

September 30, 2020

Hayley Hicks, Portfolio Manager
Jose Menjivar, Portfolio Manager

Return on Investment

| | |
|-----------------------|----------|
| Current Share Price | \$709.54 |
| Target Price | \$740.00 |
| Dividend Yield | 0.00% |
| Holding Period Return | 4% |
| Conviction Rating | 2 |

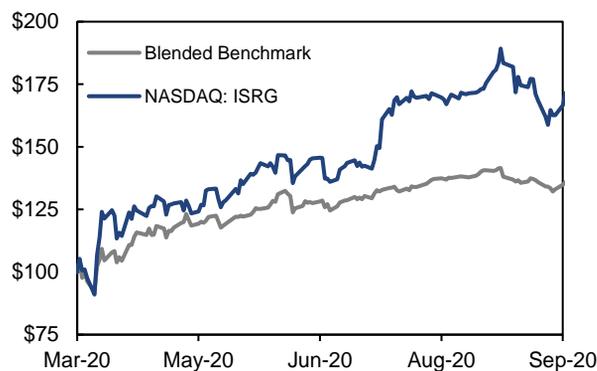
Market Profile

| | |
|-------------------------------|---------------------|
| 52-Week Range | \$360.50 - \$778.83 |
| Market Capitalization (US\$m) | \$83,035 |
| Net Debt (US\$m) | (\$6,361) |
| Enterprise Value (US\$m) | \$76,673 |
| Beta (5-Year Monthly) | 0.94 |

Metrics

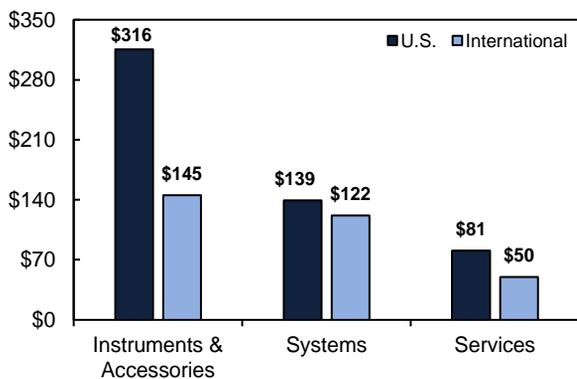
| | 2020E | 2021E | 2022E |
|-----------------|---------|---------|---------|
| Revenue (US\$m) | \$4,052 | \$4,687 | \$5,546 |
| EBITDA (US\$m) | \$1,422 | \$1,835 | \$2,136 |
| EPS | \$4.49 | \$7.33 | \$14.33 |
| EV/EBITDA | 53.9x | 40.5x | 35.9x |

Holding Period Trading Performance (Indexed to \$100)



Source: S&P Capital IQ

Figure 1: Q2 2020 Revenue Breakdown (US\$m)



Source: Company Filings

Business Description

Intuitive Surgical, Inc. (NASDAQ: ISRG) specializes in standardized design and integrative manufacturing of robotic surgical equipment. The Company's da Vinci X and Xi surgeon console and vision cart components are universal and interchangeable within its portfolio of advanced instruments. The Company designs, manufactures, and markets da Vinci Surgical Systems, EndoWrist Instruments, Ion endoluminal Diagnostic systems, vision products, and accessories comprising of sterile drapes to ensure sterile fields during surgery. ISRG markets to hospitals across the U.S. and internationally, recently starting direct operations in India and Taiwan.

Product Pipeline

The da Vinci Surgical Systems advances Management of Information Systems (MIS) across a wide spectrum of surgical procedures, with each generation improving overall operating room (OR) efficiency, inventory management, precision, and streamline port and placement.

Systems: The da Vinci Surgical Systems include surgeon's consoles, patient-side carts, 3-D vision systems, skills simulators, da Vinci Xi integrated table motions, and Firefly fluorescence imaging products. Generations include the da Vinci X, da Vinci iX, da Vinci Xi, and da Vinci SP (Single-Port). Da Vinci Xi is ISRG's most capable system, with integrated table motion, automated OR efficiency, and multi-quadrant access. The da Vinci SP differs from previous generations through its narrow-access focus. It has a single arm that delivers three multi-jointed instruments and a fully wristed 3D HD camera for visibility and control. Notably, China recently approved 154 da Vinci Xi systems, which will be implemented via a partnership between ISRG and Fosun.

