



Equity Research Report  
McKesson Corporation  
07 March 2017

*Analyst: Mark Venzor*



## Overview

### BUY

#### Key Metrics

Sector	Healthcare
Industry	Pharmaceutical
Share Price (02/24/17)	\$150.85
Target Price	<b>\$212.35</b>
Upside	+41.30%
52 Week Share Price Range:	\$114.53 - \$199.43
Exchange Traded	NYSE
Ticker	MCK
Dividend Yield	.75%
Annual Dividend	\$1.12
# Shares Out	212m

#### Key Ratio (As of 07 March 2017)

Market Cap	31.35B
EPS	\$8.43
P/E	17.54
Beta (5-year avg)	1.05
Peer Companies:	Cardinal Health, Inc. (NYSE:CAH); AmerisourceBergen Corporation (NYSE:ABC)

#### Analysts

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**BUY:** McKesson Corporation (McKesson) is the oldest and largest health care company in the United States serving more than 50% of the U.S. hospitals, 20% of the physicians and 96% of the top 25 health plans. It is a global pharmaceutical distributor and information technology company, having the largest market share in the U.S. Its two primary business segments are: McKesson Distribution Solutions and McKesson Technology Solutions. The company continues to improve its operational efficiencies through cost cutting initiatives and divestures of non-core business lines. McKesson continued to expand its portion and the size of pie through new sourcing agreements, such as the one with Wal-Mart Stores, Inc., and through multiple accretive acquisitions. McKesson announced \$4 billion worth of acquisitions in 2016.

### Key Investment Rationale

McKesson's share price is **undervalued by 41.30%** with a **target price of \$212.35**. A buy is recommended, McKesson's fundamentals are strong and its corporate governance team have proven to be good stewards of capital, have been able to effectively manage industry risks, and have strategically focused capital on growing the company's core business lines.

### Assumptions

Due to industry wide risks, a conservative growth rate average of **2.31%** (2017-2019) and **4.50%** (2020-2027) were utilized to forecast McKesson's intrinsic value. **2.00%** was used for the terminal growth and **8.37%** was used for the WACC.

### Business Risks

Although the healthcare sector has proven very profitable over the past decade, the following systemic risks provide the greatest headwinds for McKesson over the forecasted period: stagnation/deflation of drug prices, increased competitive pricing, consolidation of customers, and ambiguous political and regulatory guidance.

2016-2017 MCK Stock Price



Source of data in tables and graph: Yahoo Finance & S&P Capital IQ

## *Company Overview*

McKesson is a global pharmaceutical distribution service and information technology company, currently ranked 11<sup>th</sup> on the Fortune 500. McKesson delivers a comprehensive offering of pharmaceuticals and medical supplies and provides services to help its customers improve the efficiency and effectiveness of healthcare operations. McKesson has two primary segments: McKesson Distribution Solutions and McKesson Technology Solutions.

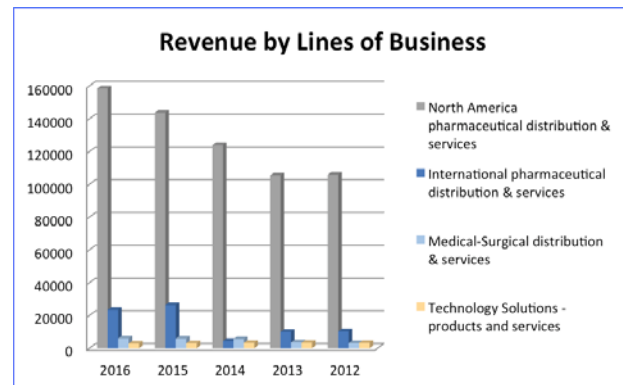


Figure 1 Source: McKesson 10-K

McKesson Distribution Solutions segment is composed of the North America Pharmaceutical Distribution and Services, International Pharmaceutical Distribution and Services, and the Medical-Surgical Distribution Services. The Distribution Segment distributes branded and generic pharmaceutical drugs and other healthcare-related products worldwide and provides practice management, technology, clinical support and business solutions to community-based oncology and other specialty practices.<sup>1</sup>

McKesson Technology is composed of McKesson Health Solutions, Connected Care and Analytics (“CCA”), Imaging and Workflow Solutions, Business Performance Services, and Enterprise Information Solutions. The Technology Solutions segment provides a comprehensive portfolio of information technology and services to help healthcare organizations improve quality of care and ensure patient safety, reduce the cost and variability of care and better manage their resources and revenue stream.<sup>2</sup>

McKesson’s total revenues have progressively increased from \$122.73 billion in 2012 to \$190.88 billion in 2016 an increase of 56%. In 2014, McKesson’s revenue grew by over \$40 million due to the inflation of drug prices. Additionally, its net income grew by 65% during the same period. The rise of net income resulted in an increase of EPS from \$5.59 in 2012 to \$9.70 in 2016.<sup>3</sup> (See Figure 1)

Institutional and mutual fund owners hold 86.50% of McKesson’s shares. McKesson’s three largest institutional holders are: Wellington Management Company, LLP; Vanguard Group, Inc.; and Capital Research Global Investors.<sup>4</sup>

## *Pharmaceutical Industry Overview*

“Drug, Cosmetic & Toiletry Wholesaling” industry recorded revenues of \$948.1 billion and profits of \$50.2 billion in 2016.<sup>5</sup>

From 2012 to 2017, the S&P 500 Health Care Sector (HCX) index has experienced a 95% increase in its overall monthly index value, compared to McKesson’s of 66%.<sup>6</sup> In general, the

Pharmaceutical industry faces the following risks: generic vs. brand drug pricing changes in governmental regulations, foreign exchange risk, and high level of legal costs. However, a key strength of investing in the pharmaceutical industry, or the healthcare sector in general, is the “defensive” nature of the companies that compose the sector.

## *Pharmaceutical Distribution Industry Overview*

The Pharmaceutical Distribution Industry is composed of “The Big Three:” McKesson, AmerisourceBergen Corporation (ABC), and Cardinal Health Inc. (CAH). Due to low margins and efficiencies of scale, there is a high barrier to entry into the pharmaceutical distribution industry. “The Big Three” control about 85% of all pharmaceutical distribution revenues in the U.S.<sup>7</sup> (See Figure 2)

McKesson is the largest U.S. pharmaceutical distributor with a market capitalization of \$31.35 billion. It’s U.S. market share ranges from 15% to 22% depending on the source.<sup>8 9</sup>

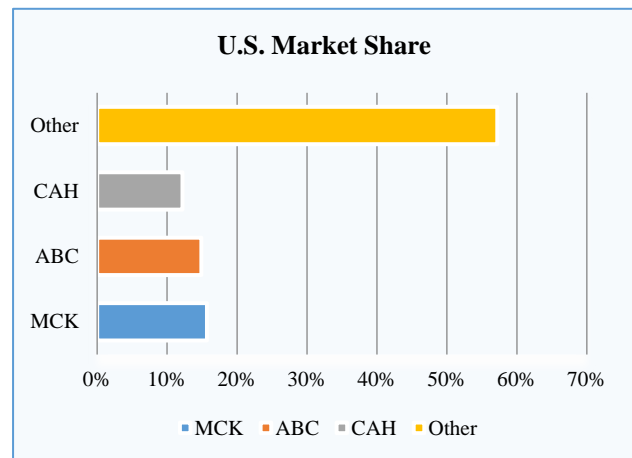


Figure 2 Source IBISWorld Industry Report

## *McKesson Financial Ratio Analysis vs. Peer Companies*

**McKesson when compared to “The Big Three” has demonstrated the greatest growth in profitability and consistency its fundamentals.** Per figure 3, since 2013 ABC has demonstrated the largest revenue growth, the highest ROE, but is also the most leveraged of “The Big Three.” Per Appendix 1, Figure 6, McKesson has realized the most reliable profit margins of its peers. **In respect to EPS, McKesson has strongly outperformed its peer competitors over the last five years.**<sup>10</sup>

