

McKesson Corporation (MCK)

\$150.67 (As of 01/14/20)

Price Target (6-12 Months): **\$158.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/22/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: A

Summary

McKesson has outperformed the industry in a year's time. Strong second-quarter show by core U.S. Pharmaceutical and Specialty, and Medical-Surgical Solutions segments buoy optimism. Management is optimistic about the 10-year partnership signed with Rite Aid. McKesson Canada too witnessed healthy growth in recent times. The company also launched an Opioid Foundation recently to address the current U.S. opioid crisis. McKesson exited the fiscal second quarter on a mixed note, wherein the bottom line met the consensus mark while the top line surpassed the same. However, McKesson's European Pharmaceutical Solutions has been witnessing softness of late thanks to challenging retail pharmacy environment in the U.K. Price fluctuation of generic pharmaceuticals and stiff competition in the MedTech space are added concerns.

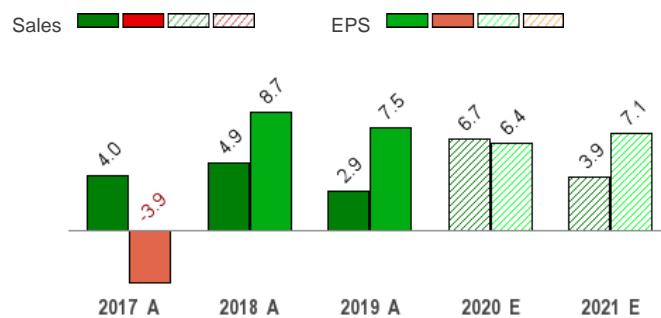
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$154.79 - \$110.52
20 Day Average Volume (sh)	955,153
Market Cap	\$27.1 B
YTD Price Change	8.9%
Beta	1.12
Dividend / Div Yld	\$1.64 / 1.1%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Top 46% (116 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	4.9%
EPS F1 Est- 4 week change	1.9%
Expected Report Date	02/04/2020
Earnings ESP	0.0%
P/E TTM	10.8
P/E F1	10.4
PEG F1	1.5
P/S TTM	0.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	58,333 E	59,781 E	61,280 E	57,057 E	237,619 E
2020	55,728 A	57,616 A	59,540 E	55,722 E	228,692 E
2019	52,607 A	53,075 A	56,208 A	52,429 A	214,319 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.64 E	\$3.87 E	\$3.63 E	\$4.29 E	\$15.47 E
2020	\$3.31 A	\$3.60 A	\$3.45 E	\$4.07 E	\$14.44 E
2019	\$2.90 A	\$3.60 A	\$3.40 A	\$3.69 A	\$13.57 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/14/2020. The reports text is as of 01/15/2020.

Overview

San Francisco, CA-based McKesson Corporation is a health care services and information technology company. McKesson operates through two segments:

The Distribution Solutions segment distributes branded and generic pharmaceutical drugs along with other healthcare-related products on a global basis worldwide. The segment also provides practice management, technology, clinical support and business solutions to community-based oncology and other specialty practices. In addition, the segment provides specialty pharmaceutical solutions for pharmaceutical manufacturers including offering multiple distribution channels and study access to oncology physicians. The segment also provides medical-surgical supply distribution, equipment, logistics and other services to healthcare providers within the U.S.

The Technology Solutions segment provides enterprise-wide clinical, patient care, financial, supply chain, and strategic management software solutions.

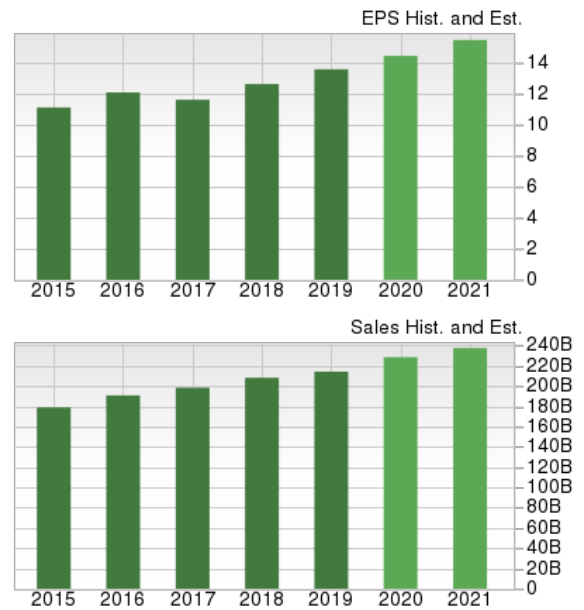
However, in the first quarter of fiscal 2019, McKesson reported revenues through three segments: U.S. Pharmaceutical and Specialty Solutions, European Pharmaceutical Solutions, Medical-Surgical Solutions.

