



McKesson Corporation (MCK)

Updated February 10th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$501	5 Year CAGR Estimate:	5.4%	Market Cap:	\$66 B
Fair Value Price:	\$414	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	02/29/24
% Fair Value:	121%	5 Year Valuation Multiple Estimate:	-3.7%	Dividend Payment Date:	04/01/24
Dividend Yield:	0.5%	5 Year Price Target	\$637	Years Of Dividend Growth:	16
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Hold

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 190 years since, McKesson has grown into a powerhouse in the pharmaceutical and medical distribution industry and today, generates more than \$300 billion in annual revenue and trades with a \$66 billion market capitalization.

McKesson posted third quarter earnings on February 7th, 2024, and results were much better than expected on both the top and bottom lines. Adjusted earnings-per-share came to \$7.74, which was 69 cents better than expected. Revenue was \$80.9 billion, soaring 15% year-over-year and besting estimates by more than \$3 billion. Sales gains were primarily attributable to growth in the US Pharma segment, which was from increased prescription volumes, partially offset by divestitures within the company's international segment.

Earnings were bolstered by a lower tax rate, a lower share count, and the aforementioned growth in US Pharma. Higher corporate expenses were due to a tax benefit from last year that did not repeat in Q3 2024.

The company raised guidance after Q3 results, and we've done the same. We now expect to see \$27.60 in earnings-per-share this year as McKesson continues to perform very strongly.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$8.35	\$11.11	\$9.84	\$11.61	\$12.62	\$13.57	\$14.95	\$17.21	\$23.69	\$25.94	\$27.60	\$42.47
DPS	\$0.92	\$0.96	\$1.08	\$1.12	\$1.30	\$1.51	\$1.62	\$1.67	\$1.83	\$2.09	\$2.48	\$3.48
Shares¹	231	232	225	211	202	191	173	158	145	136	133	125

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. However, as McKesson continues to report better than expected results, we're expecting growth to be 9%.

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. Organic sales growth has also been improving.

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, and commentary from management has been very bullish.

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 \$2.48 to \$3.48 in five years, but the dividend remains just a small fraction of earnings, and the yield is low as a result.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	16.8	17.9	20.1	14.1	12.0	9.7	9.3	9.4	9.3	14.1	18.2	15.0
Avg. Yld.	0.7%	0.5%	0.5%	0.7%	0.5%	1.1%	1.2%	1.0%	0.8%	0.6%	0.5%	0.5%

The stock's price-to-earnings ratio has ebbed and flowed in the past decade but today, at 18.2 times earnings, it appears to be overvalued relative to its historical norm. We see fair value as 15 times earnings and thus, McKesson looks overvalued at the moment. This could provide a headwind 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	11%	9%	11%	10%	10%	11%	11%	10%	8%	8%	9%	8%

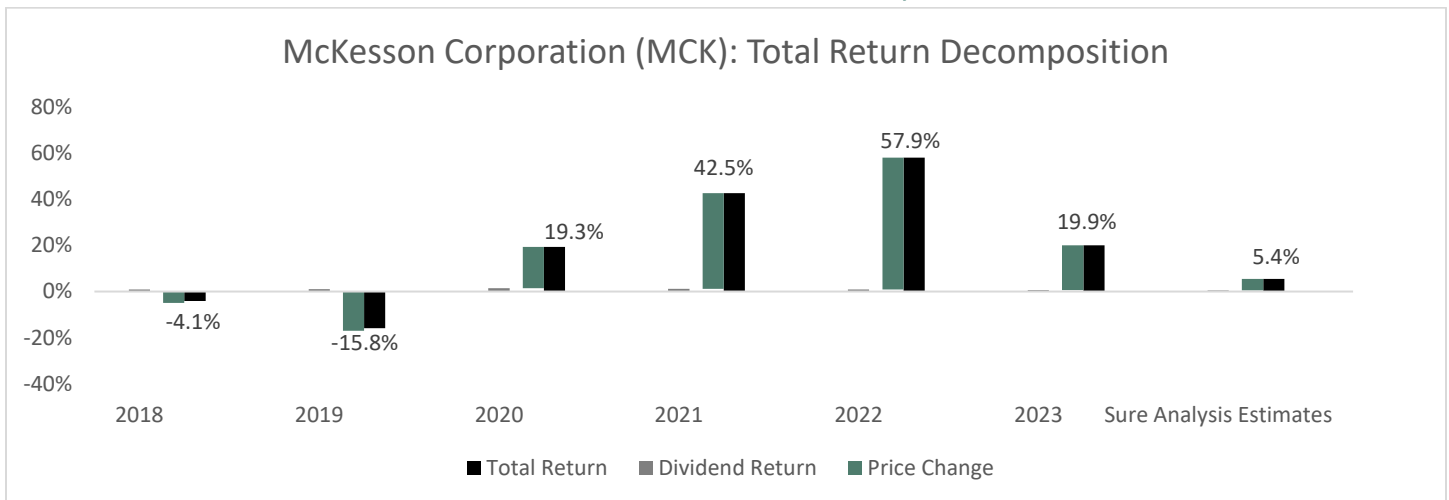
The payout ratio will remain very low barring a material strategic shift, which we are not forecasting. Instead, McKesson will almost certainly continue to boost earnings-per-share by reducing the float.

