Thermo Fisher Scientific

Health Care
NYSE: TMO
Market Perform | Hold

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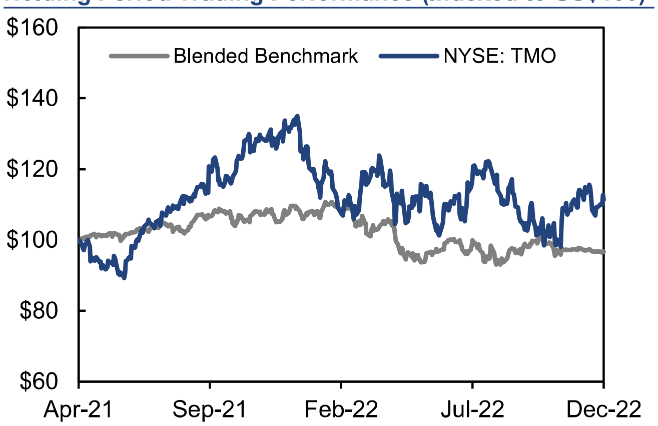
Return on Investment	
Current Share Price	$550.69
Intrinsic Value	$570.00
Dividend Yield	0.21%
Implied Discount	4%
Conviction Rating	2

Market Profile	
52-Week Range	$667.24 - $484.71
Market Capitalization (US$mm)	$216,972
Net Debt (US$mm)	$26,241
Enterprise Value (US$mm)	$243,213
Beta (5-Year Monthly)	0.80

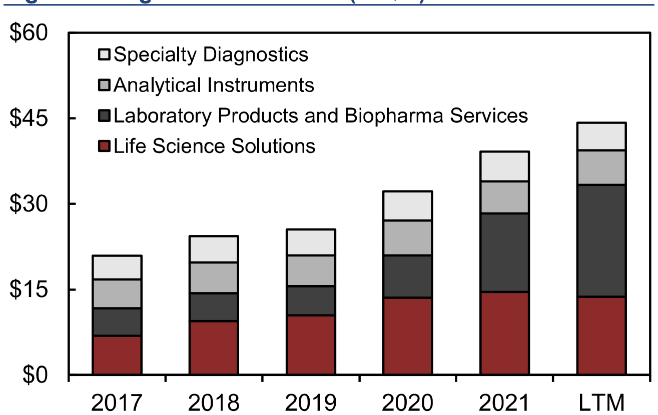
Metrics	2022E	2023E	2024E
Revenue (US$mm)	$43,808	$47,221	$50,554
EBITDA (US$mm)	$13,924	$14,963	$15,910
EPS (US$)	$24.22	$26.65	$29.25
EV/EBITDA	17.5x	16.3x	15.3x

Holding Period Trading Performance (Indexed to US$100)



Source: S&P Capital IQ

Figure 1: Segmented Revenue (US$B)



Source: Company Filings

Business Description

Thermo Fisher Scientific (NYSE: TMO) is a global diversified manufacturer and distributor of scientific instruments, consumables, and related services. TMO's product and service portfolio consists of various brands, including Thermo Scientific, Applied Biosystems, Invitrogen, Fisher Scientific, and Unity Lab Services. The Company's key end-markets consist of biotech and pharmaceuticals (biopharma) companies, hospitals and clinical diagnostic labs, universities, research institutions, and government agencies. TMO is based in Waltham, Massachusetts and operates through four segments: (1) Analytical Instruments, (2) Life Science Solutions, (3) Specialty Diagnostics, and (4) Lab Products & Services.

