



Supplying the Growing Pharmaceutical Demand

We made AmerisourceBergen Corp (ABC: \$141/share) a [Long Idea](#) in [October 2019](#). Since then, the stock has gained 64% while the S&P 500 is up just 41%. Even after its outperformance, the stock has 30%+ upside and could be worth at least \$182/share today.

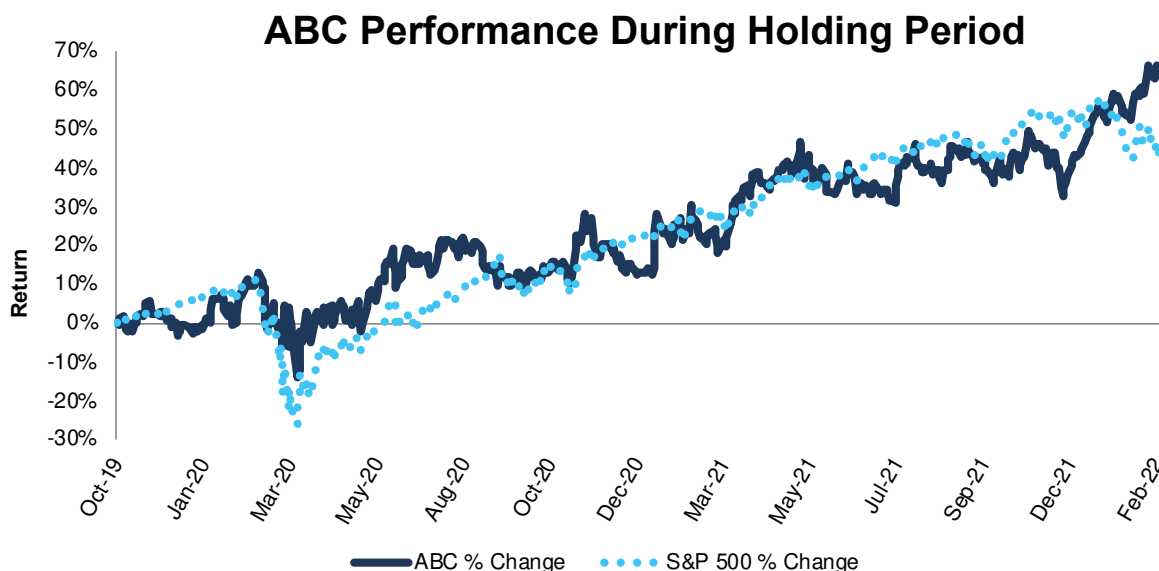
Learn more about the best fundamental research

We leverage more [reliable fundamental data](#), as proven in [The Journal of Financial Economics](#)¹, and shown to provide a [new source of alpha](#), with qualitative research to pick this Long Idea.

ABC Has More Upside After Outperformance Based on:

- Being well-positioned to benefit from several trends that will drive long-term growth of pharmaceutical sales.
- Contracts with its two largest customers reduces customer-concentration risk.
- The acquisition of Alliance Healthcare will create more shareholder value.
- The company's stock is priced as if profits will permanently fall 10% below TTM levels.

Figure 1: Long Idea Performance: From Date of Publication Through 2/22/2022



Sources: New Constructs, LLC

What's Working

Long-term Trends Favor the Pharmaceutical Industry: Several favorable trends will drive continued demand for pharmaceuticals such as:

- **Ageing population:** In the U.S., the number of individuals 65 and over [is expected](#) to exceed 65 million by 2025. Healthcare costs rise exponentially in individuals 65 and over.

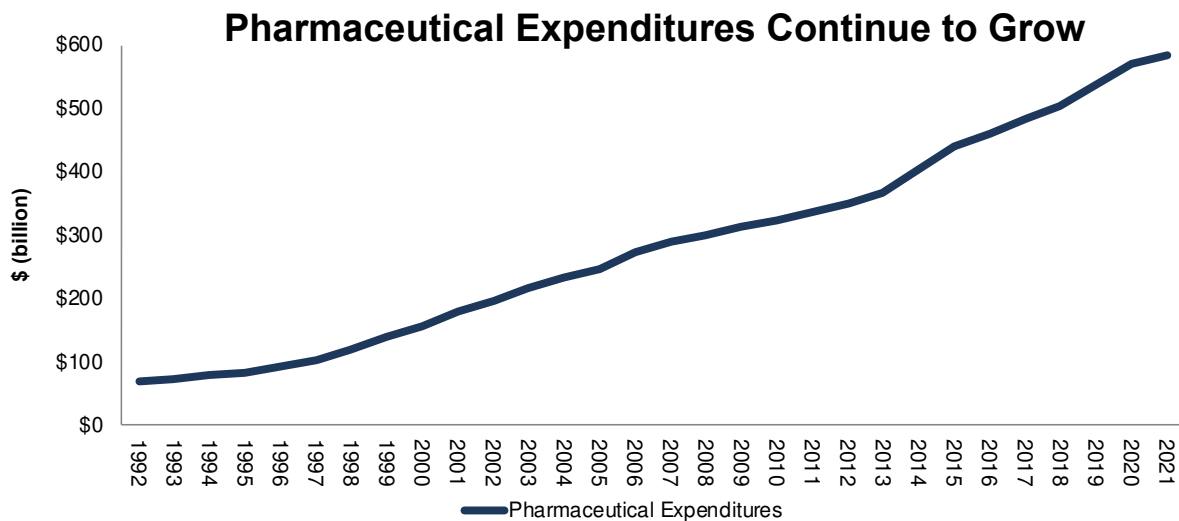
¹ Our research utilizes our [Core Earnings](#), a more reliable measure of profits, as proven in [Core Earnings: New Data & Evidence](#), written by professors at Harvard Business School (HBS) & MIT Sloan and published in [The Journal of Financial Economics](#).



