



McKesson Corporation (MCK)

Updated February 5th, 2022, by Josh Arnold

Key Metrics

Current Price:	\$266	5 Year CAGR Estimate:	5.8%	Market Cap:	\$40 B
Fair Value Price:	\$281	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	02/28/22
% Fair Value:	95%	5 Year Valuation Multiple Estimate:	1.1%	Dividend Payment Date:	04/01/22
Dividend Yield:	0.7%	5 Year Price Target	\$342	Years Of Dividend Growth:	14
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	11.9%

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 189 years since, McKesson has grown into a powerhouse in the pharmaceutical and medical distribution industry and today, generates about \$260 billion in annual revenue and trades with a \$40 billion market capitalization.

McKesson reported third quarter earnings on February 2nd, 2022, and results were ahead of expectations on both earnings and revenue. Earnings-per-share came to \$6.15 on an adjusted basis, which handily beat estimates by 73 cents. Revenue was \$68.6 billion a nearly-10% gain year-over-year, and almost \$2 billion ahead of estimates. The gain in revenue was driven primarily by growth in the US Pharmaceutical segment, which was due to higher volumes from retail national account customers and market growth. This was once again partially offset by the conversion of customers from branded products to generic ones.

Earnings were driven by strong operating performances across all its segments, including the COVID-19 vaccine distribution program. The US government is paying McKesson for distribution, kitting, and storage of the vaccine, a tailwind we expect will abate over time.

McKesson has returned \$2.2 billion to shareholders in the first three quarters of the year, including \$2 billion in share repurchases, and the balance in dividend payments.

We expect another year of massive growth for McKesson, with earnings-per-share hitting \$23.40 on an adjusted basis this year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$5.83	\$6.33	\$8.35	\$11.11	\$9.84	\$11.61	\$12.62	\$13.57	\$14.95	\$17.21	\$23.40	\$28.47
DPS	\$0.80	\$0.80	\$0.92	\$0.96	\$1.08	\$1.12	\$1.30	\$1.51	\$1.62	\$1.67	\$1.88	\$2.64
Shares¹	235	227	231	232	225	211	202	191	173	158	153	130

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 4% annual earnings-per-share growth as sustainable moving forward. We slightly reduced our growth estimate due to the extremely high base of earnings.

McKesson can achieve this result largely via revenue gains, as it continues to acquire growth in bolt-on acquisitions with 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.

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 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. We note that the COVID tailwind from last year and this year will potentially abate in fiscal 2023 and beyond, but there are no signs of this yet.

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 \$1.88 to \$2.64 in five years, but the dividend remains just a small fraction of earnings, and the yield is low as a result.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.8	14.9	16.8	17.9	20.1	14.1	12.0	9.7	9.3	9.4	11.4	12.0
Avg. Yld.	1.0%	0.8%	0.7%	0.5%	0.5%	0.7%	0.5%	1.1%	1.2%	1.0%	0.7%	0.8%

The stock's price-to-earnings ratio has ebbed and flowed in the past decade but today, at 11.4 times earnings, it appears to be 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 tailwind to total returns over the next five years if the stock's valuation reverts to more normalized levels. The yield should remain about where it is for the foreseeable future, and we note McKesson is not a high-income stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	13%	13%	11%	9%	11%	10%	10%	11%	11%	10%	8%	9%

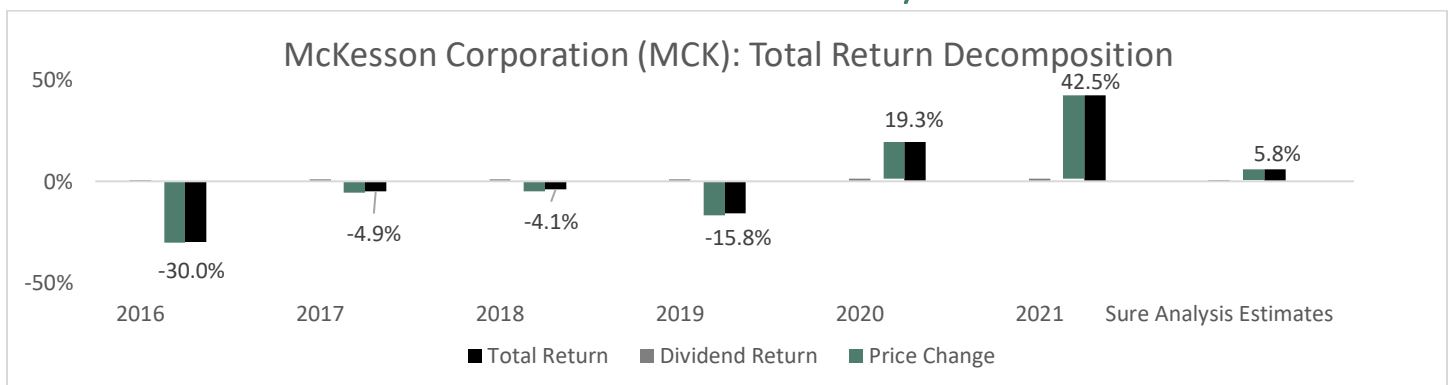
The payout ratio will remain very low barring a material strategic shift, which we are not forecasting. Instead, McKesson will almost certainly continue to boost earnings-per-share by reducing the float.