Acquisitions

In Jan 2018, McKesson announced that it has completed the acquisition of RxCrossroads from CVS Health Corp. RxCrossroads is a provider of tailored services to pharmaceutical and biotechnology manufacturers. The transaction is valued at \$735 million and has been entirely funded by cash on hand. RxCrossroads will become part of McKesson's Specialty Health business. In Jun 2018, McKesson completed the acquisition of MSD for the net purchase consideration of \$784 million, which was funded from cash on hand.

FY19 at a Glance

Revenues in fiscal 2019 grossed \$214.32 billion, compared with \$208.36 billion a year ago. U.S. Pharmaceutical and Specialty Solutions (78% of net revenues), European Pharmaceutical Solutions (13%), Medical-Surgical Solutions (4%) and Other (5%).



Reasons To Buy:

- ▲ **Share Price Performance:** In the past year, shares of McKesson have gained 22.4% compared with the industry's rise of 3.1%. Meanwhile, the S&P 500 Index's rallied 25%.

Multi-year growth initiatives, acquisitions and strategic collaborations and strong position in the pharmaceutical and medical supplies distribution market bolster the company's prospects.

- ▲ **Multi-Year Growth Initiatives:** In recent times, McKesson announced a multi-year strategic growth initiative, focused on creating innovative new solutions that improve patient care delivery and drive incremental profit growth. The plan is to implement differential pricing for brand, generic, specialty, biosimilar and OTC (Over-the-counter) drug classes in line with services offered to both customers and manufacturers. In the previous quarter earnings call, McKesson announced a multi-year strategic growth initiative update that is currently expected to generate approximately \$400 million to \$500 million (up from the previously guided range of \$300-\$400 million) in annual pre-tax gross savings. This will be substantially realized by the end of fiscal 2021.

Management aims to increase efficiency, accelerate execution and improve long-term performance through its initiatives that consist of multiple growth pillars. In January 2019, Genpact extended its tie-up with the company wherein the former will deploy digitally-enabled advanced technologies such as Artificial Intelligence and machine learning to simplify and standardize McKesson's finance operations.

- ▲ **Strong Player in Distribution Market:** McKesson is a major player in the pharmaceutical and medical supplies distribution market.

The Distribution Solutions segment caters to a wide range of customers and businesses and stands to benefit from increased generic utilization, inflation in generics driven by several patent expirations in the next few years, and an aging population.

- ▲ During the fiscal second quarter, the company opened a new distribution center in the Seattle area – an eco-friendly facility boasting of the latest in supply chain technology and state-of-the-art automation.

It is encouraging to note that, in the fiscal fourth quarter 2019, Rite Aid renewed its 10-year distribution and sourcing relationship with McKesson, while pharmaceutical distribution relationship with CVS Health was renewed through June 2023.

Additionally, in the fiscal third quarter 2019, McKesson launched its Opioid Foundation that will focus on helping advance solutions to the U.S. opioid crisis. Per management, the company has contributed \$100 million toward building the foundation for opioid response efforts — a foundation dedicated entirely for driving solutions to the epidemic.

- ▲ **Acquisitions & Strategic Collaborations:** McKesson has been actively pursuing deals, divestitures and acquisitions to drive growth. Recently, MedTech bigwig, Cerner Corporation collaborated with McKesson's CoverMyMeds, a wholly-owned subsidiary of its Prescription Technology Solutions sub unit.

In June, QIAGEN inked an agreement with Medical-Surgical wherein the latter will serve as the exclusive distributor of QIAGEN's QIAstat-Dx syndromic testing solution in the acute market segment of U.S. hospitals, which have 200 beds or less. McKesson Medical-Surgical will also distribute the solution in other select segments.

In recent past, McKesson completed the acquisition of RxCrossroads from CVS Health Corp. RxCrossroads is a provider of tailored services to pharmaceutical and biotechnology manufacturers. The transaction is valued at \$735 million and has been entirely funded by cash on hand. McKesson had also acquired electronic prior authorization solutions provider to pharmacies, providers, payers and pharmaceutical manufacturers—CoverMyMeds.