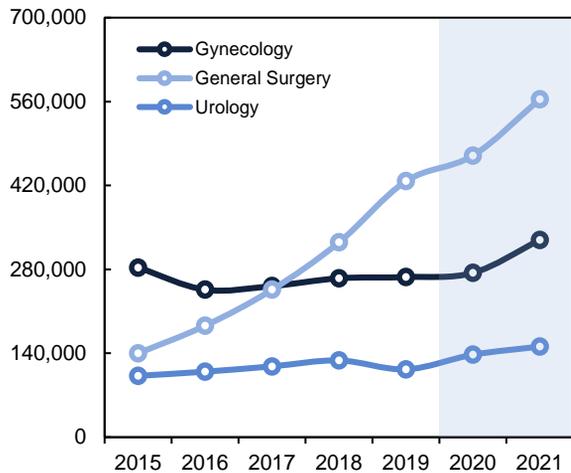
Instruments and Accessories: ISRG manufactures EndoWrist instruments, such as forceps, scissors, electrocautery tools, scalpels, and other surgical tools. EndoWrist is a minimally invasive technological approach inspired by the human hand and uses graspers, needle drivers, and energy instruments to enable surgical precision with a greater range of motion. In addition, the Company offers the EndoWrist Stapler, a wristed stapling instrument for the resection, transection, and creation of anastomoses. Lastly, ISRG's EndoWrist One Vessel Sealers are wristed single-use instruments for bipolar coagulation and mechanical transection of vessels up to 7mm in diameter.

The Ion Endoluminal System was FDA-approved in 2019 and is a robot-assisted platform for minimally invasive biopsy in the lung. It is an ultra-thin, maneuverable catheter praised for its level of stability.

Industry Overview

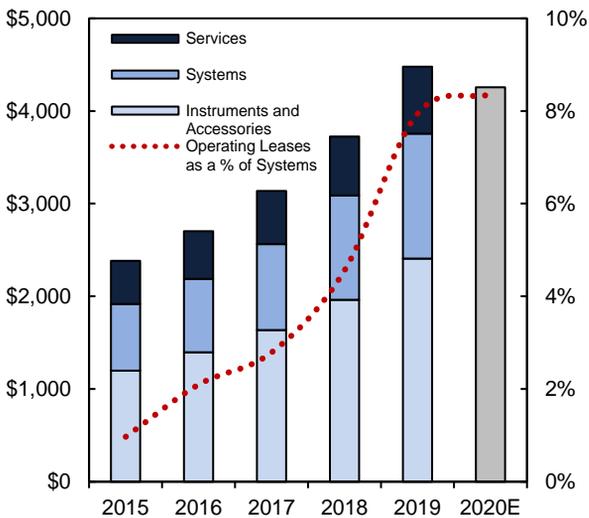
ISRG has enjoyed an effective monopoly within the robotic surgery subindustry of medical devices since the Company's inception in 1995. However, the COVID-19 pandemic has created a need for hospitals to shift resource allocation away from elective procedures towards sanitization and personal protective equipment.

Figure 2: U.S. Procedure Growth



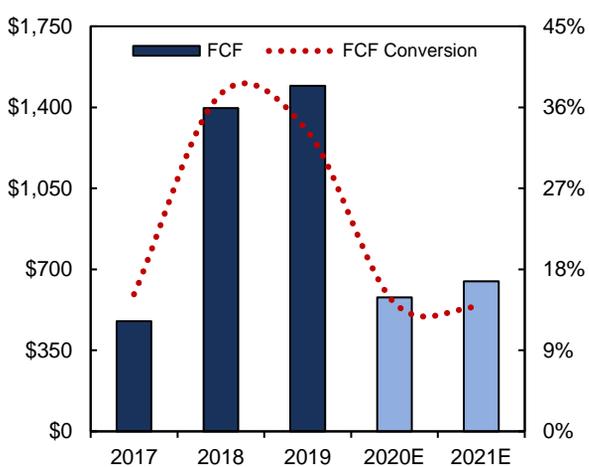
Source: Company Filings, CPMT Estimates

Figure 3: Revenue Breakdown Over Time (US\$m)



Source: Company Filings, CPMT Estimates

Figure 4: FCF Generation (US\$m) & Conversion



Source: Company Filings, CPMT Estimates

These resource allocation shifts, coupled with uncertain COVID-19 vaccine timelines, amount to a general lack of visibility on hospitals' capital budgets. Even with ISRG's industry entrenchment (achieved through extensive surgeon education, capital deployment, and first mover advantage), constrained hospital capex will continue to create sales uncertainty.