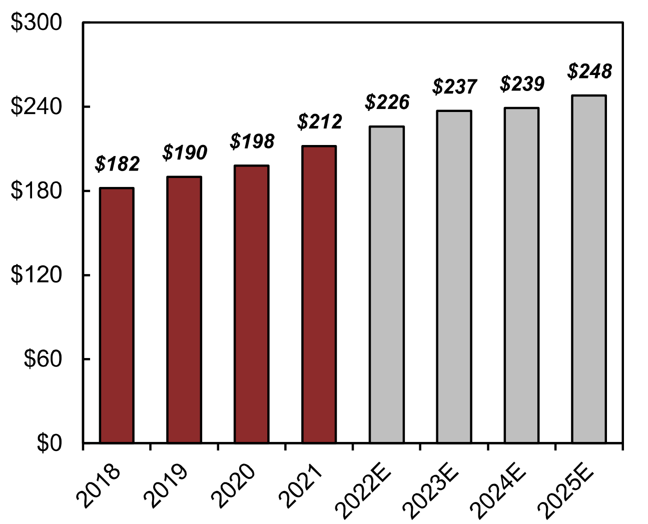
TMO recently announced the completion of its acquisition of The Binding Site Group, a global leader in specialty diagnostics, for €2.3B (US$2.8B) in cash from Nordic Capital.

Industry Overview

The U.S. life sciences industry provides researchers and scientists with analytical instruments, research consumables, laboratory software and equipment, and contract services necessary to accelerate scientific exploration. Unique aspects of the industry include changes in leverage based on government subsidization and investment and a symbiotic relationship with the biopharma industry, as key drivers include the National Institutes of Health (NIH) budgeting and biopharma R&D spending. Key drivers for the life sciences industry have been positive, resulting in a robust average annual revenue growth rate of 13% from 2016 - 2019. The industry is highly competitive and fragmented, but players can gain a competitive advantage through scale, software-integrated instruments, vertical integration, and broad product and service offerings. The Biotech industry remains well-funded despite the slowdown in public markets. The industry raised US$42B in 2022, down from US$97B in 2020 and US$91B in 2021 but remains in-line with historical levels. As a result of capital inflows to the industry, FDA drug approvals accelerated over the past five years to an average of ~50 per year and is expected to continue with an average of ~60 drugs per year beginning in 2023.

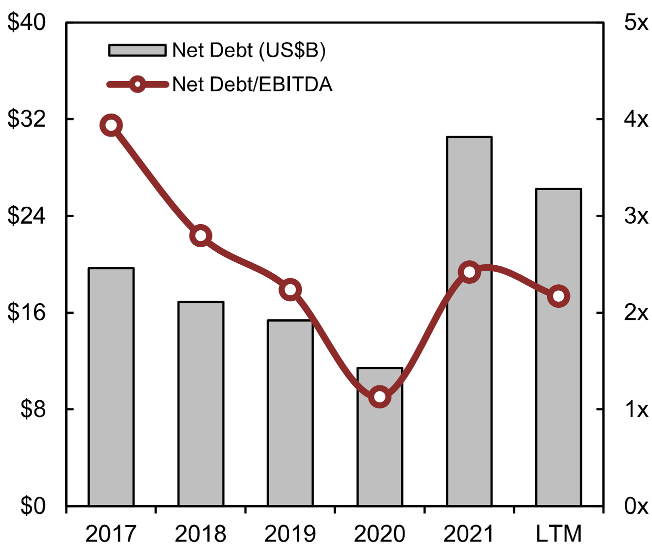
TMO's flexibility and scale allow it to respond to unforeseen events faster and better than its peers. In response to COVID-19, TMO leveraged its industry-leading polymerase chain reaction testing platform to develop and launch a test kit for the virus. The Company generated ~US$20B of COVID-related revenue from a combination of testing and vaccine/therapy products, which equated to 19% of total revenue since the start of the pandemic. Following a U.S. government contract win to address an acute shortfall of sample collection materials, TMO built a new facility in Kansas in ~6 weeks to manufacture Viral Transport Media (VTM), with a similar facility in Scotland also being built. While testing revenue has declined significantly, TMO believes vaccine/therapy related sales are sustainable and have been included in 'core' revenue. TMO's EPS growth from COVID-related revenues in 2020 and 2021 equated to 58% and 29%, respectively. The CPMT expects TMO's large contract backlog to offset the decrease in COVID-related revenue.

