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J.P.Morgan

North America Equity Research
06 April 2018

AmerisourceBergen

ABC Week Day 5: A Look at Other Businesses; Lowering Estimates on PharMEDium Facility Delay

Neutral

ABC, ABC US

Price: $87.38

▼ **Price Target: $100.00**
Previous: $105.00

Healthcare Technology & Distribution

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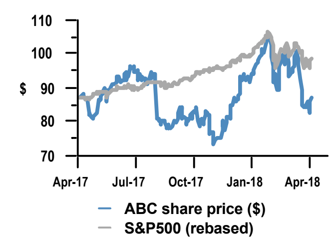
Price Performance



	YTD	1m	3m	12m
Abs	-7.1%	-7.9%	-8.3%	0.2%
Rel	-5.9%	-5.8%	-5.4%	-13.0%

For Day 5 of ABC Week we take a deeper dive into the company's other businesses outside of core pharmaceutical and specialty distribution, including PharMEDium, as well as the MWI Veterinary Supply, World Courier, and AmerisourceBergen Consulting Services (ABCS) businesses. Driven by acquisitions, ABC has delivered strong growth in the Other segment (comprised of MWI, World Courier and ABCS), and while we project this segment to comprise just under 4% of the company's total F2018E revenue, we estimate it will account for ~18% of adjusted operating profit. Recall that we hosted a conference call on Monday afternoon with CEO Steve Collis and CFO Tim Guttman. See our note here for key takeaways from the call.

- **We are lowering estimates to reflect a delay in the resumption of production at PharMEDium's Memphis facility.** Following the 8-K on 4/2, we are lowering our FY18 adjusted EPS estimate by $0.16, and now assume production at the Memphis facility resumes in early F4Q (vs. ABC's prior F2Q expectation). Note that given the level of automation, the Memphis facility contributes a large portion of profitability. We are lowering our FY19 estimate by $0.12 as we assume it takes time to reach full production and that not all lost volume is immediately recaptured.

- **ABC believes PharMEDium issues are manageable and remains positive on the longer term outlook.** PharMEDium is the leading national provider of customized outsourced compounded sterile preparations (CSPs) to acute care hospitals in the U.S. There are no other pure play national competitors, and ABC has noted that PharMEDium is 3x larger than its closest competitor. The company believes the fundamental outlook remains intact, driven by strong demand for outsourced CSPs.

- **We estimate MWI drives roughly half of ABC's Other segment revenue.** A leading animal health distributor, MWI serves the companion and production animal markets. MWI reported nearly $3B in revenues in FY14. Animal health distribution in the U.S. has consolidated around three large players (MWI, Patterson and Henry Schein). MWI provided revenue diversification, and is expected to drive cost and purchasing synergies (at least $50M in synergies by year three).

- **World Courier specializes in logistics for global clinical trials.** The WCG acquisition strengthened ABC's service offerings to global pharmaceutical manufacturers, and provided an established platform from which to grow its service offering outside of North America given WCG's large global network (the company operates in 50+ countries worldwide and has an established distribution network).

AmerisourceBergen (ABC;ABC US)

FYE Sep	2015A	2016A	2017A	2018E (Prev)	2018E (Curr)	2019E (Prev)	2019E (Curr)
EPS ($)							
Q1 (Dec)	1.14	1.27	1.36	1.55A	1.55A	-	-
Q2 (Mar)	1.45	1.68	1.77	1.75	1.74	-	-
Q3 (Jun)	1.20	1.37	1.43	1.60	1.50	-	-
Q4 (Sep)	1.17	1.30	1.33	1.65	1.60	-	-
FY	4.96	5.62	5.88	6.55	6.39	7.34	7.22
Bloomberg EPS FY ($)	4.97	5.55	5.88	-	6.55	-	7.36

Source: Company data, Bloomberg, J.P. Morgan estimates. 'Bloomberg' above denotes Bloomberg consensus estimates.

Company Data	
Price ($)	87.38
Date Of Price	05-Apr-18
52-week Range ($)	106.27-71.90
Market Cap ($ mn)	19,295.43
Fiscal Year End	Sep
Shares O/S (mn)	221
Price Target ($)	100.00
Price Target End Date	31-Dec-18

See page 14 for analyst certification and important disclosures.

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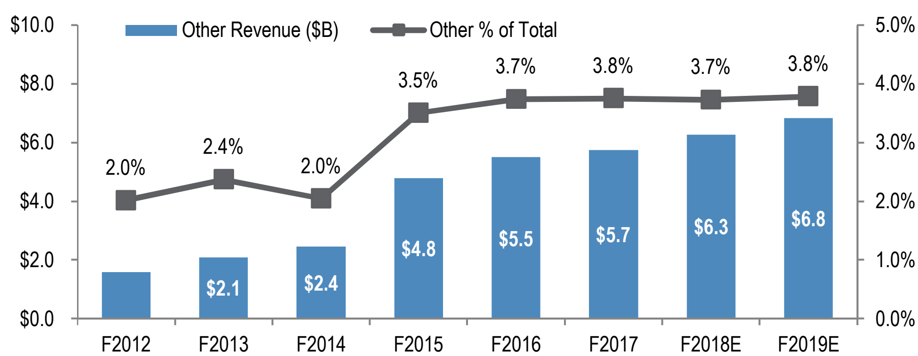
Other Business