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. In addition, the company is constantly reevaluating its portfolio, divesting non-core assets, and using proceeds to acquire future growth. McKesson held up well during the COVID crisis given its product assortment that offers healthcare consumers things they need, and not discretionary items.

Final Thoughts & Recommendation

McKesson offers a strong growth outlook, a robust share repurchase program and a valuation that is ahead of our view of fair value. We are forecasting 5.4% annual total returns going forward, consisting of the current 0.5% yield, 9% earnings-per-share growth and a 3.7% headwind from a contracting valuation. We reiterate the stock at a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue (\$B)	137.4	179.0	190.9	198.5	208.4	214.3	231.1	238.2	264.0	276.7
Gross Profit	8,352	11,411	11,416	11,271	11,184	11,754	12,023	12,148	13,130	12,358
Gross Margin	6.1%	6.4%	6.0%	5.7%	5.4%	5.5%	5.2%	5.1%	5.0%	4.5%
SG&A Exp.	5,388	7,901	7,379	7,447	8,138	8,403	9,168	8,849	10,537	7,776
D&A Exp.	735	1,017	885	910	951	949	922	887	760	608
Operating Profit	2,507	3,118	3,645	3,483	2,921	3,280	2,759	3,299	2,593	4,582
Operating Margin	1.8%	1.7%	1.9%	1.8%	1.4%	1.5%	1.2%	1.4%	1.0%	1.7%
Net Profit	1,263	1,476	2,258	5,070	67	34	900	(4,539)	1,114	3,560
Net Margin	0.9%	0.8%	1.2%	2.6%	0.0%	0.0%	0.4%	-1.9%	0.4%	1.3%
Free Cash Flow	2,717	2,567	2,995	4,182	3,765	3,479	3,868	3,901	3,899	4,601
Income Tax	757	815	908	1,614	(53)	356	18	(695)	636	905

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	51,759	53,870	56,523	60,969	60,381	59,672	61,247	65,015	63,298	62,320
Cash & Equivalents	4,193	5,341	4,048	2,783	2,672	2,981	4,015	6,278	3,532	4,678
Acc. Receivable	12,169	13,117	14,519	14,602	14,349	14,941	17,201	17,106	16,438	17,160
Inventories	12,986	14,296	15,335	15,278	16,310	16,709	16,734	19,246	18,702	19,691
Goodwill & Int.	14,798	13,258	12,807	14,251	15,026	13,047	12,516	12,371	11,510	12,224
Total Liabilities	41,441	45,785	47,515	49,696	50,324	51,385	55,938	64,840	65,090	63,810
Accounts Payable	21,128	25,166	28,585	31,022	32,177	33,853	37,195	38,975	38,086	42,490
Long-Term Debt	10,594	9,844	8,114	8,545	7,880	7,595	7,387	7,148	5,879	5,594
Total Equity	8,522	8,001	8,924	11,095	9,804	8,094	5,092	(21)	(2,272)	(1,857)
LTD/E Ratio	1.24	1.23	0.91	0.77	0.80	0.94	1.45	---	-2.59	-3.01

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.9%	2.8%	4.1%	8.6%	0.1%	0.1%	1.5%	-7.2%	1.7%	5.7%
Return on Equity	16.2%	17.9%	26.7%	50.7%	0.6%	0.4%	13.7%	-179%	---	---
ROIC	7.7%	7.6%	12.9%	27.4%	0.4%	0.2%	6.3%	-45.3%	17.6%	86.9%
Shares Out.	231	232	225	211	202	191	173	158	154	142
Revenue/Share	589.67	761.89	819.24	890.28	996.92	1,087.9	1,269.5	1,483.4	1,713.0	1,945.9
FCF/Share	11.66	10.92	12.85	18.75	18.01	17.66	21.25	24.29	25.30	32.36

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

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