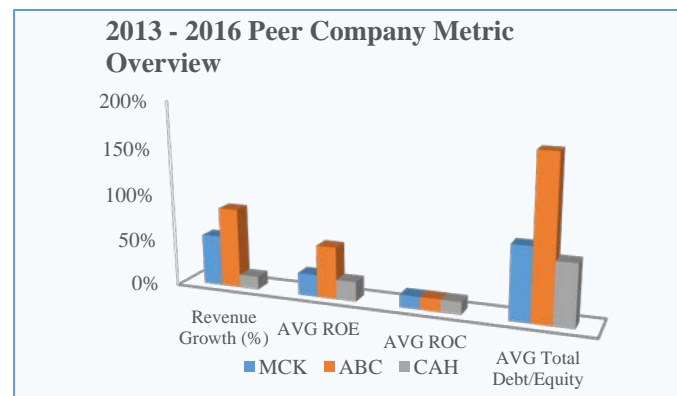


Figure 3 Analysis Source from Capital IQ

### **Market Value Ratios**

**McKesson’s Market Value is forecasted to increase during the next 10 years, due to an increase in earnings driven by organic and inorganic growth.** McKesson’s current P/E ratio is ~18x earnings. The P/E ratio of “The Big Three” is currently below the HCX, with McKesson being relatively inexpensive when compared to its peers. In addition, McKesson also has the lowest PEG ratio of the “The Big Three.” The lower PEG ratio further supports the assessment

that McKesson is undervalued and trading at a discount, when compared to its peers and the HCX. (See Appendix 1, Figure 1, 2, 3)

### **Profitability Ratios**

**McKesson's consistent ROE and Net Income Margin demonstrates management's ability to deal with industry risk and proactively grow the company's core business lines. Management has demonstrated their ability to generate profits while maintaining stable fundamentals.** Within the Pharmaceutical Distribution Industry, the profit margins are very tight, between .8% and 1.2% making it difficult for new competitors to enter the market. The differentiation factor between the companies is their ability to minimize cost of goods sold and operating costs. Per Appendix 1, Figure 4 McKesson has the greatest Profit Margin. McKesson's dominate share of the market and large size gives it an advantage when negotiating contracts with manufactures and its customers. However, looking at Appendix 1, Figure 2 CAH has demonstrated a larger operating profit margin than McKesson over the last five years. In 2016, McKesson over took the pack with a slightly better operating profit margin than CAH.

It is expected that McKesson's Operating Profit Margin will surpass 2% over the next 10 years. This growth will be driven by McKesson's cost cutting initiatives and divesture of its non-core business lines. McKesson's acquisition integrations costs will be a short-term head wind that will further hold down McKesson's operating profit margin. However, from a strategic perspective, the higher costs due to acquisitions are considered a positive since acquisitions have proven to be a key driver of growth for the company. (See Appendix 1, Figure 4, 5, 6)

### **Payout Ratios**

Even though McKesson Dividend Payout Ratio is the lowest of "The Big Three" it has been able to maintain a ratio between ~13% to 18% over the last five years. Compared to ABC, who has a Dividend Payout Ratio that has fluctuated between ~20% to 630%. Even though McKesson Dividend Payout Ratio has fluctuated its dividend per share has steadily increased from \$.20 in 2012 to \$.28 in 2017. (See Appendix 1, Figure 7)

### **Liquidity Ratios**

**"The Big Three" have a relatively healthy level of liquidity and solvency indicated by a DEBT/EBITDA ratio below ~2 and a current ratio of ~1.** McKesson when compared to its peers and the HCX appears to have a similar financial flexibility. McKesson has been able to effectively utilize cash on hand and debt to support acquisitions such as Vantage Oncology Holdings LLC and Rexall Health in 2016, UDG Healthcare Plc and J Sainsbury Plc in 2015, and Celesio AG in 2014. (See Appendix 1, Figure 8, 9)

### **Efficiency Ratios**

**In general McKesson seems to be less efficient than its peers.** Within the Pharmaceutical Distribution Industry, it is critical to maintain low costs of good sold and high inventory efficiencies in order to drive greater margins. Based on the comparison, "The Big Three's"

efficiency ratios are very similar. However, it does seem that ABC and CAH are more efficient when in respect to total asset turnover and accounts receivable turnover. (See Appendix 1, Figure 10, 11, 12) Future monitoring will be required to determine if McKesson's cost cutting initiatives and acquisitions will improve its efficiency ratios.

## ***McKesson's Management***

**McKesson's management team has a proven track record with a solid vision for the future.** Management has successfully implemented a restructuring program, executed M&A activities, and improved the company's bottom-line.<sup>11</sup> It is expected that McKesson's managers will continue to drive long-term growth and increase shareholder value by identifying efficiencies within the organization, maintaining a customer first philosophy, and differentiated itself through innovative technologies and cutting-edge supply chain management.<sup>12</sup> In 2016, the board impressively increased quarterly dividend rate to \$0.28 per share an increase of 40% over the last five years; reinvested more than \$677 million in the company through internal capital spending; returned more than \$1.5 billion in cash to shareholders via share buybacks, and repaid \$1.6 billion in long term debt.<sup>13</sup>

McKesson's board is comprised of 9 members, of which 8 are independent. 6 of the 9 of the Board members have 5 more years of tenure on the McKesson Board.<sup>14</sup> John H. Hammergren has served as Chairman of the Board since 2002, and President and Chief Executive Officer of the Company since April 2001.<sup>15</sup> The ability for Mr. Hammergren to serve in all three roles affords a great opportunity for McKesson to have increased consistency in decision making and strategic vision alignment, however the "duality" may dampen the check and balances between the board and the executives.

The compensation for the CEO and NEOs are predominately based on long-term sustained performance. For example, 91% of the CEO's compensation mix is linked to performance and it is composed of a base salary, management incentive pay (i.e., annual cash incentive), long-term performance bases incentives (i.e., long-term cash incentive, long-term equity incentive), and other compensation benefits.<sup>16</sup> As of 2016, McKesson directors, NEOs, and executive officers (18 persons in total) own 2.6 million (1.151%) of the company's outstanding common stock with the Mr. Hammergren owning 1.8m shares/stock options of the total 2.6 million.<sup>17</sup>

## ***McKesson's Business Model***

McKesson is a pharmaceutical distribution company. Pharmaceutical wholesaling continues to be the dominant way to distribute branded and generic drugs in the U.S.<sup>18</sup> Since 2004, McKesson and its peer supply chain companies have been shifting to a fee-for-service (FFS) model. The FFS drive increased information sharing between the distributor and manufactures while compensating the distributors with a per-unit fee. Previously the pharmaceutical distribution companies had operated under a buy-and-hold business model under which a company would purchase drugs from manufacturers in large manufactures quantities and then sell the drugs to its customers for a higher price.<sup>19</sup> Under the buy-and-hold business model the distributor would bear the majority of the risk, since it would buy large amounts of products in anticipation of drug price increases. Under

the FFS model, risk was shifted from the distributor to the manufacturer; the model also boosted opportunities for supply chain efficiency, and profits for both the manufacturer and distributor.<sup>20</sup>

McKesson is a mature company with a long-term strategy to strengthen its core competencies within the Distribution Solutions segment. Over the last five years it has aggressively expanded its distribution network within North America and Europe, while divesting itself of non-core assets within its McKesson Technology Solutions (MTS) segment. For example, in 2016 McKesson utilized the majority of MTS to support a joint venture with Change Healthcare Holding, Inc. to create Change Healthcare, a new company. McKesson is currently studying strategic alternatives for its Enterprise Information Solutions (EIS) business line.<sup>21</sup>

### ***McKesson's Key Value Drivers***

McKesson generated ~98% of revenue from its Distribution Solutions Segment and ~2% from its Technology Solutions segment. In 2014, McKesson established its International Pharmaceutical Distribution and Services line of business with the purchase of Celesio.<sup>22</sup>

**Cost of Goods Sold: The primary driver of value for the pharmaceutical distribution industry is to maintain low cost of goods sold.**

- **Contract Negotiation** - McKesson benefited from the brand and generic name drug inflation prices in 2014. However, starting in 2015 drug price increases started to stagnate. The ability to re-negotiate terms with manufacturers and retail clients is critical for McKesson to maintain market share and grow earnings. For example, in 2016, due to a price-cutting initiative to gain market share by a competitor, McKesson was forced to negotiate lower prices with its independently owned pharmacies in order to maintain market share.<sup>23</sup>
- **Brand vs. Generic Drugs** – Brand name drugs are a primary revenue driver for McKesson. The transition of brand name drugs to generics leads to a deflation of drug prices and a reduction of earnings. Even though brand name drugs create the majority of the earnings, historical pharmaceutical distributors gain a greater profit margin from generic drugs, since they can negotiate better terms.<sup>24</sup>

**Restructuring: McKesson's cost reduction initiatives, as well as the integration of acquired businesses have created a streamlined organization that will drive earnings in the future.** In 2016, the company committed itself to lowering operating costs under its "Cost Alignment Plan." The actions under this program included the reduction of workforce and the implementation of improved business process prior to the end of 2019.

