



MCKESSON

Empowering Healthcare

MALARKEY CAPITAL MANAGEMENT

SEPTEMBER 30TH, 2016

Overview

Headquarters: San Francisco, CA

Medical Distribution Industry

Market Cap: 38 Billion

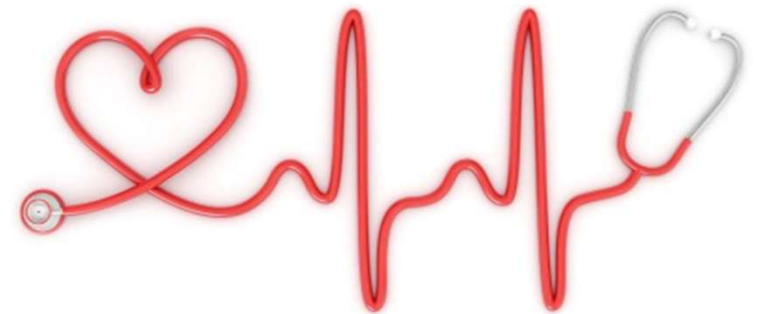
Today's Price: \$166.43

Return on Equity & Return on Capital: >15%

Price/Earnings Ratio: 17x

Price/Owners Earnings Ratio: 14.5x

PEG Ratio: 1.13



History

1833 - Founded by John McKesson in New York City as a drug wholesaler

1855 - Became one of the first wholesale firms to manufacture drugs

1900s - Became the largest wholesaler of pharmaceutical drugs after buying several competing wholesalers

1960s - Became Foremost-McKesson Inc. after merging with the Foremost Dairies

1990s - Focus shifts to health care specifically and acquires General Medical, the largest distributor of medical-surgical supplies.

1993 - Founded Acumax, a barcode warehouse management solution.

2010 - Acquired US Oncology, becoming the second-largest specialty company

2013 - Announced CommonWell Health Alliance, an effort among health IT suppliers to support universal access to health care data

2014 - Acquired Celesio, which made McKesson the 11th largest company on the Fortune 500



Acquisitions

- ▶ 2016
 - ▶ Biologics, Inc. (Services to providers and patients, solutions to manufacturers and payers)
 - ▶ TBD - Rexall Health (470 Canadian Pharmacies)
- ▶ 2014
 - ▶ Celesio (International Distribution)
- ▶ 2013
 - ▶ PSS World Medical, Inc. (Medical-Surgical Distribution)



Business

MC





What Do We Do?

- ▶ Global pharmaceutical distribution services and information technology
- ▶ Deliver a comprehensive offering of pharmaceuticals and medical supplies as well as technological services
- ▶ Work with payers, healthcare providers, pharmacies, pharmaceutical companies and others across the healthcare industry

Business Segments

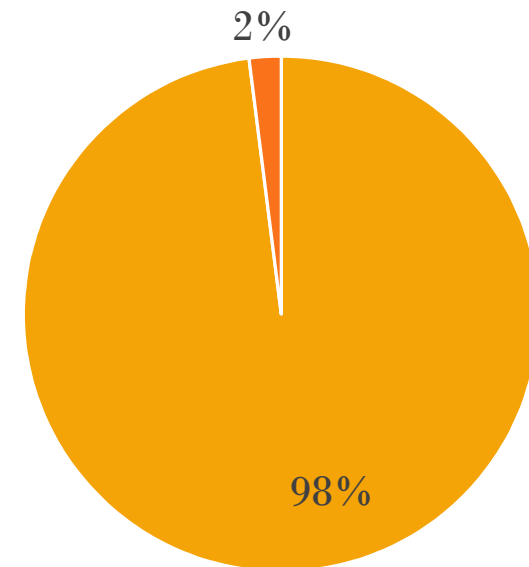
▶ Distribution Solutions

- ▶ Branded and generic pharmaceutical drugs
- ▶ Medical and surgical supply equipment
- ▶ Inventory Management

Technology Solutions

- ▶ Hospital/Clinical services
- ▶ Patient Care
- ▶ Financial
- ▶ Supply Chain Management

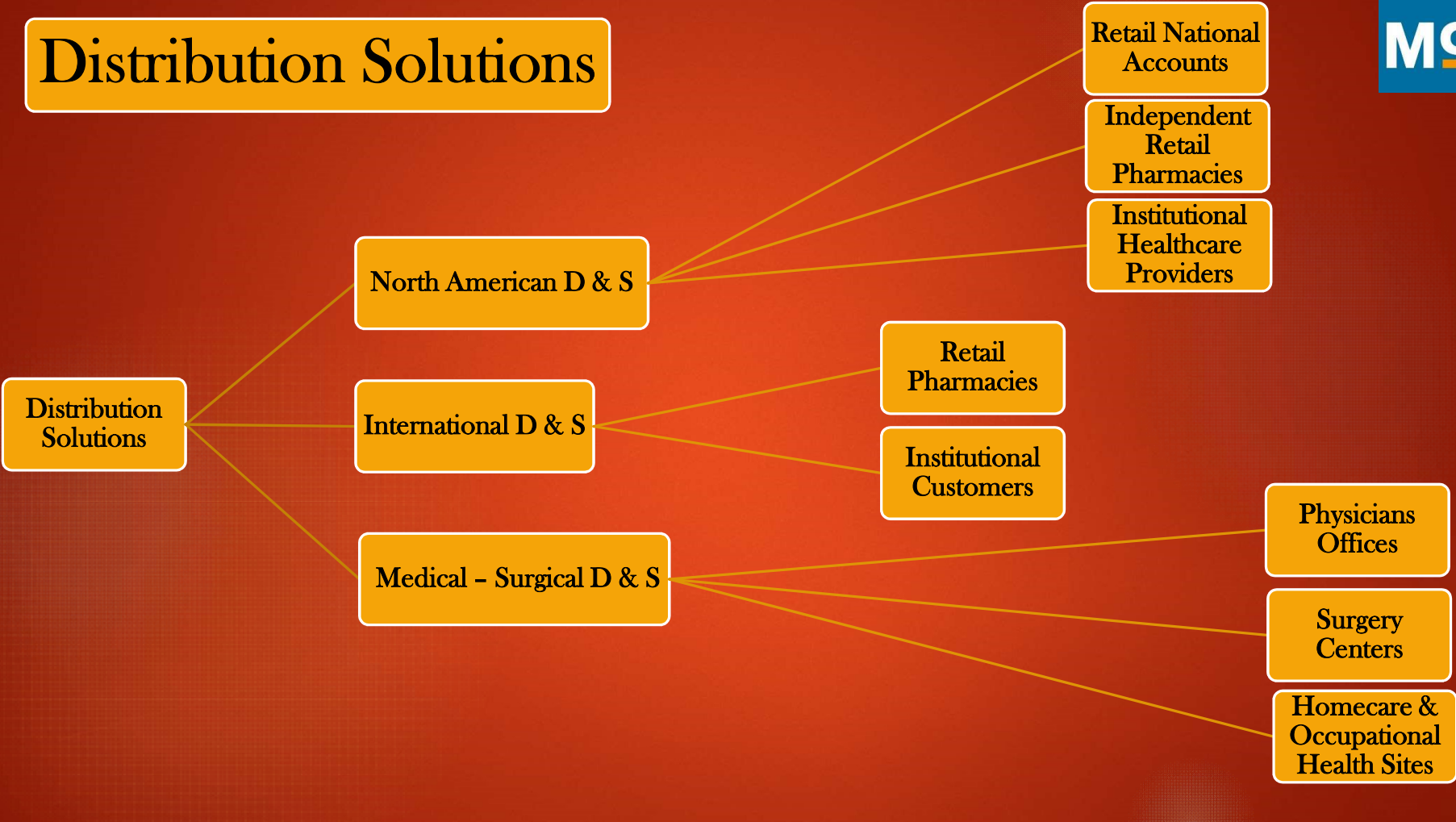
Revenue



■ Distribution Solutions ■ Technology Solutions



Distribution Solutions





Distribution Solutions Customers

**Retail National
Accounts**

**Independent Retail
Pharmacies**

**Institutional
Healthcare Providers**

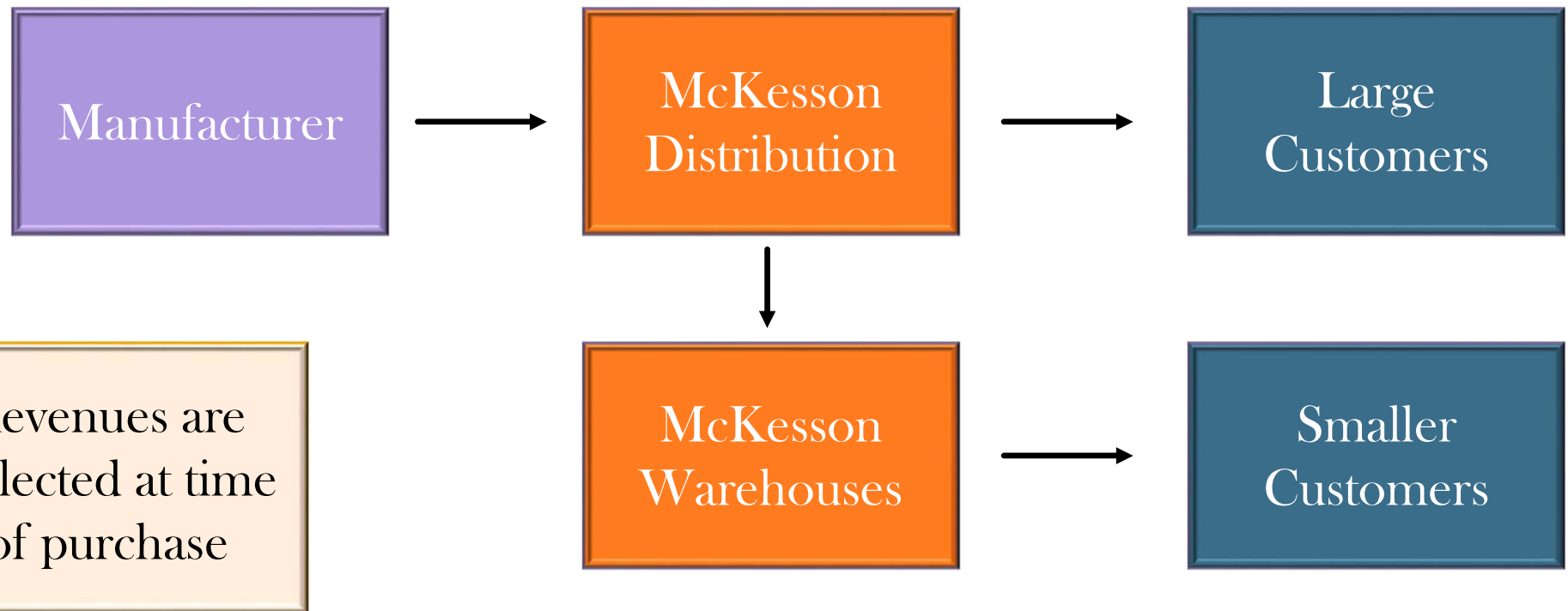
**Central Fill™
Redistribution Centers
McKesson SynerGx®**

**HealthMart®
McKesson OneStop
Generics®**

**Fulfill-Rx
Asset Management**



How Do We Make Money? (Distribution Solutions)



Technology Solutions

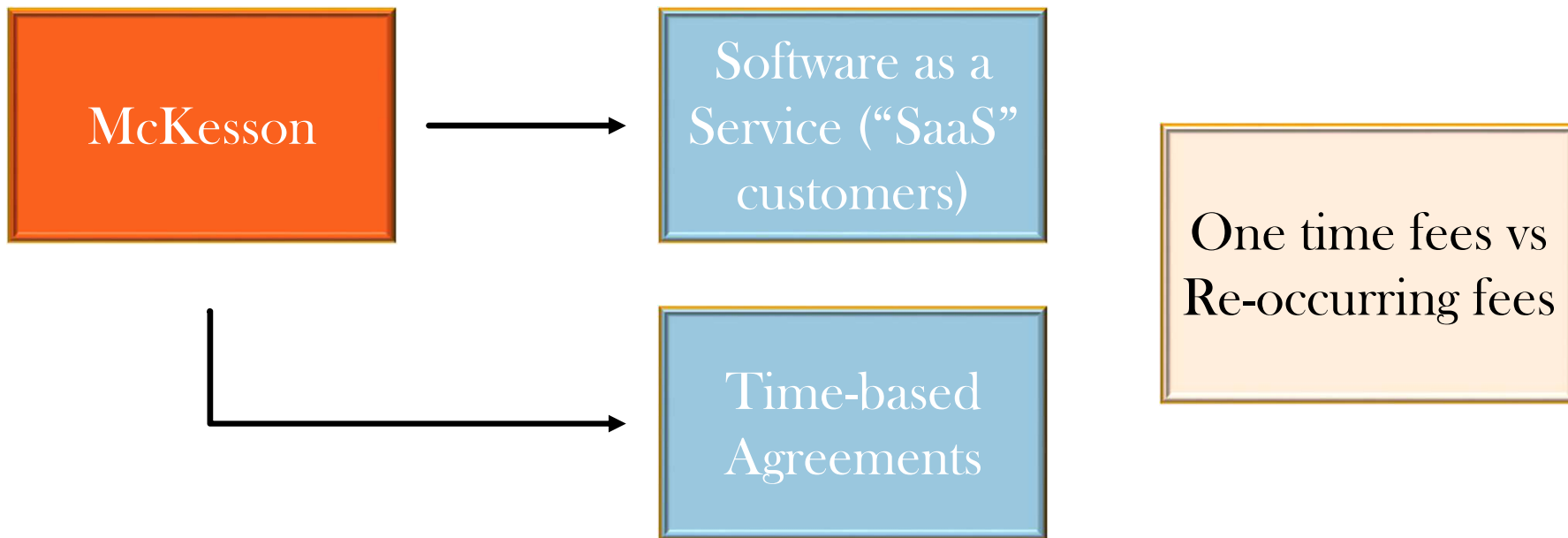




Technology Solutions Merger

- ▶ June 28, 2016 McKesson and Change HealthCare announced a merger agreement
 - ▶ 70% of McKesson Technology Solutions
 - ▶ 100% of Change HealthCare
- ▶ New company expected to produce \$4 Billion in annual revenues
 - ▶ McKesson owns 70%
 - ▶ Change HealthCare owns 30%

