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EQUITY RESEARCH
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CVS Health Corp
(NYSE: CVS)

BUY

Investment Thesis

CVS Health Corporation has seen strong annual revenues and profits for the past several years, beating Walgreens. Through expansion into new business lines and tactful acquisitions and store openings, CVS sees a dominant future. With the partnership of Anthem and the proposed acquisition of Aetna in the 2nd half of 2018, growth looks to be promising and the greater market share, integration, and control will help fight against Amazon's new entrance into healthcare.

Key Statistics

Current Price	$68.63
Market Cap	$69.77 B
Sector:	Healthcare
Industry:	Retail Pharmacy & PBM
52-Week High/Low	60.14 – 84.00
Simple Moving Avg	8.675 Million (Vol)
P/E	12.39
Est P/E 12/18	9.92
Beta	1.016
Div & Yield	$2.00, 2.91%

Company Highlights

- **Acquisition of Aetna for $68 Billion**
- **Anthem Partnership**
- **Dividends of .50 per share**

Key Statistics

Target Price: $88.26

Current Price: $68.63

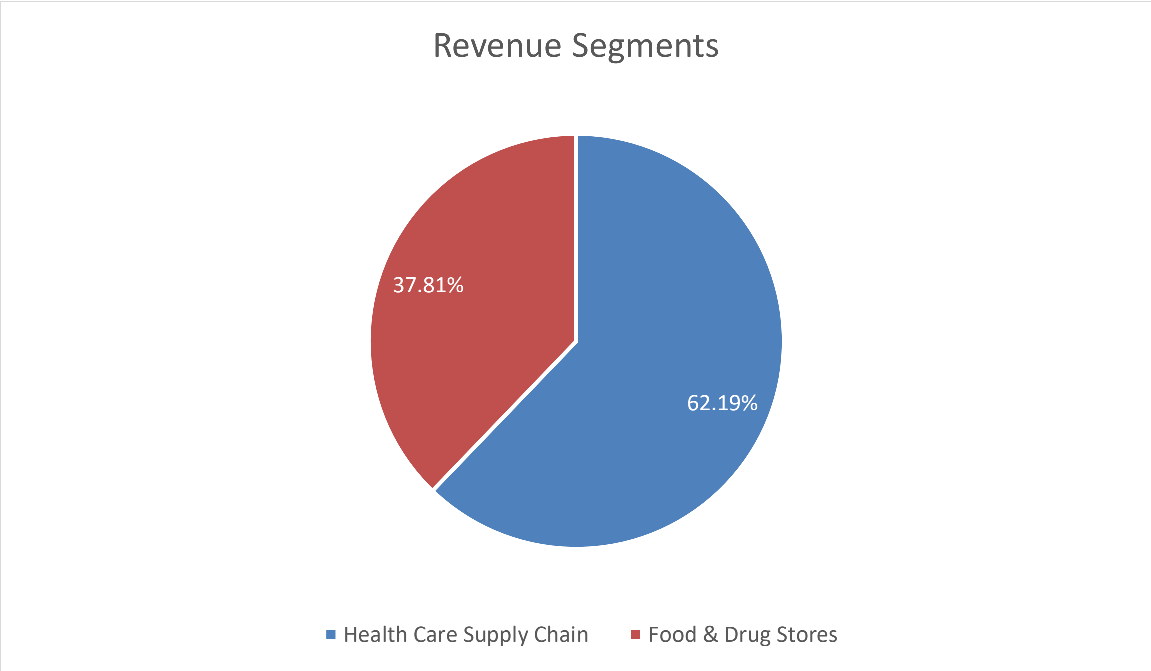
Potential Upside: 29%

Quarterly YoY Performance

Revenue:	$45.7 B (2.6% Inc.)
Gross Profit:	$6.9 B (4.3% Inc.)
Operating Profit:	$1.9 B (8.5% Inc.)
EPS:	$1.48 (26.49% Inc.)

Business Description

CVS Health Corporation is classified as a leading integrated health care provider. This company is involved in mail order, retail and specialty pharmacy, disease management programs, pharmacy benefit services, and retail clinics. As of now, CVS operates in the United States, Brazil, and Puerto Rico. The company runs over 9,700 specialty and retail drugstores. There are over 1000 MinuteClinics located in CVS stores in which customers can do various walk-in services. Almost 90 million plan members are under this pharmacy benefit manager.



