

McKesson Corporation (MCK)

\$149.19 (As of 05/26/20)

Price Target (6-12 Months): **\$157.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 11/24/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: F

Summary

McKesson exited the fiscal fourth quarter on a strong note, wherein both earnings and revenues beat their respective consensus marks. Strong fiscal fourth-quarter show by all the segments instills investor optimism in the stock. Further, management continues to remain optimistic about the McKesson and Walgreens Boots Alliance agreement to form a JV that is anticipated to combine their respective pharmaceutical wholesale businesses in Germany. Strong fiscal 2021 outlook also buoys optimism. On Mar 10, 2020, McKesson completed the separation of its investment in Change Healthcare. The company outperformed the industry in a year's time. However, contraction in gross margin adds to woes. Price fluctuation of generic pharmaceuticals and stiff competition in the MedTech space remain concerns.

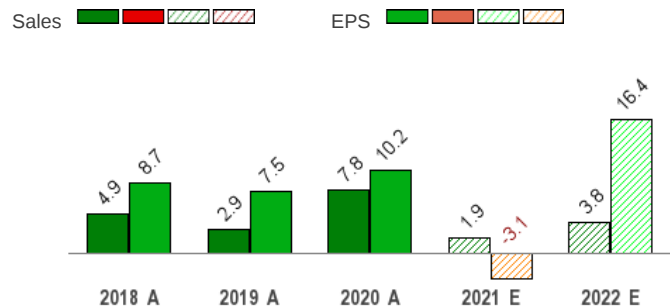
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$172.18 - \$112.60
20 Day Average Volume (sh)	1,543,751
Market Cap	\$26.4 B
YTD Price Change	7.9%
Beta	0.82
Dividend / Div Yld	\$1.64 / 1.1%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Bottom 33% (169 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.2%
Last Sales Surprise	5.6%
EPS F1 Est- 4 week change	-6.6%
Expected Report Date	07/29/2020
Earnings ESP	-5.7%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	57,135 E	59,966 E	63,832 E	61,559 E	244,280 E
2021	54,418 E	58,299 E	61,833 E	58,924 E	235,393 E
2020	55,728 A	57,616 A	59,172 A	58,535 A	231,051 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$3.38 E	\$4.01 E	\$4.43 E	\$4.97 E	\$16.86 E
2021	\$2.44 E	\$3.30 E	\$4.11 E	\$4.57 E	\$14.49 E
2020	\$3.31 A	\$3.60 A	\$3.81 A	\$4.27 A	\$14.95 A

*Quarterly figures may not add up to annual.

P/E TTM	10.0
P/E F1	10.4
PEG F1	1.5
P/S TTM	0.1

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/26/2020. The reports text is as of 05/27/2020.

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.

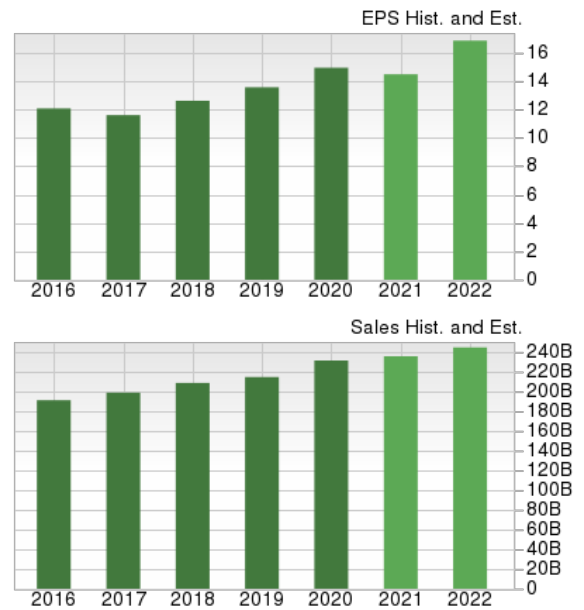
However, in the first quarter of fiscal 2019, McKesson reported revenues through three segments: U.S. Pharmaceutical and Specialty Solutions, European Pharmaceutical Solutions, Medical-Surgical Solutions.

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.

FY20 at a Glance

Revenues in fiscal 2020 grossed \$231.05 billion, compared with \$214.31 billion a year ago. U.S. Pharmaceutical and Specialty Solutions (79% of net revenues), European Pharmaceutical Solutions (12%), Medical-Surgical Solutions (4%) and Other (4%).