- **Industry R&D Spending Creates Demand:** the large amount of industry spending in research and development (R&D) means the industry will continue to offer new products, thereby creating demand for AmerisourceBergen’s distribution services.
- **Growing Access to Healthcare:** The growing number of people covered by health insurance contributes to higher healthcare expenditures, including pharmaceuticals. The number of [people in the U.S. covered with health insurance](#) rose from 244 million in 2001 to 298 million in 2020.

These long-term trends have pushed pharmaceutical expenditures higher for decades and are likely to do so going forward. Per Figure 2, pharmaceutical expenditures in the U.S. have steadily grown over the past 30 years, from \$68 billion in 1992 to \$585 billion in 2021, or 8% compounded annually. The relatively low-cost nature of pharmaceuticals compared to the cost of other healthcare treatments means insurance companies and governments are likely to place greater emphasis on drug therapies as they seek to lower healthcare costs. Pharmaceutical expenditures account for just ~10% of total healthcare costs.

Figure 2: 30-Years of U.S. Pharmaceutical Expenditures: 1992 – 2021



Sources: New Constructs, LLC and [FRED](#)

Long-term Contracts Reduce Business Risk: AmerisourceBergen extended distribution agreements in 2021 with its two largest customers, which accounted for 43% of the company’s fiscal 2021 revenue. The company will continue to distribute pharmaceuticals to Walgreens’ (WBA) through 2029 and Express Scripts, a subsidiary of Cigna (CI) through 2026. By extending these two significant customers’ contracts, AmerisourceBergen reduces the risk of large disruption to its [Core Earnings](#), which have grown from \$1.3 billion in fiscal 2017 to \$1.8 billion over the trailing-twelve-months (TTM).

Acquisition Creates Value: AmerisourceBergen’s acquisition of Alliance Healthcare from Walgreen’s in fiscal 3Q21 broadens the company’s global network as it expands its footprint in Europe. The acquisition looks to already be creating shareholder value as well. The company’s [economic earnings](#) rose from \$234 million in fiscal 4Q21 to \$342 million in fiscal 1Q22. In fact, the company’s economic earnings in fiscal 1Q22 rose 34% year-over-year.

What’s Not Working

Pandemic Boost Will Fade: AmerisourceBergen played a key role in the distribution of vaccines and therapeutics during the pandemic. As COVID-19 becomes endemic to the population, demand for vaccines and therapeutics is likely to wane. However, increased expenditures in other areas of healthcare should offset the effects of declining demand for COVID vaccines and subsequent treatments.

Litigation Risk: The company is involved in large litigation regarding its role in the opioid crisis. Though the company believes it can reasonably estimate the cost of the litigation settlement – \$6.7 billion, complications in the settlement process, or a higher settlement amount would not be favorable for the stock. As of its fiscal 1Q22 earnings release, 46 of 49 states, all 5 U.S. territories, and Washington D.C. had agreed to the proposed settlement involving AmerisourceBergen, Cardinal Health (CAH), and McKesson (MCK).



AmerisourceBergen Is Priced for Profits to Fall 10% Below TTM Levels

AmerisourceBergen’s price-to-economic book value ([PEBV](#)) ratio of 0.9 means the stock is priced for profits to fall, permanently, by 10% from TTM levels. Below, we use [our reverse discounted cash flow \(DCF\) model](#) to analyze the expectations for future growth in cash flows baked into a couple of stock price scenarios for AmerisourceBergen.

In the first scenario, we assume AmerisourceBergen’s:

- net operating profit after tax ([NOPAT](#)) margin stays at 0.8% (equal to TTM, vs. 10-year average of 0.9% TTM) from fiscal 2022 – 2031, and
- revenue falls by 1% (vs. fiscal 2022 – 2024 consensus CAGR of +7%) compounded annually from fiscal 2022 – 2031

In this [scenario](#), AmerisourceBergen’s NOPAT falls by <1% compounded annually from fiscal 2022 – 2031 and the stock is worth \$141/share today – equal to the current price. In this scenario, AmerisourceBergen’s NOPAT in fiscal 2031 is just \$1.7 billion, or 9% below TTM levels.