For Day 5 of ABC week, we look at several of the company's other businesses beyond core pharmaceutical and specialty distribution. This includes PharMEDium, as well as the MWI Veterinary Supply (MWI), World Courier Group (WCG) and AmerisourceBergen Consulting Services (ABCS) businesses. Importantly, note that for reporting purposes, ABC's "Other" segment includes MWI, WCG and ABCS, as PharMEDium falls under the Pharmaceutical Distribution segment, although given the unique characteristics of that business, we have opted to include it in today's note. We note that ABC does not provide any breakout of revenue or operating profit contribution from PharMEDium. Looking at the financial performance, the revenue contribution of the Other segment is relatively modest in relation to traditional drug distribution but has been growing as a result of acquisitions. Other revenue accounted for $5.7B of sales in F2017, or roughly 3.7% of total sales. However, this is up from $1.6B in sales and 2.0% of total sales in F2012. We point to the acquisitions of World Courier and TheraCom in 2012 and the acquisition of MWI in February 2015. Going forward, we estimate the Other segment will account for $6.3B in sales and 3.7% of total sales in F2018E.

Figure 1: Other Revenue, F2012-F2019E

$ in billions



Source: Company reports, J.P. Morgan estimates.

Adjusted operating profit contribution from the Other segment has grown nicely over the past few years, reaching 18.5% of total adjusted operating profit in F2017 (up from just 7.2% in F2012), and we project the Other segment to account for over 18% of total adjusted operating profit in F2018E and F2019E.

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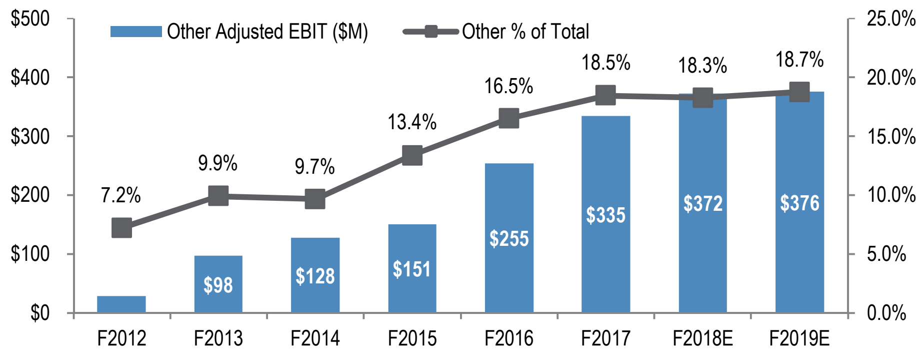
Figure 2: Other Adjusted EBIT, F2012-F2019E

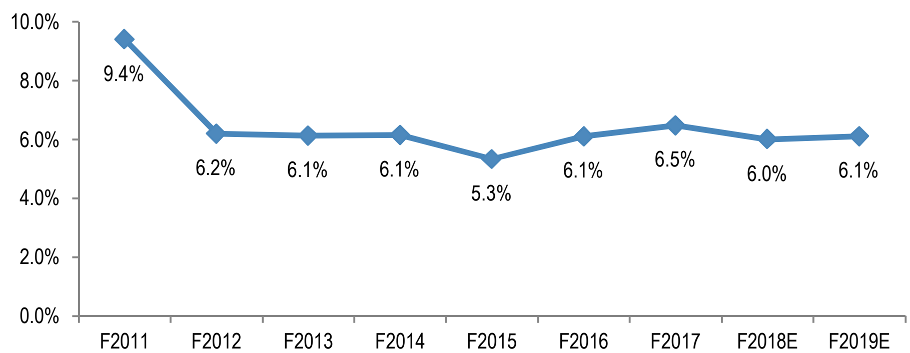
$ in millions



Source: Company reports, J.P. Morgan estimates.

We do note that acquisitions of lower margin businesses over the past few years have driven some margin compression in the Other segment, as margins declined to 6.5% in F2017 from 9.4% in F2011, although they have been relatively stable over the F2012-F2017 period. We also expect some modest margin compression in F2018E, driven by the Fusion technology system implementation at Lash, but expect a return to y/y growth in F2019E.

Figure 3: Other Adjusted EBIT Margin Trend, F2011-F2019E



Source: Company reports, J.P. Morgan estimates.

PharMEDium

Background

As previously noted, PharMEDium does not fall under ABC's "Other" reporting segment, but instead had historically fallen within the legacy AmerisourceBergen Drug Corporation, or ABDC, which is consolidated under the Pharmaceutical Distribution segment. However, given the different characteristics of this business versus ABC's typical distribution businesses, we are addressing it separately in our Day 5 note.

On November 6, 2015 AmerisourceBergen completed the acquisition of privately-held PharMEDium Healthcare Holdings, Inc. for $2.7 billion in cash, on a cash-free, debt-free basis. PharMEDium is the leading national provider of customized outsourced compounded sterile preparations (CSPs) to acute care hospitals in the U.S. The "sterile-to-sterile" CSPs that PharMEDium provides are mixtures of FDA-approved drugs in finished dosage form and FDA-approved diluents and FDA-cleared containers. The CSPs are delivered to hospitals on an anticipatory basis, in a ready-to-use form, meet specific hospital and physician clinical needs and quality standards, and are in formulations that are not otherwise commercially available.