During the third quarter, CoverMyMeds and RxCrossroads announced the launch of AMP (Access for More Patients), which is a first-in-class technology driven patient support solution that transforms how patients access afford and adhere to their medications.

- ▲ **Divestitures:** In an initiative to focus on core strength, McKesson's divested Enterprise Information segment in recent past. Notably, the Enterprise Information Solutions portfolio included a robust set of clinical and financial solutions supporting the full scope of care delivery processes — including Paragon (EHR solution); STAR and HealthQuest (Revenue Cycle solutions); Lab Analytics and Blood Bank; and OneContent (Content Management solutions).

- ▲ **Separating Technology Business:** In recent past, McKesson divested its Technology Solutions business and merged the same with Change Healthcare Holdings to form a new healthcare information technology entity.

The Technology Solutions business had been facing challenges for quite some time as revenues declined. Hence, in a bid to focus on its core distribution business, McKesson offered the majority of its Technology Solutions businesses to Change Healthcare but has retained RelayHealth Pharmacy and Enterprise Information Solutions (EIS). McKesson is currently holding 70% of the new company. Meanwhile, McKesson's Prescription Technology Solutions displayed strong performance in the fiscal first quarter. Per management, the company continues to make investments in this business, which in turn will position it well for future growth.

- ▲ **McKesson Canada Improves:** McKesson Canada plays a pivotal role in providing solutions to manufacturers, pharmacies and hospitals who serve the needs of patients in Canada every day. In the fiscal second quarter, the company witnessed growth in Canadian operations.

It is encouraging to note that the company made substantial progress in mitigating the impact of government-imposed generic pricing cuts throughout fiscal 2019. Moreover, the company has been witnessing better prescription trends in its owned Canadian retail business that represents the company's focus on the retail customer experience.

McKesson has been pursuing deals and acquisitions to drive growth. The company is a major player in the pharmaceutical and medical supplies distribution market.

Reasons To Sell:

▼ **Other Global Headwinds:** Per management, reimbursement and minimum wage headwinds impact the entire Canadian supply chain and retail pharmacy operations extensively. Similar headwinds prevail in the U.K., which have affected the company's fiscal 2019 performance. Moreover, the company apprehends that the hindrances will remain in the quarters ahead. In fact, the company's European Pharmaceutical Solutions revenues were \$6.59 billion in second-quarter fiscal 2020, down 0.6% on a year-over-year basis. The segment was impacted by challenging retail pharmacy environment in the U.K. The segment's adjusted operating profit declined 22.6% year over year to \$41 million.

Sluggish growth in the pharmaceutical distribution business is concerning. Global regulatory headwinds persist.

Management stated in the fiscal second-quarter earnings call that European Pharmaceutical Solutions is anticipated to deliver low single-digit percent growth in operating profit in fiscal 2020. The company estimates flat to low single-digit percent decline in revenues.

▼ **Escalating Pricing Pressure:** McKesson reaffirmed fiscal 2020 guidance of branded inflation in the mid-single digits. Additionally, during fiscal 2019, McKesson witnessed increased price competition in the independent retail pharmacy channel. The company continues to face intense competition for selling generic pharmaceuticals in the United States.

▼ **Weak Trends:** McKesson distributes generic pharmaceuticals, which are subject to price fluctuation. The Distribution Solutions segment had experienced weaker generic pharmaceutical pricing trends, which continue to persist. Continued volatility, unfavorable pricing trends, reimbursement of generic drugs, significant fluctuations in the nature, frequency and magnitude of generic pharmaceutical launches could have a material adverse impact on McKesson.

▼ **Stiff Competition:** Distribution Solutions faces stiff competition both in terms of price and service from various full-line, short-line and specialty wholesalers, service merchandisers, self-warehousing chains, manufacturers engaged in direct distribution, third-party logistics companies and large-payer organizations. Moreover, the company depends on fewer suppliers for its products. As a result, it is not in a position to negotiate pricing.

▼ Also, the prices for company's products and services may erode due to greater bargaining power of other healthcare enterprises. In addition, the company's Technology Solutions segment experiences substantial competition from many firms, including other software services firms, consulting firms, shared service vendors, certain hospitals and hospital groups, payers, care management organizations, hardware vendors and internet-based companies with technology applicable to the healthcare industry.

