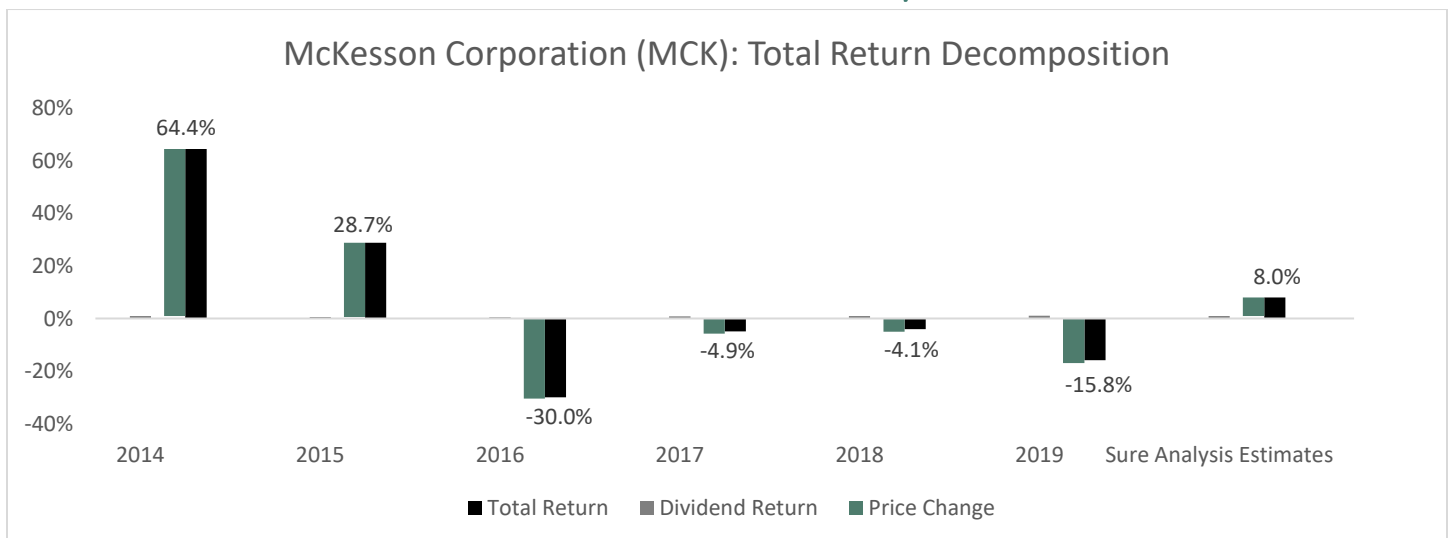
The payout ratio will remain very low barring a material strategic shift, which we are not forecasting. Instead, McKesson will almost certainly continue to boost earnings-per-share by reducing the float, as it did once again in fiscal 2019.

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. McKesson should hold up well during the next recession given its product assortment that offers healthcare consumers things they need, and not discretionary items.

Final Thoughts & Recommendation

McKesson continues to look attractive as it offers a decent growth outlook, a robust share repurchase program and a valuation that is still under our view of fair value. We are forecasting 8.0% annual total returns going forward, consisting of the current 1% yield, 6% earnings-per-share growth and a small tailwind from a rising valuation. That would make McKesson attractive for investors seeking growth or value, but its low yield would make it unattractive for investors seeking high levels of income. Due to the higher valuation, we're moving McKesson from buy to hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue (\$B)	106.6	108.70	112.08	122.32	122.20	137.39	179.05	190.88	198.53	208.36
Gross Profit	5378	5676	5970	6402	6881	8352	11411	11416	11271	11184
Gross Margin	5.0%	5.2%	5.3%	5.2%	5.6%	6.1%	6.4%	6.0%	5.7%	5.4%
SG&A Exp.	3325	3312	3529	3727	4110	5388	7901	7379	7460	8138
D&A Exp.	441	148	496	493	581	735	1017	885	910	951
Operating Profit	1196	1988	2034	2273	2338	2507	3118	3645	3470	2921
Operating Margin	1.1%	1.8%	1.8%	1.9%	1.9%	1.8%	1.7%	1.9%	1.7%	1.4%
Net Profit	823	1263	1202	1403	1338	1263	1476	2258	5070	67
Net Margin	0.8%	1.2%	1.1%	1.1%	1.1%	0.9%	0.8%	1.2%	2.6%	0.0%
Free Cash Flow	959	1938	1950	2552	2083	2717	2567	2995	4182	3765
Income Tax	241	601	505	514	587	757	815	908	1614	-53

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	25267	28189	30886	33093	34786	51759	53870	56523	60969	60381
Cash & Equivalents	2109	3731	3612	3149	2456	4193	5341	4048	2783	2672
Acc. Receivable	N/A	7256	7982	9977	9975	13780	15914	17980	18215	17711
Inventories	8527	9441	9225	10073	10335	12986	14296	15335	15278	16310
Goodwill & Int.	4410	4353	5972	6782	8675	14798	13258	12807	14251	15026
Total Liabilities	19074	20657	23666	26262	27716	41441	45785	47515	49696	50324
Accounts Payable	N/A	N/A	N/A	16114	16108	21128	25166	28585	31022	32177
Long-Term Debt	2509	2296	4004	3980	4873	10594	9844	8114	8545	7880
Total Equity	6193	7532	7220	6831	7070	8522	8001	8924	11095	9804
D/E Ratio	0.41	0.30	0.55	0.58	0.69	1.24	1.23	0.91	0.77	0.80

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	3.3%	4.7%	4.1%	4.4%	3.9%	2.9%	2.8%	4.1%	8.6%	0.1%
Return on Equity	13.4%	18.4%	16.3%	20.0%	19.3%	16.2%	17.9%	26.7%	50.7%	0.6%
ROIC	9.9%	13.6%	11.4%	12.7%	11.8%	7.7%	7.6%	12.9%	27.4%	0.4%
Shares Out.	271	271	252	235	227	231	232	225	211	202
Revenue/Share	382.2	398.18	426.17	487.33	511.28	589.67	761.89	819.24	890.28	996.92
FCF/Share	3.44	7.10	7.41	10.17	8.72	11.66	10.92	12.85	18.75	18.01

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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