Industry Outlook

- As of now, the Trump administration's goal to lower drug costs did not make a big overhaul of the system that a lot of investors were worried about.
- Pharma is increasing its lobbying activities of the 340B program that allow discounts to be acquired by safety-net hospitals.
- Health-care distribution stocks were outperformed by the S&P 500 through June 15, but Amazon and Berkshire Hathaway could be blamed for this.
- There is a growing trend of integrating health insurance with healthcare delivery.
- Attractive dividend yields and overall cost structure seem to keep improving.

Recommendation

Catalyst 1: CVS-AET Deal Anticipated to Come in 2nd Half of 2018 and Allow for Better Integration

- Last month, a federal court's favorable ruling between the AT&T and Time Warner merger helped raise positive sentiment for the $68 billion deal between CVS and Aetna as getting through antitrust authorities is a big win.
- Through the integration with Aetna, CVS should expect to realize more efficiencies and lower consumers' costs.
- Non-emergency health-care problems should be covered more successfully and at a lesser cost through the promotion of walk-in clinics.
- The fixed costs should be more spread with the added scale economies and there should be improved individualized care.

Catalyst 2: Anthem Partnership to Create IngenioRx Better Secures Control of Rising Costs of Prescription Drugs

- This is a hit to one of CVS health's competitors, Express Scripts, since Anthem's contract with Express Scripts expires in 2020 and Express Scripts receives almost a fifth of their revenues from Anthem.

- The expensive hospital admissions should be reduced as a result of the new business expansion the companies plan to start.

Company Compared to Competitors

Industry Revenue (PBM)		
Company	FY Revenue	Total Revenue
CVS HEALTH CORP	131B	62.19%
MCKESSON CORP	208B	88.88%
AMERISOURCEBERGE	153B	100.00%
CARDINAL HEALTH	130B	100.00%
EXPRESS SCRIPTS	100B	100.00%
UNITEDHEALTH GRP	63.8B	31.69%

Equity Valuation of Industry Comparables (RV)				
Metric	Company	Comps Low	Comps Median	Comps High
Est P/E Current Yr	9.92	8.75	13.4	28.5
EV / EBITDA (FY1)	7.3	6.01	9.08	14.7
P/E Ratio (FY1)	9.92	8.75	13.4	28.5

Operating Statistics of Industry Comparables (RV)				
Metric	Company	Comps Low	Comps Median	Comps High
Sales Growth YoY (%)	4.08	-4.17	4.29	25.1
EBITDA Margin (%)	6.49	0.822	5.56	29.2
Return on Equity	18.4	0.641	14.7	29.9

Valuation

DCF Model Perpetuity Growth Method - Value Per Share	
Free Cash Flow at Year 5	9,934
WACC	10.10%
Perpetuity Growth Rate	2.30%
Perpetuity Value at End of Year 5	130,890
Present Value of Perpetuity (@ 10.1% WACC)	80,904
(+) Present Value of Free Cash Flows (@ 10.1% WACC)	34,028
(=) Current Enterprise Value	114,932
Short Term Debt	4,821
(+) Long Term Debt	22,181
(-) Cash and Marketable Securities	1,807
(-) Current Net Debt	25,195
(-) Current Preferred and Minority Interest	4
(=) Equity Value	89,733

Shares Outstanding	1,017
DCF Estimated Value per Share (USD)	$88.26
Consensus Price Target	$85.70
Current Price (USD)	$68.63
Estimated Upside	29%

Risks & Mitigation

Risk 1: Amazon's Acquisition of PillPack Could Bring More Competition

- Amazon could build this company's infrastructure to a point where PBMs may become threatened.
- Amazon's potential ability to combine its Prime service with PillPack could take a large amount of customers who favor speedy deliveries.

Risk 2: Trump Administration Aims to Do a Drug-price Crackdown

- The government is trying to turn around the increases in average sales price of drugs in the health care sector.
- There are already changes being made to the 340B program, which helps to provide discounts on medications for US hospitals.

Disclosure

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