- **Divestiture:** Part of McKesson's restructuring efforts have been to divest non-core business lines. As of 2016, McKesson divested itself of the majority of its Technology Solution Business to create a new health care information technology company. McKesson's leadership is looking at making a strategic decision on what to do with Enterprise Information Solutions (EIS). McKesson will continue to divest itself of its Technology Solutions business segment over the next few years, with no net loss in revenue due to its continued organic and inorganic growth of its distribution and services business segments.<sup>25</sup>

- **Acquisitions:** Since 2010, McKesson has positively increased its revenue through key acquisitions. For example, McKesson's acquisition of US Oncology Holdings, Inc. supported the increase of McKesson's revenue from \$108m to \$122m in 2 years. Through the acquisition of Celesio AG, McKesson established its International Pharmaceutical Distribution & Services line of business.<sup>26</sup> McKesson's strategy of acquiring companies that align with its core competencies will continue to be a driving force in future earnings.

**Drug utilization:** An aging population will continue to be a driving force for revenue generation for McKesson.

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## *McKesson's Business Risks*

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**In the near term, the McKesson's operations will face the following head winds:**

**Increased competition and consolidation within the retail pharmacy industry.** In 2016, an unexpected price war took place when McKesson was forced to lower generic drug prices in response to ABC's efforts to gain market share by enticing independent pharmacy customers to change distributors, when their contracts expired.<sup>27</sup> The acquisition of Rite Aid Corporation by Walgreens Boots Alliance is a perfect example of the impact that consolidation has on the pharmaceutical distribution industry. When reports of the Walgreens-Rite Aid deal were released to public in 2015, McKesson's shares drop by 4% in one day. It is estimated that the Rite Aid acquisition will cost McKesson about 15% (\$15 to \$25 million) of its annual revenue.<sup>28</sup>

**Increased use of direct to pharmacy distribution model by manufacturers.** Manufacturers have increased their use of direct accounts when drug shortages arise.<sup>29</sup>

**Regulation and Politics.** There is no clear bearing on how President Trump's Administration and 115<sup>th</sup> Congress will shape health care and drug price regulation over the next two years.<sup>30</sup> Prior to the election it was expected that a Trump victory would have provided the entire pharmaceutical industry a strong tail wind. However, this prognosis seems murky after President Trump met with pharmaceutical executives on the 31<sup>st</sup> of January 2017.

**Foreign Exchange Risk.** As McKesson is expected to have larger costs and exposure to FX risk as continues to grow its International Pharmaceutical Distribution & Services Segment in Canada, England and Europe. McKesson uses foreign currency forward contracts and cross currency swaps to reduce its FX risk.<sup>31</sup>

**Interest Rate Risk.** Since 2014, McKesson had reduced its outstanding variable interest rate debt from \$1.0 billion dollars to \$35 million by March 2016.<sup>32</sup> With the reduction of its variable interest rate debt and the companies growing cash reserves it has been able to reducing its exposure to interest rate risk. As of March 2016, McKesson had \$4 billion in cash and cash equivalents. They estimated the effect of a 50bp increase in the underlying interest rate on cash and debt would create a favorable impact on earnings of \$26 million in 2016.

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## *McKesson's Valuation*

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After witnessing a two-year decline in stock price, dropping from ~\$240 to ~\$120, McKesson's stock has stabilized at the \$150 level. **Due to the company facing strong head winds in the short term, a conservative revenue growth rate was used for years 1 to 3 of the forecast period. However, a more optimistic growth rate was used for years 4 to 10, based on the expected strengthening of McKesson's fundamentals, its accretive acquisitions will begin to generate positive revenue, and drug price inflation rates will stabilize.**

Both the short and long term perspectives on McKesson have been accounted for and reflected throughout the quantitative valuation process.

### Projected Growth Rates: (See Appendix 2-5)

Business Segment	Forecasted Period 1 (2017-2019)	Forecasted Period 2 (2020-2027)	Terminal Growth Rate
North American PD&S	3.0%	6.5%	2%
International PD&S	4.0%	7.0%	2%
Medical-Surgical PD&S	1.75%	4%	2%
Technology Solutions	.5%	.5%	2%
<b>Average Revenue Growth Rate</b>	<b>2.31%</b>	<b>4.50%</b>	<b>2%</b>
Cost of Goods Sold/Total Revenue	94.10%	93.85%	94.00
SG&A/Total Revenue	3.25%	3.0%	3.00%

### Assumptions per period

- **Forecast Period 1 (2017-2019):** The conservative growth rate of 2.31% was based on the expectation: that revenue from generic and brand drugs will contract due to deflationary effects on drug prices; continued consolidation within the sector; continued pricing competitiveness within the sector; less generic drug launches in the short term; and current acquisitions will take a few years to impact revenue growth. It is expected that McKesson will not realize the full efficiency of its "Cost Alignment Plan" until 2020. Until then SG&A costs are estimated to be 3.25%. The forecasted sales estimates and EPS from 2017 to 2019 are on par with Bloomberg Consensus.
- **Forecast Period 2 (2020-2027):** The optimistic growth rate of 4.13% was based on the expectation: that drug price inflation rates will stabilize, McKesson's acquisitions costs will decrease, acquisitions will begin generating positive revenue, and cost cutting initiatives begin to affect the bottom-line. As for Cost of Goods Sold, McKesson management was able re-negotiate new terms in response to ABC price cutting initiatives 2016, so it is expected that McKesson will continue to use its economies of scale in its favor to drive down Cost of Goods Sold.

### Assumptions impacting both forecasted periods

- A stronger growth potential for McKesson's International Pharmaceutical distribution & Services line of business.

- The economy is expected to improve over the next few years and increased demand for medical care is expected between 2012 and 2050 due to more baby boomers reaching age 65 and over.<sup>33</sup>
- The company will continue to streamline and strengthen its organization after its restructuring efforts (i.e., cost cutting initiatives, acquisitions, and divestitures).
- It is estimated that the Technology Solutions segment will stagnate with a .05% growth rate per year.
- Federal Reserve will raise interest rates over the next few years.

The McKesson's projected earnings growth will support its historical practice of increasing dividend payout by \$.04 every few years, since 2012.

### Valuation

Based on the DCF valuation with a calculated WACC of 8.37% as the discount rate, **the intrinsic value per share of \$221.35 is higher than the recent close price of the stock \$150.24. McKesson's stock is undervalued by approximately 41.3%.** (See Appendix 2 and 3)

Finally, if the marginal Tax Rate is dropped from 35% to 20% the intrinsic value per share would be \$269.75 an upside of 79.5%.

### *Conclusion/Recommendation*

**BUY:** McKesson is the largest of the pharmaceutical distribution companies with many years of dominant performance over its peer competitors. In recent years, the company has had its fair share of challenges, ranging from systemic factors such as drug price deflation to increases in peer competitor competition. The firm is currently in the process of streamlining its operations through divesting itself of non-core assets and initiating cost cutting efforts to be completed by 2019. McKesson's acquisitions have proven to positively impact revenue growth. The expansion and success of its International Pharmaceutical Distribution & Services line of business will be critical in the long-term growth of McKesson.

The company is led by an excellent management team, which will continue to avoid risks, focus on the company core assets, and continue to be smart users of capital. **McKesson is a mature business and will continue to be a market leader in the pharmaceutical distribution industry for years to come.**

<sup>1</sup> McKesson Corporation. "2016 Form 10-K; McKesson Corporation." SEC. US Government, 31 Mar. 2016, 3.

<sup>2</sup> McKesson Corporation. "2016 Form 10-K; McKesson Corporation." SEC. US Government, 31 Mar. 2016, 3.

<sup>3</sup> McKesson. 2016 10-K, 33.

<sup>4</sup> "McKesson Corporation. (MCK)." Yahoo Finance. [www.finance.yahoo.com/quote/MCK/holders?p=MCK](http://www.finance.yahoo.com/quote/MCK/holders?p=MCK). Accessed Feb 2017.

<sup>5</sup> Turk, Sarah. IBISWorld Industry Report 32541a: Brand Name Pharmaceutical Manufacturing in the US. 9 September 2016, 4.

<sup>6</sup> Capital IQ. <https://www.capitaliq.com/ciqdotnet/login-sso.aspx?contextType=external&username=string&enablePersistentLogin=true&OverrideRetryLimit=0&contextVa>

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<sup>7</sup> “2016 MDM Market Leaders Top Pharmaceuticals Distributors.” <https://www.mdm.com/2016-top-pharmaceuticals-distributors>. Accessed Feb and Mar 2017.

<sup>8</sup> “Drug. Cosmetic & Toiletry Wholesaling in the US.” *IBISWorld*.

<http://clients1.ibisworld.com/reports/us/industry/default.aspx?entid=964>. Accessed 18 Feb 2017.