How Do We Make Money? (Technology Solutions)



Economic Moat





Economic Moat

- ▶ Operate in a Duopoly
- ▶ Market Share
 - ▶ McKesson, Cardinal Health, and AmerisourceBergen have 90% market share
- ▶ Size and Scale
- ▶ Distribution Network
 - ▶ Largest percentage of small pharmacies in North America



Risk Factors



Risk Factors

- ▶ Changes in United States and Canadian HealthCare System
 - ▶ Reforms
 - ▶ Government Caps on Markup Price
- ▶ Pricing Transparency
- ▶ Industry Consolidation



Buffettology

Qualitative Review



What type of business is this: commodity or sustained competitive advantage?	Sustained Competitive Advantage
Can you easily explain what the business does?	Yes
Is it heavily unionized?	There is a union presence
Does it require heavy capital infusion?	No
Does it require lots of R&D?	No
Can inventory become obsolete?	Yes
Are there chronic “one-time” write-offs?	No
Is the company able to raise its prices to offset inflation?	No
Will the company be able to sell more in the future?	Yes
If I gave you \$1 billion could you develop a competitor?	No

Interpretation of Financial Statements

<u>TTM</u>	<u>Value</u>	<u>Threshold</u>	<u>Ruling</u>
Gross Profit Margin	5.98%	≥ 20%	Fail
SGA % of GP	63.73%	≤ 80%	Pass
R&D % of GP	3.43%	≤ 10%	Pass
Depreciation % of GP	2.46%	≤ 10%	Pass
Interest % of OP	9.96%	≤ 15%	Pass
Net Profit Margin	1.18%	≥ 10%	Fail
Current Ratio	1.10	≥ 1	Pass
Obligation Ratio	1.41 years	< 5 years	Pass
Adj. Debt to Shareholder Equity	0.65	< 0.8	Pass
Return on Equity	26.68%	≥ 15%	Pass
Return on Capital	19.88%	≥ 15%	Pass
Dividend Payout Ratio	11%	≤ 60%	Pass
Preferred Stock	None	None	Pass
CAPEX/Net Income	29%	≤ 25%	Fail
Net Earning Trend	Increasing	Increasing	Pass
Retained Earnings Trend	Increasing	Increasing	Pass

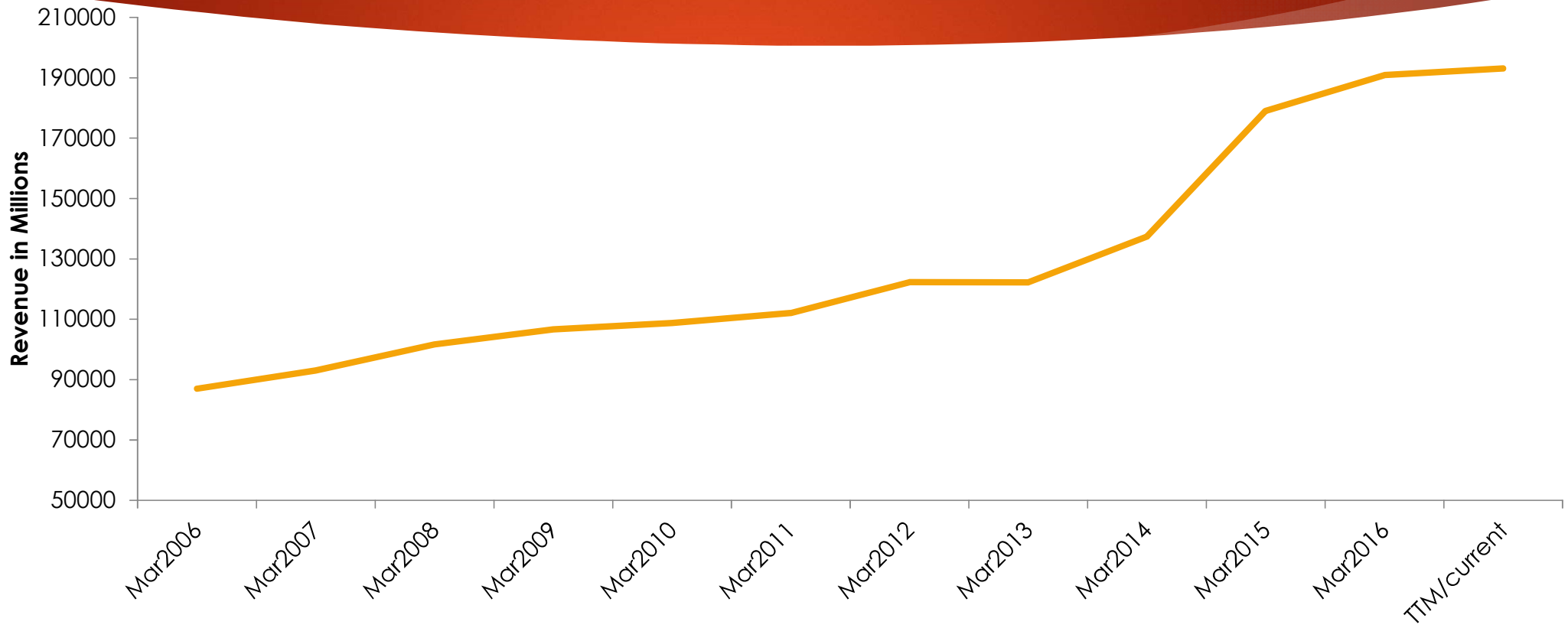
Historical Trend Analysis



Metric	Ruling
Sales per Share	Increasing
Cash flows per Share	Increasing
Earnings per Share	Increasing
Dividends Declared per Share	Increasing
Book Value per Share	Increasing
Revenues	Increasing
Gross Profit Margin	Increasing
Operating Profit Margin	Increasing
Net Profit	Increasing
Net Profit Margin	Increasing
Working Capital	Increasing
Return on Total Capital	Increasing
Return on Shareholder's Equity	Increasing
Common Shares Outstanding	Decreasing
Long Term Debt	Increasing
LTD Payable in 5 years	Yes
All Dividends to Net Profit under 60%	Yes