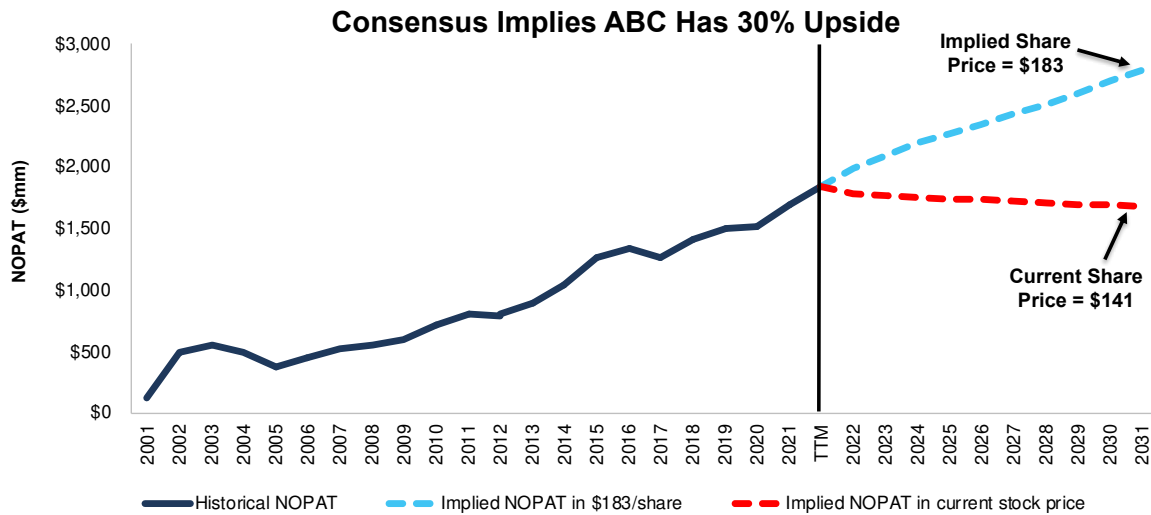
AmerisourceBergen’s Shares Could Reach \$183 or Higher

If we assume AmerisourceBergen’s:

- NOPAT margin stays at 0.8% from 2022 – 2031,
- revenue grows at a 7% (equal to consensus) CAGR from fiscal 2022 – 2024, and
- revenue grows by 3.5% compounded annually from fiscal 2025 – 2031, then

the stock is worth [\\$183/share today](#) – 30% above the current price. In this scenario, AmerisourceBergen’s NOPAT CAGR from fiscal 2022 – 2031 is just 5%. For comparison, AmerisourceBergen grew NOPAT by 8% compounded annually from fiscal 2011 to fiscal 2021. Should AmerisourceBergen grow NOPAT more in line with historical growth rates, the stock has even more upside.

Figure 3: AmerisourceBergen’s Historical and Implied NOPAT: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings

This article originally published on [February 23, 2022](#).

Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

Follow us on [Twitter](#), [Facebook](#), [LinkedIn](#), and [StockTwits](#) for real-time alerts on all our research.



It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our “novel database” enables investors to overcome these flaws and apply [reliable](#) fundamental data in their research.
3. Our proprietary measures of [Core Earnings](#) and [Earnings Distortion](#) materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms’ data collection processes to provide superior [fundamental data](#), [earnings](#) models, and [research](#). More [details](#).

Key quotes from the paper:

- “[New Constructs’] *Total Adjustments* differs significantly from the items identified and excluded from Compustat’s adjusted earnings measures. For example... 50% to 70% of the variation in *Total Adjustments* is not explained by S&P Global’s (SPGI) *Adjustments* individually.” – pp. 14, 1st para.
- “A final source of differences [between New Constructs’ and S&P Global’s data] is due to data collection oversights...we identified cases where Compustat did not collect information relating to firms’ income that is useful in assessing core earnings.” – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

Key quotes from the paper:

- “...an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC.” – pp. 8, 5th para.
- “The majority of the difference...comes from New Constructs’ machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies.” – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts’ stock ratings outperform those from human analysts as shown in this [paper](#) from Indiana’s Kelley School of Business. Bloomberg features the paper [here](#).

Key quotes from the paper:

- “the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant.” – pp. 6, 3rd para.
- “Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts.” – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are [here](#).



DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, "New Constructs") is an independent organization with no management ties to the companies it covers. None of the members of New Constructs' management team or the management team of any New Constructs' affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs' Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs' reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.

All material in this report is the property of, and under copyright, of New Constructs. None of the contents, nor any copy of it, may be altered in any way, copied, or distributed or transmitted to any other party without the prior express written consent of New Constructs. All trademarks, service marks and logos used in this report are trademarks or service marks or registered trademarks or service marks of New Constructs. Copyright New Constructs, LLC 2003 through the present date. All rights reserved.