<sup>9</sup> “McKesson.” *Fortune 500*, <http://beta.fortune.com/fortune500/mckesson-5>. Accessed 23 Feb 2017.

<sup>10</sup> S&P Capital IQ. Accessed Feb and Mar 2017.

<sup>11</sup> “McKesson Corporation Competitive Environment Trends and Business Model Assessment.” *Lawaspect.com*.

<https://lawaspect.com/mckesson-corporation-competitive-environment-trends-business-model-assessment/>.

Accessed 18 Feb 2017.

<sup>12</sup> *McKesson Corporation*. “2016 Form 10-Q; McKesson Corporation.” *SEC. US Government*, 31 Dec. 2016, 12-36.

<sup>13</sup> *McKesson Corporation*. 27 July 2016, Schedule 14A. 8.

<sup>14</sup> *McKesson Corporation*. 27 July 2016, Schedule 14A. 10.

<sup>15</sup> *McKesson Corporation*. 27 July 2016, Schedule 14A. 12.

<sup>16</sup> *McKesson Corporation*. “2016 Schedule 14A; McKesson Corporation.” *SEC. US Government*, 27 Jul. 2016, 34-35.

<sup>17</sup> *McKesson Corporation*. 27 July 2016, Schedule 14A, 28.

<sup>18</sup> “Resell vs. Direct Models: US Branded Drug Distribution in the Future.” *PharmaExec.com*. 17 Jul. 2015.

<http://www.pharmexec.com/resell-vs-direct-models-us-branded-drug-distribution-future>.

<sup>19</sup> “McKesson (MCK).” *Wikiinvest*, [http://www.wikininvest.com/stock/McKesson\\_\(MCK\)](http://www.wikininvest.com/stock/McKesson_(MCK)). Accessed 17 Feb 2017.

<sup>20</sup> Zhao, Hui, Chuanhui Xiong, Srinagesh Gavirneni, Adam Fein, Fee-For-Service Contracts in Pharmaceutical Distribution Supply Chains: Designs, Analysis, and Management.

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<sup>21</sup> “McKesson to Explore Strategic Alternatives for Enterprise Information Solutions.” *McKesson*. 28 June 2016.

<http://www.mckesson.com/about-mckesson/newsroom/press-releases/2016/mckesson-to-explore-strategic-alternatives-for-enterprise-information-solutions/>.

<sup>22</sup> *McKesson Corporation*. “2014 Form 10-K; McKesson Corporation.” *SEC. US Government*, 14 May 2014, p 31.

<sup>23</sup> “Is McKesson Investable Again? *INO.com Traders Blog*. 04 January 2017. <http://www.ino.com/blog/2017/01/is-mckesson-investable-again/#.WLBLiBiZMiU>.

<sup>24</sup> “Wholesaler Profits: Brand vs. Generic Drugs.” *Drug Channels*. 03 June 2010.

<http://www.drugchannels.net/2010/06/wholesaler-profits-brand-vs-generic.html>.

<sup>25</sup> *McKesson*. 2016 10-Q, 10.

<sup>26</sup> *McKesson Corporation*. “2012 Form 10-K; McKesson Corporation.” *SEC. US Government*, 02 May 2012, p 28.

<sup>27</sup> <http://www.cnbc.com/2016/10/28/cramer-the-drug-wholesale-price-war-has-officially-begun--steer-clear.html>

<sup>28</sup> <http://www.reuters.com/article/mckesson-deals-rite-aid-idUSL3N12T64N20151029>

<sup>29</sup> <http://www.ino.com/blog/2017/01/is-mckesson-investable-again/#.WLBLiBiZMiU>

<sup>30</sup> “Trump’s Plan for Lowering Big Pharma Drug Prices Comes At a High Cost.” *Newsweek*. 03 Feb 2017.

<http://www.newsweek.com/trump-drug-prices-big-pharma-552295>.

<sup>31</sup> *McKesson*. 2016 10-Q, 52.

<sup>32</sup> *McKesson*. 2016 10-K, 52.

<sup>33</sup> Ortman, Jennifer, Velkoff, Victoria, and Howard Hogan. “An Aging Nation: The Older Population in the United States.” *United States Census Bureau*. US Government, May 2014.

Note: The McKesson Analyst Report format was derived from a previously developed Analyst Report “Merck &Co” completed by Mark Venzor, Chad Dixon, Cecilia Cui, Rong Hu, and Ian Ding for Turbo Finance.

