Healthcare Observer

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Not a Normal Distribution of Returns

We believe the drug distribution industry is economically lucrative, even with seismic industry changes.

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The confluence of health care reform, shifting payer dynamics, and growth of nontraditional pharmaceuticals has shifted the competitive landscape for the major three distributors: AmerisourceBergen (ABC), Cardinal Health (CAH), and McKesson (MCK). As a result, each player has recently made specific tactical moves that include partnerships, acquisitions, and international expansion. After analyzing these near-term trends and formulating our long-term outlook, our thesis for the space is highly positive. We believe Amerisource, Cardinal, and McKesson all possess wide economic moats that strong core businesses and positive secular trends underpin. Within the group, Amerisource looks to be the most undervalued as it trades at a material discount to our $75 fair value estimate. We believe the market is currently not fully appreciating the firm's opportunity to capture value from its Walgreen partnership and dominant position within the specialty drug distribution market.

Morningstar Pharmaceutical Industry Summary

Name	Moat Rating	5 Yr. FWD ROIC %	Price/Fair Value %	Moat Dynamics
Amerisource	Wide	27	88	ABC's recent WAG partnership should bolster its operational advantages and Wide Economic Moat.
Cardinal	Wide	14	109	Cardinal's China and med. supply investments are neutral at best, but its core distribution business remains strong.
McKesson	Wide	17	111	McKesson recently purchased Europe's largest wholesaler, enhancing its sourcing and distribution capabilities.

Source: Morningstar Equity Research

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Key Report Highlights

- We believe AmerisourceBergen, Cardinal Health, and McKesson each possess wide economic moats. The combined 85% market share of the major three pharmaceutical distributors enables each to obtain advantageous supplier pricing and fixed-cost scale that smaller distributors or new market entrants cannot match. Critically, the major three also utilize their large size to manage their capital efficiently. Thus, even with operating margins in the lower-single digits, Amerisource, Cardinal, and McKesson consistently churn out economic profits—a trend we believe will last for years.
  - The combination of dominant market share of the major three and slim industry profit keeps new entrants at bay. A new player would have a tough time carving out enough share to efficiently leverage its distribution assets into positive economic profits.
  - The major three obtain deep pricing discounts from drug manufacturers, which many of their customers cannot acquire on their own. This dynamic makes these players an essential cog in the pharmaceutical industry vertical.
  - A critical driver of outsize ROICs for Amerisource, Cardinal, and McKesson is the asset efficiency they achieve by running a colossal amount of product through their respective distribution networks. Effective route density, efficient warehousing infrastructure, and unparalleled logistical expertise has driven solid asset returns.
- Over the course of 2013, Amerisource, Cardinal, and McKesson have made a series of strategic maneuvers that involved partnerships, operational tie-ups, significant equity investments, and all-out acquisitions of other pharmaceutical services players. While the operational and capital composition of each deal varies, the underlying motivation of all is the need to source and deliver pharmaceuticals more cost effectively. Given the growing power of PBMs and the need of health plan sponsors to curb costs, we believe there will be increasing pricing pressure for most pharmaceutical supply chain participants. Despite our positive view of the operational strategy for these deals, we believe the major three will not earn a significant amount of economic profits from these projects. We do not believe these investments are value destructive, but fairly priced and will yield close to each firm's WACC.
- The role drug distributors play within the specialty pharmaceutical market is complex, with the major three participating on many levels. The growing importance of specialty pharmaceuticals will motivate these players to formulate and maintain an appropriate specialty drug distribution strategy. However, we believe the core operations for Amerisource, Cardinal, and McKesson will remain the biggest driver of capital returns and shareholder value.

Amerisource, Cardinal, and McKesson Have Procured Wide Economic Moats

Vishnu Lekraj

Colossal scale is the key to churning out economic profits within the health care services space, and this dynamic is especially true for the pharmaceutical distribution sector. The razor-thin profits of the industry can create a challenging environment for participating firms. However, the major three drug distributors (AmerisourceBergen, Cardinal Health, McKesson) control a significant portion of pharmaceutical volume within the United States and we believe this dynamic gives them key long-term competitive advantages. The major three are able to leverage their combined 85% market share into advantageous supplier pricing and fixed-cost scale that smaller distributors or new market entrants cannot match. Critically, the major three drug distributors also utilize their large size to manage their capital efficiently. Thus, even with operating margins in the lower-single digits, Amerisource, Cardinal, and McKesson consistently churn out economic profits—a trend we believe will last for years.

Key Takeaways

- We believe the pharmaceutical distribution industry provides its major players with wide economic moats. We rate Amerisource, Cardinal, and McKesson with wide moats based on three variables:
  - Dominant market positions keep competition minimal and rational. The combined 85% market share of the major three distributors and slim industry profit keeps new entrants at bay.
  - The major three obtain deep pricing discounts from drug manufacturers, which many of their customers cannot acquire on their own. This dynamic makes these players an essential cog in the pharmaceutical industry vertical.
  - The asset efficiency achieved by running a colossal amount of product through their respective distribution networks is a critical driver of outsize ROICs for Amerisource, Cardinal, and McKesson. Effective route density, efficient warehousing infrastructure, and unparalleled logistical expertise have driven decent asset returns.

The above variables lead to three stalwart moat sources that support outsize economic profits for the major three distributors: cost advantages, moderate network effect, and efficient scale.

- There are two fundamental and basic lines of business for the pharmaceutical distributors: contracts with independent smaller pharmacies (mom and pops) and contracts with larger mass chain pharmacies (Walgreen and Target). The degree of reliance upon distribution services and the level of gross profitability vary greatly among this bifurcated cross section of customers.

- Independent pharmacies rely upon a distributor for all drug supply as they lack the manufacturer relationships, pricing power, and infrastructure to operate a cost-effective procurement system.

Large pharmacies usually have sophisticated procurement operations and source most of their generic supply directly from manufacturers. However, these players still obtain all branded drugs from distributors as branded manufacturers prefer not to sell directly to retail outlets.

Every major participant within the pharmaceutical supply chain likely interacts with a distributor either to move product efficiently or procure a cost-effective supply of drugs. More specifically, though, the relationships among the various players along the pharmaceutical supply chain can be complicated, given that several firms participate on multiple fronts. However, we believe it's important for investors to remember that there are two fundamental and basic lines of business for the pharmaceutical distributors: contracts with independent smaller pharmacies (mom and pops) and contracts with larger-mass chain pharmacies (Walgreens and Target). The degree of reliance upon distribution services and the level of gross profitability vary greatly among this bifurcated cross-section of customers.

Relationships With Independent (Smaller) Retail Pharmacies

Independent pharmacies rely upon a distributor for all drug supply as they lack the manufacturer relationships, pricing power, and infrastructure to operate a cost-effective procurement system. These players can be a member of a group purchasing organization (GPO) that contracts with a primary distributor delivering product directly to a member's retail outlet. This customer subset also utilizes other distributor services such as franchising-network infrastructure, inventory management, reimbursement-payment management services, group purchasing discounts, and other operational activities. We believe gross margins for these contracts usually fall within a range of 4%–5%.

Exhibit 1 Flow of Goods for Small-Customer Contracts

Source: Morningstar Equity Research

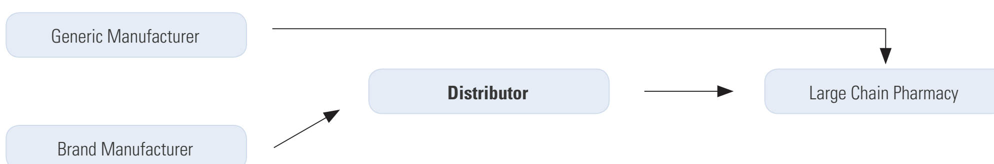
Relationships With Mass (Larger) Retail Chain Pharmacies

Mass retail pharmacies usually have sophisticated procurement operations and source most of their generic supply directly from manufacturers. However, these players still obtain all branded drugs from distributors as branded manufacturers prefer to not sell directly to retail outlets.

The substitutability of many branded drugs is obviously not as strong as it is for generics because of patent protection. Therefore, branded manufacturers do not need to "incentivize" retail demand for their products through material discounts or extensive retail relationships. Accordingly, instead of dealing with hundreds of retail entities, branded manufacturers have the luxury of only needing to work with the major pharmaceutical distributors.

Branded manufacturers utilize the major three distributors as their logistical operations by paying incentives and fees to these players for the effective inventory management and order fulfillment of their branded products. Thus, branded manufacturers are able to leverage the logistical infrastructure of a third party and avoid the extensive asset investment in internal distribution operations. These inventory management incentives and fees are analogous to providing a product discount to distributors, making a distributor's acquisition price lower than that for retail pharmacies. We believe gross margins for mass chain contracts usually fall within a range of 0.3%–0.6% for the major three. Although the profit profile of these contracts is slim, the asset efficiency gained from large volume customers is a positive for capital returns.

Exhibit 2 Flow of Goods for Large-Customer Contracts



Source: Morningstar Equity Research

Asset Efficiency Is the Foundation of Distributor Moats

Given the dynamics and slim gross profitability of pharmacy customer contracts, efficiency and scale are the critical economic drivers for the pharmaceutical distribution industry. On the surface, it may seem impossible for any player to churn out ROICs above WACC given the low-single-digit operating margins the sector yields; however, Amerisource, Cardinal, and McKesson have consistently produced robust economic profits. We believe these players will continue on this path over the next few decades and we have rated all three with wide moats as a result.

Exhibit 3 Historical and Forecast Profitability

	Historical: 5 Year Average			Forecast: 5 Year Average		
	Gross Margin %	Operating Margin %	ROIC %	Gross Margin %	Operating Margin %	ROIC %
ABC	3.1	1.4	20.3	2.9	1.3	27.3
CAH	4.2	1.6	11.9	5.8	2.6	13.7
MCK	5.3	1.6	20.6	6.2	2.1	16.7

Sources: Morningstar Equity Research

We believe three main market variables allow these players to produce robust and sustainable economic profits:

1. **Dominant market positions keep competition minimal and rational**
The combined 85% market share of the major three distributors and slim industry profit keeps new entrants at bay. A new player would have a tough time carving out enough share to efficiently leverage its distribution assets into positive economic profits. This dynamic solidifies the long-term competitive position of Amerisource, Cardinal, and McKesson.

Additionally, there is very little share shift among these major players, leading to a mostly rational market. Major share shift among the three occurs with the business of mass retail pharmacies, which include large pharmacy chains such as Walgreen, mass retailers such as Wal-Mart, and huge mail-order pharmacies such as Express Script. The slim gross margins for large customer contracts make any share shift less detrimental to the major drug distributors. However, we do note asset efficiency is affected negatively when a material amount of volume is lost. The major three do trade large-scale customer contracts, competition for more profitable smaller retail pharmacy customers remains steady with each possessing about 26% of that market.

2. **Significant pricing discounts make the major three an essential cog along the drug supply chain**
The major three obtain deep pricing discounts from drug manufacturers, which many of their customers cannot acquire on their own. This dynamic makes these players an essential cog in the pharmaceutical industry vertical. This is especially true for small independent retail pharmacies, GPOs, and many medical providers as they do not have the price negotiation power and rely on Amerisource, Cardinal, and McKesson for most drug inventory sourcing. In addition, many smaller pharmacies use other distributor services for essential operational needs, building some stickiness into this customer niche. These services include franchising and network infrastructure, inventory management, reimbursement and payment management services, group purchasing discounts, and other operational activities.

Even though most large-scale pharmacies sidestep distributors in sourcing generics, they are still reliant upon the major three for advantageous branded drug pricing. Branded pharmaceutical manufacturers utilize the major three as the main distribution channel for their drug products and pay them incentives and fees for these services—in essence providing an exclusive discount to the distributors. This dynamic makes Amerisource, Cardinal, and McKesson essential to large pharmacies for sourcing branded drugs.