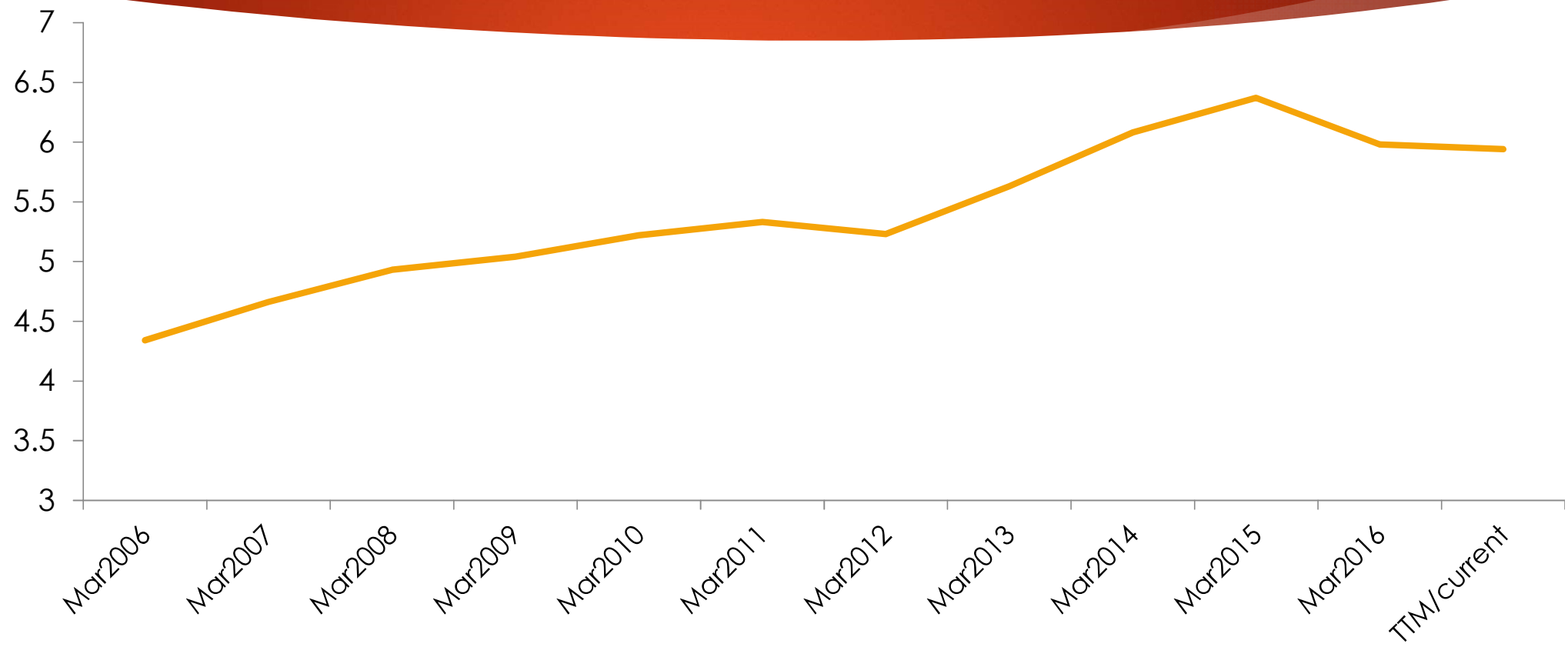


Revenues



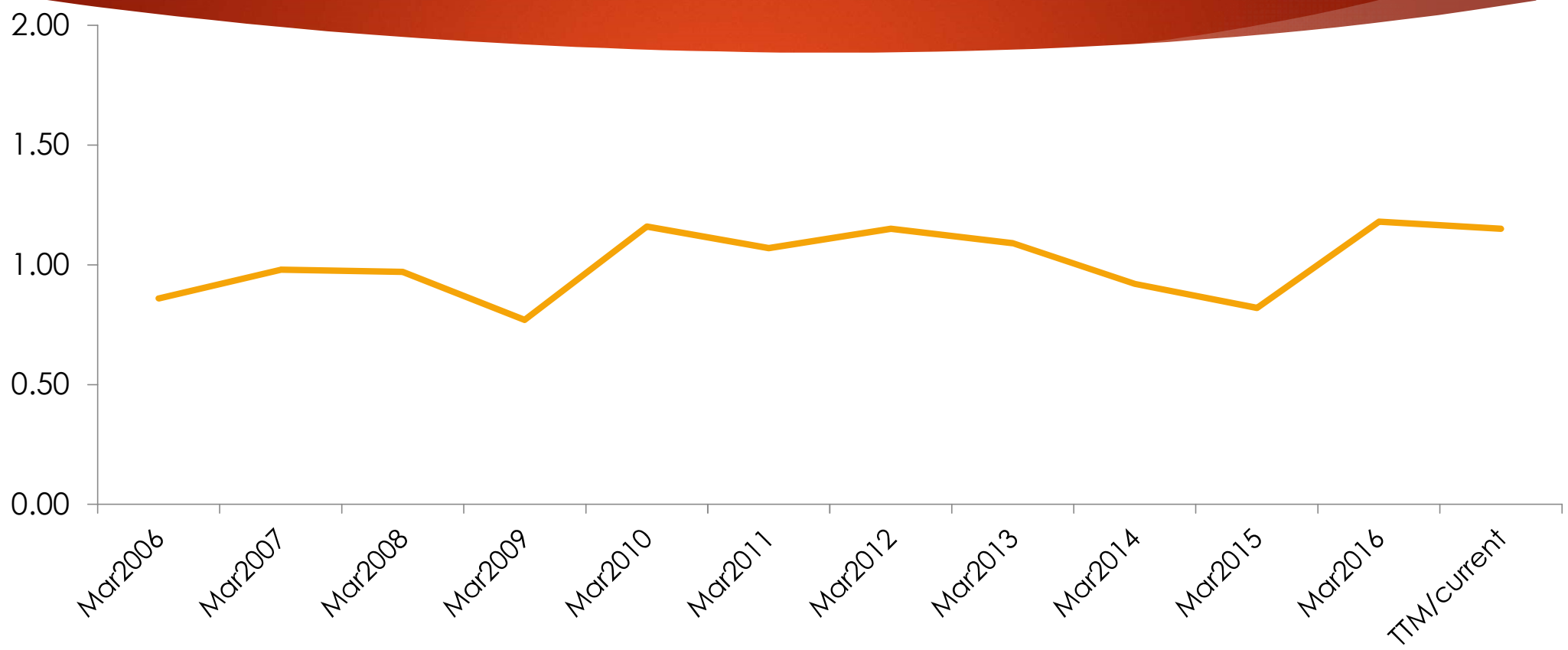


Gross Profit Margin



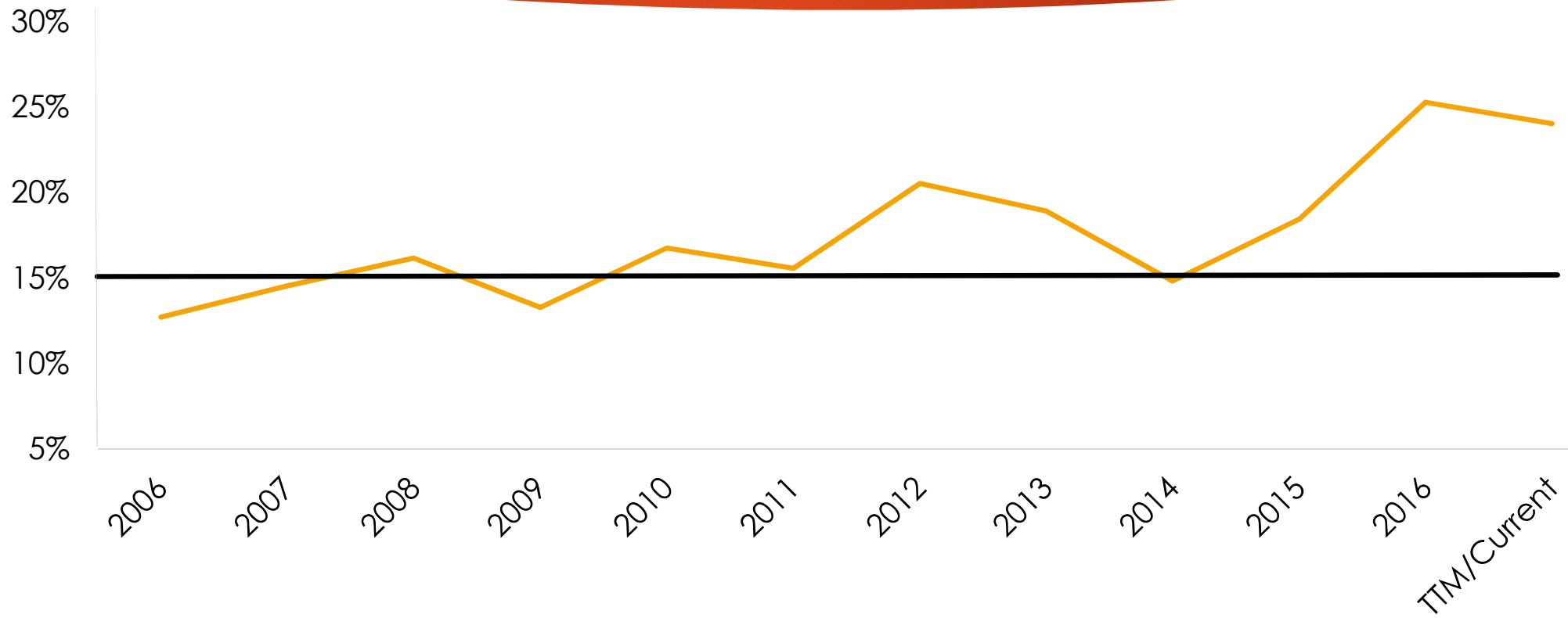


Net Profit Margin



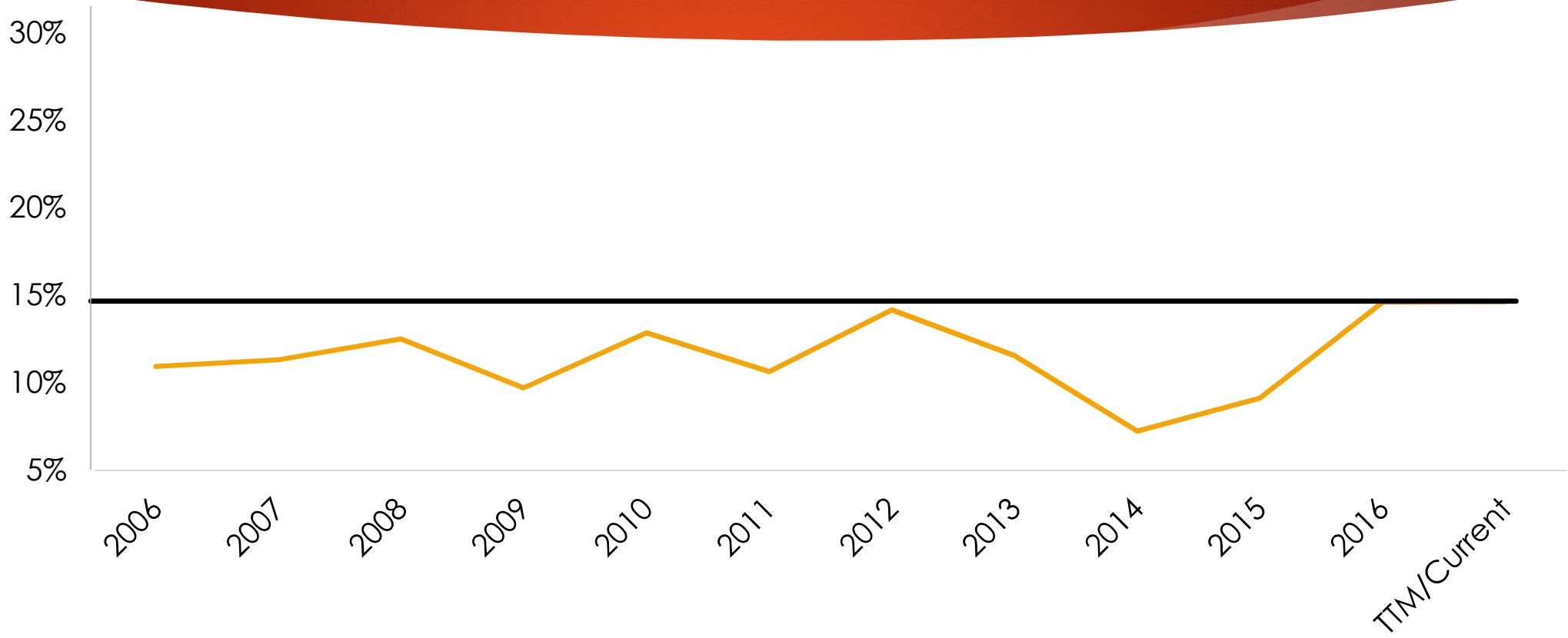


Return on Equity



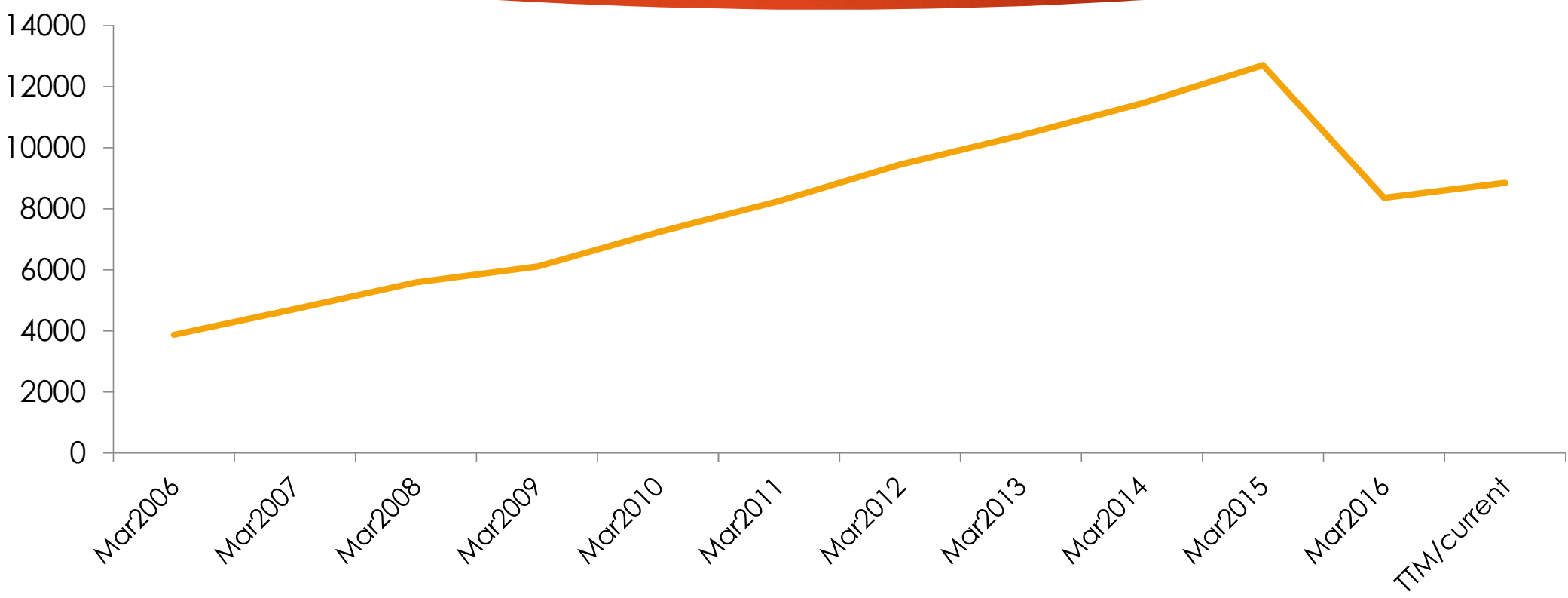


Return on Capital



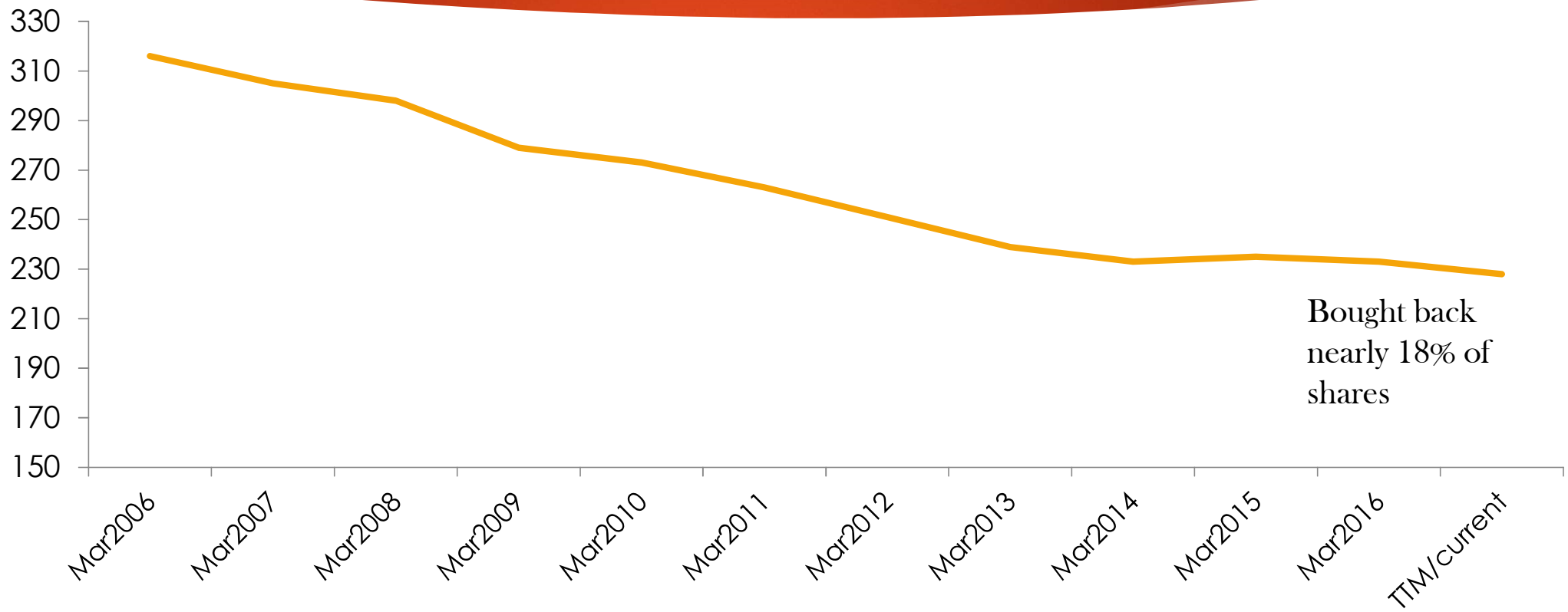


Retained Earnings





Shares Outstanding

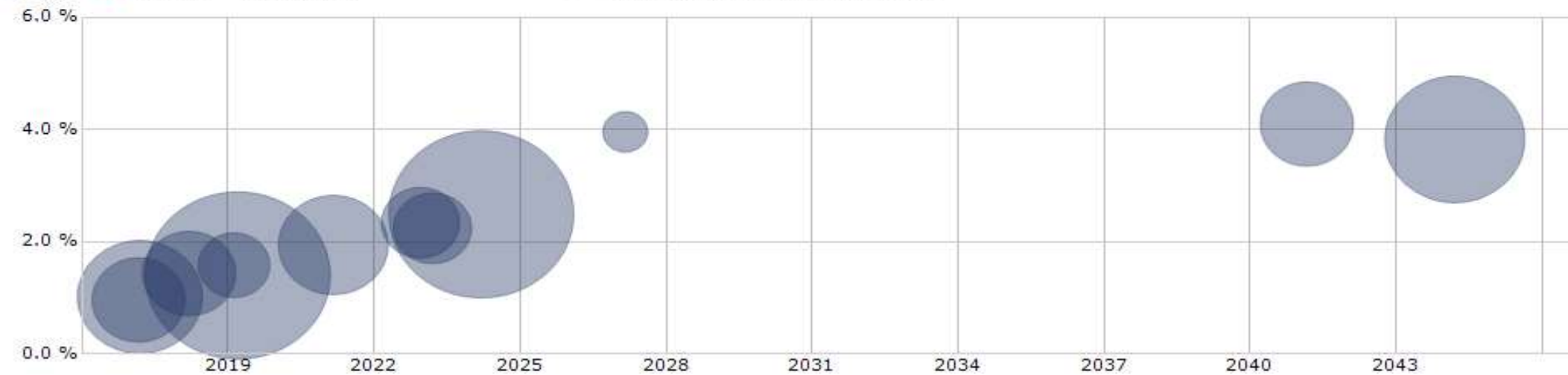


Bought back
nearly 18% of
shares

Yield to Maturity

● Debt ● Preferred ● Convertible

● ● ● Circle size determined by issue amount



Name	Maturity Date	Amount \$(Mil)	Credit Quality	Price	Coupon %	Coupon Type (Fixed/Floating)	Callable	Rule 144A	Yield to Maturity %
Mckesson Corp New 5.7%	03/01/2017	500.0	---	102.0	5.700	Fixed	No	No	0.96
Mckesson Corp New 1.292%	03/10/2017	700.0	---	100.1	1.292	Fixed	No	No	1.01
Mckesson 1.4%	03/15/2018	500.0	---	100.0	1.400	Fixed	No	No	1.43
Mckesson Corp New 7.5%	02/15/2019	350.0	---	114.0	7.500	Fixed	No	No	1.58
Mckesson Corp New 2.284%	03/15/2019	1,100.0	---	102.1	2.284	Fixed	No	No	1.39
Mckesson 4.75%	03/01/2021	600.0	---	111.9	4.750	Fixed	No	No	1.94
Mckesson Corp New 2.7%	12/15/2022	400.0	---	102.1	2.700	Fixed	No	No	2.33
Mckesson 2.85%	03/15/2023	400.0	---	103.7	2.850	Fixed	No	No	2.24
Mckesson Corp New 3.796%	03/15/2024	1,100.0	---	108.9	3.796	Fixed	No	No	2.48
Per-Se Tech Cv 3.25%	06/30/2024	125.0	---	---	3.250	Fixed	No	No	---