The competitive landscape within the industry has been slowly changing over time. Johnson & Johnson (NYSE: JNJ), and Medtronic (NASDAQ: MDT) are in the process of developing alternative robotic surgery offerings. However, JNJ's system is expected to undergo human clinical trials in the second half of 2022, which could delay product launches to late 2024. MDT has provided little clarity on its product launch, but it is expecting to file for a U.S. Investigational Device Exemption (IDE) in the coming months to collect usage data. Additionally, Medcaroid, a Japanese health care company, received regulatory approval for its robotic surgery device in Japan for urology purposes. Although the market acknowledged this as a surprise release, Japan represents a small percentage of ISRG's revenue. COVID-19 has delayed competition for da Vinci systems, but competition will inevitably enter the market in upcoming years. The CPMT believes that ISRG's market positioning, extremely high switching costs for hospitals, and high recurring revenues (Services and Instruments and Accessories, comprising ~73% of total revenue), will continue to sustain ISRG's FCF generating capacity and allow it to maintain its competitive advantage.

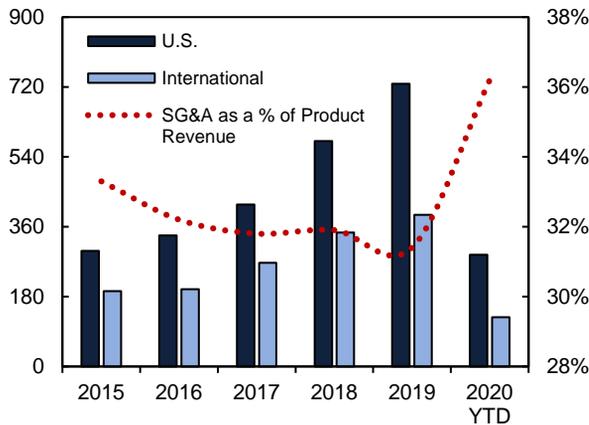
COVID-19 Response

From July to September, robotic procedure scheduling saw capacity reductions at ~50%, largely due to postponements of surgeries, distancing and capacity restrictions, and overall patient fear of COVID-19. Despite this, gynecology and urology procedures remained above ~65% capacity, acting in ISRG's favour as these are the largest operational markets the Company services. For October to December, surgeons anticipate improvement in robotic procedure capacity and operations up to normal levels, with certain procedures on hold until the pandemic recedes. Cancer and cardiac cases are most likely to proceed in coming months. Surgeons expect gynecology, urology, and colorectal to recover quickly in Q4 2020, indicating a prioritization of urgent elective procedures, as well as an increase in patient willingness to undergo surgery. In 2019, ISRG received FDA approval for certain transoral otolaryngology procedures in adults, radical tonsillectomies, and tongue base resections for da Vinci SP. However, the Company delayed the start of IDE trials for colorectal due to COVID-19.

Risks and Catalysts

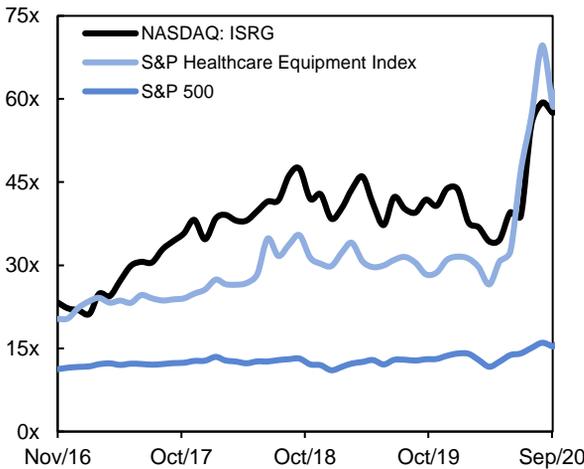
Risks in the near term include lagging hospital capital expenditures. 68% of respondents in a survey conducted by J.P. Morgan indicated decreased YoY investment in surgical equipment. However, the CPMT believes ISRG can mitigate this risk through the increase of capital invested in its internal "Intelligent Surgery" division. The Company defines intelligent surgery as "an integrated, insight driven approach, built on a deep understanding of surgical team needs, a comprehensive family of smart systems and instruments, and actionable digital insights", which has fruitfully produced instruments, such as Ion and Iris. Other notable risks include decreased additional development and slower expected growth for new systems (Xi, SP, and Ion). **Catalysts** for ISRG include increased flexibility in purchasing plans for hospitals, new product cycles for SP/Ion, and the Company's expansion into international markets.