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 held up well during calendar 2020 given its product assortment that offers healthcare consumers things they need, and not discretionary items.

Final Thoughts & Recommendation

McKesson offers a modest growth outlook, a robust share repurchase program and a valuation that is still slightly under our view of fair value. We are forecasting 5.8% annual total returns going forward, consisting of the current 0.7% yield, 4% earnings-per-share growth and a small tailwind from a rising valuation. We reiterate the stock at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue (\$B)	122.3	122.2	137.4	179.0	190.9	198.5	208.4	214.3	231.1	238.2
Gross Profit	6,402	6,881	8,352	11,411	11,416	11,271	11,184	11,754	12,023	12,148
Gross Margin	5.2%	5.6%	6.1%	6.4%	6.0%	5.7%	5.4%	5.5%	5.2%	5.1%
SG&A Exp.	3,727	4,110	5,388	7,901	7,379	7,447	8,138	8,403	9,168	8,849
D&A Exp.	493	581	735	1,017	885	910	951	949	922	887
Operating Profit	2,273	2,338	2,507	3,118	3,645	3,483	2,921	3,280	2,759	3,299
Operating Margin	1.9%	1.9%	1.8%	1.7%	1.9%	1.8%	1.4%	1.5%	1.2%	1.4%
Net Profit	1,403	1,338	1,263	1,476	2,258	5,070	67	34	900	(4,539)
Net Margin	1.1%	1.1%	0.9%	0.8%	1.2%	2.6%	0.0%	0.0%	0.4%	-1.9%
Free Cash Flow	2,552	2,083	2,717	2,567	2,995	4,182	3,765	3,479	3,868	3,901
Income Tax	514	587	757	815	908	1,614	(53)	356	18	(695)

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	33,093	34,786	51,759	53,870	56,523	60,969	60,381	59,672	61,247	65,015
Cash & Equivalents	3,149	2,456	4,193	5,341	4,048	2,783	2,672	2,981	4,015	6,278
Acc. Receivable	8,562	8,683	12,169	13,117	14,519	14,602	14,349	14,941	17,201	17,106
Inventories	10,073	10,335	12,986	14,296	15,335	15,278	16,310	16,709	16,734	19,246
Goodwill & Int.	6,782	8,675	14,798	13,258	12,807	14,251	15,026	13,047	12,516	12,371
Total Liabilities	26,262	27,716	41,441	45,785	47,515	49,696	50,324	51,385	55,938	64,840
Accounts Payable	16,114	16,108	21,128	25,166	28,585	31,022	32,177	33,853	37,195	38,975
Long-Term Debt	3,980	4,873	10,594	9,844	8,114	8,545	7,880	7,595	7,387	7,148
Total Equity	6,831	7,070	8,522	8,001	8,924	11,095	9,804	8,094	5,092	(21)
LTD/E Ratio	0.58	0.69	1.24	1.23	0.91	0.77	0.80	0.94	1.45	---

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.4%	3.9%	2.9%	2.8%	4.1%	8.6%	0.1%	0.1%	1.5%	-7.2%
Return on Equity	20.0%	19.3%	16.2%	17.9%	26.7%	50.7%	0.6%	0.4%	13.7%	-179%
ROIC	12.7%	11.8%	7.7%	7.6%	12.9%	27.4%	0.4%	0.2%	6.3%	-45.3%
Shares Out.	235	227	231	232	225	211	202	191	173	158
Revenue/Share	487.33	511.28	589.67	761.89	819.24	890.28	996.92	1,087.9	1,269.5	1,483.4
FCF/Share	10.17	8.72	11.66	10.92	12.85	18.75	18.01	17.66	21.25	24.29

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

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