## Appendix 1

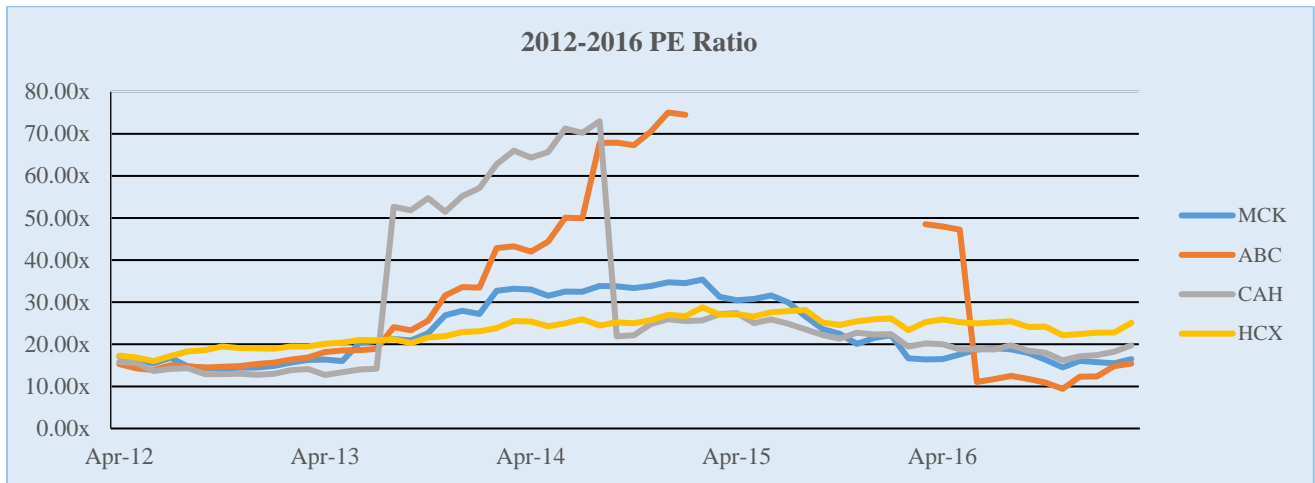


Figure 1 Data Source S&P Capital IQ

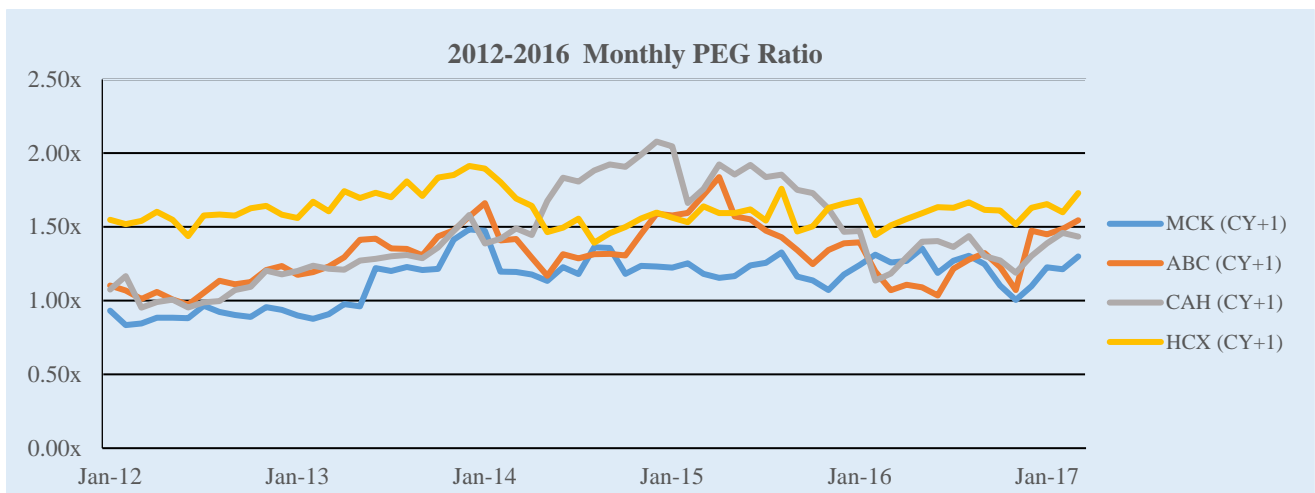


Figure 2 Data Source S&P Capital IQ

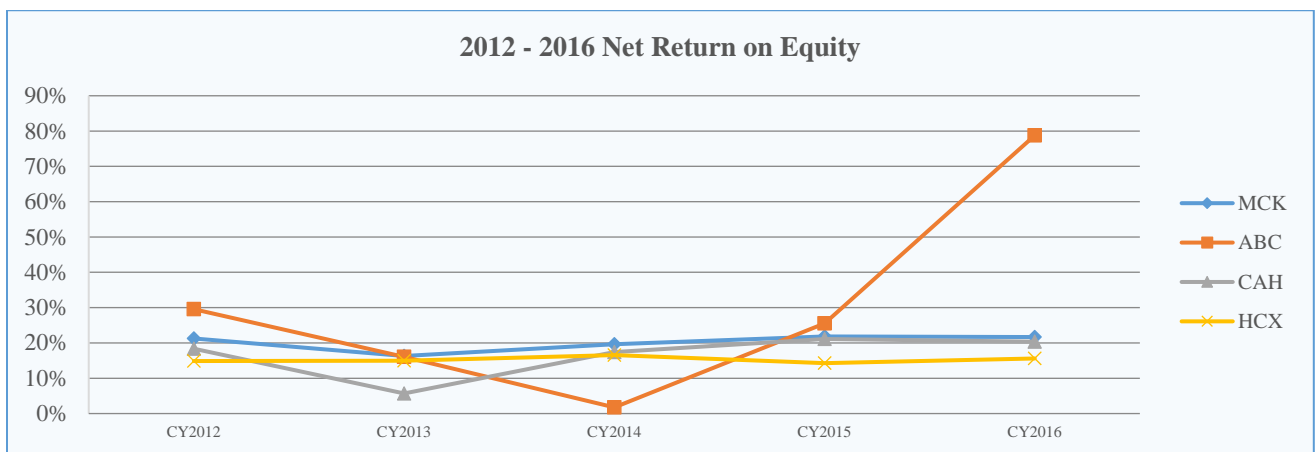


Figure 3 Data Source S&P Capital IQ

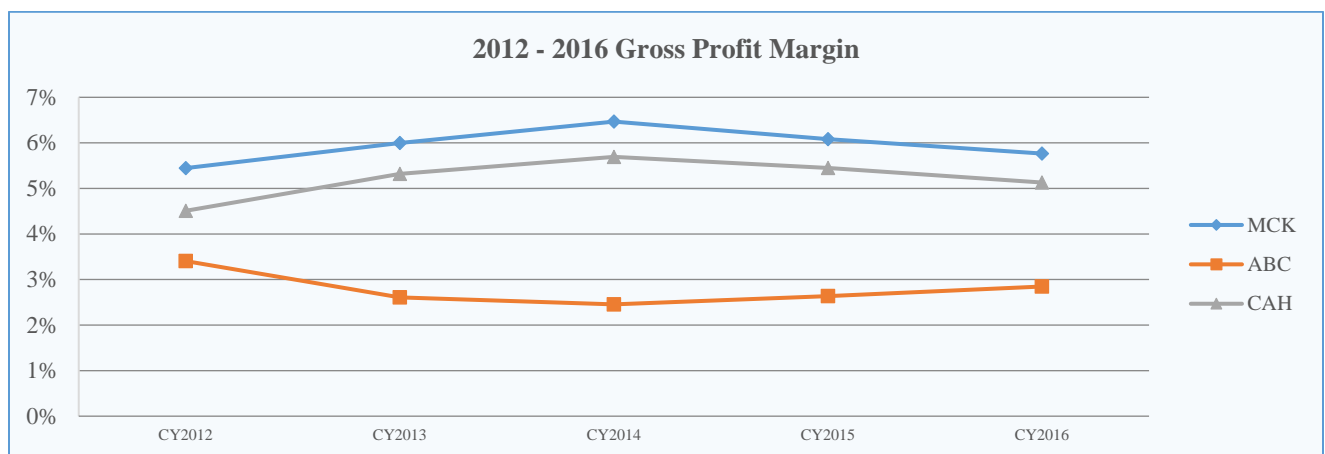


