CAIRN INVESTMENT GROUP

COMPANY SPOTLIGHT:

McKesson Corp.

COMPANY DESCRIPTION

Headquartered in San Francisco, CA, McKesson is the largest U.S. pharmaceutical distribution and services company. The company provides its services to healthcare providers, pharmacies, and pharmaceutical manufactures.

With the company since 1996, John Hammergan became CEO in 2002.

COMPANY HIGHLIGHTS AND FINANCIALS

McKesson is the largest pharmaceutical distributor in the U.S., ahead of Cardinal Health and AmerisourceBergen. The high barriers to entry in this space allows McKesson to produce consistent and stable operating results as their large distribution network would be hard to emulate for a new company entering the market. In recent years, the company has expanded overseas with the acquisition of Celesio, a German based logistics provider to the healthcare sector. This acquisition furthers their focus on technology solutions, complimenting their pharmaceutical distribution arrangements. The company's strong supply chain management, and large customer relationships allows them to generate significant cash flows even in a low margin business.

KEY POINTS

- A leader in pharmaceutical distribution services.
- High barriers to entry allows for consistent cash flow generation and high operational efficiency.
- Good financial health with over $2 billion in cash and Net Debt to Capital of 24%.
- Compelling upside as valuations and growth remain attractive.
- Strong competitive advantage and supply chain management allows for consistent growth.

VALUATION AND RISKS

McKesson is trading at a discount compared to its historical valuations and below fair value based on scenario analysis of free cash flow growth. McKesson has a dividend yield of 0.78% and generates over $4 billion in free cash flow to give them the flexibility to continue to raise their dividend over time. On a free cash flow basis, we expect the company to grow cash flow at 1.5% annually over the next decade, below its current growth rate of 8% over the previous 10 years, due to higher pricing pressure on pharmaceuticals and high revenue concentration. Modeling our conservative assumption places a price of $190 on shares which is almost a 32% premium based on the price as of the date of this report. If our conservative assumptions turn out to still be overly optimistic, we feel there is a margin of safety built into the current price based on the company's high returns on capital and strong cash flow generation.

4/12/2017 :: Ticker: MCK :: Div. Yield: 0.78% :: Closing Price: $143.99

Though McKesson has only two main competitors in the pharmaceutical distribution business, it is a highly competitive environment. We would like to see continued discipline in regards to capital spending and renewed contracts with CVS when it expires in 2019. Continued focus on the company's revenue breakdown, along with integration among its recent acquisitions will be areas to monitor closely.

Weighing the potential rewards and risks, we are optimistic that McKesson will be a good long-term investment.

—Patrick Mason, Investment Analyst, Cairn Investment Group

CAIRN INVESTMENT GROUP

ABOUT CAIRN INVESTMENT GROUP Cairn Investment Group is an independent fee only Registered Investment Advisor based in Portland, Oregon. Cairn staff has the experience and capabilities to serve our investors with a level of personal attention that only a smaller, independent company can provide. We pride ourselves on working in close contact with our investors.

503.241.4901 :: 877.241.4901 :: cairninvestment.com

121 SW Morrison, Suite 1060 :: Portland, Oregon 97204