Hospitals may choose to outsource the preparation of "sterile-to-sterile" CSPs to PharMEDium for a number of reasons, including: process and quality controls; sterility assurance; reliable and consistent supply; extended dating to reduce waste; reduced medication errors; increased productivity; and better resource/capital management. PharMEDium's services help customers drive pharmacy operating efficiencies, enhance patient safety and improve outcomes. PharMEDium's four 503b-registered compounding facilities are staffed by pharmacists and pharm-techs, providing a broad range of 2,000 SKUs across five therapeutic categories (pain management, nerve block, operating room anesthesia, labor & delivery, and intensive care). The company has over 3,000 hospital customers across all 50 states. At the time the deal was announced in 2015, PharMEDium had pointed to annual contract retention rates in the mid-90% range.

The market that PharMEDium competes in is highly fragmented, with no other pure play national competitors, and a number of smaller regional and local players, although we do note the potential for new entrants into the market over time. At the time the deal was announced, PharMEDium had noted that it was 3x larger than the next closest competitor (B. Braun's CAPS division), although we note that PharMEDium focuses on a different segment of the market. PharMEDium had estimated an overall addressable market of ~$6.5 billion at the time, implying a ~6% share, although it further noted that just 20% of the market had been outsourced, and that that the percentage outsourced could potentially increase over time. Key competitive advantages for PharMEDium include: scale; preferred provider relationships; a track record and commitment to quality (especially important given heightened regulatory requirements following product safety issues over the past few years across the industry); and relationships with key manufacturers.

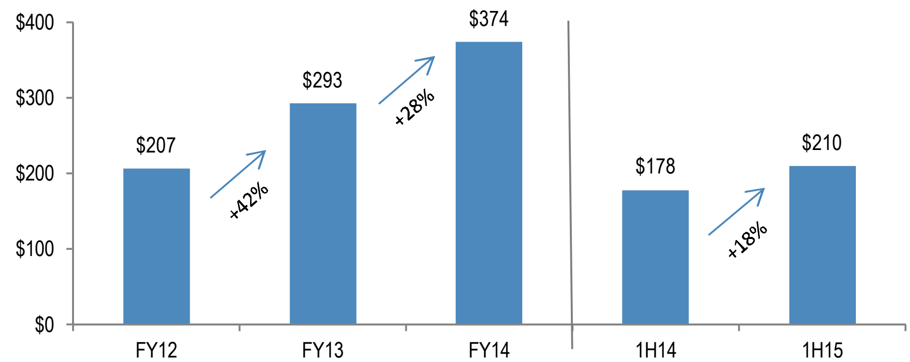
At the time the deal was announced, ABC had indicated that it expected PharMEDium to drive FY16 adjusted EPS accretion of $0.22-$0.26, which was on a net basis and included the impact of $0.05 in financing costs and a $0.04 impact from curtailing regular share repurchases during FY16. The transaction was funded with cash, existing credit facilities and a new term loan. From a leverage standpoint, ABC had indicated that it expected to return to the target leverage ratio by September 2016. At the time the deal was announced, ABC management cited projections of $470M in revenues for 2015 (up over 20% y/y) and adjusted EBITDA growth in excess of 20%. Longer term the company pointed to unit volume growth in the mid-teens range, with revenue and operating margin growth in the high teens. ABC had previously indicated that it expects to generate ~$30M in synergies by fiscal 2018, coming from incremental revenue growth (as the ABC health system sales force cross-sells PharMEDium services), and expense savings by leveraging ABC's size and scale. Finally, the acquisition expanded ABC's offerings for health system customers, which has been a key area of focus.

Historical Financial Performance

For reference, in Figure 4 - Figure 6 below, we show the historical revenue and EBITDA performance for PharMEDium over the 2012-2014 timeframe, and also show the comparison for 1H15 vs. 1H14. Revenue growth had been strong over that period, and was generally driven by multiple factors, including: 1) base volume growth; 2) expanding penetration within existing customers (i.e., increasing the level of outsourcing); 3) adding new customers; 4) adding new product lines/therapeutic categories; and 5) adding new sites of care (i.e., alternate site). We also point to a flight to quality following industry regulatory requirements.

Figure 4: PharMEDium Revenue Trend

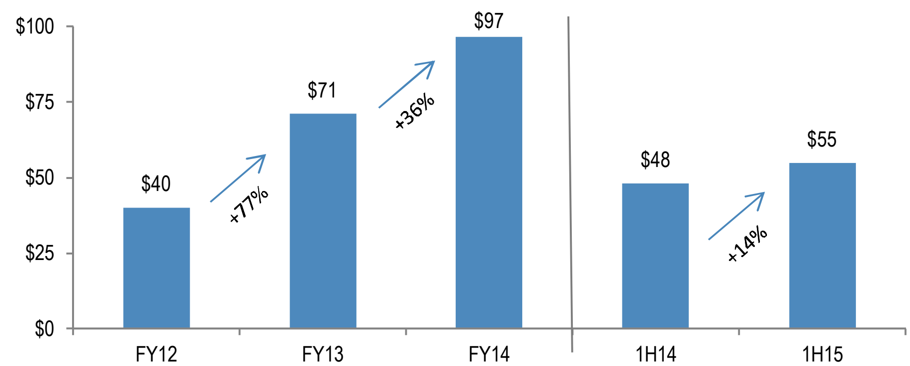
$ in millions



Source: Company reports.