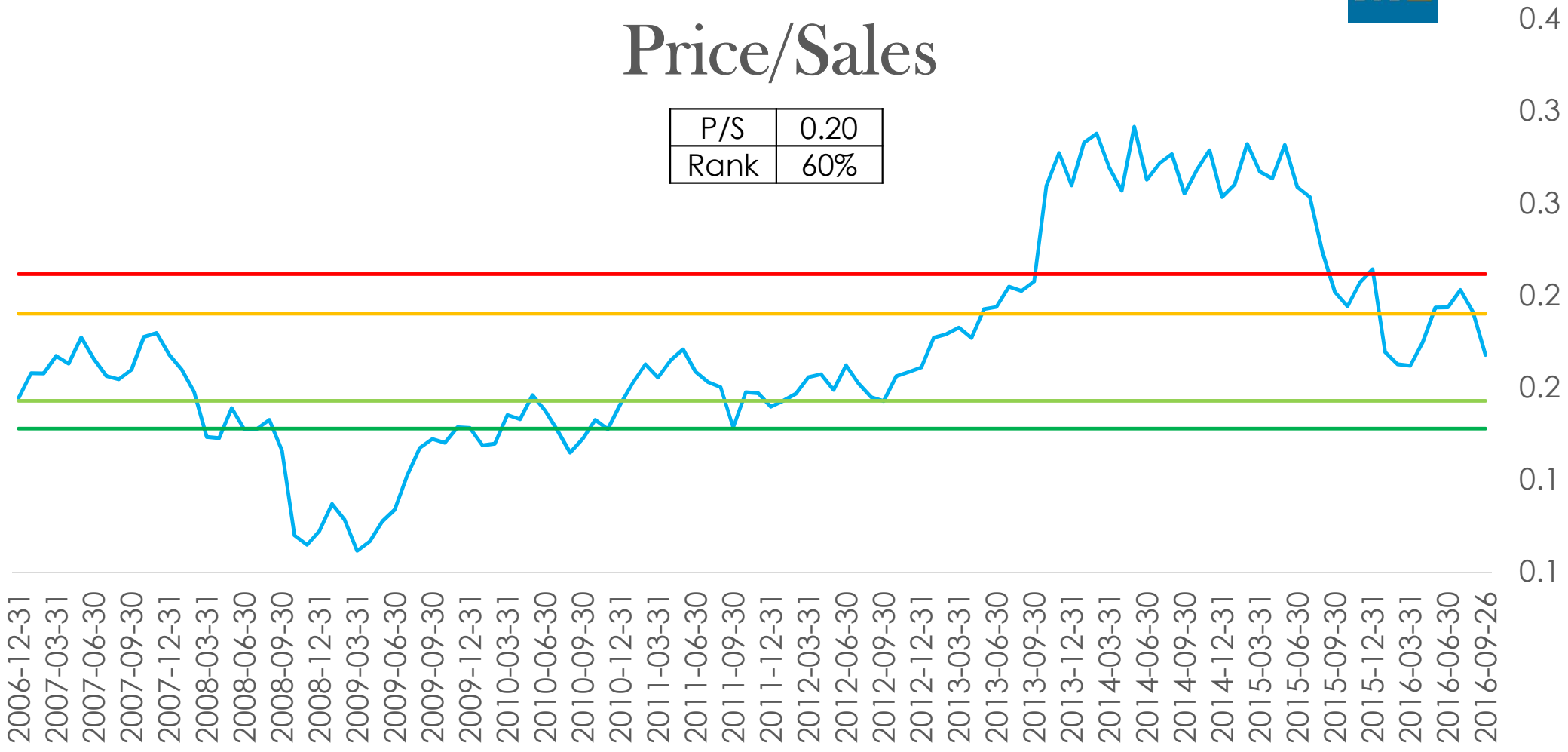


Value Bands



Price/Sales

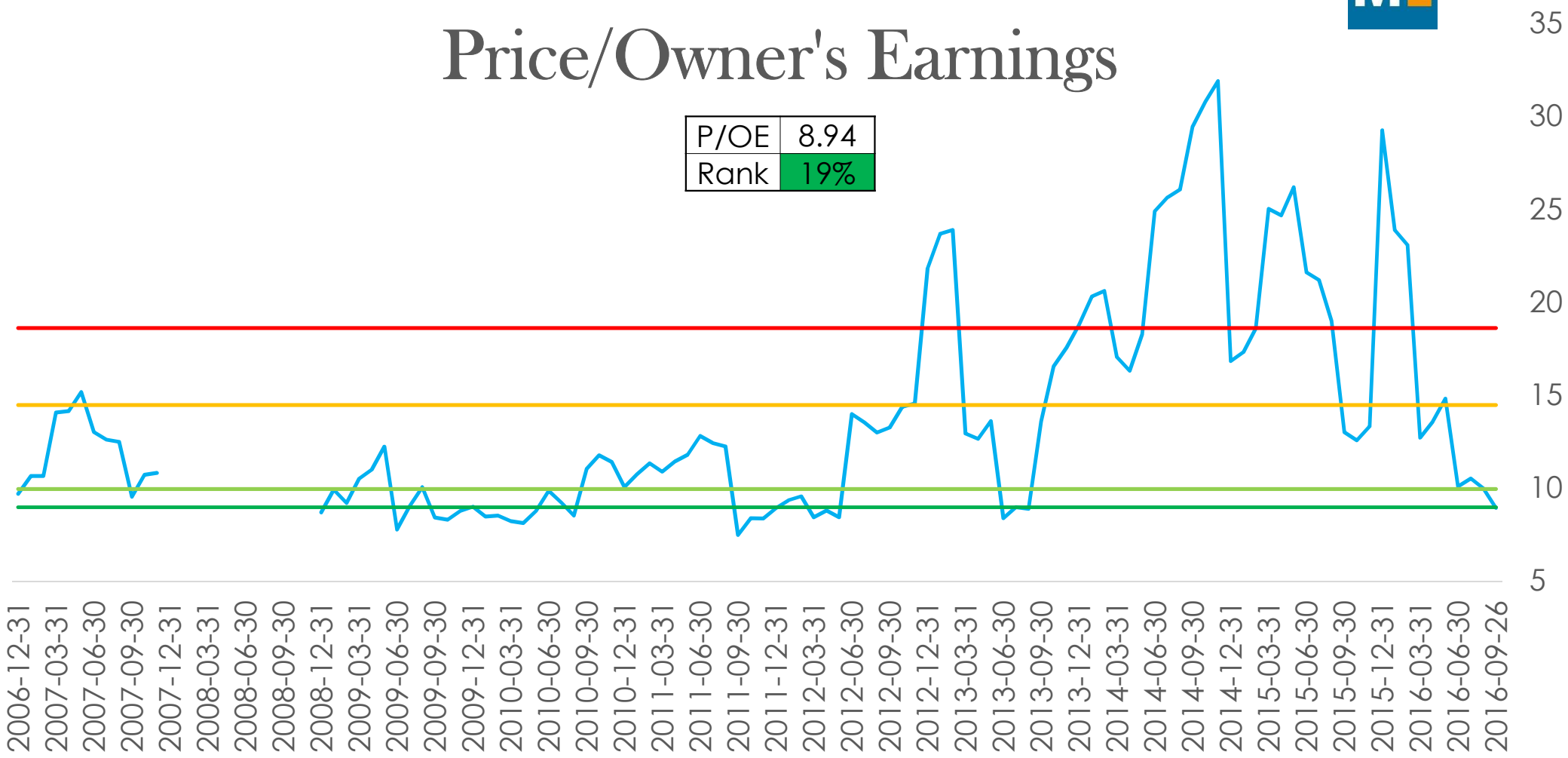
P/S	0.20
Rank	60%





Price/Owner's Earnings

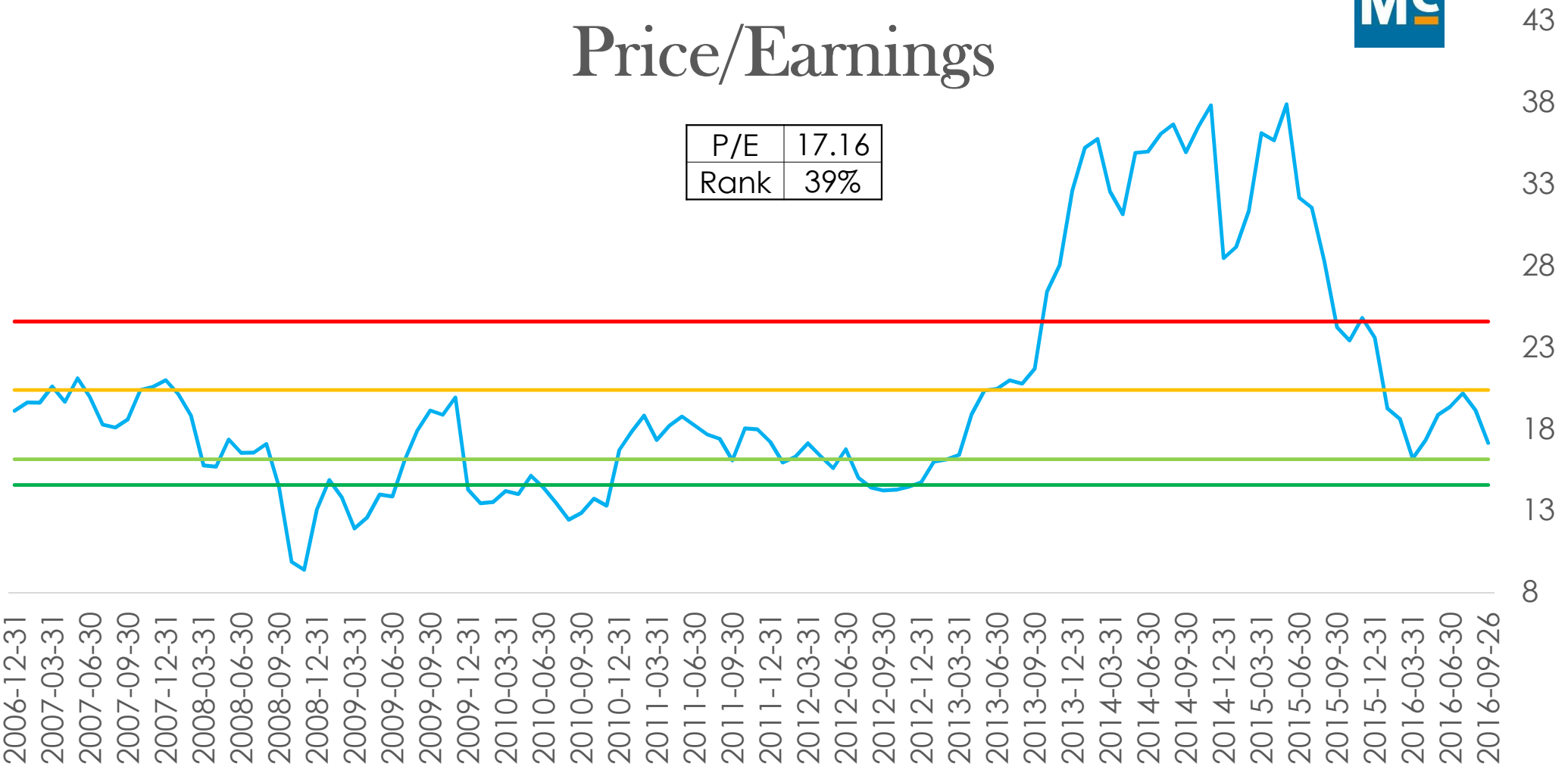
P/OE	8.94
Rank	19%





Price/Earnings

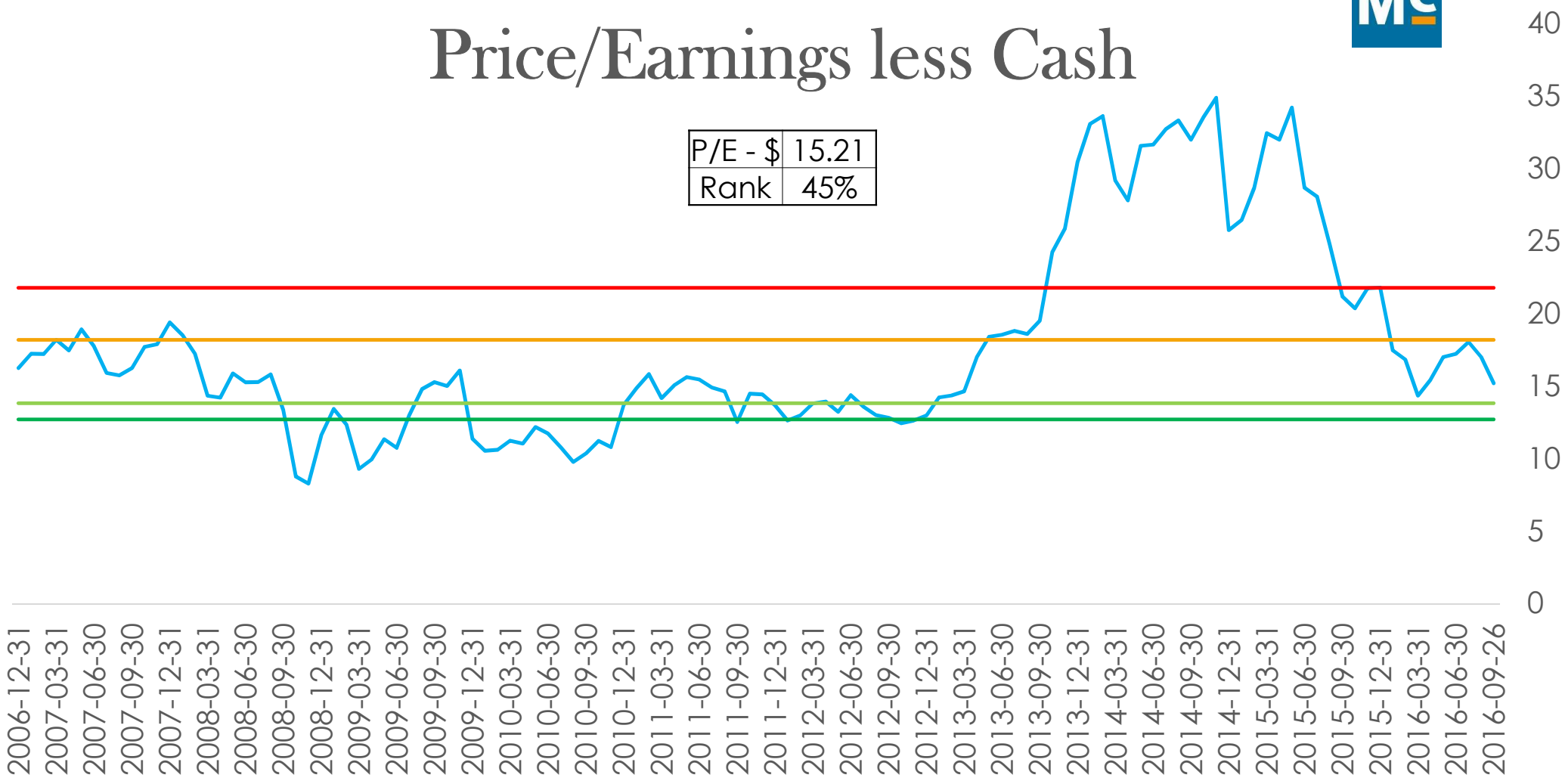
P/E	17.16
Rank	39%





Price/Earnings less Cash

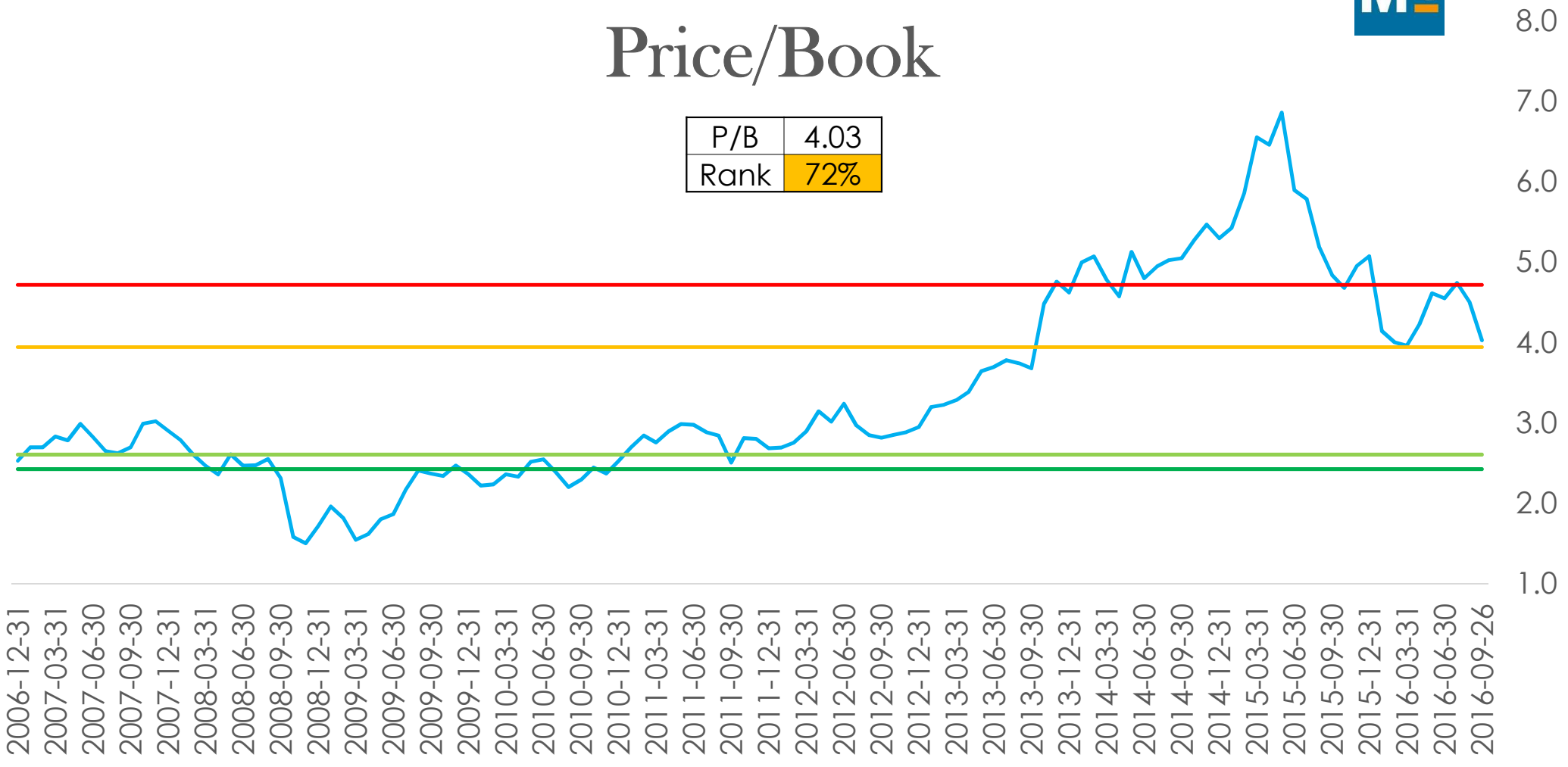
P/E - \$	15.21
Rank	45%





Price/Book

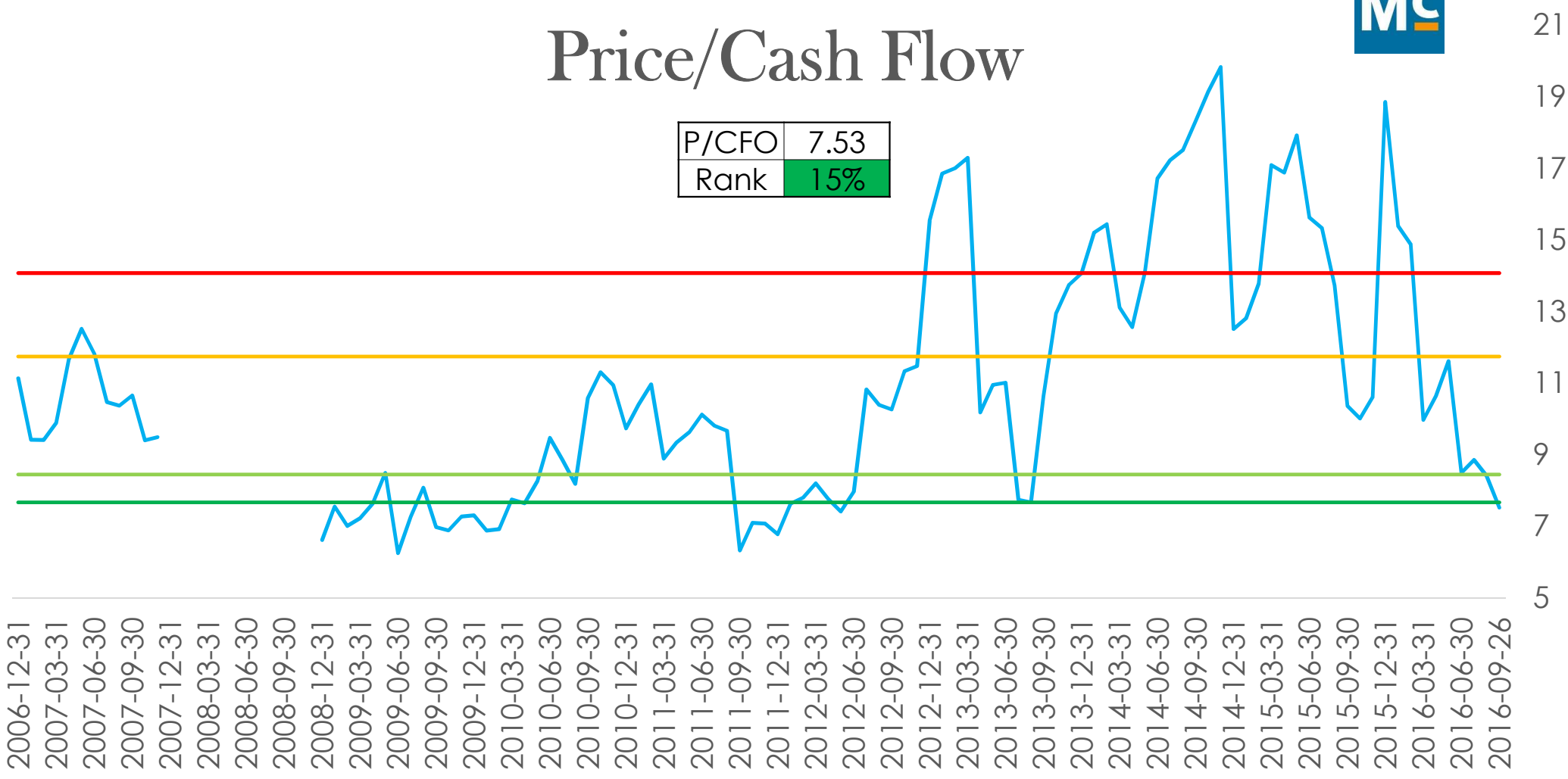
P/B	4.03
Rank	72%





Price/Cash Flow

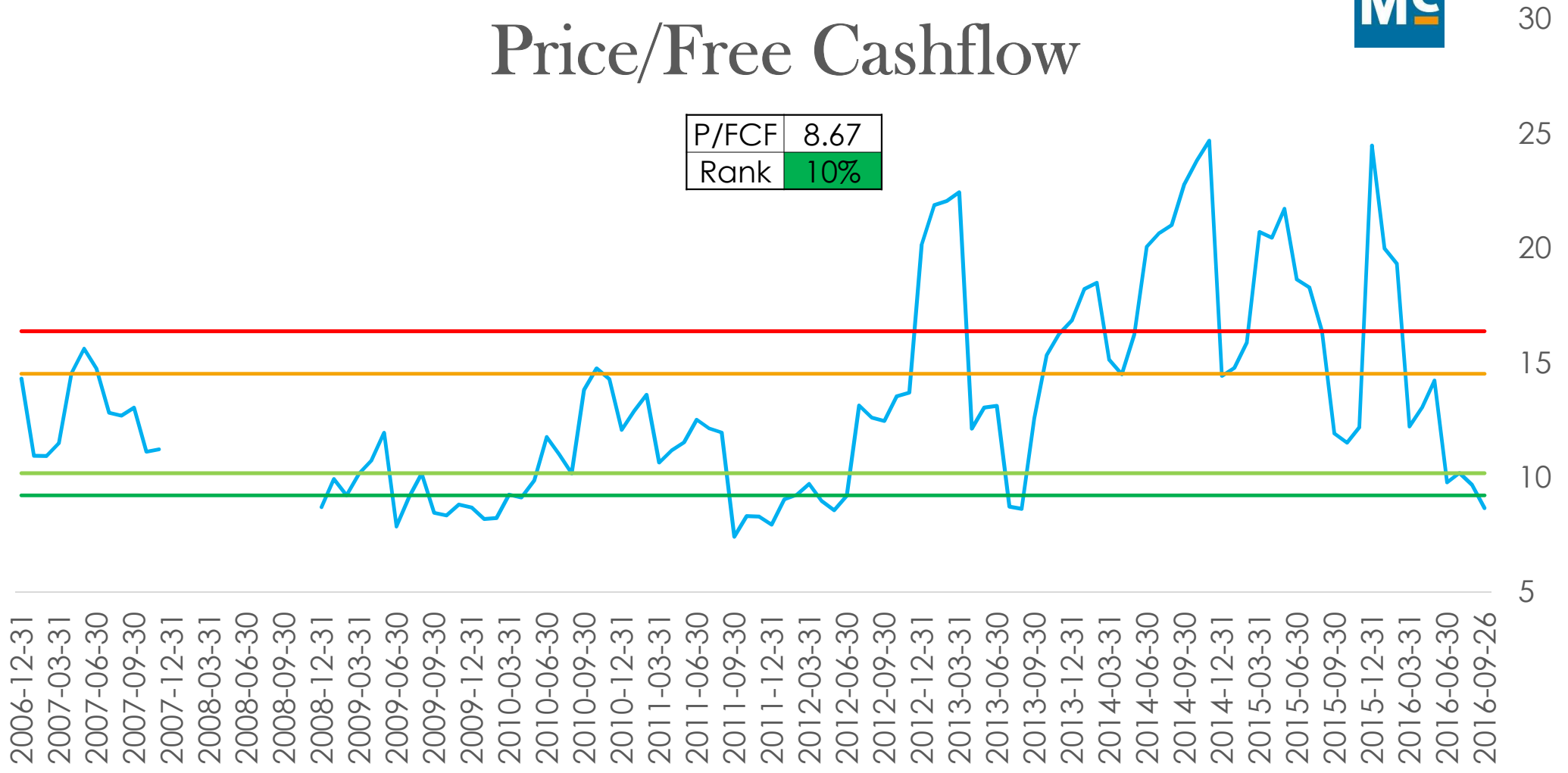
P/CFO	7.53
Rank	15%





Price/Free Cashflow

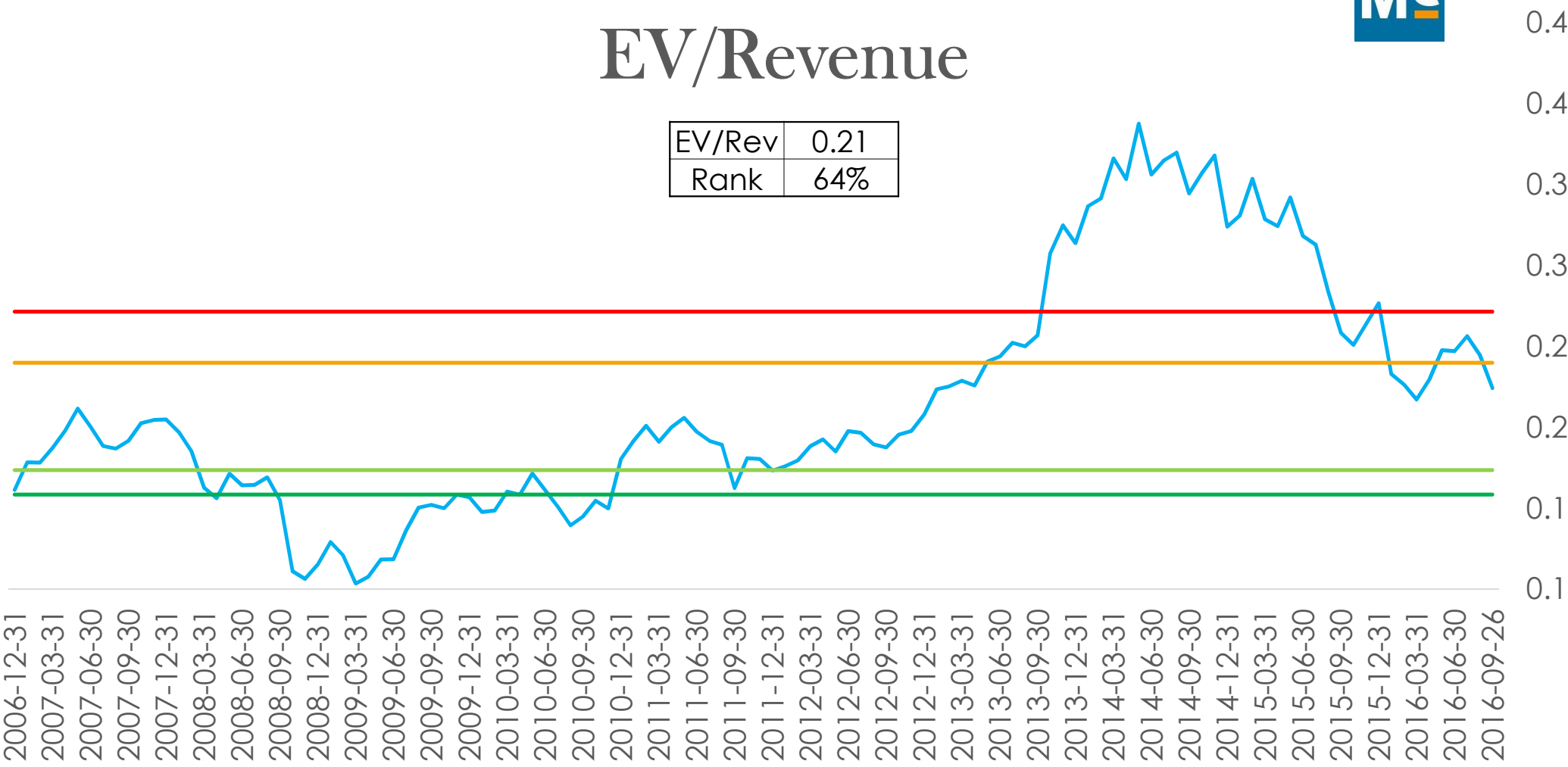
P/FCF	8.67
Rank	10%





EV/Revenue

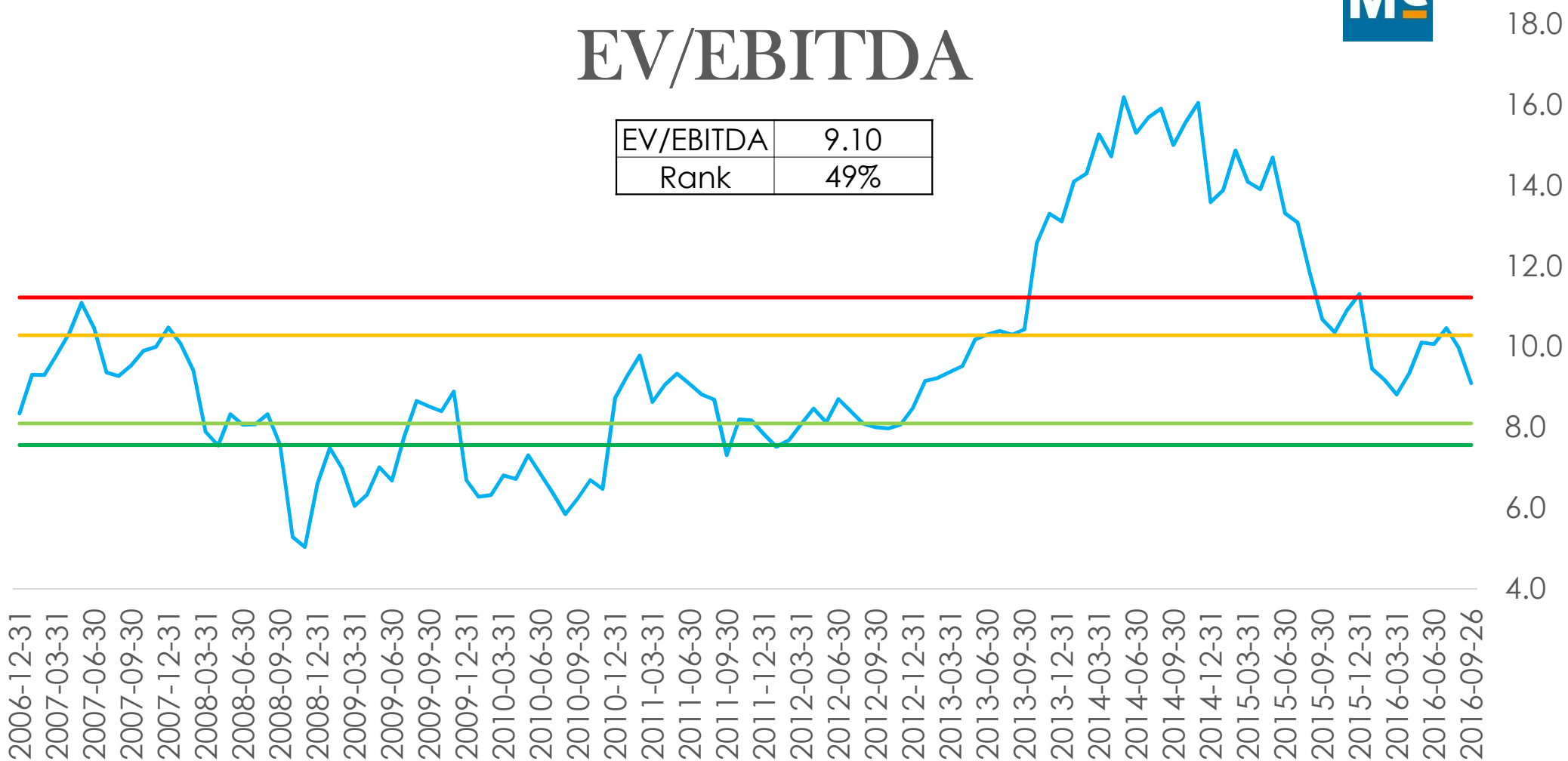
EV/Rev	0.21
Rank	64%





EV/EBITDA

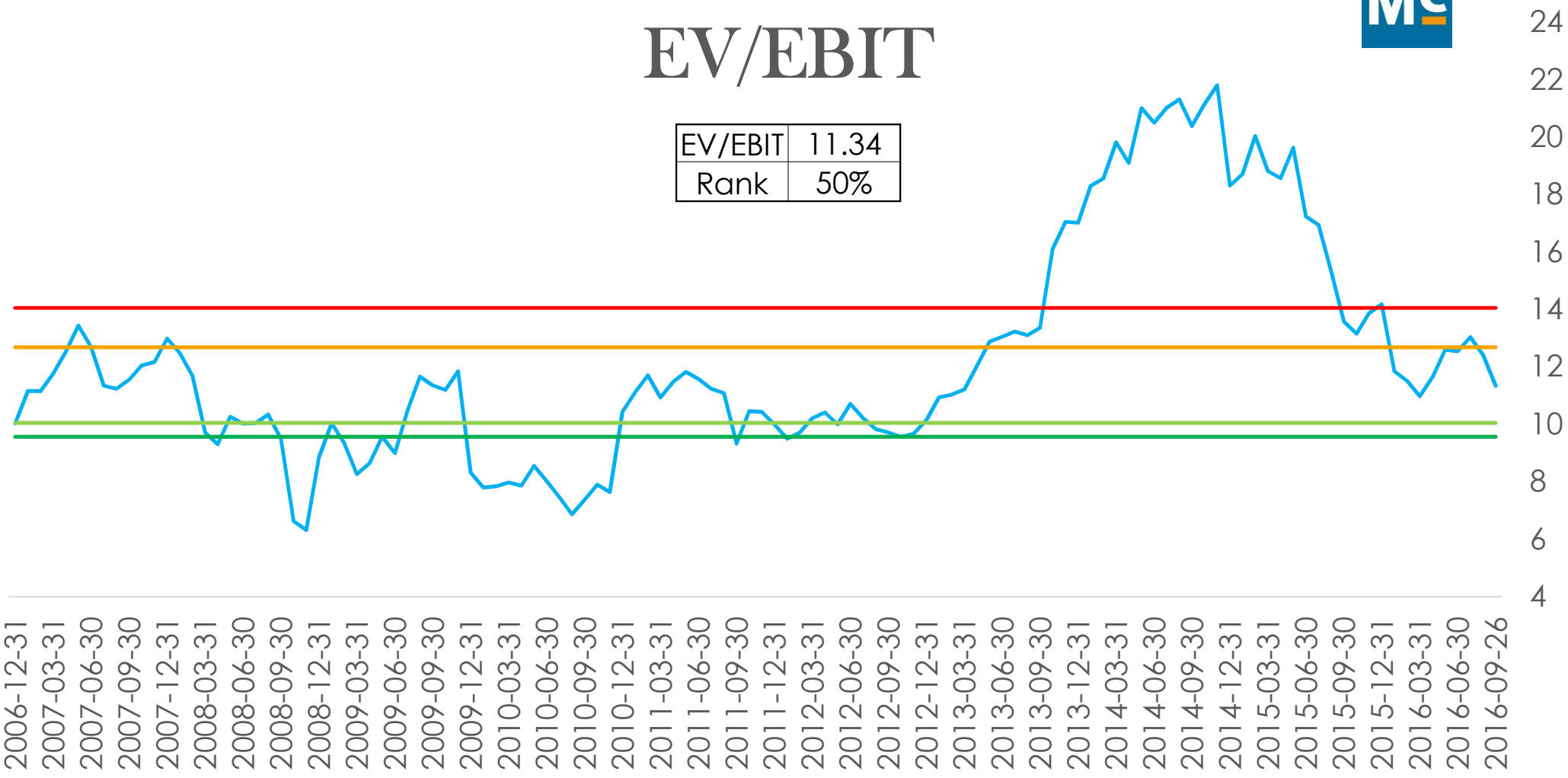
EV/EBITDA	9.10
Rank	49%





EV/EBIT

EV/EBIT	11.34
Rank	50%





Value Bands

Metric	Multiple	Rank
Price/Sales	0.2	60%
Price/Owner's Earnings	8.9	19%
Price/Earnings – Cash	15.2	45%
Price/Earnings	17.2	39%
Price/Book	4.0	72%
Price/Cash Flow	7.5	15%
Price/Free Cash Flow	8.7	10%
EV/Revenue	0.2	64%
EV/EBITDA	9.1	49%
EV/EBIT	11.3	50%

Current Intra-Evaluations



Ticker	Price / Sales
▷ MCK	0.2
▷ WMT	0.5
▷ BBBY	0.6
▷ CHRW	0.8
▷ PII	1.1
▷ CMI	1.2
▷ AIG	1.4
▷ BRK.B	1.7
▷ IBM	1.9
▷ NSRGY	2.7
▷ UNP	4.0
▷ QCOM	4.2
▷ ORCL	4.6
▷ MSFT	5.4

Ticker	Price / Earnings
▷ BRK.B	-
▷ BBBY	8.5
▷ IBM	12.8
▷ PII	13.1
▷ WMT	15.6
▷ MCK	16.3
▷ CMI	16.4
▷ NSRGY	17.5
▷ QCOM	18.5
▷ UNP	18.5
▷ ORCL	19.0
▷ CHRW	19.1
▷ MSFT	27.6
▷ AIG	-

Ticker	P/E Adjusted
▷ BRK.B	-
▷ BBBY	9.9
▷ PII	13.8
▷ IBM	16.2
▷ CMI	16.9
▷ QCOM	17.2
▷ ORCL	17.3
▷ MCK	17.8
▷ NSRGY	18.4
▷ WMT	18.8
▷ CHRW	20.5
▷ UNP	22.0
▷ MSFT	23.9
▷ AIG	-

Ticker	Price / Book
▷ AIG	0.7
▷ BRK.B	1.4
▷ BBBY	2.6
▷ WMT	2.9
▷ CMI	3.0
▷ QCOM	3.0
▷ ORCL	3.4
▷ UNP	3.9
▷ NSRGY	4.0
▷ MCK	4.1
▷ PII	5.2
▷ MSFT	6.3
▷ CHRW	7.9
▷ IBM	9.5

Ticker	Price / FCF
▷ MCK	8.7
▷ BBBY	9.3
▷ IBM	10.6
▷ WMT	10.8