3. Enormous scale leads to excellent asset efficiency

A critical driver of outsize ROICs for Amerisource, Cardinal, and McKesson is the asset efficiency they achieve by running a colossal amount of product through their respective distribution networks. Effective route density, efficient warehousing infrastructure, and unparalleled logistical expertise has driven decent asset returns. However, because of the slim profit margins of pharmaceutical distribution, ROAs for the major three fall below those of other moaty distribution operators:

Exhibit 4 Return on Assets Comparison Across Distributors

ROA	Moat Rating	2009 %	2010 %	2011 %	2012 %	2013 %
Drug Distributors						
Amerisource	Wide	3.9	4.5	4.8	4.7	2.5
Cardinal	Wide	6.0	2.6	4.5	4.5	1.3
McKesson	Wide	3.3	4.7	4.1	4.4	3.9
Other Distributors						
Fastenal	Wide	13.3	18.8	23.0	24.5	23.1
Cintas	Narrow	6.0	5.6	5.9	7.0	7.4
Grainger	Wide	11.9	13.4	15.3	14.2	15.3
MSC Industrial	Narrow	16.5	17.6	23.1	23.8	18.5
Wal-Mart	Wide	8.2	8.6	9.3	8.4	8.6

Source: Morningstar Equity Research

Nevertheless, their ability to effectively manage their capital bases is the true driver of outsize returns for the group. This is evident when comparing the asset turns of the same subset:

Exhibit 5 Assets Turnover Comparison Across Distributors

Asset Turnover	Moat Rating	2009	2010	2011	2012	2013
Drug Distributors						
Amerisource	Wide	5.56	5.55	5.35	5.13	5.12
Cardinal	Wide	7.64	4.37	4.79	4.57	4.04
McKesson	Wide	4.28	4.07	3.79	3.84	3.61
Other Distributors						
Fastenal	Wide	1.39	1.61	1.78	1.83	1.71
Cintas	Narrow	1.00	0.92	0.92	0.96	1.01
Grainger	Wide	1.72	1.88	1.87	1.84	1.84
MSC Industrial	Narrow	1.32	1.46	1.69	1.75	1.45
Wal-Mart	Wide	2.47	2.44	2.40	2.39	2.37

Source: Morningstar Equity Research

This advantage would be hard for smaller existing or new industry participants to achieve given the extensive asset investment needed to build an efficient revenue level. Therefore, the ability to move billions in drug inventory profitably from a fragmented based of manufacturers to a fragmented base of providers is only achievable by large distributors.

Due to their large size, Amerisource, Cardinal, and McKesson are also able to negotiate favorable supplier and customer payment terms. This enables these players to produce excellent cash flow and cash conversion metrics. In addition, manufacturer pricing incentives, the natural use and consumption of pharmaceutical products, the growth of cheaper generic drug usage, and the entrenched industry position of their operations keep product inventory at extremely efficient levels for the major three.

Exhibit 6 Inventory Days Comparison Across Distributors

Inventory Days	Moat Rating	2009	2010	2011	2012	2013
Drug Distributors						
Amerisource	Wide	24.06	24.63	25.56	26.46	26.60
Cardinal	Wide	13.52	25.41	25.37	26.93	30.81
McKesson	Wide	31.59	31.83	32.10	30.32	32.25
Other Distributors						
Fastenal	Wide	215.86	184.55	170.45	169.54	177.36
Cintas	Narrow	36.19	33.11	34.75	38.68	35.44
Grainger	Wide	95.68	82.21	90.31	93.19	90.25
MSC Industrial	Narrow	133.59	108.12	109.47	108.39	114.97
Wal-Mart	Wide	41.83	40.34	40.07	42.01	43.76

Source: Morningstar Equity Research

Exhibit 7 Cash Conversion Comparison Across Distributors

Cash Conversion	Moat Rating	2009	2010	2011	2012	2013
Drug Distributors						
Amerisource	Wide	1.37	0.83	0.16	–0.95	–1.75
Cardinal	Wide	5.54	8.94	6.91	7.30	8.08
McKesson	Wide	14.40	14.16	13.18	11.36	11.06
Other Distributors						
Fastenal	Wide	235.63	203.76	191.59	192.03	200.49
Cintas	Narrow	60.76	57.53	57.56	61.99	59.92
Grainger	Wide	101.50	89.28	94.78	97.62	97.44
MSC Industrial	Narrow	154.48	122.07	122.81	123.85	132.93
Wal-Mart	Wide	9.70	8.35	6.91	8.24	10.03

Source: Morningstar Equity Research

The combination of the above factors has led to outsize ROICs for Amerisource, Cardinal, and McKesson, which we believe will last over an extended period.

Exhibit 8 Historical and Forecast ROIC

ROIC	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)	2014E (%)	2015E (%)	2016E (%)	2017E (%)	2018E (%)
ABC	17.6	19.7	23.9	22.8	17.5	20.8	23.9	27.7	30.2	27.5
CAH	8.5	10.9	12.6	14.6	13.1	12.1	13.6	14.6	14.9	13.8
MCK	21.5	18.8	17.8	21.6	23.1	11.3	14.3	16.5	18.6	20.0

Sources: Morningstar Equity Research

We don’t believe there will be any significant challenges to the major three over the foreseeable future as the asset investment needed to compete effectively with these players would be significant. In order for a pharmaceutical distributor to produce consistent economic profits they would need to build an extensive distribution operation to source a global drug supply, move this supply to thousands of pharmacies (both independent and chain) across the U.S., and effectively manage inventory for branded manufacturers. Considering the small amount of market share not owned by the big three and the slim profitability of the industry, we believe the heavy asset investment needed would not be advantageous for potential new entrants or large-scale expansion by smaller existing drug distributors.

In order to illustrate this point we lay out our estimated level of market share a new distributor would need to achieve in order to just earn its WACC. We walk through this example in three parts.

1. Table 1: We average the end of fiscal year invested capital, operating margins, and WACC for Amerisource, Cardinal, and McKesson and assume this to be a rough approximation for the needed level of capital and profits that must be generated by a firm seeking to build an effective distribution network. We note that these metrics include assets and liabilities for other segments, but these segments are dwarfed by the core pharmaceutical distribution operations of the major three, making their influence minimal.
2. Table 2: We take the average capital requirements of the major three and determine which level of profits and revenue a new industry entrant would need to achieve in order to earn just its WACC, assuming average industry metrics.
3. Table 3: We then take our revenue estimate and measure this metric against the balance of market share that is not owned by the major three distributors.

Exhibit 9 Average 2013 Balance Sheet and Profit Metrics for ABC, CAH, & MCK

Total Net PP&E	1,205
Total Assets	26,508
Invested Capital	8,496
WACC	9.23%
Op Margins	1.72%

Source: Morningstar Equity Research

Exhibit 10 Implied Required Return Metrics for New Competitor

Capital Charge/WACC Breakeven	784	(WACC X Invested Cap.)
Implied Op Profit	1,121	(Capital Charge/30% Tax Rate)
Implied Revenue	64,974	(Op Profit/Op Margins)

Source: Morningstar Equity Research

Exhibit 11 Implied Market Share Metrics for Breakeven New Competitor

Estimated Drug Distribution Market	320,000	
Big 3 Market Share	268,374	
Balance Remaining	51,626	
Percent of Balance Needed	126%	(Implied Rev./Balance)

Source: Morningstar Equity Research

Based on the above analysis, we believe the stalwart competitive positions for Amerisource, Cardinal, and McKesson will remain intact for years. A new entrant would not only need to capture the balance of remaining market share not owned by the major distributors, but also win share from these players. Irrational pricing could capture some share; however, given the slim gross profits of the industry it would be a painful exercise. Profits are already so slim that there is not much room to cut pricing. Additionally, we believe manufacturers and most sophisticated pharmacy operators would be hesitant to rely upon an unproven distributor for critical logistical activities and drug supply. This dynamic would make capturing market share a tough proposition and not worth the heavy asset investment required, in our opinion.

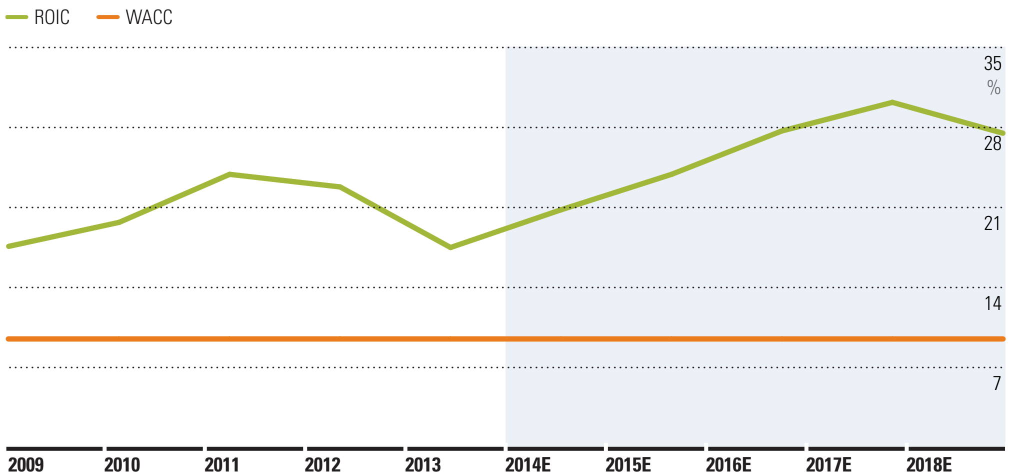
We Are Upgrading Distributors Moats to Wide, and Changing Moat Trends to Stable From Negative.

We recently updated our outlook for the pharmaceutical distribution industry and recalibrated our ratings for Amerisource, Cardinal, and McKesson. Even with a shifting competitive environment, we upgraded the moat ratings for all three players to wide from narrow. We no longer believe these firms will be squeezed out of the pharmaceutical distribution supply chain and are in fact a more essential cog given the industry's recent major partnerships. Additionally, we believe the major three will be able to withstand PBM pricing pressure given their highly efficient operations and the critical logistical activities they execute for manufacturers; allowing them to pass most pricing pressure onto drug manufacturers. We also adjusted or moat trend ratings for all three from negative to stable. The dynamics inherent within the pharmaceutical distribution industry will allow the three major players to earn outsize ROICs at least over the next few decades.

Firm	Moat Rating	Trend Rating
AmerisourceBergen	Wide	Stable

AmerisourceBergen is the second-largest pharmaceutical distributor by revenue and is the main supplier to large pharmacy outlets Walgreen and Express Scripts Mail Order Pharmacy. The firm recently signed a major strategic agreement with Walgreen where it will now supply the majority of the retail pharmacy's branded drugs and will eventually do the same for its generic inventory. This last aspect is key as becoming the major supplier of more profitable generic drugs to one of the biggest generic drug retail outlets is a major positive for profits and returns (the generic wholesaling agreement for the partnership is unique when compared to traditional large customer agreements and we cover the reasoning behind this in the next article). Additionally, ABC will also have the opportunity to procure its generic inventory from the already sizable Walgreen Boots Alliance Development. This should allow Amerisource to obtain its generic drug inventory at lower cost levels and drive profits, especially among its smaller pharmacy customers. The firm is also the largest specialty drug distributor in the U.S. which positions it favorably to benefit from the fastest growing drug category within the pharmaceutical industry. We believe Amerisource's distribution efficiency will allow it to produce ROICs over an extended period on par with a wide moat firm. Its solid industry positioning and future outlook also gives us confidence its moat trend will remain stable for some time to come.

