

Introduction

Prepared by: Nate LaBombard & Seng Juan Goh

Senior Analyst: Kyle Kolb

Thermo Fisher Scientific Inc. (TMO) is a unique health care company founded in 2006 that has a market capitalization of about \$100 billion. They have 75,000 employees around the world and currently operate in several different geographical locations, that include; the Americas (55%), Africa and the Middle East (5.7%), Asia/Pacific (22.3%), and Europe (17%). Thermo Fisher supplies analytical instruments, equipment, reagents and consumables, and software and services for research, analysis, discovery, and diagnostics. All these segments are offered through four main products line. These lines are Life Science Solutions (25% of revenue), Analytical Instruments (21%), Specialty Diagnostics (15%), Laboratory Products and Services (39%). Overall, Thermo Fisher has a highly diversified portfolio, built of several solid segments in multiple geographic areas. Their stock price has done extremely well in the past, and we expect this trend to remain steady. As you can see from the chart below, they are currently near a 52-week high. We believe they will beat this resistance level soon and continue to outperform the market within the next year.



Recommendation

We recommend a **BUY** on Thermo Fisher Scientific Inc. (TMO). The stock is currently trading at \$249.55; however, we believe the stock price will increase to \$278.89, based off our valuations. This would offer an investment with a return as much as 11.75%. Due to our beliefs on the sector, our valuation, and our investment thesis below, we highly recommend a buy for TMO.

Investment Thesis

Strong International Presence:

In previous reports, we stressed the importance of finding companies that are looking to have an international presence. Thermo Fisher has already established themselves well in some of the strongest financial markets in the world, including the Americas, Asia, and Europe. However, the most significant information we found about Thermo Fisher is the extent in which they are growing in key geographical areas that will propel them forward in the future. These areas include India, Japan, Brazil, and China. These four countries have either large, aging populations and/or steadily rising incomes. For the past three years, Thermo Fisher has had year-over-year revenue growth of 4% in China, 6.7% in Japan, 21.7% in India, and 33.1% in Brazil. By penetrating these markets now, they are positioning themselves for strong revenue growth for decades to come. This is because when incomes rise, more money is spent on personal health. There is also plenty of revenue growth from an aging population. There is a large aging population that is living longer and will have to spend thousands of dollars a year to sustain their health. TMO has done an impressive job of improving the company, not only now, but preparing for future growth in the future as well.

Solid Product Array:

One of the critical factors that separates Thermo Fisher from other peers is the product array they currently have. They operate in many different segments as mentioned above. These segments cover nearly every level of many hospital visits which includes the laboratory supplies required to take samples, the equipment necessary to diagnose diseases, test kits for accurate results, and finally they help with the research to provide medicine. The product lines they have developed provide multiple streams of revenue that can give them consistent earnings year after year. They currently have over 110 patents to secure the products they have designed. Not only do they have a wide range of products, but they currently spend a large amount of money on acquisitions and research and development. They currently spend about \$1 billion a year on research and development, and we expect this trend to continue. This will offer more products, and hopefully more revenues in the future. In the past 3 years, they have purchased approximately 20 companies for a total value of about \$13 billion.

Strong Diversification:

The strong product line and the different regions where Thermo Fisher receives is extremely beneficial for the company's health. If revenues from a product, a region, or an entire segment are not doing very well, Thermo Fisher has a diversified product line that will provide a consistent revenue stream regardless of the conditions. Furthermore, Thermo Fisher has 91 customers between four segments that include diagnostics and healthcare, pharma and biotech, industrial and applied, and academic and government. This is a positive because not all the revenues they receive are tied up into one customer or sector. The diversification of Thermo Fisher minimizes the downside of the company, while providing future growth.

Increasing Margins

Since 2009, Thermo Fisher has had increasing revenues. As the years progressed and revenues increased, Thermo Fisher did an impressive job of decreasing costs and increasing the overall margins that the company has received. As a result, the net income has increased for seven straight years. We believe this reflects very positively on the management, showing that they can handle the large growth within the company. We also believe that the company will further be able to reduce costs in the future which will create a larger bottom line.

Positive Culture

Thermo Fisher has a culture that gives you faith as an investor. They are serious about their corporate responsibility to treat employees well, provide a sustainable business strategy while not harming the environment, and to give back to the world around them through philanthropy. Being a younger company, we believe creating a positive atmosphere and strong brand name will bolster their growth in the future. Having happy employees leads to increased productive, better product innovation, and a more efficient workplace. By giving back to the community and helping stabilize the environment, it will give them a brand name that reflects positively with people around the world.

Valuation

- With our **DCF model**, we get a target price of **\$279.10**, which is a 11.84% upside. This target price represents a conservative number due to our assumptions. We believe that growth in the next five years would be at least 7%, given our target price being a conservative estimate. The target price was determined using the following assumptions:

Discount Rate	13%
Long term growth rate	3%
EBIT, D&A, Δ NWC 1st year growth	15%
EBIT, D&A, Δ NWC 2nd and 3rd year growth	6%
EBIT, D&A, Δ NWC 4th and 5th year growth	3%

Perpetuity Growth Rate

	0.00	1.00	2.00	3.00	4.00	5.00	6.00
9.90	282.48	292.85	305.84	322.60	345.04	376.64	424.45
10.90	272.85	281.31	291.68	304.67	321.43	343.87	375.47
11.90	264.68	271.72	280.18	290.55	303.55	320.31	342.75
12.90	257.64	263.59	270.63	279.10	289.46	302.46	319.22
13.90	251.49	256.58	262.54	269.58	278.04	288.41	301.41
14.90	246.06	250.47	255.57	261.52	268.56	277.03	287.40
15.90	241.23	245.08	249.49	254.59	260.54	267.58	276.05

WACC

- For the **multiples approach**, we get a target price of **\$278.60**, which is a 11.64% upside. We chose to use P/E and EV/EBITDA ratios. First, we found the mean P/E ratio and EV/EBITDA ratio of Thermo Fisher's peers, who are; Abbott Lab, Danaher Corporation, Stryker and Becton, Dickinson and Company. Then we weighted the P/E and EV/EBITDA ratio with a 30-70 weight to get a target price of \$278.60. More weight was placed on EV/EBITDA because of the consistency of values among the peers, unlike the P/E ratio which had vast differences.