▷ PII	11.9
▷ ORCL	13.7
▷ CMI	14.1
▷ QCOM	14.9
▷ CHRW	15.6
▷ MSFT	18.6
▷ BRK.B	20.5
▷ AIG	24.3
▷ NSRGY	25.5
▷ UNP	26.4

Ticker	52-wk Range
▷ BBBY	\$41.15 - \$61.49
▷ PII	\$67.80 - \$124.39
▷ MCK	\$148.29 - \$202.20
▷ CHRW	\$59.71 - \$76.10
▷ AIG	\$48.41 - \$64.31
▷ ORCL	\$33.13 - \$42.00
▷ NSRGY	\$68.00 - \$83.25
▷ BRK.B	\$123.55 - \$151.05
▷ IBM	\$116.90 - \$164.95
▷ WMT	\$56.30 - \$75.19
▷ CMI	\$79.88 - \$127.64
▷ UNP	\$67.06 - \$98.28
▷ MSFT	\$43.05 - \$58.70
▷ QCOM	\$42.24 - \$64.00



Historical Intra-Evaluations

Ticker	5-Year Price / Sales Range
NSRGY	
BBBY	0.6 1.9
PII	1.0 3.1
CHRW	0.6 1.3
MCK	0.2 0.3
WMT	0.4 0.6
QCOM	2.8 7.2
CMI	0.8 1.7
IBM	1.4 2.4
ORCL	3.6 5.4
BRK.B	1.2 2.0
UNP	2.1 4.9
AIG	0.3 1.4
MSFT	2.9 5.5

Ticker	5-Year Price / Earnings Range
NSRGY	
BBBY	8.2 18.2
MCK	13.2 38.4
PII	9.9 30.6
CHRW	14.0 29.7
QCOM	12.4 24.9
WMT	11.6 18.9
UNP	11.9 24.0
IBM	8.1 16.0
CMI	8.3 20.3
ORCL	13.3 20.3
MSFT	8.8 39.5
AIG	1.8 -
BRK.B	13.4 -

Ticker	5-Year Price / Book Range
NSRGY	
BBBY	2.6 5.0
PII	4.8 17.6
IBM	8.0 14.5
ORCL	2.9 4.3
WMT	2.3 3.8
CHRW	5.7 11.2
CMI	1.9 4.5
MCK	2.4 6.8
BRK.B	1.1 1.6
QCOM	2.0 4.1
UNP	2.1 5.1
AIG	0.4 0.8
MSFT	3.1 6.3

Ticker	5-Year Price / Cash Flow Range
NSRGY	
BBBY	6.1 14.9
WMT	6.8 12.3
PII	6.7 23.4
CHRW	13.4 30.8
MCK	6.0 21.7
QCOM	11.3 20.7
IBM	6.5 12.8
CMI	7.2 15.3
BRK.B	8.3 14.1
UNP	6.9 16.6
ORCL	9.6 14.3
AIG	5.7 -
MSFT	7.1 16.1

Ticker	5-Year Price Range
BBBY	\$41.15 \$80.82
PII	\$46.83 \$159.33
IBM	\$116.90 \$215.90
CMI	\$79.53 \$161.03
WMT	\$51.29 \$90.97
QCOM	\$42.24 \$81.97
MCK	\$66.61 \$243.61
UNP	\$38.87 \$124.52
ORCL	\$24.91 \$46.71
CHRW	\$50.21 \$77.49
AIG	\$19.18 \$64.93
NSRGY	\$53.48 \$83.25
BRK.B	\$69.07 \$152.94
MSFT	\$24.26 \$58.70



DuPont Historical MCK

MCK	Total Asset Turnover	Net Profit Margin	Financial Leverage Multiplier	Return on Equity
TTM	3.43	1.15	6.26	24.88
2016	3.46	1.18	6.34	26.68
2015	3.39	0.82	6.73	17.87