Reasons To Buy:

▲ **Share Price Performance:** In the past year, shares of McKesson have gained 14.7% against the industry's decline of 11.8%. Multi-year growth initiatives, acquisitions and strategic collaborations and strong position in the pharmaceutical and medical supplies distribution market buoy 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. As discussed in the fiscal fourth-quarter earnings call, McKesson is on track when it comes to its multi-year strategic growth initiative update that is currently expected to generate approximately \$400 million to \$500 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.

▲ **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 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 fiscal 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.

On Dec 12, 2019, McKesson and Walgreens Boots Alliance announced an agreement to form a joint venture (JV) that is anticipated to combine their respective pharmaceutical wholesale businesses in Germany.

▲ **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).

Notably, on February 4, 2020, McKesson's wholly-owned subsidiary, PF2 SpinCo, Inc., filed a registration statement with the Securities and Exchange Commission (SEC) with regards to a potential exit of the company from its investment in the Change Healthcare JV.

▲ **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.

On Mar 10, 2020, McKesson completed the separation of its investment in Change Healthcare.

▲ **McKesson Canada Improves:** McKesson Canada plays a crucial role in providing solutions to manufacturers, pharmacies and hospitals, which cater to the needs of patients in Canada every day. In the fiscal fourth quarter, the company witnessed growth in Canadian operations.

Additionally, McKesson Canada also has broad specialty assets and capabilities. The company is also well-positioned to participate in the growth of specialty in the Canadian market. In Canada, the company's retail pharmacies have remained open, thereby offering the essential

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

community-based care that its customers bank upon. Moreover, the company is expanding its pharmacy services to include virtual health offerings, home delivery in certain markets, and increased online pharmacy capabilities.

▲ **Stable Liquidity Position:** McKesson exited fiscal fourth quarter with cash and cash equivalents of \$4.02 billion, up from \$2.07 billion sequentially. The company's long-term debt came in at \$6.34 billion in the quarter under review, which declined from \$8.51 billion on a sequential basis. Although, the quarter's long-term debt is much higher than the corresponding cash and cash equivalent level, the current-year debt is at \$1.05 billion, down from \$3.48 billion from the previous quarter, is considerably lower than the short-term cash level. This is good news in terms of the company's solvency level as, at least during the year of economic downturn, the company is holding sufficient cash for debt repayment.

The company's cash flow trends remain robust with cumulative cash flow from operating activities for the fiscal fourth quarter came in at \$4.37 billion, up from \$4.04 billion in the year-ago period. McKesson's capital deployment policy is based on the return of shareholders' money through share repurchases and dividends. The company returned \$2.2 billion to its shareholders in the form of share buybacks and dividends in fiscal 2020. Further, the current payout ratio is at a low level of 10.8%, indicating sustainability of its current dividend payment.

Reasons To Sell:

▼ **Other Global Headwinds:** Management stated in the fiscal fourth-quarter 2020 earnings call that revenues in the European Pharmaceutical Solutions are anticipated to be flat or decline within a 5% range in 2021 compared with the previous year. Adjusted operating is also estimated to fall in the range of 20-25% attributable to expected impact of the COVID-19 pandemic on customer behavior patterns over the first half of the fiscal year. Moving on to Medical-Surgical segment, the company projects a decline in revenues in the band of 3-8%, primarily due to weakened demand in the first half of the fiscal year. Also, adjusted operating profit is expected to fall between 10-20% in 2021.

For the remaining businesses included in Other, revenues are estimated to decrease around 7-12% owing to anticipated lower foot traffic in retail stores across Canada in the short-term and lower prior authorization volumes.

Also, the company anticipates the impact of foreign currency exchange rate movements to result in a net unfavorable impact of about 5 cents. Further, the company expects adjusted earnings per share to decline sharply on a year-over-year and sequential basis in first-quarter fiscal 2021.

▼ **Escalating Pricing Pressure:** In the U.S. market, the company continues to estimate mid-single-digit branded pharmaceutical price increases, largely in line with its experience in fiscal 2020. 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.

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

Last Earnings Report

McKesson Q4 Earnings and Revenues Surpass Estimates

McKesson Corporation's reported fourth-quarter fiscal 2020 adjusted earnings per share of \$4.27, which beat the Zacks Consensus Estimate of \$4.10 per share by 4.1%. Further, the bottom line improved 15.7% on a year-over-year basis.

For full-year fiscal 2020, the company reported adjusted EPS of \$14.95, up 10.2% from the prior-year period. The figure beat the consensus mark by 1.3%.