Figure 2: Global Biopharma R&D Spend (US$B)



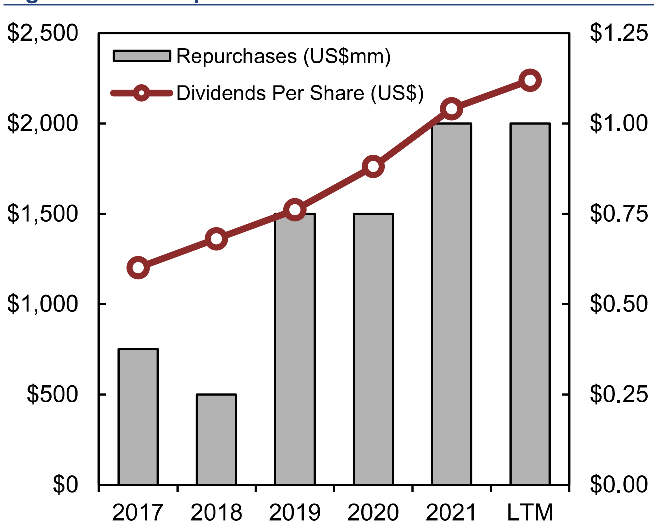
Source: Street Research

Figure 3: LHS Net Debt vs RHS Net Debt/EBITDA



Source: Company Filings, S&P Capital IQ

Figure 4: LHS Repurchases vs RHS Dividends Per Share



Source: Company Filings, S&P Capital IQ

Mandate Fit

Quality Management: The Company's management team is guided by President, CEO, and Chairman of the Board, Marc Casper, who has held the position of CEO since 2009 and Chairman of the Board since 2020. TMO's management has demonstrated a track record of success through its capital allocation strategy by completing ~100 acquisitions since 2006 and successfully integrating these companies into its operating segments, leading to further operational synergies and outsized growth relative to peers.

Competitive Advantage: Having completed eight acquisitions since 2018, TMO is a serial acquirer that outpaces the growth of its peers through acquiring high-quality firms which enhances diversification among its end-markets. TMO has been gradually increasing its bio-pharma end-market mix to ~60% of its sales with its recent acquisitions of Patheon and PPD. With BioPharma accounting for 45% of sales for the Life Science Tools End-Markets, TMO is in a strong position to utilize its vertically integrated supply chain to capture additional market share from its competitors.

Strong Balance Sheet: The Company is currently undrawn on its revolving credit facility of US$5B, which provides ample liquidity to capitalize on future accretive M&A opportunities when they arise. Additionally, TMO has Net Debt/EBITDA of 2.17x as of Q3 2022 which is lower than the current peer average of 2.23x (NYSE: A, AVTR, DHR, MTD, PKI, TMO). Furthermore, TMO has a credit rating of A- (stable) rating from S&P Global and a BBB+ (stable) rating from Fitch Ratings.

Growing Free Cash Flow: TMO had strong FCF generation of US$7.4B in 2021, with a CAGR of 14% from 2017-2021. FCF is forecasted to grow at a CAGR of 10% through 2024, which represents a slight decline from the historical average due to decreased COVID-related revenues and increased capital costs.

Risks

As the Company actively seeking to grow inorganically, TMO may feel the pressures of the high interest rate environment. Increased capital costs may hinder its ability to pursue future acquisition targets as they may not qualify with current central bank rates. Due to the current macroeconomic environment, the Company may experience lower inorganic growth rates, which is a quintessential component to its overall growth strategy. Additionally, TMO has previously taken on debt to achieve its growth strategy, which resulted in ~US$30B total debt on its balance sheet as of Q3 2022. As a result of the heightened interest rate environment, the Company is experiencing higher interest costs associated with its variable debt which materially impacts its bottom line. Lastly, the current strength of the U.S. dollar is causing foreign exchange headwinds for internationally generated revenue which will negatively impact cashflow during the forecast period.

Investment Thesis & Valuation

TMO was valued using a five-year DCF model with a 50/50 blend of the Gordon growth method (7.5% WACC and 2.5% terminal growth rate) and an EV/EBITDA exit multiple of 20.0x. Despite macroeconomic headwinds, the Fund expects TMO to continue stable FCF generation during the forecast period underpinned by modest organic and inorganic growth as its diversified end-markets are expected to remain stable. As the Company is limited by the macroeconomic outlook and the reduced demand of COVID-19 related products, the Fund will continue to hold TMO while exploring other opportunities within the healthcare sector.