2014	3.18	0.92	6.07	16.20
2013	3.60	1.09	4.92	19.25



DuPont Competitors (TTM)

	Net Profit Margin	Total Asset Turnover	Financial Leverage Multiplier	Return on Equity
MCK	1.15%	3.43	6.26	24.88
ABC*	1.14%	4.82	16.98	93.30
CAH	1.17%	3.73	5.21	22.79

	MCK	CAH	ABC
Market Cap (mil)	37,435	24,895	17,877
Revenue (mil)	193,071	121,546	144,759
Price/Earnings	17.26	18.09	11.29
Price/Sales	0.20	0.22	0.13
Price/Book	4.05	3.84	9.52
EV/EBIT	11.27	11.62	11.30
ROA	3.95	4.38	5.49
ROE	24.88	21.79	108.75
Operating Margin	1.86	2.02	1.27
Net Margin	1.15	1.17	1.14



Conscious Investor



10 Year

	3/07	3/08	3/09	3/10	3/11	3/12	3/13	3/14	3/15	3/16	EPSttm	Years	HGROWTH	STAEGR [®]
EPS (\$)	3.150	3.320	2.950	4.620	4.570	5.590	5.590	5.410	6.270	9.700	\$9.620	10	11.58%	87.38%
SPS (\$)	312.838	352.200	389.406	401.114	444.778	522.272	539.449	595.710	771.746	848.373		10	11.28%	95.20%



10 Year - Expected Rate of Return

	Price	EPSttm	P/E Ratio	HGrowth	Payout	STRET®
Default	164.42	\$9.620	24.27	11.58%	13.6%	14.04%
Safety	164.42	\$9.620	14.46	9.13%	2.9%	6.31%

Cut P/E by 40%
Cut Growth rate by 20%
Cut Payout Ratio by 78%



6 Year

	3/07	3/08	3/09	3/10	3/11	3/12	3/13	3/14	3/15	3/16	EPSttm	Years	HGROWTH	STAEGR®	
EPS (\$)	3.150	3.320	2.950	4.620	4.570	5.590	5.590	5.410	6.270	9.700	\$9.620	6	11.92%	88.63%	
SPS (\$)	312.838	352.200	389.406	401.114	444.778	522.272	539.449	595.710	771.746	848.373		6	13.73%	95.76%	



6 Year

	Price	EPSttm	P/E Ratio	HGrowth	Payout	STRET [®]
Default	164.42	\$9.620	24.27	11.92%	13.6%	14.37%
Safety	164.42	\$9.620	14.46	9.82%	2.9%	6.91%

Cut P/E by 40%
Cut Growth rate by 21%
Cut Payout Ratio by 78%



3 Year

	3/07	3/08	3/09	3/10	3/11	3/12	3/13	3/14	3/15	3/16	EPSttm	Years	HGROWTH	STAEGR®	
EPS (\$)	3.150	3.320	2.950	4.620	4.570	5.590	5.590	5.410	6.270	9.700	\$9.620	3	33.90%	94.29%	
SPS (\$)	312.838	352.200	389.406	401.114	444.778	522.272	539.449	595.710	771.746	848.373		3	19.34%	97.06%	