Exhibit 12 Amerisource ROIC



Source: Morningstar Equity Research

Firm	Moat Rating	Trend Rating
Cardinal Health	Wide	Stable

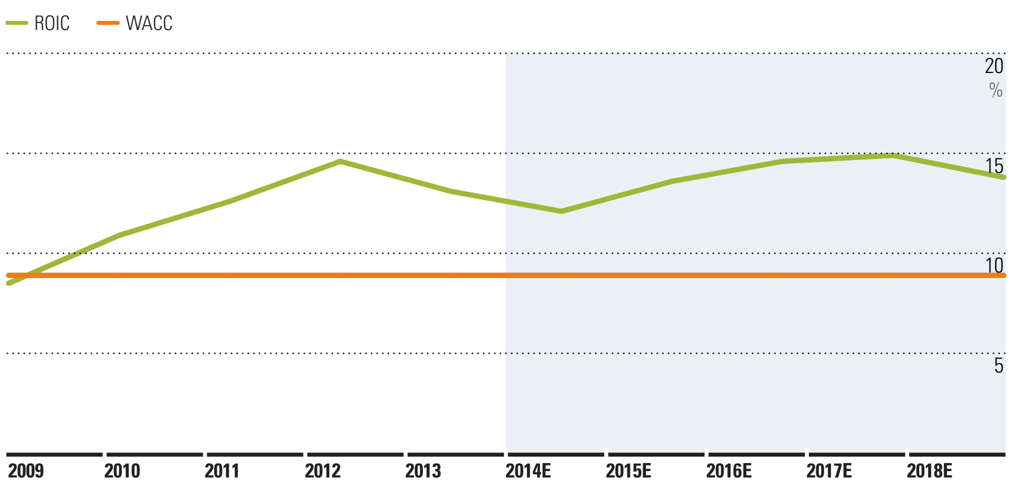
Cardinal is the third-largest pharmaceutical distributor by revenue and is the main supplier to CVS Caremark's retail pharmacy network. The firm also supplies several large provider GPOs and mass retailers. Cardinal recently lost its primary supplier contracts with Express Scripts Mail Order Pharmacy and Walgreen to rival Amerisource and this will be a headwind upon Cardinal's top-line growth. However, the razor thin profitability of these relationships will affect the bottom-line to a much lesser degree. With the change in revenue mix, Cardinal will actually see an increase in operating margins moving forward as its services will skew more toward smaller and regional customers. Nevertheless, the lower asset efficiency due to the loss of a significant amount of volume will provide somewhat of a headwind to ROICs.

Cardinal has also made a few strategic moves we believe will be beneficial over the long-term. The firm signed an agreement with CVS Caremark where the two firms will combine generic sourcing operations. This should allow CAH to enhance profitability as the combined sourcing entity will be able to garner greater pricing discounts from generic manufacturers.

In addition, Cardinal has moved heavily into the Chinese pharmaceutical distribution market. This market remains very fragmented and dominated by smaller Chinese players. The benefit the firm will gain from this venture is still uncertain, but positively Cardinal has received the explicit backing of the Chinese government. Its potential to drive consolidation within the Chinese drug distribution market, greater brand value because its supply of drugs is viewed as safer, first mover advantage, and expected strong growth in demand for medical care within China gives Cardinal a strong opportunity for success.

We believe the firm's distribution efficiency will allow it to produce ROICs over an extended period on par with a wide moat firm. Its solid industry positioning and future outlook also gives us confidence its moat trend will remain stable for some time to come.

Exhibit 13 Cardinal ROIC



Source: Morningstar Equity Research

McKesson is the largest pharmaceutical distributor by revenue and is the main supplier to large

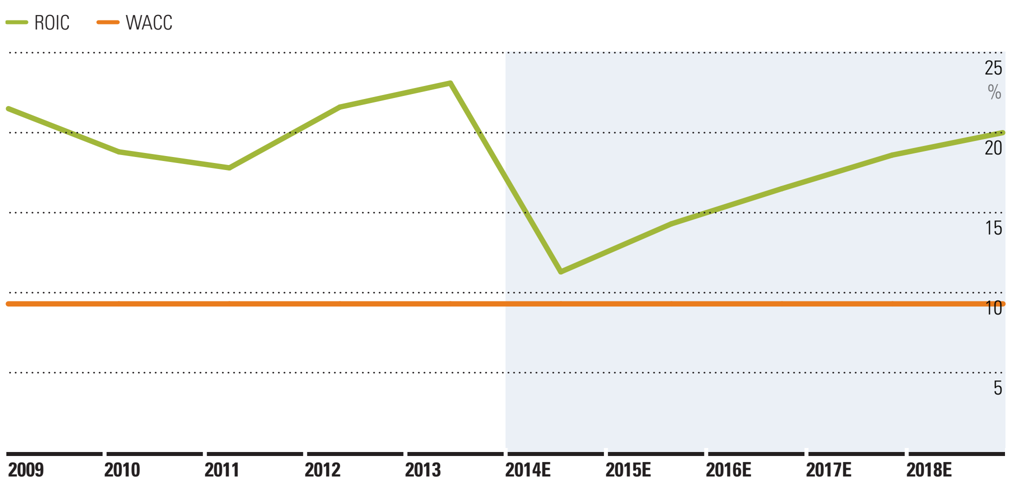
Firm	Moat Rating	Trend Rating
McKesson	Wide	Stable

pharmacy outlets CVS Caremark Mail Order Pharmacy, Rite Aid, and Wal-Mart. The firm is the oldest distributor, tracing its roots back to 1833. This has given it a solid foothold within the drug distribution industry. Over the past decade McKesson has made a concerted effort to change its revenue mix to higher-profit smaller customers. According to Pembroke Consulting, from 2005 to 2013 the firm has doubled its revenue from smaller customers while seeing a 20% decline in revenue from large pharmacies. Additionally, the distributor has also grown to become the second-largest specialty drug distributor within the United States. These strategic moves should help drive excellent profit and asset return growth over the coming years.

McKesson recently acquired Europe's largest drug distributor and second-largest retail pharmacy chain, Celesio. We believe this strategic move is mainly positive as it will allow the firm to move into the European market and give it some geographic diversification. More important, however, this acquisition will increase McKesson's pricing power among its suppliers and benefit from a cheaper sourcing operation. McKesson is also a major player within the health care technology space. The firm provides IT services and products to most major industry providers, including hospitals and physician offices. While this segment constitutes a small portion of total revenue, its $3.5 billion top line makes it one of the largest players within the health care IT sector. Segment profit margins, ROAs, and growth outlook are also materially higher for this segment than for those of McKesson's core distribution business—adding to ROIC.

We believe the firm's distribution efficiency will allow it to produce ROICs over an extended period on par with a wide moat firm. Its solid industry positioning and future outlook also gives us confidence its moat trend will remain stable for some time to come.

Exhibit 14 McKesson ROIC



Source: Morningstar Equity Research

Our Analysis of the Industry's Recent Strategic Moves and Outlook for each Firm

Vishnu Lekraj

Over the course of 2013 Amerisource, Cardinal, and McKesson have made a series of strategic maneuvers that involved partnerships, operational tie-ups, significant equity investments, and all-out acquisitions of other pharmaceutical services players.

1. Amerisource—Walgreen/Alliance Boots
   Amerisource will become the exclusive distributor for all of Walgreen's pharmaceutical supply which will eventually encompass the retail chains generic inventory. Amerisource will also be able to source its generic supply from the Walgreen Alliance Boots global partnership.

2. Cardinal—CVS Caremark
   Cardinal will combine its generic sourcing operations with those of CVS Caremark and create the world's largest generic drug purchasing entity.

3. McKesson—Celesio
   McKesson recently purchased Celesio which is one of the largest European pharmaceutical wholesalers and retail chains. This will expand McKesson's reach internationally and strengthen its drug purchasing power.

Key Takeaways

- While the operational and capital composition of each deal varies, the underlying motivation of all is the need to source and deliver pharmaceuticals more cost effectively. Given the growing power of PBMs and the need of health plan sponsors to curb costs, we believe there will be increasing pricing pressure for most pharmaceutical supply chain participants.

- The recent partnerships agreements between the major distributors and global retail pharmacies overall make strategic sense given the greater pricing pressure these players face from PBMs, in our opinion. These new entities will become powerful firms within the health care market and we believe will shift some additional power from pharmaceutical manufacturers to distributors and retail pharmacies. This dynamic will be especially pronounced within the generic market where the pricing power between generic manufacturers is significantly weaker than their branded counterparts.

- Despite our positive view of the operational strategy for these deals, we believe the major three will not earn a significant amount of economic profits from these projects. We do not believe these investments are value destructive, but fairly priced and will yield close to each firm's WACC.

AmerisourceBergen Strengthens its Sourcing Operations but Pays Walgreen for the Opportunity

Morningstar's Overall Analysis: On balance the deal should be beneficial to shareholders. Operationally positive, but the financial terms could dilute shareholders.

Overall Relative Grade: B–

From a strategic operational standpoint, we view Amerisource's partnership with Walgreen favorably. The value that will be created for the firm through increased supplier pricing power is a major positive. Additionally, the opportunity to become the primary distributor for all of Walgreen's pharmaceutical supply, and the gained efficiency management claims this relationship will yield, should be beneficial.

However, the financial terms of the deal are complicated and bring an element of dilution risk to current equityholders. Walgreen will now have the option to claim 16% of all Amerisource equity value moving forward. The distributor also ceded some control over its strategic direction as it will grant two board seats to Walgreen (assuming WAG reaches certain ownership percentages). When we compare the cost of this strategic partnership with those of its peers, we believe Amerisource paid a hefty price.

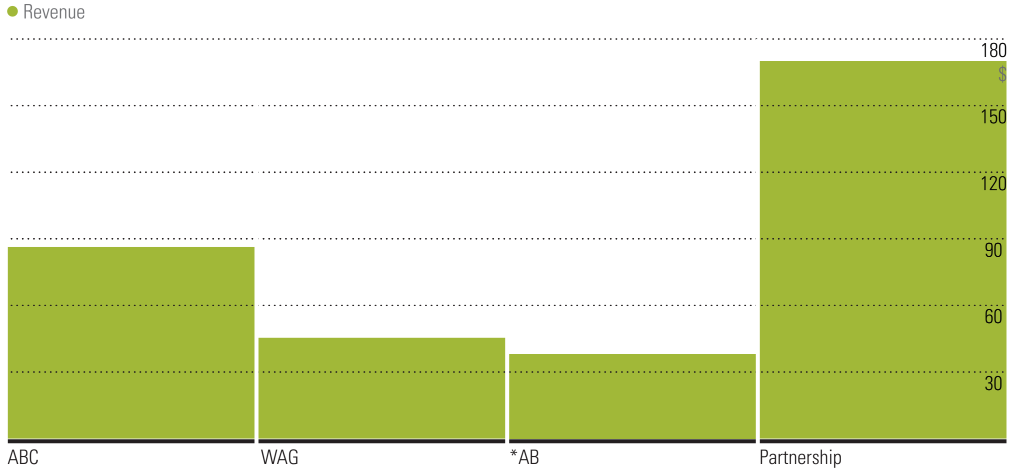
Strategic Operational Analysis: A very positive strategic move for Amerisource that will build increased supplier pricing advantages for the distributor and secures it a long-term partnership with one of the largest U.S. retail pharmacy chains.

Relative Strategic Grade: A

We believe Amerisource's long-term partnership with Walgreen is a positive from an operational standpoint. It will allow both firms to benefit from increased supplier pricing power and more efficient distribution operations. The 10-year length of the contract also solidifies Amerisource's position as a key player within the pharmaceutical supply chain.

In our opinion, the most critical aspect to this agreement for both entities is the increased supplier pricing power they both gain. The new sourcing operation will not only include demand from Amerisource and Walgreen, but also demand from Alliance Boots. We estimate the three firms combined will control approximately $170 billion in global pharmaceutical demand. Although individually each firm controls a formidable level of demand, the new sourcing partnership will be one of the world's most powerful pharmaceutical supply chain players.