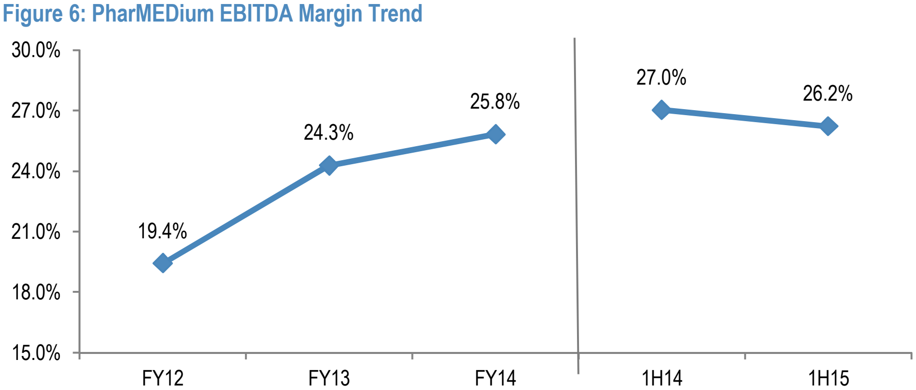
Figure 5: PharMEDium EBITDA Trend

$ in millions



Source: Company reports.

Figure 6: PharMEDium EBITDA Margin Trend



Source: Company reports.

Recent Issues and Estimate Revisions

While ABC does not break out performance of PharMEDium separately, as of the end of F2016, management had noted that performance had exceeded internal expectations. However, in F2Q17, ABC management indicated that the company had strategically increased the investment in PharMEDium to support its continued growth by enhancing the company's quality assurance (QA) and quality control (QC) systems, which will support batch level finished product testing prior to product release. The company had noted that this initiative would enable it to deliver the highest levels of product quality and patient safety, while also creating a compelling competitive advantage. However, this was expected to result in fewer units shipped and incremental costs, which drove a headwind to profit for the PharMEDium business in FY17.

More recently, after FDA inspections of the company's 503B outsourcing facilities in late calendar 2017, the company voluntarily suspended production activities at the Memphis outsourcing facility (PharMEDium's largest production facility, accounting for ~50% of total production, and also the most automated facility) in December 2017 pending execution of certain remedial measures. As a result, revenue and gross profit contribution from the pharmaceutical compounding operations in F1Q18 (ended December) were significantly lower as that business shipped fewer units due to the Memphis facility not being operational in the month of December 2017. During F1Q, the company also incurred certain fixed costs and scrapped non-usable inventory related to the Memphis facility, which drove $8.3M in costs (although these costs were recorded within Employee Severance, Litigation, and Other, and as such, were excluded from adjusted operating profit and adjusted EPS).

On the F1Q18 call in early February, management noted that it had originally expected the Memphis facility to resume operations in early January, and while that did not happen, the company was optimistic that it would resume operations during F2Q (the March 2018 quarter), with production ramping over the balance of FY18 to exit the year at full production. With remediation efforts taking longer than anticipated, as a result of the delay, ABC had reduced the FY18 adjusted operating profit growth forecast for the Pharma Distribution Services segment to 1-4% from 4-7%, which implied a ~ $50M headwind at the midpoint of the ranges, due almost entirely to the PharMEDium impact. The updated guidance assumed the Memphis facility would resume operations in F2Q, with the company disclosing that results would continue to be adversely impacted until the Memphis facility is fully operational.

However, on Monday (4/2), the company filed an 8-K indicating that production at the Memphis facility remained voluntarily suspended while the company completes remediation measures. The company noted that it remains in active communication with the FDA, and will provide a further update to the FDA upon completion of such remediation efforts, and is working to resume production as soon as possible thereafter. In addition, we note that on the F1Q18 earnings call in February, the company had noted that all other inspections were complete, and the other three 503B outsourcing facilities had remained operational throughout the process. However, according to a recent report by STAT news, the State of California had issued a 30-day cease-and-desist order to PharMEDium's Sugarland, Texas facility after an inspection by the State Board of Pharmacy found a variety of violations. Importantly, while the facility remains open, and the cease-and-desist order would only impact shipments to California from the Sugarland facility, we believe this could potentially drive a minor incremental headwind.

ABC has noted that it will wait until F2Q18 earnings on May 8 to provide any update to guidance despite the disclosure earlier this week around the Memphis facility. ABC did not provide incremental detail on the financial impact with the 8-K filing, and on our call earlier this week, management noted that it believes it will have a better sense of where it stands with respect to the PharMEDium remediation timeline, and with over half of the fiscal year behind, trends in the rest of the business, which would allow them to provide a more comprehensive view across the entire company.

That said, we are taking this opportunity to lower our estimates due to the delay in resuming production at the Memphis facility. Note that given the level of automation, the Memphis facility does contribute a large portion of profitability. We estimate every additional month of delay could drive a $10-$15M headwind to adjusted operating profit. At this point, assuming production does not resume until early F4Q (a 3-4 month incremental delay), and pushing out the timeline for the company to return to full production (originally expected in F4Q), that would imply an additional ~$45M in headwind to Pharmaceutical Distribution adjusted operating profit (an incremental 2.2% headwind for FY18). This equates to a $0.16 headwind to FY18 adjusted EPS, or a reduction of ~2.4% vs. our prior estimate. We include a sensitivity analysis in Table 1 below to demonstrate the impact of varying assumptions of operating profit headwind to the EPS line. To frame the potential impact, we note that based on PharMEDium's historical financial results, a mid-teens CAGR on the EBITDA line would have led to ~$170M in EBITDA in FY18 (or ~$200M assuming the realization of $30M in synergies), which would equate to ~9% of ABC's total EBITDA. We are also conservatively assuming a modest reduction in FY19 ($35M in adjusted operating profit and a $0.12 impact to adjusted EPS), as we assume it takes incremental time to reach full production and that the company does not immediately recapture all of the lost volume.