Figure 5: Systems Shipped vs SG&A Over Time



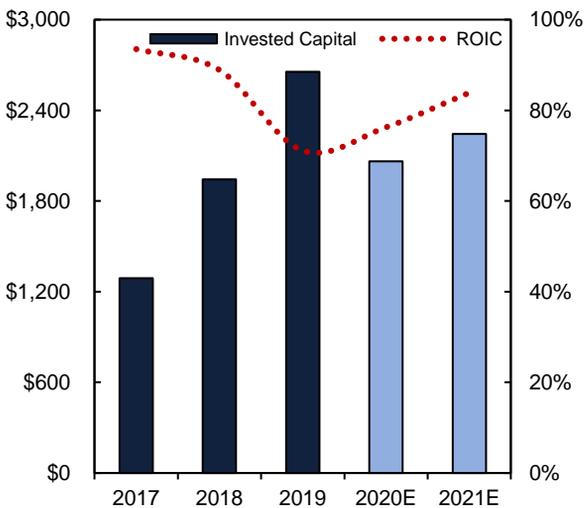
Source: Company Filings

Figure 6: LTM EV/EBITDA vs Relevant Indices



Source: S&P Capital IQ

Figure 7: Invested Capital (US\$m) vs ROIC



Source: Company Filings, CPMT Estimates

Developments and Re-evaluation Rationale

The CPMT entered a position in ISRG in March 2020. Given the tumultuous market conditions over the last six months, we decided it would be sound to revisit valuation and our outlook going forward. ISRG has yet to provide any guidance for year-end 2020 and 2021; however, some key developments have the potential to substantially disrupt its revenue model going forward. ISRG announced its “Extended Use Program”, which will roll out in Q4 2020. This program will allow select da Vinci Xi/X consumables to be used 12-18 times, as opposed to its current 10-time limits. The Company will also lower the price of certain instruments used in lower acuity procedures (cholecystectomy, benign hysterectomy, inguinal hernia), which would lower costs enough for these procedures to be competitive with conventional surgery. Lost revenue is expected to be partially offset by higher average system prices.

Revised Valuation

In our updated valuation, we maintained our previous terminal growth rate of 3.5% while adjusting WACC to 6.5%. We increased our target price from \$650 to \$740 to reflect a lower interest rate environment and a market that is valued fundamentally higher on hopes of strong post-pandemic recovery gains. We adjusted our 2020 growth to be largely negative, with SG&A and operating expenses kept higher for 2020/21 due to COVID response measures and a transition to lower price points for consumables. We expect price-cutting measures to enhance ISRG’s market penetration and allow for more procedures to use da Vinci systems. However, we anticipate that ISRG’s valuation multiples will compress as competition enters the market and challenges ISRG’s monopoly status within the robotic surgery market, albeit unpredictably.

Investment Thesis and Considerations

Our original investment thesis was grounded on ISRG’s clear mandate fit, ample opportunities for target market expansion (from a product and geographic perspective), and financial flexibility that allows for better service to customers (operating leases, usage increases, lower accessory prices). After re-evaluating the name, the CPMT continues to view ISRG as a compelling investment opportunity. The Fund believes that the long-term fundamentals of the robotic surgery market are still intact. However, in the short term, constrained hospital capital expenditures are inevitable. ISRG continues to fit all mandate points, with the temporary exception of growing FCF due to unprecedented market circumstances. Remarkably, the Company continues to build on its competitive advantage through its pricing strategies, ensuring better entrenchment in the market before competition establishes itself. Additionally, ISRG’s R&D has continued to strengthen its product pipeline. The Ion Endoluminal System and Iris Augmented Reality device are promising diagnostic devices that expand ISRG’s target market. Notably, regulatory approval for the da Vinci SP system is advancing for different procedures. Lastly, a Chinese quota on Xi systems will provide ISRG with predictable CF from the region.

Extremely high valuations remain a concern as the market continues to rise in hopes of a COVID vaccine, which the CPMT will continue to watch closely. Additionally, lower utilization rates (-27%) on da Vinci systems during the pandemic are worrisome. Due to these clear short-term headwinds, the fund decided to Trim the position down to 4% from 5.5% AUM to maintain our current conviction at 2. The CPMT remains confident on ISRG as a long-term holding.