Exhibit 15 Pharmaceutical Related Revenue ($B)



Source: Morningstar Equity Research
*Based on March 19, 2014 pound U.S. dollar exchange rate

By combining demand and utilizing the most effective generic procurement channels, both firms should benefit, from a COGS perspective. This is especially key for Amerisource as it will benefit materially from any incremental improvement in costs due to the slim profits of the drug distribution industry. Based on our DCF model, a 10-basis-point drop in average COGS margin over our 5-year explicit forecast period increases Amerisource's fair value estimate by 7%.

Exhibit 16 Fair Value Estimate Sensitivity

ABC DCF FVE	Avg. COGS Margin (%)	FVE ($)
Base Case	97.05	75
10 bps Decrease	96.95	80
Delta (%)	–0.10	6.67

Source: Morningstar Equity Research

The other major aspect of the Amerisource-Walgreen partnership is the integration of U.S. distribution operations between the two firms. Over the next few years Amerisource will eventually become the primary distributor for all of Walgreen's drug supply—including generics. Amerisource management states the expanded agreement will build more efficiency into its distribution network as the firm will be able to leverage unused capacity. This variable is hard to verify without explicit knowledge of Amerisource's distribution operations; however, we believe the expanded Walgreen partnership will be more profitable than a usual large customer contract if the firm is indeed able to utilize existing infrastructure.

Financial Analysis: We believe Amerisource Paid a Price for its Walgreen Deal

Relative Financial Grade: C

We believe the financial structure of the Amerisource/Walgreen deal is the most complicated when compared with the other major agreements recently consummated within the drug distribution industry. The major financial variable of the deal involves Walgreen eventually acquiring 23% of Amerisource equity—assuming all warrants are exercised and Walgreen purchases the remaining 45% of outstanding Alliance Boots equity. There are three major pillars to the financial framework of the deal:

1) Walgreen and Alliance Boots have the option to initially purchase a combined 7% of outstanding Amerisource fully diluted equity (including the warrant options listed below).

2) Walgreen and Alliance Boots have been given two tranches of equity warrants.

   a) Tranche 1:
      Walgreen and Alliance Boots are issued equity warrants for the right to purchase a combined 8% of outstanding Amerisource equity at a $51.50 strike price during a six-month period beginning March 2016.

   b) Tranche 2:
      Walgreen and Alliance Boots are issued equity warrants for the right to purchase a combined 8% of outstanding Amerisource equity at a $52.50 strike price during a six month period beginning March 2017.

The financial structure and complex nature of this deal does tie the interests of both firms closer together, but the price Amerisource paid Walgreen for the partnership seems steep, in our opinion. Based on the strike prices of each equity warrant tranche, the initial fixed cost of the deal was $12 per share or approximately $3 billion. This reflects the discounted strike prices of each tranche subtracted from the $49 per share Amerisource's stock was trading for at the time (March 18, 2013). Even though the strike prices are slightly above the stock price when the deal was struck, we believe the true price to original shareholders should reflect time value of money.

Exhibit 17 Estimated Fixed Cost of Walgreen Partnership to Amerisource Shareholders

Initial Fixed Cost of WAG Deal	$
Tranche 1 Discounted Price:	39
Tranche 2 Discounted Price:	36
Blended Strike Price:	37
March 18th, 2013 stock price	49
Price Paid by Original Shareholders	12

Source: Morningstar Equity Research

In addition, Amerisource has given Walgreen the right to 16% of all future equity value above the strike prices and will allow the firm to appoint two directors to its board. Walgreen will also get to leverage Amerisource's demand into improved supplier pricing. In our opinion, this is a steep price to pay for Amerisource.

Other Major Strategic Initiatives: Movement toward large-customer contracts

Over the past few years Amerisource has increasingly become the major supplier to large-pharmacy customers. Besides the recent Walgreen agreement, the firm won the Express Scripts mail-order contract in 2013. The distributor's top line increased sharply in 2013 as a result and we expect the same in 2014. A material portion of this revenue growth will carry a lower level of profitability due to the gross margins of large-customer contracts. However, if the firm can leverage its current infrastructure and utilize its unused capacity as management claims, these recent large contract wins will be more profitable than historical norms.

Cardinal Health Gains Excellent Supplier Pricing Advantages With its CVS Caremark Partnership

Morningstar's Overall Analysis: We believe the deal will be beneficial to shareholders. Operationally, it should enhance Cardinal's pricing power with manufacturers while the financial costs are less than what its peers have paid.

Overall Relative Grade: B

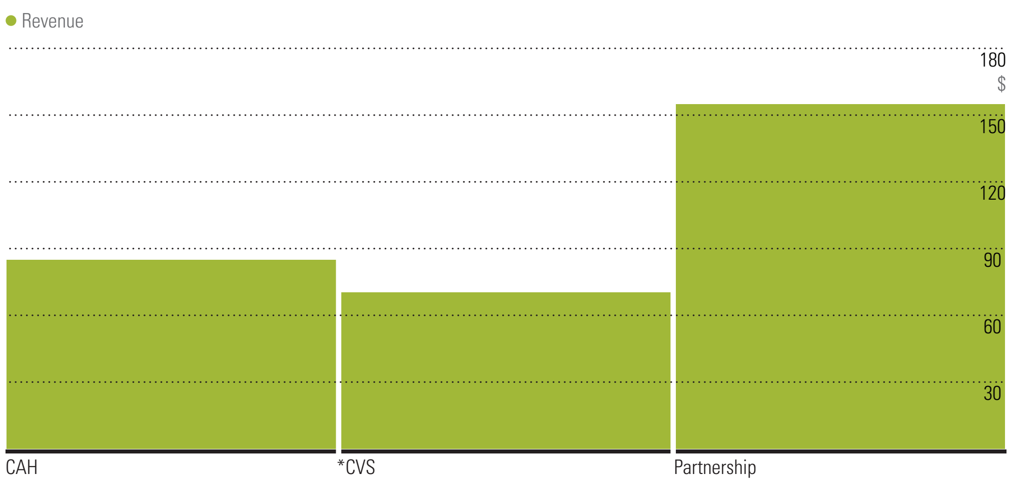
By entering into the partnership with CVS, Cardinal has solidified its position as a key player within the pharmaceutical supply chain and has strengthened its supplier pricing advantages. The firm will be able to obtain its generic drug supply at cheaper cost than it could have on its own. This is especially important given its revenue mix has and will continue to skew toward smaller pharmacies that source their entire generic supply from distributors. The relatively cheap cost of the deal builds significant shareholder value into this venture.

Strategic Operational Analysis: Cardinal should benefit from a cheaper generic sourcing operation, positively enhancing its cost structure.

Relative Strategic Grade: B
We believe Cardinal's long-term generic procurement partnership with CVS will enhance its supplier pricing advantages and help to drive more efficiency through its souring operations.
However, operationally, this partnership is not as robust as Amerisource's or McKesson's as there is no opportunity for Cardinal to enhance its distribution operations. Nevertheless, we believe this strategic move is still highly positive and will enable Cardinal to operate at a lower-cost basis.

The joint venture will begin in July 2014 and have a 10-year length. In our opinion, Cardinal benefits greatly from the long duration of the partnership as this dynamic makes it a critical partner over an extended period to one of the most powerful firms within the health care industry. In our opinion, the combined entity will be one of the world's most powerful players within the pharmaceutical supply chain.

Exhibit 18 Pharmaceutical Related Revenue ($B)



Source: Morningstar Equity Research
*Only includes retail pharmacy revenue, excludes revenue from front-end products and PBM services

By combining demand and utilizing the most effective generic procurement channels, both firms should benefit, from a COGS perspective. This dynamic should help drive gross and operating margin expansion over the next several years for Cardinal and CVS.

Financial Analysis and Price of Deal: The clean and straightforward financial nature of the deal along with no equity ownership concession makes this a great value for Cardinal.

Relative Grade: B+

Unlike the Amerisource-Walgreen agreement, the financial parameters of the Cardinal-CVS Caremark partnership are straightforward. Cardinal will pay CVS a $100 million annual fee over the duration of the joint venture. The fee represents approximately 10 basis points of Cardinal's annual COGS, which we believe will be more than offset by the savings the firm will gain through the new joint venture. Additionally, we view the less complicated financial structure of this agreement, no significant equity cost, and no need to grant board seats to CVS as a great overall value for Cardinal.

Other Major Strategic Initiatives: Aggressive expansion into the Chinese drug and U.S. medical supply distribution markets.

Over the last few years Cardinal has expanded into the Chinese health care market. The increasing demand for pharmaceuticals and relatively fragmented nature of the local Chinese drug distribution market provides the firm with a strong growth opportunity, in our opinion. Through our conversations with the firm, Cardinal expects to reap significant value from this international investment as there have been issues with pharmaceutical product safety in the growing Chinese drug market. The firm states this dynamic will give it a major brand advantage. In particular Cardinal sees the Western provinces of China as ripe for consolidation and in need of better distribution efficiency. Boosting its efforts has been the explicit backing of the Chinese government; which believes Cardinal will bring more efficiency into its pharmaceutical distribution market.

We believe this strategy could create value if Cardinal can avoid supply chain issues (especially to the Western provinces) and side-step any political headwinds that could creep in. The Chinese government still wields a heavy hand within its economy and the relatively nascent nature of a growing Chinese health care market could prove troublesome from a political perspective. Nevertheless, we expect this segment to remain a relatively small piece of the firm's top line over the next several years.

In addition to its Chinese expansion, Cardinal will look to expand its U.S. medical product distribution business. Overall we are skeptical of how much value this investment will create. The growth outlook for medical product distribution is minimal, in our opinion. Cardinal will also have to compete with Owens and Minor (OMI), a well-established and entrenched player within the market. Not only will competition and growth be tough for Cardinal, the medical supply sector is also highly concentrated from a supplier perspective – making pricing difficult. We believe this strategic move has the greatest potential of being value destructive when compared to the firm's other major efforts.

McKesson Forgoes the Partnership Route and Buys a Major European Pharmaceutical Player

Morningstar's Overall Analysis: McKesson's acquisition of Celesio will strengthen its distribution operations; however, the deal has an extra element risk because McKesson chose to buy its partner.

Overall Relative Grade: B–
On balance, the supplier pricing advantages and enhanced distribution advantages should be beneficial to McKesson operationally. The firm will have the opportunity to more efficiently acquire its drug supply and leverage the best practices of both firm's to build a stronger distribution operation. Even with these positive variables, the strategy of an all-out acquisition instead of a partnership builds more risk into the equation for shareholders. McKesson will have to effectively integrate both operations and be able to deliver on its estimated synergies. Additionally, the firm will now have to navigate a number of separate international pharmaceutical markets which are more heavily regulated than its core U.S. operations. Positively, McKesson will have direct control over the entire project instead of partial control of a joint venture.

Strategic Operational Analysis: A Mainly positive move that expands McKesson's supplier pricing power and international reach.