Table 1: Potential EPS Headwind from Varying Levels of EBIT Reduction

EBIT $ in millions

EBIT impact	$10.0	$20.0	$30.0	$40.0	$50.0	$60.0	$70.0	$80.0
EPS impact	$0.03	$0.07	$0.10	$0.14	$0.17	$0.21	$0.24	$0.27

Source: J.P. Morgan estimates.

While we are currently assuming no offsets, we note the potential that ABC could partially offset the PharMEDium headwind with stronger than expected performance in the core pharma distribution business as the market stabilizes, as well as via additional share repurchase (note that we currently assume that sharecount remains essentially flat over the balance of the fiscal year, which is consistent with the company's guidance of share repurchases to offset dilution from employee stock option exercises, although we believe the company does have the financial flexibility to do incremental repurchases).

Note that on our call earlier this week, management had stated that it does not feel like the issues at PharMEDium are daunting, and believes they are manageable and containable and that they have the necessary resources focused on it. Further, the company continues to believe in the longer term opportunities PharMEDium, with the fundamental outlook supported by strong demand for outsourced compounded sterile preparations, and believes the business will come back and be a top performer as they had originally expected at the time the deal was done. The company pointed to support of customers, who are awaiting the company's return to full capacity (ABC believes that this business has since been insourced, rather than lost to other competitors).

MWI Veterinary Supply

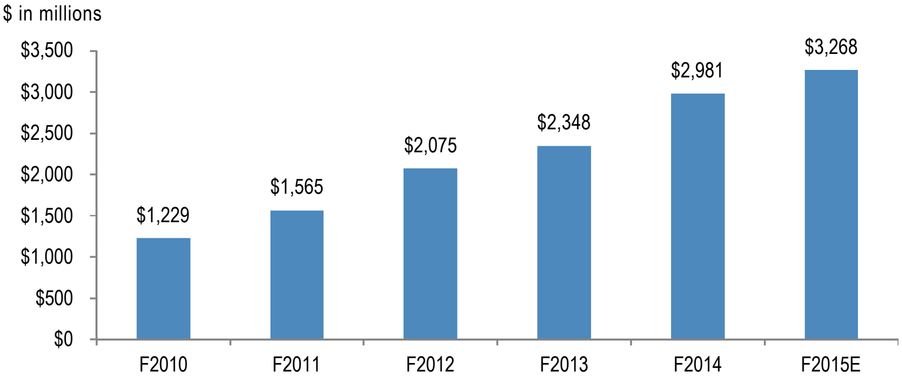
On February 24, 2015, ABC closed the $2.6B acquisition of MWI Veterinary Supply. MWI is a leading animal health distributor, selling pharmaceuticals, vaccines, parasiticides, diagnostics, micro feed ingredients, and other products to customers in both the companion animal market (~75% of revenue at the time of the deal) and the food production animal market (~25% of revenue at the time of the deal). MWI also offers other value-added services, including an e-commerce platform, technology management systems, pharmacy fulfillment, inventory management system, equipment procurement consultation, special order fulfillment, and educational seminars. The segment is led by EVP and President, MWI Veterinary Supply James Cleary, who had previously served as President and CEO of MWI since 2002.

Historical Financial Performance

MWI's revenues are primarily from the U.S., although the company does have a small presence in the U.K. as well. In fiscal 2014, MWI had reported ~$3.0B in revenues and $133M in EBITDA (a 4.5% EBITDA margin), with revenue and EBITDA up 27% and 19%, respectively, on a y/y basis. We note that the latest fiscal 2015 Bloomberg consensus estimates for MWI prior to the transaction close had projected ~10% top-line growth and ~8% EBITDA growth. ABC had noted that MWI had contributed $1.9B in revenue in F2015, which was a partial year of contribution (just over seven months of contribution). While ABC no longer breaks out performance of MWI separately, management had noted that MWI had a solid F2016, driven by the companion side of the business, with organic growth, new product introductions and market share gains having contributed to growth. Penetration rates at existing customers improved, while the company had also pointed to a doubling of corporate accounts. Management pointed to strong revenue and volume growth at MWI in F2017.

Figure 7: MWI Veterinary Supply Revenue, F2010-F2015E

$ in millions



Source: Company reports, Bloomberg consensus.

The animal health distribution market has seen a fair amount of consolidation over the past few years, with three dominant players having emerged. In addition to MWI, Patterson Companies and Henry Schein are both larger players. We note that all three companies have revenues just over the $3 billion, although we note that the mix is relatively different at all three. As noted above, at the time of the transaction, roughly 75% of MWI revenues had come from the companion animal (i.e., dogs, cats, birds, etc.), while ~25% had come from food production animals (e.g., cattle, dairy, swine, poultry), and on an overall basis, ~10% of MWI's revenues had come from outside of the U.S. Following the acquisition of Animal Health International in 2015, Patterson more than doubled its animal health revenue. The company's business is split roughly evenly across the companion and production animal segments, while ~20% of Patterson's animal health business is international (comes entirely from the U.K.). Finally, Henry Schein's revenues are split nearly evenly across U.S. and international, with the U.S. being comprised of nearly entirely of companion animal, while the international segment has a small component of production animal business.