Figure 4 Data Source S&P Capital IQ

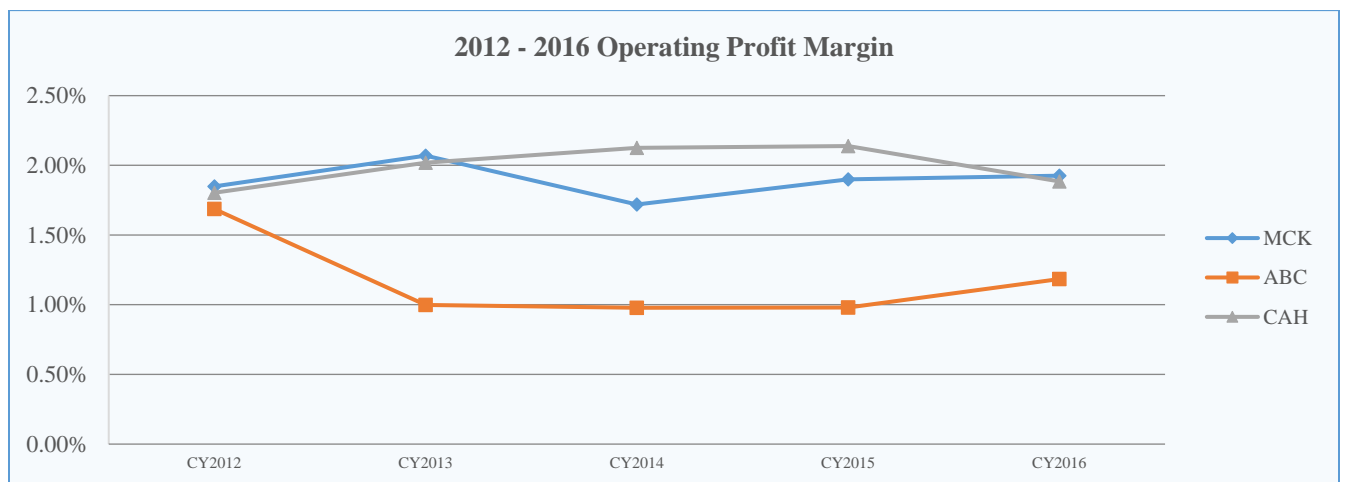


Figure 5 Data Source S&P Capital IQ

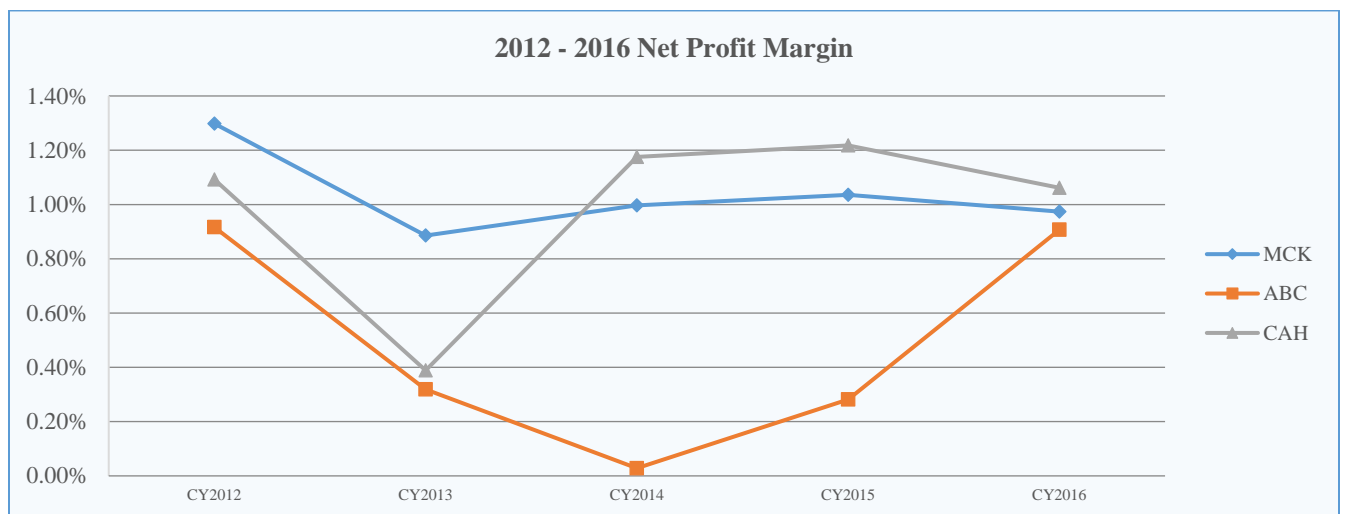


Figure 6 Data Source S&P Capital IQ

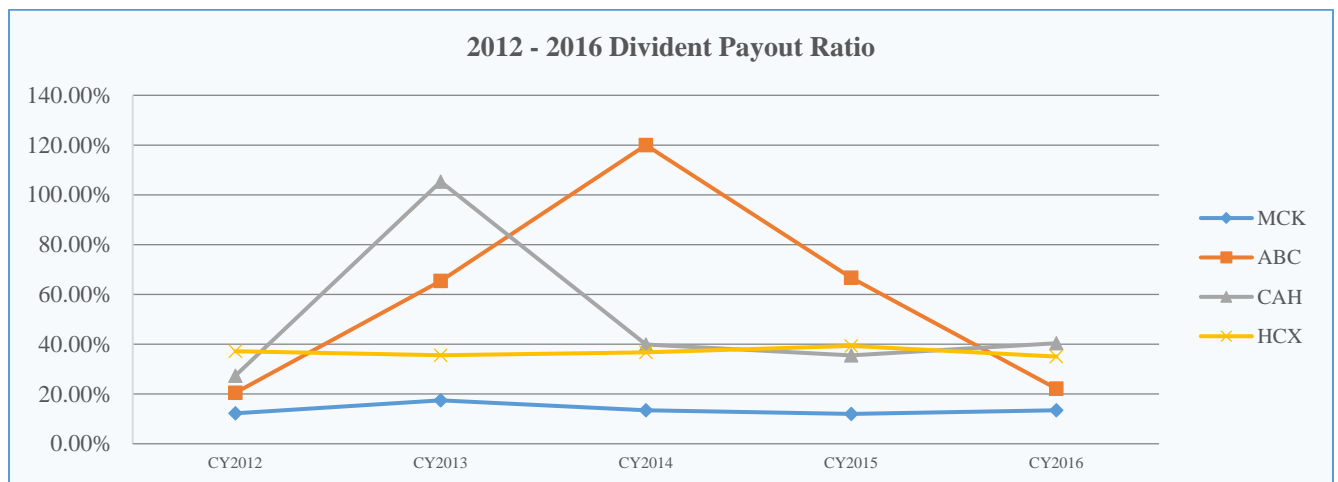


Figure 7 Data Source S&P Capital IQ (Note: ABC reached 637.59% in 2014)