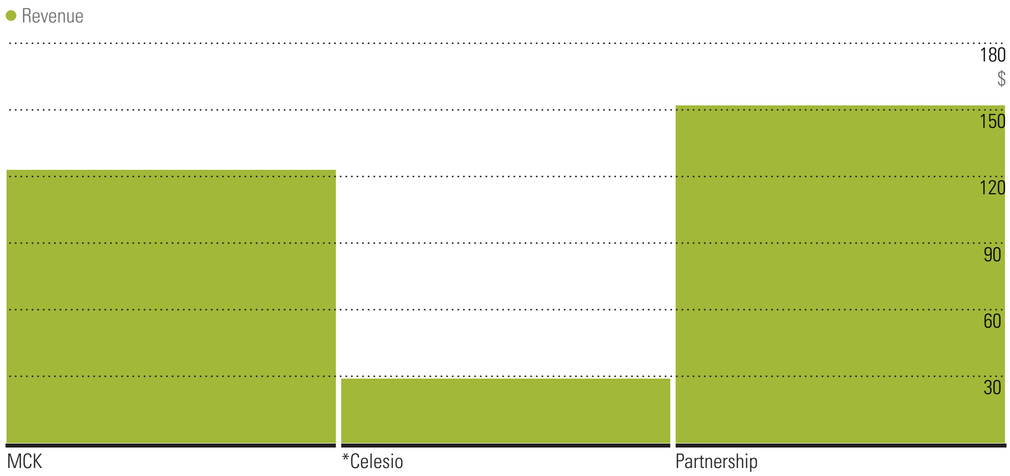
Relative Strategic Grade: B+

By acquiring Celesio, McKesson cements its status as the premier global pharmaceutical distributor. The firm expands its operations into several global markets both on the wholesale and retail pharmacy front. Celesio is not only Europe's largest pharmaceutical distributor, but also the region's second-largest retail pharmacy. The distinguishing factor of this deal is McKesson's all-out acquisition of Celesio, which gives it total control of the combined entity's operations. McKesson adds to its already sizable supplier pricing advantages and instantly owns the most extensive drug distribution networks in Europe. We believe this last dynamic is key as McKesson will gain material efficiencies by expanding its distribution network into one of the most robust and mature health care markets in the world.

We believe McKesson will gain significant distribution efficiencies as it will control the entire network and reap all of the synergies gained from the combined entity. However, we also believe it will take McKesson longer to reap these benefits. In our opinion, it will take several years before the firm is able to fully implement a true global distribution network given the complexity of integrating the various global markets.

McKesson will also fold a significant retail pharmacy operation into its portfolio of health care businesses. The firm is already a major player within the U.S. health care IT market and will now own a major European pharmacy chain. Even though this segment could add to the firm's growth potential, we believe the distribution assets were the main target of McKesson.

Exhibit 19 Pharmaceutical Related Revenue ($B)



Source: Morningstar Equity Research
*Based on March 19, 2014 pound to U.S. dollar exchange rate

Financial Analysis and Price of Deal: McKesson wanted to own instead of leasing its partnership, paying $8 billion

Relative Grade: C

We estimate McKesson purchased Celesio for approximately $8 billion, based on the following variables:

1) McKesson acquires all of Franz Haniel & Cie. GmbH shares for EUR 23.50 per share— approximately 76% of outstanding shares.
2) We assume the outstanding equity balance will be acquired at a moderate premium as remaining shareholders will "hold out" for a premium.
3) The firm pays EUR 700 million for convertible bonds owned by Elliot Asset Management.
4) McKesson takes ownership of the EUR 2 billion of Celesio debt outstanding.
5) Total cost of the acquisition equals EUR 6.814 billion or $8.410 billion, assuming a 1.36 EUR/USD exchange rate.

Exhibit 20 Cost of Celesio Acquisition

Number of Shares Outstanding	170
Haniel Euro Bid Price	€ 23.50
# of 76% of Shares Outstanding	129
Equity Cost	€ 3,038
Premium Price for Remaining Shareholders	€ 25.00
# of 24% of Shares Outstanding	41
Equity Cost	€ 1,021
Total Equity Cost	€ 4,059
Cost of Elliot Bonds	€ 700
Total Celesio Debt @ end of Fiscal 2013	€ 2,083
Total Acquisition Cost	€ 6,841
Euro/Dollar Rate	1.36
Total U.S. Acquisition Cost	$9,304

Source: Morningstar Equity Research, Company Reports

Based on Celesio's 2012 full-year EBITDA of $856 million, McKesson paid approximately a 10–11 times EBITDA multiple. In our opinion, this is a fair price factoring Celesio's retail pharmacy operations and the $275 million–$325 million in annual estimated synergies. We do not believe the project will yield a significant amount of positive NPV, but it should add modestly to shareholder value.

Other Major Strategic Initiatives: McKesson is a leader in the health care IT market, which is poised for strong growth. The firm also expanded its distribution deal with Rite Aid—a positive development.

McKesson owns one of the largest health care IT businesses in the United States. It competes against a few large firms in this market, but the fragmented nature of this sector creates opportunity for growth. We view this segment favorably and believe it will drive long-term value creation for shareholders. However, given this business does not fully fit with McKesson's core drug distribution operations and the firm's major Celesio and Rite Aid investments, we would not be surprised if it divested the IT business within the medium term.

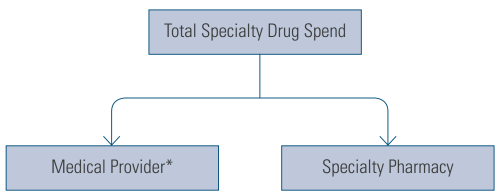
In addition to its Celesio acquisition, McKesson recently expanded its Rite Aid contract to supply the retail pharmacy chain with its entire drug inventory (including generics) over the next five years. This deal is similar to the Amerisource/Walgreen distribution agreement and will allow McKesson to enhance the profitability of a large customer contract. We view this contract expansion favorably and believe it will drive excellent shareholder value.

Making Dollars and Sense of the Specialty Pharmaceutical Distribution Market

Vishnu Lekraj

The role drug distributors play within the specialty pharmaceutical market is complex, with the major three participating on many levels. The opportunities available to Amerisource, Cardinal, and McKesson vary greatly and are dependent upon the type of treatment regimen and the setting for where this regimen is administered. However, we believe investors should view this market on the basis of two basic distribution channels:

Exhibit 21 Major Specialty Pharmaceutical Distribution Channels



Source: Morningstar Equity Research
* Hospital/Physician

Key Takeaways

- Over time, we believe the specialty drug market will most likely shift in terms of where the treatment is conducted and where the gross dollars are spent. With the growing use of specialty pharmaceuticals, insurers and payers have targeted the costs for these health care products as a key area to tighten control. This dynamic will dictate where these drugs are administered and ultimately greatly affect the three major pharmaceutical distributors.

- We believe Amerisource is the best positioned to handle the changing dynamics of the specialty pharmaceutical market as it has the greatest market share and most robust specialty distribution operations among the major three pharmaceutical distributors.

- The growing importance of specialty pharmaceuticals will play a major role within the pharmaceutical industry and the major industry distributors will need to formulate and maintain an appropriate strategy to deal with this dynamic. However, we believe the core operations for these players will remain the biggest driver of capital returns and shareholder value for Amerisource, Cardinal, and McKesson.

Where specialty drugs are administered determines how expensive they are, motivating a shift

There is a major difference in costs for a specialty regimen administered at a provider facility (hospital and/or physician's office) and a specialty pharmacy. A major driver of these higher costs involves how specialty pharmaceuticals are submitted for payment to an insurance benefit plan. Health benefit insurance products are sponsored by a "payer" (employer, retirement plan, union plan, and other organizations) and have two different components.

1) Medical Benefit:

   This part of a health insurance plan pays for medical procedures and treatments administered at a provider (hospital or physician office, for example). The management of these benefits is usually handled by an MCO or health insurance company. MCOs and health insurers have expertise in negotiating pricing for medical procedures, determining the most cost-efficient provider network, managing a plan member's medical treatment cost-effectively, and underwriting a payers' population for the forecast use of medical procedures.

2) Pharmacy Benefit (drug benefit):

   This part of a health insurance benefit plan pays for pharmaceuticals prescribed by a physician and obtained through a pharmacy. The management of these benefits is usually handled by a PBM or a health insurance company with PBM capabilities. PBMs have expertise in negotiating drug pricing with suppliers (pharmacies, distributors, manufacturers), determining the most efficient pharmacy network, managing a plan member's drug regimens cost-effectively, and underwriting a payers' population for the forecast consumption of pharmaceuticals.

Each of these separate health plan benefits obviously has different dynamics and therefore needs different expertise in managing it the most efficiently, from both a health outcome and cost basis. This is the reason payers many times separate these two benefits and use separate entities to manage them.

When a specialty pharmaceutical is administered at a provider the hospital and/or physician office processes the cost through the medical benefit rather than the pharmacy benefit, which then flows to an MCO for adjudication. As we mentioned previously, MCOs usually do not have the expertise to effectively manage drug costs (specialty or traditional). Thus, there usually is a lower level of cost containment measures applied (such as formulary management, step therapies, utilization management, optimal supplier pricing) to the specialty regimen, and this leads to a higher level of specialty drug costs.

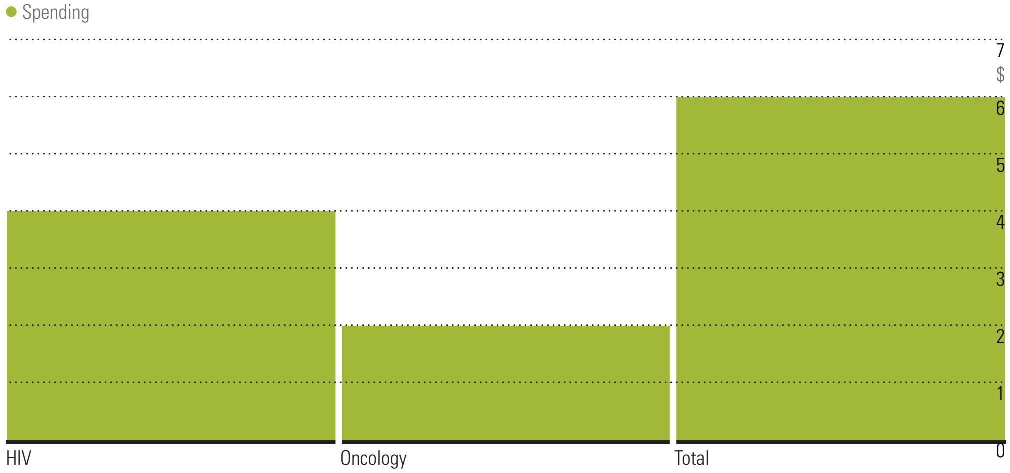
Additionally, when a specialty drug is administered at a medical provider its costs are usually folded in with the cost for labor, asset usage, and other professional fees a provider charges an MCO. Thus, the costs for specialty pharmaceuticals are at many times hard to identify and manage when they are run through the medical benefit.

We believe as specialty pharmaceuticals continue to grow and the specialty drug expense line becomes a greater portion of health benefit plan costs, payers will look to better manage these expenses. This will entail moving as much specialty pharmaceutical spending from the medical benefit to the pharmacy benefit, and by necessity moving where these drugs are administered—from a provider facility to a specialty pharmacy. This dynamic could also mean there will be a shift in which drug distributors will supply the associated pharmaceuticals and potentially affect the profit profile of these products for Amerisource, Cardinal, and McKesson. The major three may experience some profit compression for their specialty drug lines as they deliver a greater portion of these products to specialty pharmacies, where more cost controls are in place. With providers mostly indifferent to the cost of pharmaceuticals and MCOs lacking robust cost containment measures, distributors are able to earn higher profits if specialty pharmaceutical regimens are administered at provider facilities.

We estimate there is a potential for billions in specialty pharmaceutical spending to shift over the next several years, which will change the industry dynamic for the major drug distributors. According to CVS Caremark, close to half of all specialty drug spending flows through the medical benefit. We estimate the total specialty pharmaceutical spending is approximately $70 billion, which implies there is a potential for $35 billion to move from the medical benefit to the pharmacy benefit. This also potentially means $35 billion will shift from providers to specialty pharmacies, affecting the profitably of this distribution line.

To put some context around this dynamic, we analyzed data for two specific treatment categories: oncology and HIV. Many large specialty pharmacies have targeted these two treatment categories as areas for solid growth. We believe the oral treatments for these regimens will be the easiest to migrate, while more intense treatments regimens will most likely remain at a provider facility. According to data from Symphony Health Solutions, the amount of spending related to oral drug treatments for these diseases administered at institutions (providers) is $6 billion.

