Express Scripts Has Reached an Inflection Point

**Current Price:** $85.17
(As of 2/18/2015)

**Target Price:** $83.61

**Downside:** -1.83%

- Maturing Business Model Threatens Growth
- Price Wars and Intensifying Competition
- Lacking a Compelling Valuation
- Opportunity to Exit at a Reasonable Price

**Introduction & Thesis**

**Company Headwinds**

**Threats**

**Valuation & Growth**

**SELL Summary**
Business Description

- Largest PBM in the U.S.
- Serve 87 Million Americans

Success Depends On:
- Number of Subscribers
- Individual Drug Volume
  → Receive Larger Discounts
Business Description

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Success Depends On:
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  ➔ Receive Larger Discounts
Express Scripts in the Past

Growth by acquisitions and economies of scale

Source: Express Scripts Investor Relations
Express Scripts Today

- Medco acquisition
  - Little efficiency gains
  - More liabilities
  - Unnecessary assets

- Market share of 26%

- Inorganic growth is unlikely
  - Antitrust issues
  - Market dominance

Annual SG&A Expenses

Source: FactSet
Maturing Business Model

- Slowing organic growth
  - Efficiency frontier reached
  - Threatens negotiations for superior discounts
- Transitioning phase
  - Initiatives to develop new product lines
  - Extreme cost cutting measures
- Uncertainty
Growing Influence of Biotech

- High R&D Spending for New Drugs
- Less Bargaining Power
- Price Wars (Hep C Drug)
- Upcoming Drugs (Cholesterol Drug)

**Gilead Sciences**
- Pipeline Drugs (Stage 3, Near Release)
  - HIV/Aids
  - Liver Disease
  - Leukemia
  - Lymphoma
  - Cardiovascular Sodium Inhibitor

**Source:** Gilead Sciences

**SANOFI**

**REGENERON**

**Introduction & Thesis**  **Company Headwinds**  **Threats**  **Valuation & Growth**  **SELL Summary**
Peak of Generic Drugs

- Dollar value decrease
- Decreasing opportunity for easy generic wave

Estimated Dollar Amount of Expiring Patents ($Billions)

Source: Morningstar
Stressed Cash Flow

Demanding Use of Cash
(47% of Cash in 2013)

Source: FactSet
Where to Find New Growth?

2012

- Express Scripts
- Medco

NEW Express Scripts
- Elephant Problem?

Affordable Care Act
Competitive Acquisitions
Mail & Brick/Mortar
New Organic Growth?

Company Expectations of EPS Growth From 11%-17% in the Near Term Appear at Risk
**Growth Capacity**

- Analysis Supports Declining Trend Hypothesis
- Derived Growth Rates of >11% Expected By Many Investors is Unreasonable

<table>
<thead>
<tr>
<th>CAGR of Growth</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Internal Growth</td>
<td>-20.65%</td>
</tr>
<tr>
<td>Sustainable Growth</td>
<td>-27.84%</td>
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</tbody>
</table>
**Valuation (Base Case)**

**Free Cash Flow to the Firm Calculation**

<table>
<thead>
<tr>
<th></th>
<th>2013A</th>
<th>2014E</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFO</td>
<td>4768.9</td>
<td>4204</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>554.2</td>
<td>540</td>
</tr>
<tr>
<td>Tax Rate</td>
<td>36.4%</td>
<td>37.8%</td>
</tr>
<tr>
<td>CapEx</td>
<td>423.0</td>
<td>507</td>
</tr>
<tr>
<td>FCFF</td>
<td>4698.4</td>
<td>4032.9</td>
</tr>
</tbody>
</table>

**PV FCFF** $77,570.88

**MV of Debt** 15,967

**Intrinsic Value** $61,604.12

**Shares** 733.9

**IV per Share** $83.94

**Growth Period Valuation**

- FCFF
- Growth Rate

- **Cash Flow Value**
  - Base 2014
  - 2015 E
  - 2016 E
  - 2017 E
  - 2018 E
  - TV

- **Growth Rate**
  - 9.64%
  - 7.64%
  - 6.05%
  - 4.79%
  - 2.25%

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**All Figures Except IV Expressed in Millions of Dollars**
Monte Carlo Analysis

Growth Assumptions

<table>
<thead>
<tr>
<th></th>
<th>High</th>
<th>Base</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>g High for Forecast</td>
<td>11.16%</td>
<td>9.64%</td>
<td>4.76%</td>
</tr>
<tr>
<td>g Long term for TV</td>
<td>3.69%</td>
<td>2.25%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Current Price: $85.17

Monte Carlo IV: $83.27

Downside: -2.22%

Valuation Summary

- Current Price: $85.17
- FCFF Price: $83.94
- Monte Carlo: $83.27
- Overall Target: $83.61

Triangular Distributions for gHigh and gLow based on CAGR Estimates & Historical Results
Conclusion

Express Scripts Has Reached an Inflection Point

Current Price: $85.17
(As of 2/18/2015)

Target Price: $83.61

Downside: -1.83%

Maturing Business Model Threatens Growth

Price Wars and Intensifying Competition

Lacking a Compelling Valuation

Opportunity to Exit at a Reasonable Price

SELL