Quarter Ending **03/2020**

Report Date	May 20, 2020
Sales Surprise	5.62%
EPS Surprise	4.15%
Quarterly EPS	4.27
Annual EPS (TTM)	14.99

Revenue Details

Revenues came in at \$58.54 billion, which outpaced the Zacks Consensus Estimate by 5.6%. However, the figure improved 11.6% year over year.

For full-year fiscal 2020, the company delivered revenues of \$231.05 billion, up 7.8% from that of fiscal 2019. The figure surpassed the Zacks Consensus Estimate by 1.3%.

Q4 Segmental Analysis

Revenues at the U.S. Pharmaceutical and Specialty Solutions segment totaled \$46.27 billion, up 13.1% year over year. Per management, the upside was primarily driven by branded pharmaceutical price increases and higher volumes from retail national account customers. However, branded to generic conversions partially offset the upside.

At the European Pharmaceutical Solutions segment, revenues amounted to \$7.15 billion, up 5.8% year over year. Further, the metric increased 9% at constant currency (cc) on the back of growth in the pharmaceutical distribution business.

Revenues at the Medical-Surgical Solutions segment totaled \$2.21 billion, up 12.8% year over year. Growth in the Primary Care business, courtesy of higher volume of pharmaceutical products and a stronger influenza season, drove the upside.

Revenues at the Other segment were \$2.91 billion in the fiscal fourth quarter, improving 3% year over year and 4% at cc. Growth in the Canadian and MRxTS businesses contributed to the upside.

Margins

Gross profit in the reported quarter was \$3.34 billion, up 4.2% on a year-over-year basis. Meanwhile, gross margin was 5.7% of net revenues, down 40 bps.

Operating income in the quarter was \$869 million, against the year-ago quarter's operating loss of \$569 million.

The U.S. Pharmaceutical and Specialty Solutions segment reported adjusted operating profit of \$772 million, up 3% from the prior-year quarter. Adjusted operating margin was 1.7% at the segment.

Adjusted operating profit at the European Pharmaceutical Solutions segment amounted to \$75 million, soared 226% from the year-ago quarter. Meanwhile, the adjusted operating margin at the segment was 1.1%.

The Medical-Surgical segment had adjusted operating profit of \$170 million, which declined 1% from the year-ago quarter. Adjusted operating margin was 7.7% at the segment.

Adjusted operating profit was \$242 million at the Other segment, down 6% from the prior-year quarter.

Financial Update

In the quarter under review, cash and cash equivalents came in at \$4.02 billion, up 34.7% from the prior-year quarter.

Cumulative cash flow from operating activities for the fiscal fourth quarter came in at \$4.37 billion, up from \$4.04 billion in the year-ago period.

Fiscal 2021 Guidance

Per management, the fiscal 2021 guidance reflects the impact of COVID-19 pandemic and investments.

For fiscal 2021, McKesson projects adjusted earnings per share in the range of \$13.95-\$14.75. The Zacks Consensus Estimate for the same is pegged at \$15.10.

The company projects revenues to grow in the range of 2-4%.

Free cash flow is estimate to range between \$2.3 billion and \$2.7 billion.

The company anticipates adjusted earnings per share growth in the second half of fiscal 2021.

Per management, long-term fundamentals remain robust and the company continues to execute strategic growth initiatives.

Company Update

On Mar 10, 2020, McKesson completed the separation of its investment in Change Healthcare.

Valuation

McKesson's shares are up 7.9% and 14.7% in the year-to-date period and the trailing 12-month periods, respectively. Stocks in the Zacks sub-industry and Zacks Medical Market are down 4.3% and 2.4% in the year-to-date period, respectively. Over the past year, the stocks in the Zacks sub-industry are down 11.8% while that in the sector are up 3.4%.

The S&P 500 index is down 8.1% in the year-to-date period while up 5.3% in the past year.

The stock is currently trading at 9.9X Forward 12-months earnings, which compares to 18.3X for the Zacks sub-industry, 22.7X for the Zacks sector and 21.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 18.5X and as low as 7.3X, with a 5-year median of 11.3X.

Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$157 price target reflects 10.4X 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	9.89	18.27	22.66	21.5
	5-Year High	18.46	19.08	22.66	21.5
	5-Year Low	7.31	13.7	15.93	15.23
	5-Year Median	11.28	16.56	19	17.49
P/S F12M	Current	0.11	0.33	2.74	3.33
	5-Year High	0.29	0.36	3.76	3.44
	5-Year Low	0.09	0.23	2.21	2.53
	5-Year Median	0.15	0.28	2.92	3.01
P/B TTM	Current	4.97	4.23	4	4.04
	5-Year High	6.89	4.72	5.06	4.56
	5-Year Low	2.22	2.53	2.93	2.83
	5-Year Median	3.31	3.45	4.29	3.65

As of 05/26/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (169 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
AmerisourceBergen Corporation (ABC)	Neutral	3
Cardinal Health, Inc. (CAH)	Neutral	3
CVS Health Corporation (CVS)	Neutral	2
Henry Schein, Inc. (HSIC)	Neutral	4
Nu Skin Enterprises, Inc. (NUS)	Neutral	2
OwensMinor, Inc. (OMI)	Neutral	2
Thermo Fisher Scientific Inc. (TMO)	Neutral	4
Walgreens Boots Alliance, Inc. (WBA)	Neutral	3

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	MCK	X Industry	S&P 500	ABC	CAH	TMO
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	3	3	4
VGM Score	A	-	-	A	A	C
Market Cap	26.40 B	1.81 B	21.18 B	18.46 B	15.36 B	131.35 B
# of Analysts	9	5	14	7	8	9
Dividend Yield	1.10%	0.00%	2.03%	1.85%	3.66%	0.26%
Value Score	A	-	-	A	A	D
Cash/Price	0.15	0.06	0.06	0.19	0.15	0.02
EV/EBITDA	12.38	13.27	12.37	11.34	6.50	21.02
PEG Ratio	1.51	3.47	2.88	1.71	2.28	2.23
Price/Book (P/B)	4.97	4.27	2.90	4.98	12.73	4.60
Price/Cash Flow (P/CF)	6.99	14.68	11.55	9.39	6.06	18.39
P/E (F1)	10.65	28.00	21.24	12.18	9.92	27.90
Price/Sales (P/S)	0.11	2.21	2.24	0.10	0.10	5.12
Earnings Yield	9.62%	2.64%	4.57%	8.21%	10.08%	3.58%
Debt/Equity	1.51	0.33	0.76	0.98	5.60	0.67
Cash Flow (\$/share)	21.35	1.35	6.96	9.67	8.69	18.08
Growth Score	A	-	-	A	A	C
Hist. EPS Growth (3-5 yrs)	4.28%	10.40%	10.87%	8.82%	2.16%	13.78%
Proj. EPS Growth (F1/F0)	-4.05%	-2.97%	-10.31%	5.12%	0.43%	-3.48%
Curr. Cash Flow Growth	-33.76%	3.15%	5.46%	-0.05%	-0.80%	6.99%
Hist. Cash Flow Growth (3-5 yrs)	-0.50%	12.23%	8.55%	12.37%	7.74%	10.08%
Current Ratio	0.99	1.63	1.29	0.97	1.05	2.32
Debt/Capital	63.90%	30.33%	44.54%	49.44%	84.85%	40.24%
Net Margin	0.39%	2.12%	10.59%	0.85%	-2.71%	14.31%
Return on Equity	41.07%	15.11%	16.29%	48.85%	69.23%	17.25%
Sales/Assets	3.81	1.07	0.55	4.66	3.78	0.44
Proj. Sales Growth (F1/F0)	1.32%	0.00%	-2.34%	3.76%	4.96%	-0.99%
Momentum Score	F	-	-	A	A	A
Daily Price Chg	-0.15%	0.00%	2.82%	-2.53%	-1.85%	-2.26%
1 Week Price Chg	9.51%	8.57%	4.99%	8.62%	9.48%	-0.78%
4 Week Price Chg	6.29%	3.70%	3.55%	1.40%	2.24%	0.03%
12 Week Price Chg	0.94%	-1.54%	-4.95%	5.72%	-0.68%	7.16%
52 Week Price Chg	14.67%	-2.08%	-3.04%	12.23%	15.65%	24.85%
20 Day Average Volume	1,543,751	440,111	2,429,758	1,316,158	2,708,942	1,397,989
(F1) EPS Est 1 week change	-5.80%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-6.63%	-5.03%	-2.27%	0.69%	0.70%	0.36%
(F1) EPS Est 12 week change	-9.43%	-22.61%	-16.39%	-3.12%	-1.15%	-12.41%
(Q1) EPS Est Mthly Chg	-23.14%	-20.78%	-4.03%	-10.94%	-14.53%	1.79%

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	A
Momentum Score	F
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.

Disclosures

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