Exhibit 22 2013 Spending for Specialty Oral Treatments at Institutions ($B)



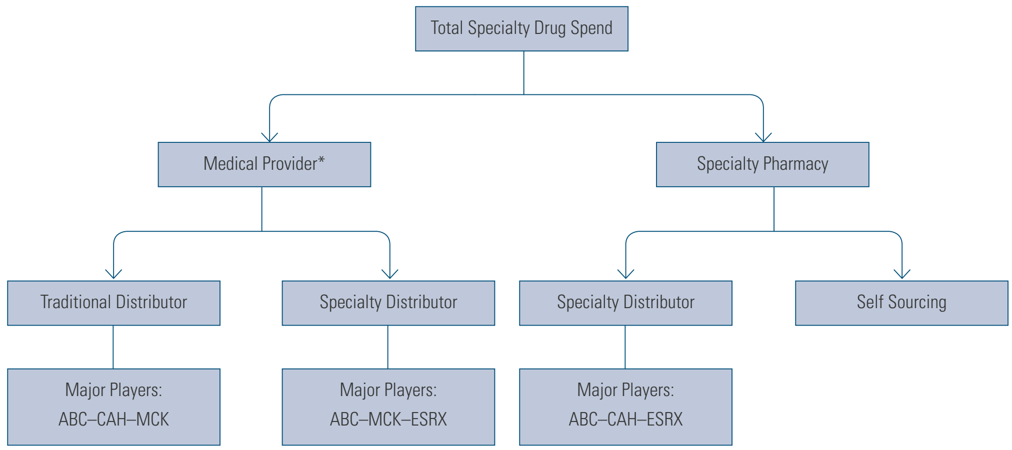
Source: Morningstar Equity Research

Based on spending data for these two treatment regimens alone gives an idea of the magnitude for potential change within the specialty pharmaceutical distribution sector. We would note, though, that certain injectable and/or infusion specialty pharmaceuticals can be administered at specialty pharmacies; however, the easiest revenue stream to capture would be oral regimens, in our opinion.

The flow of specialty pharmaceutical products and the affect upon the major three

We believe Amerisource is the best positioned to handle the changing dynamics of the specialty pharmaceutical market. According to Pembroke Consulting, Amerisource is the largest specialty distributor, followed by McKesson, with Cardinal trailing far behind. Nevertheless, as we covered in the previous section, specialty pharmaceuticals are administered at both provider and specialty pharmacy facilities. These varying entities can source their specialty drugs from different distributors, including from traditional pharmaceutical distributors. Given the complex nature of specialty pharmaceutical sourcing, we provide our analysis of the flow of goods through this niche and how the various distributors may be affected.

Exhibit 23 Major Specialty Pharmaceutical Distribution Channels



Source: Morningstar Equity Research
* Hospital/Physician

Hospitals and physician offices source their specialty pharmaceuticals from either a traditional or specialty distributor. The sourcing entity depends upon the specific provider's procurement capabilities and purchasing contracts. Most providers utilize group purchasing organizations (GPOs) that aggregate the demand from several providers and negotiate pricing with wholesales, including pharmaceutical distributors.

Hospital GPOs tend to use traditional distribution channels and the major three drug distributors benefit from these relationships. As previously mentioned, the lack of cost controls for drugs that hospitals source provides greater profitably for all players when specialty drugs are sourced through this wholesale channel.

However, certain hospital GPOs and most physician offices use specialty distributors for specialty drug sourcing. In this case, Amerisource and McKesson benefit the most. Cardinal lags far in its specialty distribution operations and in fact trails Express Scripts' CuraScript specialty distribution arm. Our sense is that there is no major profit difference for a distributor if a hospital/physician office sources a pharmaceutical through a traditional or specialty contract.

Specialty pharmacies obtain their drug inventory either through a specialty distributor or directly from manufacturers, bypassing distributors altogether. The top line for Amerisource, McKesson, and Express Scripts specialty distribution segments benefit when specialty pharmaceuticals flow through the specialty pharmacy channel, unless a contract is lost or the pharmacy self-sources its inventory.

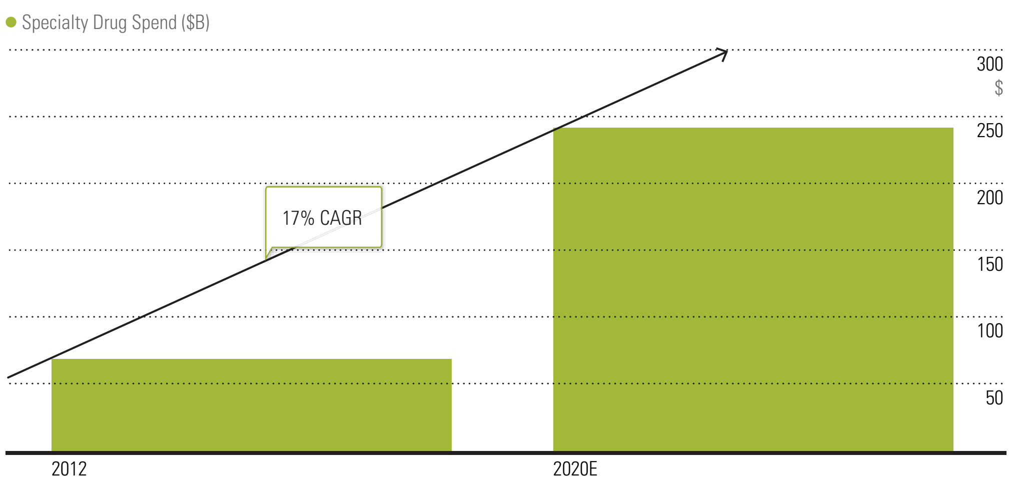
However, profitability is not as robust for specialty distributors when products are sourced by specialty pharmacies, rather than by the hospital/physician office channel. This dynamic is a headwind for Amerisource and McKesson, but not so much for Express. Express' core PBM services are its main focus and while a greater control over specialty pharmaceutical costs may hurt its distribution operations, it benefits when a greater amount of specialty volume is being managed under its core PBM operations. In fact, only 2% of the firm's revenue comes from distribution services.

The Specialty Bottom Line for Amerisource, Cardinal, and McKesson

The specialty pharmaceutical market offers both tailwinds and headwinds for the major three distributors. Amerisource and McKesson will benefit from the growth of specialty pharmaceuticals because of their current market shares and future strategies. However, we believe Amerisource is the best positioned given its dominant share and robust partnership with Walgreen. The firm will provide specialty pharmaceuticals to Walgreen and also leverage the retail pharmacy's significant specialty pharmacy operations. We believe Cardinal will remain a smaller player within the niche unless it purchases a sizable specialty distributor. Based on the firm's current investments and strategy, we do not foresee this happening over the near term.

We forecast a robust growth rate for specialty pharmaceutical spending over the next seven years. Express Scripts estimates specialty drugs will account for 50% of total payer pharmaceutical spending by 2020. Based on Centers for Medicare & Medicaid Services forecasts, this implies a 17% CAGR for specialty pharmaceutical spending over the next six years.

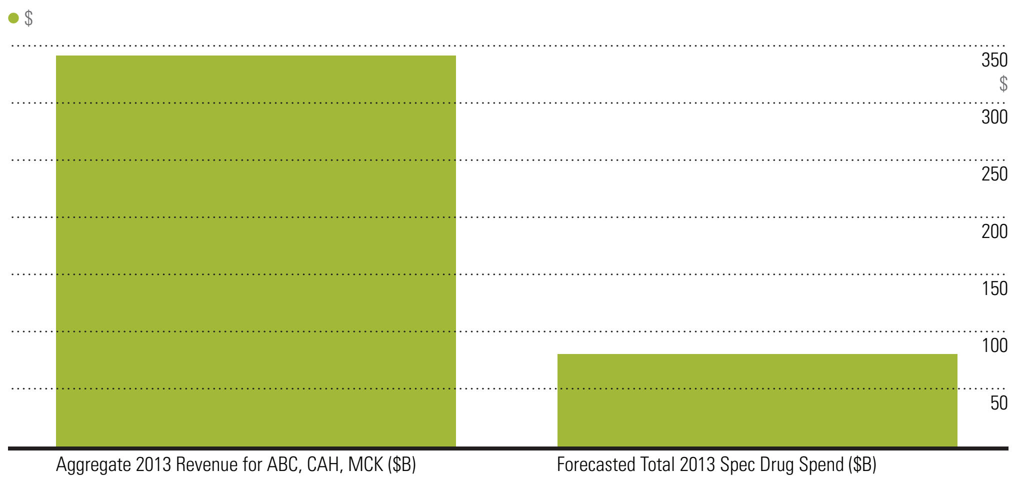
Exhibit 24 Estimated Specialty Pharmaceutical Spending ($B)



Source: Morningstar Equity Research, CMS, IMS

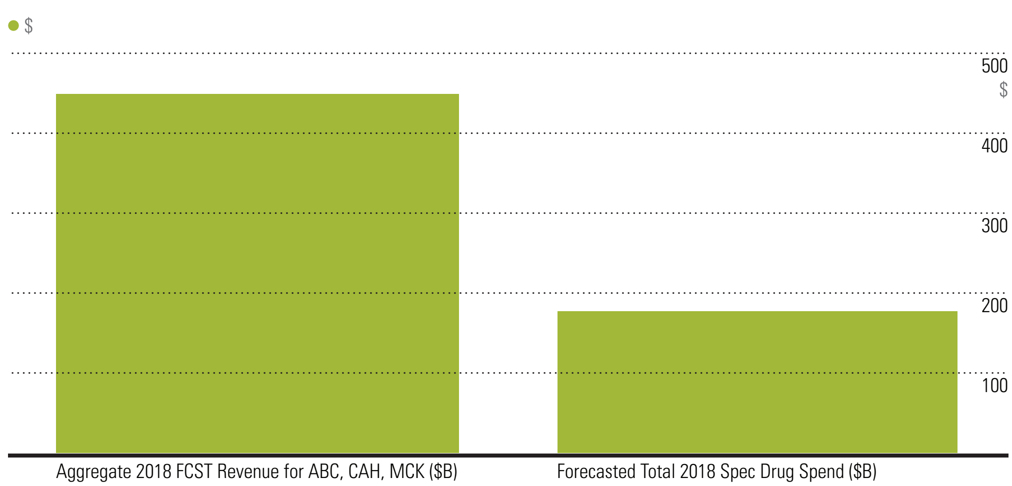
This rapid growth will definitely increase the importance of the specialty market niche for Amerisource, Cardinal, and McKesson. However, even with the growing importance of specialty pharmaceuticals within the health care market, it still represents a small percentage of the aggregate revenue for the major three drug distributors. While we forecast specialty drug spending to increase as a percentage of aggregate revenue for the major three, it will remain a smaller piece of the overall pie.

