



CVS Health



By James Owens



How will CVS Grow Revenue?

- Based on listing prices, spending on prescription pharmaceuticals is projected to rise from \$450 billion in 2016 to \$600 billion by 2021.
- CVS earns approximately 45% of its revenue from filling prescriptions, which will allow CVS to capitalize from a growing/aging US population.
- An acquisition of Aetna, which is poised to be approved by the DOJ, would mean the addition of the USA's 3rd largest health insurance company into CVS.



Is Aetna a Good Deal?

-CVS has its own Pharmacy Benefits Management system, which negotiates drugs prices with pharmaceutical companies and insurers. CVS could incentivize people to pick up prescriptions at their store, for a reduced cost if they keep Aetna health insurance.

-Aetna can incentivize the use of CVS walk-in clinics, by guaranteeing a lower price and covering that option.

-CVS is spending \$145 in cash and .8725 CVS shares (\$70 per share), per share of Aetna. This is a 38% premium compared to projected P/E ratios.



Industry Outlook

- While still facing competition from historical rivals like Rite Aid and Walgreens, CVS is now facing pressure from Walmart and Amazon
- After two failed mergers, Rite Aid has sold 1900 locations to Walgreens as it struggles to find a way to compete against larger pharmacy retailers
- Amazon's acquisition of PillPack has allowed the tech giant to gain pharmaceutical licenses in all 50 states, staging the beginning of Amazon's entry into healthcare
- Walgreens has acquired the pharmacy patient prescriptions and inventory of 185 Fred's stores, as smaller M&A deals become more mainstream

Multiples Analysis

Forward P/E Ratio

CVS	10.82X	S&P 500	17.3X
Walgreens	11.48X	S&P 500	17.3X
Rite Aid	64.0X	S&P 500	17.3X

PEG Ratio

CVS	.98X	S&P 500	1.88X
Walgreens	1.04X	S&P 500	1.88X
Rite Aid	16.67X	S&P 500	1.88X

EV/Ebitda

CVS	7.86X	S&P 500	12.3X
Walgreens	10.38X	S&P 500	12.3X
Rite Aid	9.12X	S&P 500	12.3X

INCOME STATEMENT	2016	2017	2018	2019	2020	2021	2022
Revenue	177,526	184,765	192,156	199,842	207,835	216,149	224,795
Growth (%)	NA	4.1%	4.0%	4.0%	4.0%	4.0%	4.0%
Cost of Goods Sold	148,669	156,220	161,695	168,162	174,889	181,885	189,160
% of Sales	83.7%	84.6%	84.1%	84.1%	84.1%	84.1%	84.1%
Gross Profit	28,857	28,545	30,461	31,679	32,947	34,264	35,635
% of Sales	16.3%	15.4%	15.9%	15.9%	15.9%	15.9%	15.9%
Operating Expenses (SG&A)	18,491	19,028	19,902	20,698	21,526	22,387	23,282
% of Sales	10.4%	10.3%	10.4%	10.4%	10.4%	10.4%	10.4%
Operating Income (EBIT)	10,366	9,517	10,559	10,981	11,421	11,877	12,352
Interest Expense	1,058	1,041	1,134	918	759	599	440
Pretax Income	9,308	8,476	9,425	10,063	10,662	11,278	11,913
Income Tax Expense	3,317	1,637	1,979	2,113	2,239	2,368	2,502
Tax Rate	NM	NM	21.0%	21.0%	21.0%	21.0%	21.0%
Net Income	5,991	6,839	7,446	7,950	8,423	8,910	9,411
Operating Income (EBIT)	10,366	9,517	10,559	10,981	11,421	11,877	12,352
D&A	2,475	2,479	2,629	2,734	2,843	2,957	3,075
EBITDA	12,841	11,996	13,188	13,715	14,264	14,834	15,428

FREE CASH FLOW (FCF)	2018	2019	2020	2021	2022
EBIT	10,559	10,981	11,421	11,877	12,352
Tax	2,217	2,306	2,398	2,494	2,594
<i>Tax Rate</i>	21.0%	21.0%	21.0%	21.0%	21.0%
Tax-Effectuated EBIT	8,342	8,675	9,022	9,383	9,758
Plus:					
Depreciation	2,629	2,734	2,843	2,957	3,075
Amortization	0	0	0	0	0
Less:					
Capital Expenditures	(1,975)	(2,050)	(2,125)	(2,200)	(2,275)
Change in Working Capital	(858)	(819)	(852)	(886)	(921)
Free Cash Flow	8,137	8,540	8,889	9,254	9,637

WEIGHTED AVERAGE COST OF CAPITAL (WACC)

Weighted Average Cost of Capital **9.1%**

Cost of Equity	
Risk Free Rate	3.0%
Expected Market Return	11.0%
Beta	1.03
Cost of Equity	11.24%
E / (D+E)	72.0%

Cost of Debt	
Cost of Debt	4.5%
Tax Rate	21.0%
After Tax Cost of Debt	3.6%
D / (D+E)	28.0%

PRESENT VALUE OF CASH FLOWS (PV of CF)	2018	2019	2020	2021	2022
	Year 1	Year 2	Year 3	Year 4	Year 5
Discount Factor	0.92	0.84	0.77	0.71	0.65
Present Value of Cash Flows	7,459	7,176	6,847	6,535	6,238

FIRM VALUE: PERPETUITY GROWTH RATE METHOD

Growth Rate in Perpetuity **2.0%**

WACC	9.1%	PV of CF	34,256	+	PV of Terminal Value	89,771	=	Firm Value	124,026
Fair Value:		121.83 P/V:			0.65				