Table 2: Animal Health Distributor Revenues, CY17

$ in billions

	Total Animal Health Revenue ($B)	North America Revenue	NA Companion %	NA Companion $	NA Production %	NA Production $	Outside of NA Revenue
Henry Schein	$3.5	$1.8	100%	$1.8	0%	$0.0	$1.7
Patterson Companies	$3.2	$2.7	52%	$1.4	48%	$1.3	$0.6
MWI Veterinary Supply	$3.4	$3.1	75%	$2.3	25%	$0.8	$0.3

Source: J.P. Morgan estimates. Note: MWI sales are estimates.

The MWI acquisition provided diversification within the distribution market, and ABC had indicated that it expected the deal to drive cost and purchasing synergies. At the time the deal was announced, ABC indicated that it had expected $0.08 of adjusted EPS accretion in the second half of F2015 (MWI contribution of ~$0.10 offset by $0.02 impact from foregone share repurchases). Recall that MWI was included in ABC's results for slightly more than two quarters in F2015. ABC had used ~$500M in cash to complete the purchase, and funded the rest with debt, including $1B in senior notes (two tranches of $500M) and a new $1B term loan. While the FY15 accretion guidance had not included any synergies, ABC had indicated that it aims to generate at least $50M in synergies by the third full year following the transaction close, ramping up over F2016-F2018. The company had noted that about two-thirds of the synergies are expected to come from sourcing and procurement (largely on the drug side), with the remainder of savings coming from freight savings, eliminating duplicate public company costs and operating leverage from ABC's scale. At the time of the deal, MWI had noted that <$100M of revenues had come from human generic pharmaceutical products, with the majority of pharmaceutical revenues from branded products. ABC management had previously noted that the medication and vaccine market for global animal health is ~$22B in size and growing at a rate of ~6%. ABC has previously indicated a willingness to expand in animal health via tuck-in acquisitions, and has completed few smaller deals over the past two years.

World Courier

ABC acquired World Courier Group in April 2012 for $520M. World Courier is a global specialty transportation and logistics provider for the biopharmaceutical industry. WCG specializes in logistics for global clinical trials, including temperature-controlled transportation, storage and worldwide distribution. While WCG's services are largely an extension of services that ABC already provides, the acquisition strengthened the company's service offerings to global pharmaceutical manufacturers, and ABC management views this as an established platform from which to grow its service offering outside of North America given WCG's large global network (the company operates in over 50 countries worldwide).

The company's business is based on a fee-for-service model and revenues are not necessarily tied to the outcomes of clinical trials. Of the ~$500M in revenues reported by World Courier in 2011 (the company's last year as an independent company), only ~35% was based in the U.S. with the remainder diversified globally. This provides ABC with local market expertise and an already established distribution network (and as such, did not require significant additional investments for ABC to build out a global network themselves).

Similar to MWI, World Courier revenues and earnings consolidated under ABC's Other segment and are not broken out separately. At the time the deal was announced, in March 2012, management had expected it to contribute $30-$50M in EBIT in F2013, equating to margins of 6%-10%, but after a slow start to the year expectations were later revised to $25-$40M in EBIT with ~5%-7.5% margins. Business has since improved (recall that ABC had subsequently pointed to improved margins in the World Courier business as positively impacting 2014 results in the Other segment), although we do point to a drag from foreign exchange due to currency volatility. Over the past few years, management has indicated that World Courier has been a very consistent performer, and it continues to strengthen its position as the undisputed leader in niche premium logistics in support of clinical trials. Finally, we note that in January 2017, ABC had sold the U.S. ground transportation division of World Courier, which it had determined was a non-strategic asset.

AmerisourceBergen Consulting Services (ABCS)

The company's Consulting Services business (ABCS) provides services to pharmaceutical and biotech manufacturers and also internally to ABC itself, including commercialization support, reimbursement support programs, outcomes research, contract field staffing, patient assistance and co-pay assistance programs, adherence programs, risk mitigation services and other market access programs. These services are provided under a number of operating businesses (including those shown in Table 3 below). Results for ABCS are not broken out separately (they are consolidated under the Other segment), although ABC management has previously called out strong growth during 2015 and 2016, both on revenue and operating profit. Relative to MWI and WCG, ABCS is somewhat smaller in terms of revenue contribution, but depending on the mix of business, can drive higher margins. The company has noted that the consulting business is currently in the midst of a business process redesign initiative, which includes a new ERP system implementation aimed at driving internal efficiencies and expanding capabilities to provide custom-tailored programs and services to manufacturer customers.

Table 3: ABCS Business Units

ABCS Operating Business	Services Provided
Xcenda	Commercialization consulting services, including brand strategy, messaging and market research
Lash Group	Reimbursement services for pharmaceutical, biotech and medical device companies
Premier Source	Reimbursement and strategic consulting
TheraCom	Commercialization and support services to biotech and pharma manufacturers

Source: Company reports.