Last Earnings Report

McKesson Q2 Earnings Meet Estimates, Revenues Beat

McKesson Corporation reported second-quarter fiscal 2020 earnings of \$3.60 per share, which came matched the Zacks Consensus Estimate. Further, the bottom line remained flat on a year-over-year basis.

Revenues came in at \$57.62 billion, which surpassed the Zacks Consensus Estimate by 4.9% and improved 8.6% year over year.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	4.88%
EPS Surprise	0.00%
Quarterly EPS	3.60
Annual EPS (TTM)	14.00

Q2 Segmental Analysis

Revenues at the **U.S. Pharmaceutical and Specialty Solutions** segment totaled \$45.98 billion, up 10.5% year over year. Per management, the upside was primarily driven by branded pharmaceutical price increases and higher specialty pharmaceutical volume from the company's largest retail national account customer. However, branded to generic conversions partially offset the upside.

At the **European Pharmaceutical Solutions** segment, revenues amounted to \$6.59 billion, down 0.6% year over year. However, the metric rose 4% at constant currency (cc) on the back of market growth in the pharmaceutical distribution business.

Revenues at the **Medical-Surgical Solutions** segment totaled \$2.06 billion, up 5.5% year over year. Growth in the Primary Care business, on the back of higher volume of pharmaceutical products, drove the upside.

Revenues at the **Other** segment were \$2.98 billion in the fiscal second quarter, improving 3.6% year over year and 5% at cc. Growth in the Canadian and McKesson Prescription Technology Solutions (MRxTS) businesses contributed to the upside.

Margins

Gross profit in the reported quarter was \$2.86 billion, up 2.2% on a year-over-year basis. Meanwhile, gross margin was 4.9% of net revenues, down 40 bps.

Operating income in the quarter was \$626 million, which fell 9.1% from the year-ago quarter's figure of \$689 million.

The U.S. Pharmaceutical and Specialty Solutions segment reported adjusted operating profit of \$641 million up 0.9% from the prior-year quarter. Adjusted operating margin was 1.4% at the segment.

Adjusted operating profit at the European Pharmaceutical Solutions segment amounted to \$41 million, down 22.6% from the year-ago quarter. Meanwhile, the adjusted operating margin at the segment was 0.6%.

The Medical-Surgical segment had adjusted operating profit of \$166 million, which improved 20.3% from the year-ago quarter. Adjusted operating margin was 8.1% at the segment.

Adjusted operating profit was \$221 million at the Other segment, down 26.3% from the prior-year quarter reported figure.

Fiscal 2020 Guidance Reiterated

For fiscal 2020, McKesson projects adjusted earnings per share in the range of \$14-\$14.60.

Company Updates

On Oct 21, 2019, McKesson announced an agreement in principle to settle all claims against the company in the first track of the multi-district opioid litigation, related to two Ohio counties. Resultantly, McKesson recorded a pre-tax charge of \$82 million within operating expenses for the quarter under review.

The company opened a new distribution center in the Seattle area – an eco-friendly facility boasting of the latest in supply chain technology and state-of-the-art automation.

Financial Update

In the quarter under review, cash and cash equivalents came in at \$1.36 billion, down 30.4% sequentially.

Cash flow from operating activities as of Sep 30, 2019, came in at (\$159) million, against the year-ago quarter's reported figure of 318 million.

Valuation

McKesson's shares are up 8.9% and 22.4% in the year-to-date period and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and Zacks Medical Market are up 2.9% and 0.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 2.3% and 4.3%, respectively.

The S&P 500 index is up 1.9% and 24.7% in the year-to-date period and in the past year, respectively.

The stock is currently trading at 9.85X Forward 12-months earnings, which compares to 17.96X for the Zacks sub-industry, 21.44X for the Zacks sector and 19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.47X and as low as 7.78X, with a 5-year median of 11.68X.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$158 price target reflects 10.3X forward 12-months earnings.

The table below shows summary valuation data for MCK.