Our final target price is **\$278.89** after we weighted DCF and multiples approach with a 60-40 weight which shows a 11.75% upside.

Risks

Shipping Costs:

Thermo Fisher currently distributes thousands of products, so this gives them the unique risk of shipping cost fluctuations. If relationships and contracts with delivery systems such as FedEx are weakened, the cost associated with shipping thousands of products could greatly increase which would reduce the margins for Thermo Fisher.

Currency Risk:

The currency risk with TMO is currently quite significant, and we expect the risk to grow even more. Currently, they operate in many different geographical regions which could result in fluctuations between currencies. This risk can be combated with proper hedging techniques.

Medical Landscape Changes:

As hospitals look to cut costs to reduce the overall cost of healthcare globally, this could decrease some of the margins for Thermo Fisher. This change would potentially push down profits for companies in the medical field. We do not think this is a significant risk because the costs will reduce slowly over the long-run, giving Thermo Fisher time to react and adjust their business strategy.

Government Risk:

Health is the most important piece of anyone's life. As a result, the government is directly involved in the field with many regulations that could significantly change as administration changes. Products are always monitored and must pass all three phases to hit the market. Currently, the administration intends to cut down on the necessity to have insurance. This could lead to less coverage, and less demand for devices. However, there will always be a need for medical practices, so it should not result in significant differences. Another concern is the current trade war with China. As revenues increase in this Chinese market, they are subject to more taxes.

Legal Risk:

Being in the healthcare sector poses a lot of risk legally. If any devices by Thermo Fisher negatively affect any of their customers or the individuals requiring care, it could lead to a large lawsuit. Thermo Fisher has kept a strong reputation with quality products, so we see this risk as insignificant.

Management & Board

Management

Name	Age	In position	Compensation
CEO: Marc N. Casper	50	2009	93.6% performance based. \$22.2 mil annual pay
COO: Mark P. Stevenson	55	2017	92.5% performance based: \$12.3 mil annual pay
CFO: Stephen Williamson	51	2015	87.7% performance based: \$5.1 mil annual pay
Customer Channels President: Gregory Herrema	52	2014	87.5% performance based: \$5.0 mil annual pay

The management team of TMO is relatively young, averaging at 52 years among its 21-member team. Management also serve an average tenure of 9 years which is good as they have time to develop their division and implement methods to make the company better. The Pearl Meyer Study done in 2016 on executive compensation shows that an aggregate of 67% of compensation is equity based. Thermo Fisher is providing at least 71% equity compensation on top of the 13% base salary. This is a good sign going forward as it shows that the company is primarily rewarding its officers based on their ability to improve the company and keep making profit.

Board

Name	Age	In Position
Chairman: Jim Manzi	66	2004
Marc Casper	50	2011
Nelson Chai	52	2010
Judy Lewent	69	2008

The board is also relatively young, averaging at 59 years among its 12-member oversight. With an average tenure of 7 years, this ensures that each director is aware of the company's intricacies and can provide vital oversight of the management team on behalf of the shareholders. With 83% of directors being independent, the board is free from influence of the management team and can take a neutral stand on how management does business. It is also important to note that they currently have medical professionals on the board as well.

Peer Analysis

We identified four peers for Thermo Fisher, these companies include Becton, Dickinson & Co., Danaher, Abbott Laboratories, and Stryker. These companies are how we derived a part of our valuation as well. However, none of these companies are an exact match to Thermo Fisher due to the uniqueness and wide product range within health care. Below we have created a chart to show key financial ratios and how Thermo Fisher compares relative to its peers.

Company Name	EV/EBITDA	Net Income	Net Income 3 Yr Growth %	Return on Assets	Return on Equity	Total Debt	Net Margin
<i>Thermo Fisher Scientific</i>	<i>19.76x</i>	<i>2570.5</i>	<i>30%</i>	<i>4.60%</i>	<i>10.00%</i>	<i>18,774.00</i>	<i>10.80%</i>
Becton, Dickinson	21.50x	311	-55.3	0.70%	1.80%	21,495.00	1.90%
Danaher	18.12x	2760.7	9.3	5.90%	10.40%	10,617.80	14.10%
Stryker	19.03x	1236	5	5.70%	12.20%	7,203.00	9.30%
Abbott Laboratories	21.34x	802	-68.2	1.10%	2.60%	23,558.00	2.60%
Average	20.00x	1,277.4	-27.3	3.3%	6.7%	15,718.5	7.0%

As you can see from the chart above, Thermo Fisher has a lower EV/EBITDA then average, a higher net income, better growth, and more efficient metrics. However, they do have slightly higher debt then competitors. This is not a concern due to the recent acquisitions they have made, and they currently have a times interest earned ratio of nearly six showing that they can handle the new debt they have acquired.

Ownerships of Shares

When referencing the pie chart below, you can see that more than 90% of the shares are held by institutional investors such as: Vanguard, T. Rowe Price, Massachusetts Financial, Capital Research and Management, BlackRock, and Fidelity.

All these names are well known and recent transactions from them indicate that they are increasing their holding of Thermo Fisher which bodes well for our pitch.