Exhibit 25 Estimated Specialty Pharmaceutical Spending ($ Billions) Compared With Aggregate Revenue for the Major Three



Source: Morningstar Equity Research, CMS, IMS

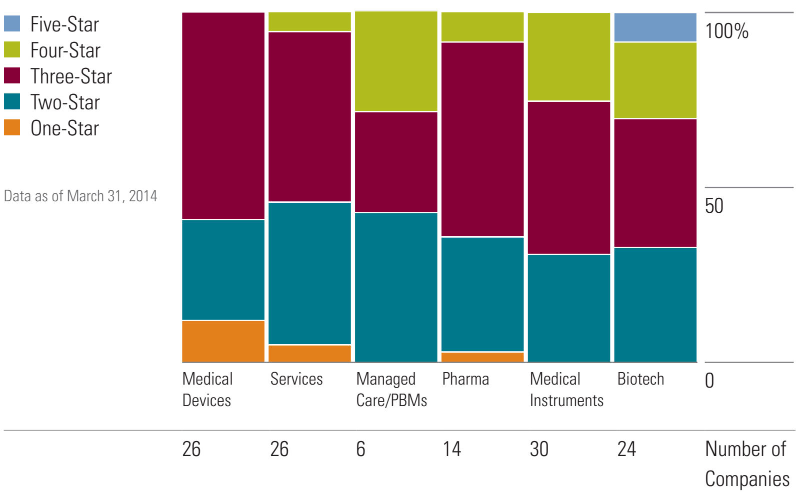
Exhibit 26 Estimated Specialty Pharmaceutical Spending ($ Billions) Compared With Aggregate Revenue for the Major Three



Source: Morningstar Equity Research, CMS, IMS

The growing importance of specialty pharmaceuticals will play a major role within the pharmaceutical industry, and the major industry distributors will need to formulate and maintain an appropriate strategy to deal with this dynamic. However, we believe the core operations for these players will remain the biggest driver of capital returns and shareholder value for Amerisource, Cardinal, and McKesson.

Outlook for Industries in Healthcare



Including both 4-star and 5-star stocks, the managed care and PBM industry along with biotech and instruments are at the top. The industries with the worst rankings are medical devices and services. Looking at the entire health-care sector, there are only two stocks with a 5-star rating.

Healthcare Large Cap Focus List

Company Name	Ticker	Moat	Uncertainty	Price to Fair Value	Star Rating	Analyst
Sanofi	SNY	Wide	Medium	0.82	★★★★	Conover
Express Scripts	ESRX	Wide	Medium	0.84	★★★★	Lekraj
Baxter	BAX	Wide	Low	0.88	★★★★	Andersen
Gilead Sciences Inc	GILD	Wide	Medium	0.89	★★★★	Andersen
Quest Diagnostics Inc	DGX	Narrow	Medium	0.89	★★★★	Wang
Covidien PLC	COV	Wide	Low	0.98	★★★	Morozov
WellPoint Inc	WLP	Narrow	Medium	1.00	★★★	Lekraj
Valeant Pharmaceuticals International Inc	VRX	Narrow	Medium	1.01	★★★	Krempa
Medtronic, Inc.	MDT	Wide	Medium	1.03	★★★	Wang
Teva Pharmaceutical Industries Ltd	TEVA	Narrow	Medium	1.10	★★★	Waterhouse

Data as of March 31 , 2014

Since the August 2008 inception, our focus list has outperformed the iShares Dow Jones US Healthcare ETF Index IYH by 83% and the S&P 500 by 124%. On an absolute basis, the focus list has returned 171% since the initial launch. We measure our performance by equally weighting each holding and rebalancing at the end of each month.

Healthcare SMID Focus List

Company Name	Ticker	Moat	Uncertainty	Price to Fair Value	Star Rating	Analyst
Catamaran Corp	CTRX	Narrow	Medium	0.79	★★★★	Lekraj
Hologic Inc	HOLX	Narrow	Medium	0.80	★★★★	Zecy
Cooper Companies	COO	Narrow	Medium	0.86	★★★★	Krempa
Biomarin Pharmaceutical, Inc.	BMRN	Narrow	Medium	0.90	★★★★	Andersen
Icon PLC	ICLR	Narrow	Medium	0.91	★★★	Krempa
Nordion, Inc.	NDZ	Narrow	High	0.96	★★★	Krempa
Laboratory Corporation of America Holdings	LH	Narrow	Medium	0.96	★★★	Wang
Edwards Lifesciences Corporation	EW	Narrow	High	0.98	★★★	Wang
Hospira	HSP	Narrow	High	0.98	★★★	Waterhouse
Waters Corporation	WAT	Wide	Medium	1.03	★★★	Morozov

Data as of March 31, 2014

Since our recent launch at the beginning of Sept. 2010, our focus list has outperformed the iShares Dow Jones US Healthcare ETF Index IYH by 61% and the Russell Mid Cap Index by 85%. On an absolute basis, the focus list has returned 173% since the initial launch. We measure our performance by equally weighting each holding and rebalancing at the end of each month. This month, we are replacing Charles River with Biomarin Pharmaceutical due to the strong run up in valuation for Charles River.

Healthcare Calendar

May 2014

				1	2	3
4	5	6	7	8	9	10
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Event	Date	Location
American Psychiatric Association (APA)	May 3–7	New York
American Society of Clinical Oncology (ASCO)	May 30–June 3	Chicago

June 2014

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29	30					

Event	Date	Location
European League Against Rheumatism (EULAR)	June 11–14	Paris, France
American Diabetes Association (ADA)	June 13–17	San Francisco

Biotechnology Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Actelion Ltd.	ATLN	Karen Andersen	★★	10,067	83.70	59.00	1.42	None	Positive	High	19.5
Alexion Pharmaceuticals, Inc.	ALXN	Stefan Quenneville	★★★	30,096	152.13	152.00	1.00	Narrow	Positive	High	31.9
Alnylam Pharmaceuticals, Inc.	ALNY	Karen Andersen	★★★	4,291	67.14	66.00	1.02	None	Positive	Very High	9.3
Amgen Inc	AMGN	Karen Andersen	★★★	93,123	123.34	125.00	0.99	Wide	Negative	Medium	14.0
Biogen Idec Inc	BIIB	Karen Andersen	★★	72,306	305.87	230.00	1.33	Wide	Stable	Medium	
Biomarin Pharmaceutical, Inc.	BMRN	Karen Andersen	★★★★	9,797	68.21	76.00	0.90	Narrow	Positive	Medium	
Celgene Corporation	CELG	Karen Andersen	★★★	56,680	139.60	135.00	1.03	Narrow	Positive	High	15.1
Cubist Pharmaceuticals, Inc.	CBST	David Krempa	★★	5,471	73.15	63.00	1.16	None	Stable	High	26.2
Dendreon Corp	DNDN	Karen Andersen	★★★	475	2.99	3.00	1.00	None	Stable	High	
Exelixis, Inc.	EXEL	Stefan Quenneville	★★★★★	689	3.54	7.50	0.47	None	Stable	Very High	
Gilead Sciences Inc	GILD	Karen Andersen	★★★★	109,001	70.86	80.00	0.89	Wide	Stable	Medium	12.3
Grifols SA	GRFS	Karen Andersen	★★	14,016	41.30	37.00	1.12	Narrow	Stable	Medium	15.8
Incyte Corp Ltd	INCY	David Krempa	★★	8,860	53.52	40.00	1.34	None	Stable	Very High	80.7
InterMune, Inc.	ITMN	Stefan Quenneville	★★	3,250	33.47	25.00	1.34	None	Stable	Very High	
Lexicon Pharmaceuticals, Inc.	LXRX	Karen Andersen	★★★★★	889	1.73	3.50	0.49	None	Stable	Very High	
MannKind Corporation	MNKD	Karen Andersen	★★★★	1,516	4.02	5.50	0.73	None	Stable	Very High	
Novo Nordisk A/S	NVO	Karen Andersen	★★★	125,538	45.65	45.00	1.01	Wide	Stable	Medium	21.3
QLT, Inc.	QLTI	Michael Waterhouse	★★★★	284	5.56	8.00	0.69	None	Stable	Very High	
Regeneron Pharmaceuticals, Inc.	REGN	Stefan Quenneville	★★★	30,006	300.28	338.00	0.89	Narrow	Positive	High	33.6
Seattle Genetics, Inc.	SGEN	Stefan Quenneville	★★★	5,603	45.56	41.00	1.11	None	Positive	Very High	
Shire PLC	SHPG	Karen Andersen	★★	29,592	148.53	129.00	1.15	Narrow	Stable	Medium	33.1
Vanda Pharmaceuticals, Inc.	VNDA	Stefan Quenneville	★★	544	16.25	12.00	1.35	None	Stable	Very High	76.3
Vertex Pharmaceuticals Inc	VRTX	Stefan Quenneville	★★★★	16,674	70.72	88.00	0.80	None	Positive	High	73.0

Diagnostics & Research Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Agilent Technologies Inc	A	Michael Waterhouse	★★	18,645	55.92	49.00	1.14	Narrow	Stable	Medium	14.6
Alere Inc	ALR	John Zecy	★★★	2,834	34.35	31.00	1.11	None	Stable	High	11.7
BioMerieux SA	BIM	Michael Waterhouse	★★★	3,141	79.62	77.00	1.03	Narrow	Stable	Medium	18.9
Charles River Laboratories International Inc	CRL	David Krempa	★★	2,876	60.34	52.00	1.16	Narrow	Stable	Medium	17.7
Covance, Inc.	CVD	David Krempa	★★	5,885	103.90	85.00	1.22	Narrow	Positive	Medium	22.8
Icon PLC	ICLR	David Krempa	★★★	2,928	47.55	52.00	0.91	Narrow	Positive	Medium	18.8
Idexx Laboratories	IDXX	Debbie Wang	★★	6,264	121.40	97.00	1.25	Narrow	Positive	Medium	25.6
Laboratory Corporation of America Holdings	LH	Debbie Wang	★★★	8,377	98.21	102.00	0.96	Narrow	Stable	Medium	13.1
Lonza Group AG	LONN	John Zecy	★★	4,680	90.15	67.00	1.35	None	Positive	High	16.8
Myriad Genetics, Inc.	MYGN	John Zecy	★★	2,495	34.19	29.00	1.18	Narrow	Negative	High	14.7
Nordion, Inc.	NDZ	David Krempa	★★★	713	11.52	12.00	0.96	Narrow	Stable	High	12.1
Parexel International Corporation	PRXL	David Krempa	★★★	3,062	54.09	50.00	1.08	Narrow	Positive	Medium	21.0
PerkinElmer Inc	PKI	Alex Morozov	★	5,085	45.06	31.00	1.45	Narrow	Negative	Medium	16.1
Qiagen NV	QGEN	Michael Waterhouse	★★★	4,933	21.09	22.00	0.96	None	Stable	Medium	18.4
Quest Diagnostics Inc	DGX	Debbie Wang	★★★★	8,358	57.92	65.00	0.89	Narrow	Stable	Medium	12.7
Quintiles Transnational Holdings Inc	Q	David Krempa	★★★	6,596	50.77	50.00	1.02	Narrow	Positive	Medium	18.1
Thermo Fisher Scientific Inc	TMO	Alex Morozov	★	47,109	120.24	84.00	1.43	Narrow	Positive	Medium	15.2
WuXi PharmaTech (Cayman), Inc.	WX	David Krempa	★★	2,625	36.86	28.00	1.32	None	Stable	High	16.2

Major Drug Manufacturers

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
AbbVie Inc	ABBV	Damien Conover	★★★	81,650	51.40	47.00	1.09	Narrow	Negative	Medium	14.1
AstraZeneca PLC	AZN	Damien Conover	★★	81,565	64.88	56.00	1.16	Wide	Negative	Medium	14.8
Bayer AG	BAYRY	Damien Conover	★★	111,853	135.26	105.00	1.29	Narrow	Stable	Medium	15.0
Bristol-Myers Squibb Company	BMY	Damien Conover	★★	85,730	51.95	47.00	1.11	Wide	Stable	Medium	29.0
Eli Lilly and Company	LLY	Damien Conover	★★★	65,906	58.86	59.00	1.00	Wide	Negative	Medium	16.0
GlaxoSmithKline PLC	GSK	Damien Conover	★★★	129,695	53.43	56.00	0.95	Wide	Stable	Medium	20.9
Johnson & Johnson	JNJ	Damien Conover	★★★	277,883	98.23	97.00	1.01	Wide	Stable	Low	15.0
Merck & Co Inc	MRK	Damien Conover	★★★	166,939	56.77	58.00	0.98	Wide	Stable	Medium	15.1
Novartis AG	NVS	Damien Conover	★★	206,266	85.02	80.00	1.06	Wide	Stable	Low	14.8
Pfizer Inc	PFE	Damien Conover	★★★	205,020	32.12	30.00	1.07	Wide	Stable	Medium	13.5
Roche Holding AG	RHHBY	Karen Andersen	★★	258,271	37.72	35.00	1.08	Wide	Stable	Low	3.2