Management pointed to the timing and expected operating expenses related to the implementation of the Fusion technology system in the Lash consulting business as one factor that is driving a headwind to growth in the Other segment in FY18. The implementation of the new platform will impact the customer capacity and the conversion of existing customers, and as such, the company is projecting a more limited ramp during this transition period. That said, the company expects to return to a normal level of growth in FY19.

Investment Thesis, Valuation and Risks

AmerisourceBergen *(Neutral; Price Target: $100.00)*

Investment Thesis

Our rating on AmerisourceBergen is Neutral. We continue to point to a positive longer term fundamental outlook for the drug distribution industry, driven by an aging population and increased utilization of prescription drugs. We believe the core pharma distribution business is stabilizing, with several of the headwinds that have driven tough y/y comps now behind. ABC should see an incremental benefit from growth at key customers (such as Walgreens completing the Rite Aid asset purchase). Further, as the largest distributor of specialty drugs to community-based oncologists, we believe the company could potentially see an incremental benefit from biosimilar launches going forward. We also point to the potential for accretive uses of cash flow. However, we note that a higher level of generic deflation and longer than expected remediation efforts at PharMEDium represent potential risks.

Valuation

ABC shares trade at 13.3x our new CY18 adjusted EPS estimate of $6.55. We are lowering our December 2018 price target to $105 from $100. Our new target is based on a 13.5x multiple on our CY19 adjusted EPS estimate of $7.38. This target multiple is below the historical average forward P/E multiple for the pharma distributors of ~14.5x over the past 10 years and represents a discount to the market multiple as we point to incremental uncertainty around the PharMEDium business. Our prior December 2018 price target of $105 had been based on a 14.0x multiple on our prior CY19 adjusted EPS estimate of $7.51.

Risks to Rating and Price Target

Several factors could cause the stock to outperform or underperform our expectations. These risks include higher or lower than anticipated drug price inflation, generic deflation, timing and dynamics of generic launches, competitive pricing pressure, potential contract wins or losses, a change in the interest rate environment, significant downward revision to the growth rate of the pharmaceutical industry, and changes in the healthcare regulatory environment.

AmerisourceBergen: Summary of Financials

Income Statement - Annual	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	**146,850**	**153,144**	**167,691**	**180,006**	**-**
COGS	(142,511)	(148,757)	(163,094)	(175,111)	-
Gross profit	**-**	**-**	**-**	**-**	**-**
SG&A	(2,091)	(2,129)	(2,313)	(2,436)	-
Adj. EBITDA	**2,248**	**2,258**	**2,283**	**2,459**	**-**
D&A	(217)	(241)	(270)	(272)	-
Adj. EBIT	**2,030**	**2,017**	**2,013**	**2,186**	**-**
Net Interest	(131)	(140)	(167)	(171)	-
Adj. PBT	**1,904**	**1,880**	**1,846**	**2,016**	**-**
Tax	(618)	(576)	(435)	(438)	-
Minority Interest	-	-	-	-	-
Adj. Net Income	**1,286**	**1,304**	**1,411**	**1,577**	**-**
Reported EPS	5.62	5.88	6.39	7.22	-
Adj. EPS	**5.62**	**5.88**	**6.39**	**7.22**	**-**
DPS	**1.26**	**1.45**	**1.51**	**1.65**	**-**
Payout ratio	22.4%	24.6%	23.7%	22.9%	-
Shares outstanding	229	222	221	218	-

Income Statement - Quarterly	1Q18A	2Q18E	3Q18E	4Q18E
Revenue	**40,466A**	**40,496**	**42,899**	**43,830**
COGS	(39,354)A	(39,295)	(41,779)	(42,666)
Gross profit	**-**	**-**	**-**	**-**
SG&A	(559)A	(568)	(585)	(601)
Adj. EBITDA	**554A**	**632**	**535**	**562**
D&A	(66)A	(69)	(67)	(68)
Adj. EBIT	**488A**	**564**	**467**	**494**
Net Interest	(36)A	(44)	(44)	(44)
Adj. PBT	**452A**	**520**	**423**	**451**
Tax	(110)A	(135)	(92)	(98)
Minority Interest	-	-	-	-
Adj. Net Income	**342A**	**384**	**331**	**353**
Reported EPS	1.55A	1.74	1.50	1.60
Adj. EPS	**1.55A**	**1.74**	**1.50**	**1.60**
DPS	**-**	**-**	**-**	**-**
Payout ratio	-	-	-	-
Shares outstanding	221A	221	221	221