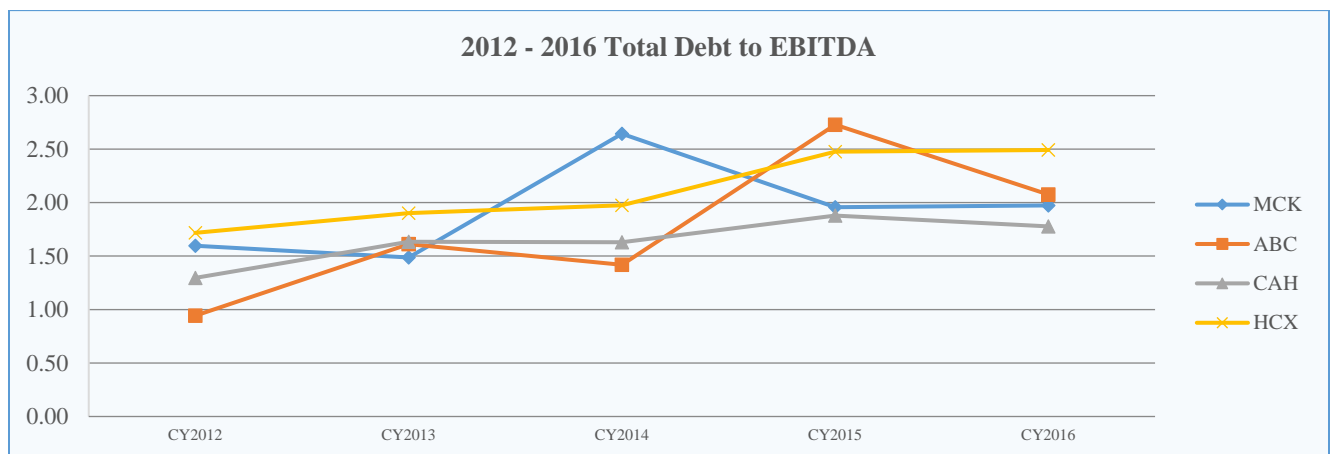


Figure 8 Data Source S&P Capital IQ

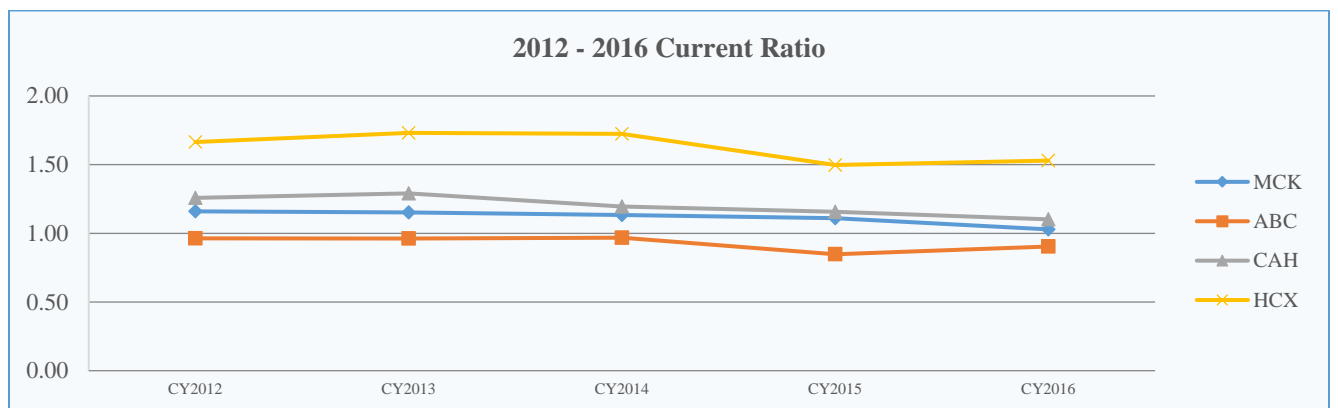


Figure 9 Data Source S&P Capital IQ

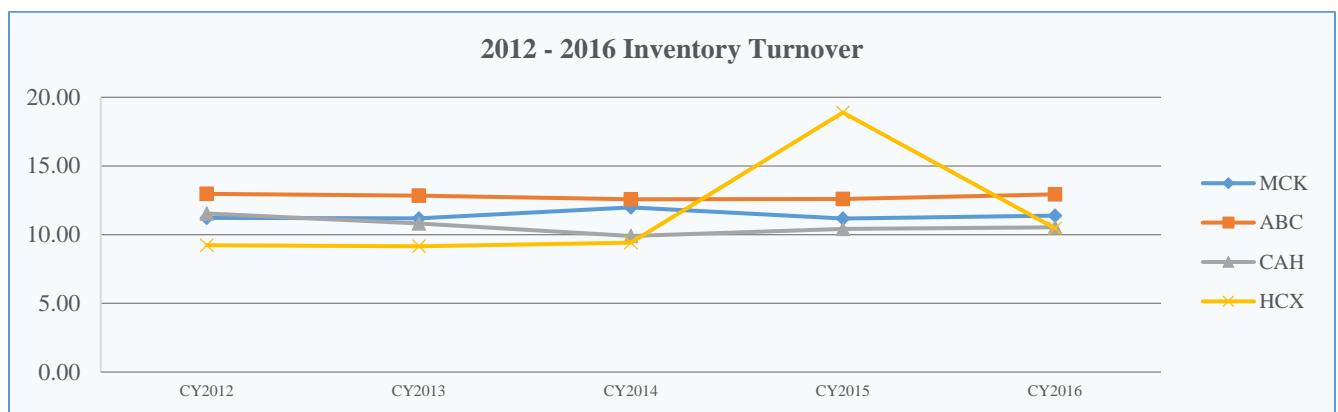


Figure 10 Data Source S&P Capital IQ

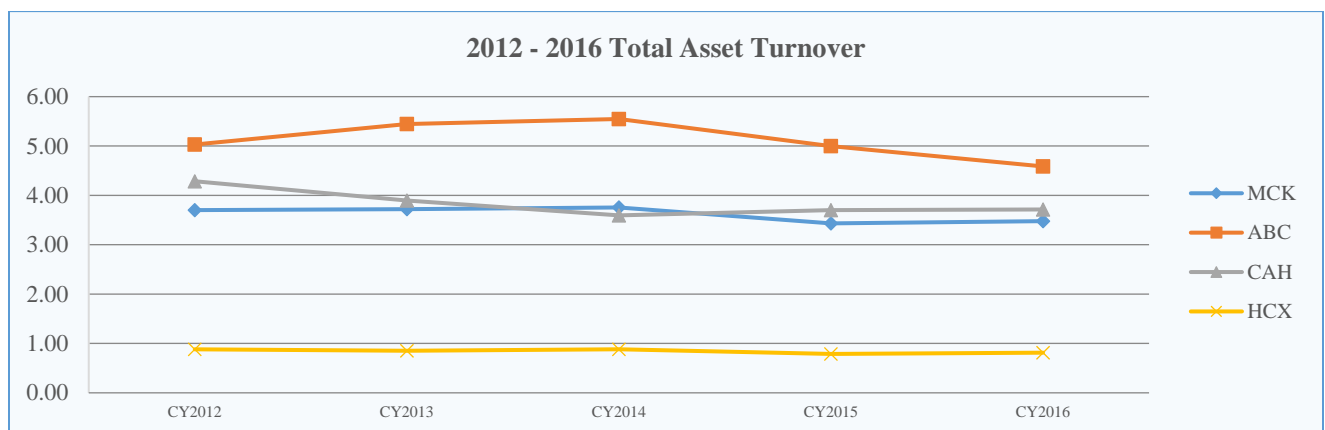


Figure 11 Data Source S&P Capital IQ

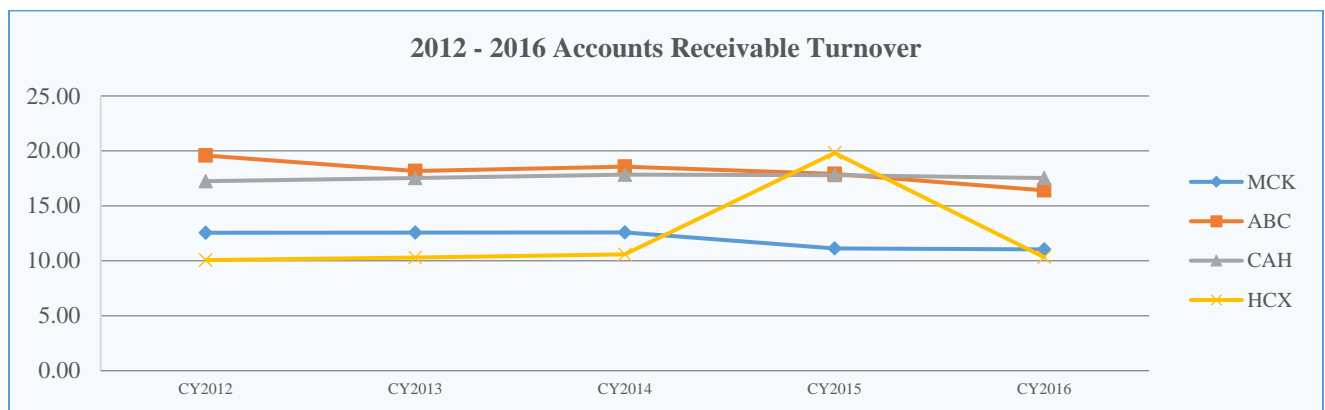


Figure 12 Data Source S&P Capital IQ

**Appendix 2**

<b>WACC Calculation (Millions)</b>	
<b>Target Capital Structure</b>	
Debt-to-Total Capitalization	20.28%
Equity-to-Total Capitalization	79.72%
Debt to Equity	25.44%
Debt	\$8,107
Equity	\$31,866
<b>Cost of Debt</b>	
Cost of Debt(3)	3.85%
Tax Rate	35.00%
<b>After-tax Cost of Debt</b>	<b>2.50%</b>
<b>Cost of Equity</b>	
Risk-free Rate <sup>(1)</sup>	4.09%
Market Risk Premium <sup>(2)</sup>	5.50%
Levered Beta (5-year Avg)	1.05
<b>Cost of Equity</b>	<b>9.87%</b>
<b>WACC</b>	<b>8.37%</b>
*Figures from 3rd QTR 2017 From 10-Q (1) Average Long Term U.S. Treasury (2) S&P 500 Returns - Risk free rate (3) McKesson Corporate Bond Avg	

## Appendix 3

Year	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E
(Dollars in millions)												
Total Revenue	\$190,884.00	\$196,697.95	\$207,694.04	\$208,878.08	\$222,252.72	\$236,498.73	\$251,673.13	\$267,856.70	\$285,054.19	\$303,394.62	\$322,931.51	\$343,743.24
% Growth		3.0%	3.0%	3.1%	6.0%	6.0%	6.0%	6.4%	6.4%	6.4%	6.4%	6.0%
Operating Income (EBIT)	\$2,660.00	\$3,427.59	\$4,844.39	\$3,947.80	\$5,311.84	\$5,652.32	\$6,014.99	\$6,401.30	\$6,812.80	\$7,251.13	\$7,718.06	\$8,215.46
Operating Margin		1.7%	2.0%	1.9%	2.0%	2.4%	2.7%	2.4%	2.4%	2.4%	2.4%	2.0%
Interest	(\$533.09)	(\$529.33)	(\$581.33)	(\$593.06)	(\$770.77)	(\$820.19)	(\$872.89)	(\$928.84)	(\$988.57)	(\$1,052.17)	(\$1,119.89)	(\$1,192.10)
Interest % of Sales		-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%
Taxes	(\$908.09)	(\$1,037.14)	(\$1,160.11)	(\$1,104.81)	(\$1,612.12)	(\$1,714.00)	(\$1,822.51)	(\$1,938.10)	(\$2,061.23)	(\$2,192.39)	(\$2,332.10)	(\$2,480.89)
Tax Rate		35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Net Income	\$2,758.00	\$1,761.12	\$2,154.48	\$2,218.89	\$2,998.94	\$3,183.14	\$3,394.67	\$3,599.34	\$3,828.00	\$4,071.57	\$4,331.04	\$4,607.44
% Growth		-72.0%	22.3%	3.0%	34.9%	6.3%	6.3%	6.3%	6.4%	6.4%	6.0%	6.0%
EBIT * (1-Tax Rate)	\$1,153.75	\$1,588.67	\$2,490.10	\$1,887.21	\$2,790.37	\$2,905.39	\$3,091.80	\$3,290.37	\$3,501.89	\$3,727.20	\$3,967.21	\$4,560.05
Add Depreciation/Amort	\$885.00	\$983.49	\$1,013.47	\$1,044.39	\$1,111.26	\$1,182.49	\$1,258.37	\$1,339.18	\$1,425.27	\$1,516.97	\$1,614.66	\$1,700.00
% of Sales		0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.3%
Plus/Minus Changes W/C	\$314.00	(\$1,623.34)	(\$193.67)	(\$193.74)	(\$452.09)	(\$464.15)	(\$490.13)	(\$522.09)	(\$556.13)	(\$592.40)	(\$631.04)	(\$672.22)
% of Sales		-0.8%	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%
Subtract Cap Ex	(\$677.09)	(\$629.43)	(\$668.62)	(\$668.41)	(\$711.21)	(\$756.89)	(\$805.39)	(\$857.09)	(\$912.17)	(\$970.86)	(\$1,033.88)	(\$1,200.00)
Capex % of Sales		-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%
FCF		\$319.38	\$2,661.27	\$2,063.45	\$2,698.43	\$2,870.54	\$3,054.68	\$3,250.40	\$3,458.86	\$3,680.92	\$3,917.45	\$3,887.83
% Growth			733.3%	-22.5%	30.8%	6.4%	6.4%	6.4%	6.4%	6.4%	6.4%	-0.8%
NPV of Cash Flows		\$18,758.21										
NPV of Terminal Value		\$27,853.73										
From Value		\$46,611.94										
Plus Cash		\$6,535.00										
Less Debt		\$8,107.00										
Equity Value		\$45,039.94										
Free Cash Flow Yield		1.00%										
Current P/E		18.1		14.8		14.4						
Projected P/E		25.6		20.9		20.3						
Current EV/EBITDA		7.6		5.7		6.7						
Projected EV/EBITDA		10.6		8.0		9.3						
Shares Outstanding		202.1										
Current Price		\$ 150.24										
Implied equity value/share		\$ 212.35										
Upside/(Downside) to DCF		41.5%										
Debt		8,107										
Cash		6,535										
Cash/share		30.81										

Terminal Discount Rate (WACC) = 35.00%  
Terminal FCF Growth = 2.00%

Terminal Value = 62,237  
Free Cash Yield = 6.25%  
Terminal P/E = 13.5  
Terminal EV/EBITDA = 6.8