Specialty & Generic Drug Manufacturers

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Actavis PLC	ACT	Michael Waterhouse	★★★	35,859	205.85	200.00	1.03	Narrow	Stable	Medium	13.0
Allergan, Inc.	AGN	Michael Waterhouse	★★★	37,040	124.10	115.00	1.08	Wide	Negative	Medium	19.6
Dr. Reddy Laboratories, Ltd.	RDY	Michael Waterhouse	★★★	7,467	43.90	43.00	1.02	Narrow	Stable	High	16.1
Endo International PLC	ENDP	David Krempa	★★★	7,938	68.65	70.00	0.98	Narrow	Stable	High	17.6
Forest Laboratories, Inc.	FRX	David Krempa	★★★	25,002	92.27	94.00	0.98	Narrow	Negative	High	28.7
H.Lundbeck A/S	LUN	David Krempa	★	32,765	167.00	100.00	1.67	Narrow	Negative	High	36.6
Hikma Pharmaceuticals PLC	HIK	Michael Waterhouse	★★	3,285	1661.00	1200.00	1.38	Narrow	Stable	High	21.7
Hospira, Inc.	HSP	Michael Waterhouse	★★★	7,199	43.25	44.00	0.98	Narrow	Stable	High	17.4
Mallinckrodt PLC	MNK	David Krempa	★★	3,689	63.41	45.00	1.41	None	Stable	High	20.7
Merck KGaA	MKGAY	David Krempa	★★	10,914	56.29	48.00	1.17	Narrow	Stable	Medium	4.2
Momenta Pharmaceuticals, Inc.	MNTA	Michael Waterhouse	★★★★	611	11.65	17.00	0.69	None	Positive	Very High	3.0
Mylan Inc	MYL	Michael Waterhouse	★★	18,160	48.83	32.00	1.53	Narrow	Negative	High	12.5
Perrigo Company PLC	PRGO	Michael Waterhouse	★★	20,685	154.66	120.00	1.29	Narrow	Stable	Medium	19.8
Pharmacyclics, Inc.	PCYC	Stefan Quenneville	★★★★	7,495	100.22	127.00	0.79	None	Positive	High	
Sanofi	SNY	Damien Conover	★★★★	138,471	52.28	64.00	0.82	Wide	Stable	Medium	6.5
Teva Pharmaceutical Industries Ltd	TEVA	Michael Waterhouse	★★★	50,033	52.84	48.00	1.10	Narrow	Stable	Medium	11.0
UCB SA	UCB	Stefan Quenneville	★★	10,661	58.12	50.00	1.16	None	Stable	High	21.4
Valeant Pharmaceuticals International Inc	VRX	David Krempa	★★★	44,146	131.83	130.00	1.01	Narrow	Stable	Medium	11.2
Zoetis Inc	ZTS	David Krempa	★★	14,491	28.94	24.00	1.21	Wide	Stable	Medium	16.5

Health Care Plan Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Aetna Inc	AET	Vishnu Lekraj	★★	27,192	74.97	65.00	1.15	Narrow	Negative	Medium	10.8
Catamaran Corp	CTRX	Vishnu Lekraj	★★★★	9,240	44.76	57.00	0.79	Narrow	Stable	Medium	14.7
Cigna Corp	CI	Vishnu Lekraj	★★	22,906	83.73	62.00	1.35	None	Negative	High	10.8
Express Scripts	ESRX	Vishnu Lekraj	★★★★	58,272	75.09	89.00	0.84	Wide	Stable	Medium	12.6
Humana Inc	HUM	Vishnu Lekraj	★★	17,363	112.72	82.00	1.37	None	Negative	High	12.4
UnitedHealth Group Inc	UNH	Vishnu Lekraj	★★★	81,104	81.99	76.00	1.08	Narrow	Negative	Medium	12.5
WellPoint Inc	WLP	Vishnu Lekraj	★★★	28,119	99.55	100.00	1.00	Narrow	Negative	Medium	10.1

Long-Term Care Facilities

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Kindred Healthcare, Inc.	KND	Michael Waterhouse	★★	1,267	23.42	14.00	1.67	None	Stable	Very High	13.2

Medical Care Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
AMN Healthcare Services, Inc.	AHS	Vishnu Lekraj	★★★	637	13.74	13.00	1.06	Narrow	Stable	High	16.3
DaVita HealthCare Partners Inc	DVA	Michael Waterhouse	★★	14,679	68.85	60.00	1.15	Narrow	Stable	Medium	14.3
Fresenius Medical Care AG & Co. KGaA	FMS	Michael Waterhouse	★★★	21,011	34.85	33.00	1.06	Narrow	Stable	Medium	9.7
HCA Holdings Inc	HCA	Michael Waterhouse	★★	23,127	52.50	37.00	1.42	None	Stable	Very High	12.2
Select Medical Holdings Corporation	SEM	Michael Waterhouse	★★	1,747	12.45	9.00	1.38	None	Stable	Very High	12.8
Tenet Healthcare Corp	THC	Michael Waterhouse	★★★	4,152	42.81	38.00	1.13	None	Stable	Very High	13.3
VCA Antech, Inc.	WOOF	Debbie Wang	★★★	2,844	32.23	31.00	1.04	Narrow	Stable	Medium	15.6

Medical Device Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Abbott Laboratories	ABT	Debbie Wang	★★★	59,424	38.51	40.00	0.96	Narrow	Stable	Low	16.2
Boston Scientific Corporation	BSX	Debbie Wang	★★	17,903	13.52	10.00	1.35	Narrow	Negative	High	20.2
Edwards Lifesciences Corporation	EW	Debbie Wang	★★★	7,954	74.17	76.00	0.98	Narrow	Stable	High	20.5
Intuitive Surgical, Inc.	ISRG	Alex Morozov	★★★	16,719	437.99	440.00	1.00	Wide	Positive	High	23.4
Medtronic, Inc.	MDT	Debbie Wang	★★★	61,590	61.54	60.00	1.03	Wide	Stable	Medium	14.7
Smith & Nephew PLC	SNN	Debbie Wang	★★	13,658	76.48	61.00	1.25	Narrow	Negative	Medium	59.5
Sonova Holding AG	SOON	Alex Morozov	★★★	8,678	129.20	122.00	1.06	Narrow	Positive	Medium	23.5
St Jude Medical, Inc.	STJ	Debbie Wang	★★	18,558	65.39	59.00	1.11	Wide	Stable	Medium	15.3
Stryker Corporation	SYK	Debbie Wang	★★	30,785	81.47	73.00	1.12	Wide	Negative	Medium	15.7
Thoratec Corporation	THOR	Julie Stralow	★★★	2,033	35.81	34.00	1.05	None	Positive	High	17.5
Varian Medical Systems, Inc.	VAR	Morningstar Analysts	★★★	8,697	83.99	78.00	1.08	Narrow	Positive	Medium	16.3
William Demant Holding A/S	WDH	Alex Morozov	★★★	27,051	463.60	491.00	0.94	Narrow	Positive	Medium	17.2
Zimmer Holdings Inc	ZMH	Debbie Wang	★★	16,014	94.58	85.00	1.11	Wide	Negative	Medium	14.1

Medical Distribution Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
AmerisourceBergen Corp	ABC	Vishnu Lekraj	★★★★	15,033	65.59	75.00	0.87	Wide	Stable	Medium	16.7
Cardinal Health Inc	CAH	Vishnu Lekraj	★★★	23,995	69.98	64.00	1.09	Wide	Stable	Medium	15.9
Henry Schein, Inc.	HSIC	Michael Waterhouse	★★	10,199	119.37	105.00	1.14	Wide	Stable	Medium	18.1
McKesson Corp	MCK	Vishnu Lekraj	★★	40,633	176.57	159.00	1.11	Wide	Stable	Medium	17.2
Owens & Minor, Inc.	OMI	Vishnu Lekraj	★★	2,210	35.03	30.00	1.17	None	Stable	Low	16.6
Patterson Companies, Inc.	PDCO	Michael Waterhouse	★★★	4,340	41.76	40.00	1.04	Wide	Stable	Medium	16.8

Medical Instruments & Supplies Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Baxter International Inc.	BAX	Karen Andersen	★★★★	39,968	73.58	84.00	0.88	Wide	Stable	Low	13.0
Becton Dickinson & Co	BDX	Alex Morozov	★★★	22,599	117.08	116.00	1.01	Narrow	Stable	Low	16.2
C.R. Bard, Inc.	BCR	Debbie Wang	★★	11,480	147.98	117.00	1.26	Narrow	Stable	Medium	19.3
CareFusion Corp	CFN	Michael Waterhouse	★★★	8,381	40.22	41.00	0.98	Narrow	Stable	Medium	14.8
Coloplast	COLOB	Debbie Wang	★★	92,242	438.50	349.00	1.26	Narrow	Stable	Medium	27.6
Cooper Companies	COO	David Krempa	★★★★	6,574	137.36	160.00	0.86	Narrow	Stable	Medium	16.3
Covidien PLC	COV	Alex Morozov	★★★	33,202	73.66	75.00	0.98	Wide	Stable	Low	15.8
DENTSPLY International, Inc.	XRAY	Michael Waterhouse	★★★	6,529	46.04	44.00	1.05	Narrow	Negative	Medium	16.0
Essilor International SA	EI	David Krempa	★★★	15,405	73.20	67.00	1.09	Wide	Negative	Medium	20.4
Hologic Inc	HOLX	John Zecy	★★★★	5,899	21.50	27.00	0.80	Narrow	Stable	Medium	14.8
Illumina, Inc.	ILMN	Michael Waterhouse	★★	19,058	148.66	100.00	1.49	None	Stable	High	51.0
Insulet Corporation	PODD	Debbie Wang	★★	2,611	47.42	32.00	1.48	None	Positive	High	92.6
Mindray Medical International Limited	MR	John Zecy	★★★★	3,877	32.36	38.00	0.85	None	Stable	High	13.4
Nobel Biocare Holding AG	NOBN	Michael Waterhouse	★★★	1,557	12.70	13.00	0.98	Narrow	Negative	Medium	20.6

Pharmaceutical Retailers

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
CVS Caremark Corp	CVS	Vishnu Lekraj	★★★	88,517	74.86	68.00	1.10	Wide	Stable	Medium	15.0
Shoppers Drug Mart Corporation	SC	Vishnu Lekraj	★★★	12,181	60.83	61.54	0.99	None	Stable	Medium	18.1
Walgreen Company	WAG	Vishnu Lekraj	★★	63,014	66.03	56.00	1.18	None	Stable	Medium	17.5

Scientific & Technical Instrument Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Mettler-Toledo International, Inc.	MTD	Alex Morozov	★★	6,927	235.68	184.00	1.28	Narrow	Stable	Medium	16.8
Waters Corporation	WAT	Alex Morozov	★★★	9,234	108.41	105.00	1.03	Wide	Stable	Medium	17.2

Specialty Chemical Companies

Company	Ticker	Active Analyst	Star Rating	Market Cap	Price	Fair Value	Price/FV	Moat	Moat Trend	Uncertainty Rating	Forward PE
Sigma-Aldrich Corporation	SIAL	Michael Waterhouse	★★★	11,155	93.38	87.00	1.07	Narrow	Stable	Medium	17.5

About Morningstar® Institutional Equity Research™
Morningstar Institutional Equity Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages, or Economic Moats.

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