Balance Sheet & Cash Flow Statement	FY16A	FY17A	FY18E	FY19E	FY20E
Cash and cash equivalents	2,742	2,435	3,319	4,097	-
Accounts receivable	9,176	10,303	10,887	11,637	-
Inventories	10,724	11,461	12,297	12,897	-
Other current assets	210	103	103	103	-
Current assets	**22,852**	**24,303**	**26,606**	**28,733**	**-**
PP&E	1,531	1,798	1,857	1,888	-
LT investments	-	-	-	-	-
Other non current assets	9,274	9,215	9,923	9,744	-
Total assets	**33,656**	**35,316**	**38,385**	**40,365**	**-**
Short term borrowings	611	12	20	20	-
Payables	23,926	25,404	26,695	27,945	-
Other short term liabilities	744	1,402	1,654	1,654	-
Current liabilities	**25,281**	**26,818**	**28,369**	**29,619**	**-**
Long-term debt	3,594	3,430	4,120	3,923	-
Other long term liabilities	2,651	3,004	3,004	3,004	-
Total liabilities	**31,527**	**33,252**	**35,492**	**36,546**	**-**
Shareholders' equity	2,129	2,064	2,893	3,819	-
Minority interests	-	-	-	-	-
Total liabilities & equity	**33,656**	**35,316**	**38,385**	**40,365**	**-**
BVPS	**-**	**-**	**-**	**-**	**-**
y/y Growth	-	-	-	-	-
Net debt/(cash)	1,464	1,007	821	(153)	-
Cash flow from operating activities	**3,178**	**1,504**	**1,755**	**1,965**	**-**
o/w Depreciation & amortization	365	398	444	448	-
o/w Changes in working capital	1,228	402	124	(100)	-
Cash flow from investing activities	**(3,169)**	**(498)**	**(1,209)**	**(300)**	**-**
o/w Capital expenditure	(465)	(466)	(325)	(300)	-
as % of sales	*0.3%*	*0.3%*	*0.2%*	*0.2%*	-
Cash flow from financing activities	**565**	**(1,313)**	**337**	**(887)**	**-**
o/w Dividends paid	(288)	(320)	(334)	(361)	-
o/w Net debt issued/(repaid)	712	(750)	698	(196)	-
Net change in cash	**574**	**(307)**	**884**	**778**	**-**
Adj. Free cash flow to firm	**2,803**	**1,135**	**1,558**	**1,799**	**-**
y/y Growth	*(25.2%)*	*(59.5%)*	*37.3%*	*15.5%*	-

Ratio Analysis	FY16A	FY17A	FY18E	FY19E	FY20E
Gross margin	-	-	-	-	-
EBITDA margin	1.5%	1.5%	1.4%	1.4%	-
EBIT margin	1.4%	1.3%	1.2%	1.2%	-
Net profit margin	0.9%	0.9%	0.8%	0.9%	-
ROE	93.7%	62.2%	56.9%	47.0%	-
ROA	4.2%	3.8%	3.8%	4.0%	-
ROCE	26.3%	23.6%	24.6%	23.1%	-
SG&A/Sales	1.4%	1.4%	1.4%	1.4%	-
Net debt/equity	68.7%	48.8%	28.4%	(4.0%)	-
P/E (x)	15.6	14.9	13.7	12.1	-
P/BV (x)	-	-	-	-	-
EV/EBITDA (x)	9.2	9.0	8.8	7.8	-
Dividend Yield	1.4%	1.7%	1.7%	1.9%	-
Sales/Assets (x)	4.8	4.4	4.6	4.6	-
Interest cover (x)	17.1	16.1	13.7	14.4	-
Operating leverage	86.1%	(15.5%)	(1.8%)	117.0%	-
Revenue y/y Growth	8.0%	4.3%	9.5%	7.3%	-
EBITDA y/y Growth	7.6%	0.5%	1.1%	7.7%	-
Tax rate	32.5%	30.7%	23.6%	21.8%	-
Adj. Net Income y/y Growth	12.7%	1.4%	8.2%	11.8%	-
EPS y/y Growth	13.4%	4.7%	8.6%	13.1%	-
DPS y/y Growth	8.6%	14.7%	4.7%	9.2%	-

Source: Company reports and J.P. Morgan estimates.
Note: $ in millions (except per-share data).Fiscal year ends Sep. o/w - out of which

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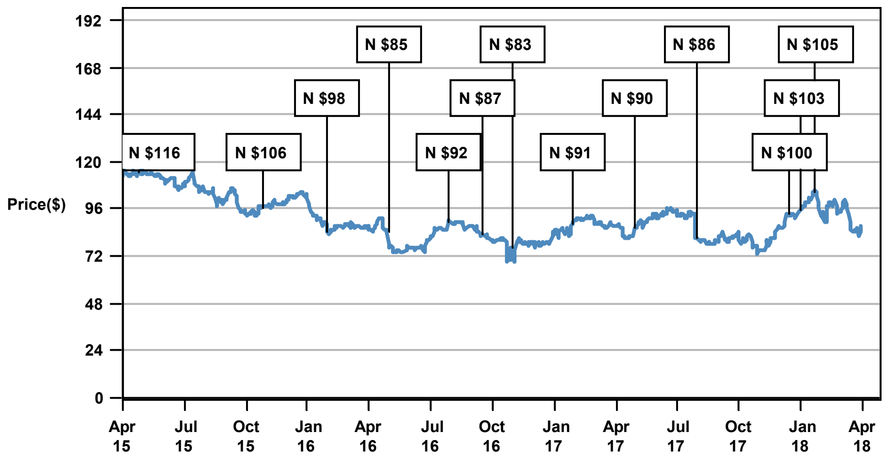
AmerisourceBergen (ABC, ABC US) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
30-Apr-15	N	114.30	116.00
30-Oct-15	N	96.51	106.00
04-Feb-16	N	84.40	98.00
05-May-16	N	84.29	85.00
03-Aug-16	N	89.43	92.00
20-Sep-16	N	83.26	87.00
03-Nov-16	N	75.96	83.00
31-Jan-17	N	88.61	91.00
05-May-17	N	85.89	90.00
04-Aug-17	N	80.83	86.00
19-Dec-17	N	93.79	100.00
05-Jan-18	N	95.32	103.00
26-Jan-18	N	104.37	105.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Jun 11, 1999.

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