## Appendix 4

### Forecasting Estimates (Income Statement, Balance Sheet, and Cash Flows)

Forecast Period	2020-2027	Average	2019-2017
North American PD&S Growth Per Year	6.50%	10.81%	3.00%
International PD&S Growth Per Year	7.00%	104.66%	4.00%
Medical-Surgical PD&S Growth Per Year	4.00%	19.49%	1.75%
Technology Solution Growth Per Year	0.50%	-3.29%	0.50%
Cost of Sales Growth/Total Revenue	93.85%	-94.10%	94.10%
Selling, distribution and administrative expenses/Total Revenue %	3.00%	-3.74%	3.25%
Research and development/Total Revenue %	0.20%	-0.30%	0.20%
Restructuring charges/Total Revenue %	N/A	-0.02%	N/A
Claim and Litigation Charges/Total Revenue %	0.06%	-0.06%	0.06%
Other Income, Net Growth Per Year %		36.76%	
Interest Expense / Operating Income	12.00%	-11.38%	12.00%
Tax Rate	35.00%	43.35%	35.00%
Receivables / Total Revenue %	8.99%	8.98%	8.99%
Inventories / Total Revenue %	8.46%	8.47%	8.46%
Accounts Payable / Total Revenue %	14.22%	14.19%	14.22%
Depreciation/Total Revenue %	0.14%	0.14%	0.14%
Amortization/Revenue %	0.36%	0.36%	0.36%
Total Payment for Property, Plant and Equipment/Total Revenue %	-0.32%	-0.32%	-0.32%

## Appendix 5

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076	2077	2078	2079	2080	2081	2082	2083	2084	2085	2086	2087	2088	2089	2090	2091	2092	2093	2094	2095	2096	2097	2098	2099	2100	2101	2102	2103	2104	2105	2106	2107	2108	2109	2110	2111	2112	2113	2114	2115	2116	2117	2118	2119	2120	2121	2122	2123	2124	2125	2126	2127	2128	2129	2130	2131	2132	2133	2134	2135	2136	2137	2138	2139	2140	2141	2142	2143	2144	2145	2146	2147	2148	2149	2150	2151	2152	2153	2154	2155	2156	2157	2158	2159	2160	2161	2162	2163	2164	2165	2166	2167	2168	2169	2170	2171	2172	2173	2174	2175	2176	2177	2178	2179	2180	2181	2182	2183	2184	2185	2186	2187	2188	2189	2190	2191	2192	2193	2194	2195	2196	2197	2198	2199	2200	2201	2202	2203	2204	2205	2206	2207	2208	2209	2210	2211	2212	2213	2214	2215	2216	2217	2218	2219	2220	2221	2222	2223	2224	2225	2226	2227	2228	2229	2230	2231	2232	2233	2234	2235	2236	2237	2238	2239	2240	2241	2242	2243	2244	2245	2246	2247	2248	2249	2250	2251	2252	2253	2254	2255	2256	2257	2258	2259	2260	2261	2262	2263	2264	2265	2266	2267	2268	2269	2270	2271	2272	2273	2274	2275	2276	2277	2278	2279	2280	2281	2282	2283	2284	2285	2286	2287	2288	2289	2290	2291	2292	2293	2294	2295	2296	2297	2298	2299	2300	2301	2302	2303	2304	2305	2306	2307	2308	2309	2310	2311	2312	2313	2314	2315	2316	2317	2318	2319	2320	2321	2322	2323	2324	2325	2326	2327	2328	2329	2330	2331	2332	2333	2334	2335	2336	2337	2338	2339	2340	2341	2342	2343	2344	2345	2346	2347	2348	2349	2350	2351	2352	2353	2354	2355	2356	2357	2358	2359	2360	2361	2362	2363	2364	2365	2366	2367	2368	2369	2370	2371	2372	2373	2374	2375	2376	2377	2378	2379	2380	2381	2382	2383	2384	2385	2386	2387	2388	2389	2390	2391	2392	2393	2394	2395	2396	2397	2398	2399	2400	2401	2402	2403	2404	2405	2406	2407	2408	2409	2410	2411	2412	2413	2414	2415	2416	2417	2418	2419	2420	2421	2422	2423	2424	2425	2426	2427	2428	2429	2430	2431	2432	2433	2434	2435	2436	2437	2438	2439	2440	2441	2442	2443	2444	2445	2446	2447	2448	2449	2450	2451	2452	2453	2454	2455	2456	2457	2458	2459	2460	2461	2462	2463	2464	2465	2466	2467	2468	2469	2470	2471	2472	2473	2474	2475	2476	2477	2478	2479	2480	2481	2482	2483	2484	2485	2486	2487	2488	2489	2490	2491	2492	2493	2494	2495	2496	2497	2498	2499	2500	2501	2502	2503	2504	2505	2506	2507	2508	2509	2510	2511	2512	2513	2514	2515	2516	2517	2518	2519	2520	2521	2522	2523	2524	2525	2526	2527	2528	2529	2530	2531	2532	2533	2534	2535	2536	2537	2538	2539	2540	2541	2542	2543	2544	2545	2546	2547	2548	2549	2550	2551	2552	2553	2554	2555	2556	2557	2558	2559	2560	2561	2562	2563	2564	2565	2566	2567	2568	2569	2570	2571	2572	2573	2574	2575	2576	2577	2578	2579	2580	2581	2582	2583	2584	2585	2586	2587	2588	2589	2590	2591	2592	2593	2594	2595	2596	2597	2598	2599	2600	2601	2602	2603	2604	2605	2606	2607	2608	2609	2610	2611	2612	2613	2614	2615	2616	2617	2618	2619	2620	2621	2622	2623	2624	2625	2626	2627	2628	2629	2630	2631	2632	2633	2634	2635	2636	2637	2638	2639	2640	2641	2642	2643	2644	2645	2646	2647	2648	2649	2650	2651	2652	2653	2654	2655	2656	2657	2658	2659	2660	2661	2662	2663	2664	2665	2666	2667	2668	2669	2670	2671	2672	2673	2674	2675	2676	2677	2678	2679	2680	2681	2682	2683	2684	2685	2686	2687	2688	2689	2690	2691	2692	2693	2694	2695	2696	2697	2698	2699	2700	2701	2702	2703	2704	2705	2706	2707	2708	2709	2710	2711	2712	2713	2714	2715	2716	2717	2718	2719	2720	2721	2722	2723	2724	2725	2726	2727	2728	2729	2730	2731	2732	2733	2734	2735	2736	2737	2738	2739	2740	2741	2742	2743	2744	2745	2746	2747	2748	2749	2750	2751	2752	2753	2754	2755	2756	2757	2758	2759	2760	2761	2762	2763	2764	2765	2766	2767	2768	2769	2770	2771	2772	2773	2774	2775	2776	2777	2778	2779	2780	2781	2782	2783	2784	2785	2786	2787	2788	2789	2790	2791	2792	2793	2794	2795	2796	2797	2798	2799	2800	2801	2802	2803	2804	2805	2806	2807	2808	2809	2810	2811	2812	2813	2814	2815	2816	2817	2818	2819	2820	2821	2822	2823	2824	2825	2826	2827	2828	2829	2830	2831	2832	2833	2834	2835	2836	2837	2838	2839	2840	2841	2842	2843	2844	2845	2846	2847	2848	2849	2850	2851	2852	2853	2854	2855	2856	2857	2858	2859	2860	2861	2862	2863	2864	2865	2866	2867	2868	2869	2870	2871	2872	2873	2874	2875	2876	2877	2878	2879	2880	2881	2882	2883	2884	2885	2886	2887	2888	2889	2890	2891	2892	2893	2894	2895	2896	2897	2898	2899	2900	2901	2902	2903	2904	2905	2906	2907	2908	2909	2910	2911	2912	2913	2914	2915	2916	2917	2918	2919	2920	2921	2922	2923	2924	2925	2926	2927	2928	2929	2930	2931	2932	2933	2934	2935	2936	2937	2938	2939	2940	2941	2942	2943	2944	2945	2946	2947	2948	2949	2950	2951	2952	2953	2954	2955	2956	2957	2958	2959	2960	2961	2962	2963	2964	2965	2966	2967	2968	2969	2970	2971	2972	2973	2974	2975	2976	2977	2978	2979	2980	2981	2982	2983	2984	2985	2986	2987	2988	2989	2990	2991	2992	2993	2994	2995	2996	2997	2998	2999	3000	3001	3002	3003	3004	3005	3006	3007	3008	3009	3010	3011	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