3 Year

	Price	EPSttm	P/E Ratio	HGrowth	Payout	STRET®
Default	164.42	\$9.620	24.27	33.90%	13.6%	36.03%
Safety	164.42	\$9.620	14.46	14.79%	2.9%	11.31%

Cut P/E by 40%
Cut Growth rate by 56%
Cut Payout Ratio by 78%



CI - 10 YR Kill It Scenario

	Price	EPSttm	P/E Ratio	HGrowth	Payout	STRET®
Default	164.42	\$9.620	24.27	11.58%	13.6%	14.04%
Safety	164.42	\$9.620	14.46	9.13%	2.9%	6.31%
🔄 Saved 2016-10-01	164.42	\$9.620	14.46	6.00%	2.9%	3.65%

Keep P/E at 14.46
Cut Growth rate by 56%
Cut Payout Ratio by 78%



CI - 10 YR Kill It Again

	Price	EPSttm	P/E Ratio	HGrowth	Payout	STRET®
Default	164.42	\$9.620	24.27	11.58%	13.6%	14.04%
Safety	164.42	\$9.620	14.46	9.13%	2.9%	6.31%
Saved 2016-10-01	164.42	\$9.620	11.50	4.00%	2.9%	0.14%

Cut P/E by 53%
Cut Growth rate by 65%
Cut Payout Ratio by 78%



Discounted Cash Flows

DCF - Base Case

Earnings Per Share ⓘ : \$ 10.22

Growth Rate In the Next ⓘ : 10 Years: 13.5 %

Terminal Growth Rate ⓘ : 4 %

Years of Terminal Growth ⓘ : 10

Discount Rate ⓘ : 12 %

Business Predictability ⓘ : ★★★★★ ⓘ

Save Parameters



DCF Reverse DCF ^{NEW}

Fair Value ⓘ : \$ 189.47

Tangible Book Value ⓘ : \$ -22.25
 Add to Fair Value

Growth Value ⓘ : \$ 110.04

Terminal Value ⓘ : \$ 79.43

Stock Price: \$ 164.42

Margin Of Safety: **13%**

DCF - Bull Case

Earnings Per Share ? :	\$ 12.08
Growth Rate In the Next ? :	10 Years: 15 %
Terminal Growth Rate ? :	4 %
Years of Terminal Growth ? :	10
Discount Rate ? :	10 %
Business Predictability ? :	★★★★★ ?

Save Parameters



DCF	Reverse DCF ^{NEW}
Fair Value ? :	\$ 295.72
Tangible Book Value ? :	\$ -22.25
	<input type="checkbox"/> Add to Fair Value
Growth Value ? :	\$ 155.52
Terminal Value ? :	\$ 140.2
Stock Price:	\$ 164.42
Margin Of Safety:	44%

DCF - Bear Case

Earnings Per Share ⓘ : \$ 12.08

Growth Rate In the Next ⓘ : 10 Years: 6.30 %

Terminal Growth Rate ⓘ : 4 %

Years of Terminal Growth ⓘ : 10

Discount Rate ⓘ : 10 %

Business Predictability ⓘ :  ⓘ

Save Parameters



DCF Reverse DCF ^{NEW}

Fair Value ⓘ : \$ 164.41

Tangible Book Value ⓘ : \$ -22.25

Add to Fair Value

Growth Value ⓘ : \$ 100.56

Terminal Value ⓘ : \$ 63.84

Stock Price: \$ 164.42

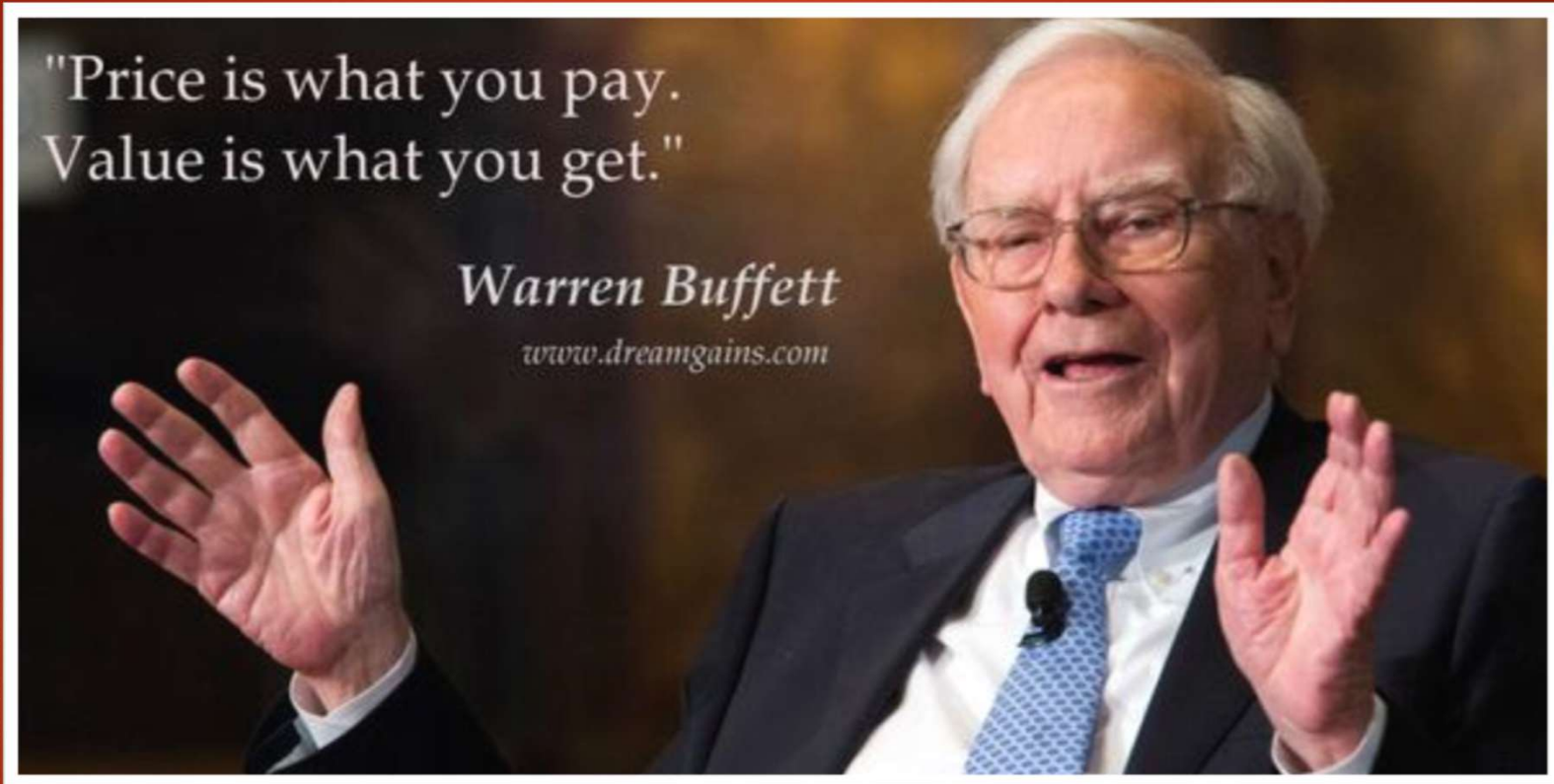
Margin Of Safety: 0%

Valuation

"Price is what you pay.
Value is what you get."

Warren Buffett

www.dreamgains.com



	P/S	P/OE	P/E	P/E-\$	P/B	P/CFO	P/FCF
Current Multiple	0.20	9.02	17.3	15.1	4.07	7.6	8.8
20% Rank Multiple	0.16	9.01	14.6	12.7	2.4	7.7	9.2
Per Share Figures	x 834.9	x 18.5	x 9.7	17.9	x 40.9	x 21.9	x 19.1
Prices	\$133.58	\$166.68	\$141.62	\$148.66	\$98.14	\$168.63	\$175.72
Buy Price	Buy Price = \$147.57						

Conclusion

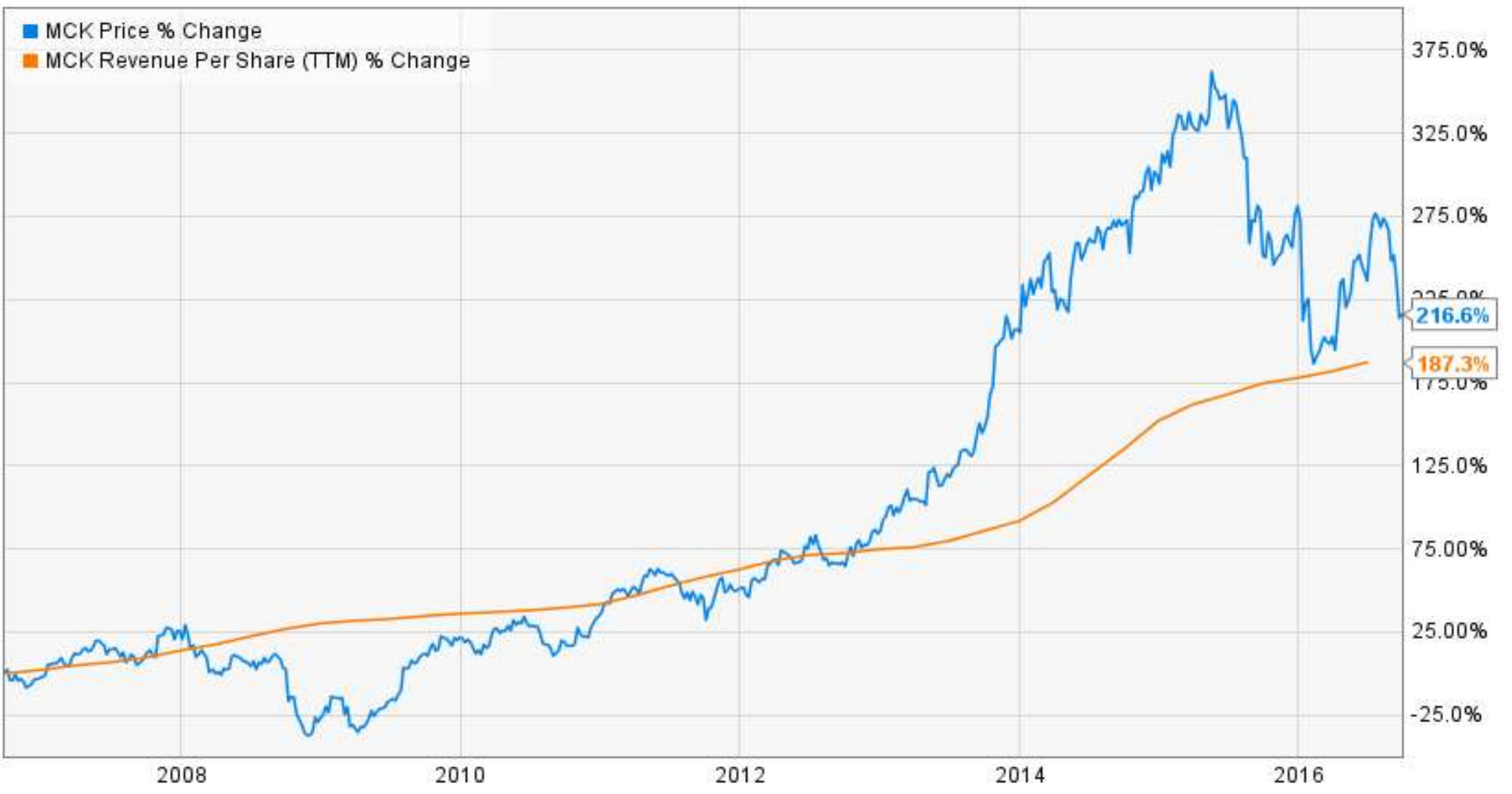
- ▶ Monopoly like business
- ▶ Sound financials and growth record
- ▶ HealthCare Industry can be unpredictable but McKesson will continue to distribute drugs and equipment in the future
- ▶ Value Gap

Recommendation: Limit Order at \$148 or wait until better premiums appear





Appendix







McKesson's Executive Committee

Diverse and Experienced Leadership





McKesson's Executive Committee

John H. Hammergren

- ▶ Chief Executive Officer, President, and Chairman of the Board
 - ▶ 20 year career at McKesson
 - ▶ 15 years as the CEO
- ▶ Under his management, revenues have more than quadrupled
- ▶ Named “Top 100 CEOs in the World” by *Harvard Business Review*





McKesson's Executive Committee

James Beer

- ▶ Executive Vice President and Chief Financial Officer
 - ▶ 3 years as the CFO
- ▶ Served as the Executive Vice President and CFO of Symantec
 - ▶ Managed the worldwide finance organization
- ▶ Served in several management positions at American Airlines for over 15 years