Valuation Multiples - MCK					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.85	17.96	21.44	19
	5-Year High	20.47	19.99	21.44	19.34
	5-Year Low	7.78	13.7	15.88	15.17
	5-Year Median	11.68	16.67	18.95	17.44
P/S F12M	Current	0.12	5.15	2.82	3.52
	5-Year High	0.3	5.92	3.81	3.52
	5-Year Low	0.1	3.63	2.42	2.54
	5-Year Median	0.16	4.8	2.93	3
P/B TTM	Current	4.06	4.55	4.5	4.49
	5-Year High	6.99	4.93	5.02	4.49
	5-Year Low	2.22	2.53	3.42	2.85
	5-Year Median	3.31	3.45	4.28	3.61

As of 01/14/2020

Industry Analysis Zacks Industry Rank: Top 46% (116 out of 254)



Top Peers

AmerisourceBergen Corporation (ABC)	Neutral
Option Care Health, Inc. (BIOS)	Neutral
Cardinal Health, Inc. (CAH)	Neutral
CVS Health Corporation (CVS)	Neutral
Henry Schein, Inc. (HSIC)	Neutral
Owens & Minor, Inc. (OMI)	Neutral
Thermo Fisher Scientific Inc. (TMO)	Neutral
Nu Skin Enterprises, Inc. (NUS)	Underperform

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	MCK Neutral	X Industry	S&P 500	ABC Neutral	CAH Neutral	TMO Neutral
VGM Score	A	-	-	A	C	B
Market Cap	27.15 B	1.56 B	24.31 B	18.29 B	15.34 B	133.45 B
# of Analysts	9	5	13	7	8	9
Dividend Yield	1.09%	0.00%	1.76%	1.80%	3.67%	0.23%
Value Score	A	-	-	A	A	C
Cash/Price	0.05	0.06	0.04	0.19	0.08	0.01
EV/EBITDA	8.94	11.57	14.12	11.88	7.06	26.87
PEG Ratio	1.48	2.05	2.05	1.59	1.69	1.96
Price/Book (P/B)	4.06	3.98	3.34	6.14	16.98	4.55
Price/Cash Flow (P/CF)	5.07	13.04	13.66	9.18	6.04	19.77
P/E (F1)	10.43	22.64	18.82	11.81	10.39	24.48
Price/Sales (P/S)	0.12	1.46	2.64	0.10	0.10	5.29
Earnings Yield	9.58%	3.94%	5.29%	8.47%	9.63%	4.09%
Debt/Equity	1.36	0.32	0.72	1.45	8.15	0.56
Cash Flow (\$/share)	29.73	1.80	6.94	9.67	8.69	16.84
Growth Score	B	-	-	A	D	B
Hist. EPS Growth (3-5 yrs)	4.30%	8.77%	10.56%	9.43%	3.56%	13.25%
Proj. EPS Growth (F1/F0)	6.40%	13.35%	7.49%	6.13%	-4.38%	10.29%
Curr. Cash Flow Growth	-1.89%	9.29%	14.83%	-0.05%	-0.80%	16.70%
Hist. Cash Flow Growth (3-5 yrs)	16.28%	12.65%	9.00%	12.37%	7.74%	17.85%
Current Ratio	1.01	1.72	1.23	0.95	1.05	1.80
Debt/Capital	61.05%	26.85%	42.99%	59.26%	89.07%	35.83%
Net Margin	-0.29%	3.65%	11.08%	0.48%	-2.81%	14.24%
Return on Equity	32.77%	15.73%	17.16%	48.84%	32.25%	17.16%
Sales/Assets	3.68	1.02	0.55	4.61	3.66	0.45
Proj. Sales Growth (F1/F0)	6.71%	5.42%	4.23%	5.92%	4.90%	5.77%
Momentum Score	A	-	-	C	F	B
Daily Price Chg	4.89%	0.00%	0.73%	3.11%	3.98%	0.23%
1 Week Price Chg	5.19%	1.82%	0.39%	3.61%	2.57%	1.83%
4 Week Price Chg	9.26%	2.17%	1.84%	6.83%	1.71%	4.07%
12 Week Price Chg	2.55%	7.97%	6.48%	3.22%	3.37%	18.44%
52 Week Price Chg	22.45%	13.41%	23.15%	14.98%	10.12%	41.33%
20 Day Average Volume	955,153	242,167	1,578,594	869,136	1,878,435	991,913
(F1) EPS Est 1 week change	1.90%	0.00%	0.00%	-0.19%	-0.05%	0.05%
(F1) EPS Est 4 week change	1.93%	0.00%	0.00%	-0.19%	-0.05%	0.04%
(F1) EPS Est 12 week change	1.99%	-0.32%	-0.48%	-0.64%	1.20%	0.28%
(Q1) EPS Est Mthly Chg	0.11%	0.00%	0.00%	1.40%	-1.15%	-0.56%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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