DeMatteo Research

IDEA NOTE

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HAE

Haemonetics Corp

Healthcare

07/28/2017

L LONG

PRESENTED

DATE		07/25/2017
PRICE	MARKET CAP	ENT VALUE
$39.90	$2.07B	$2.28B
P/E RATIO	BOOK VALUE	DIV YIELD
N/A	$14.15	0%
SHARES O/S	AVE DAILY VOL	SHORT INT
51.99M	310,417	6.14%

CURRENT

PRICE	$103.32	MARKET CAP	$5.34B

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Chart
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Haemonetics Corp. operates as a global healthcare company, which engages in the provision of products for processing, handling, and analysis of blood. Its products are divided into four categories: Plasma, Blood Center, Hospital, and Software Solutions. The Plasma product line includes plasma collection market for fractionation and the company's plasma products. The Blood Center product line offers blood collection market for transfusion and the company's blood center products. The Hospital product line provides transfusion market for hospitals and the company's hospital products. The Software Solutions deals with the software products and services. The company was founded by Allen Latham, Jr. in 1971 and is headquartered in Braintree, MA.

Publicly traded companies mentioned herein: Baxter International Inc (BAX), Grifols SA (GRFS), Haemonetics Corporation (HAE)

Highlights

The presenter is long shares of Haemonetics Corporation (HAE) at $39 and believes the successful turnaround of the company is well underway following years of mismanagement. HAE is a leader in each of its three main business units: Plasma, 46% of [fiscal 2017] revenue; Hospital, 19% of revenue; and Blood Center, 35% of revenue; and 85% of total revenue ($886mm F'17) is from the sale of disposables. He likes HAE's new management team, led by CEO Christopher Simon (joined in May 2016) and CFO Bill Burke (started in August 2016); and noted that their compensation is tied to EBIT and aligned with shareholders' interests. If operating margins can improve from 13% to 20% and management can execute over the next 3-4 years, the stock should trade up to $70+ over the next 2.5-3 years. This equates to 20x the presenter's $3.50 per share earnings forecast for fiscal 2021, and represents 80% upside.

- The Plasma unit has been growing high-single-digits (8-9% in 2017) for HAE, but growth is expected to moderate to 3-5% in fiscal 2018 (this guidance seems conservative). Blood collections are expected to grow at a 6-8% CAGR, and the presenter thinks a combination of pricing and share will allow HAE to grow faster than the market; and they have 75% share of this market
    - Plasma generated $411mm in fiscal 2017, and 91% was disposables.
    - Customers such as Grifols and Baxter have expanded capacity in recent years as a result of increasing demand for immunoglobulin (IgG) and other products to treat immune and other deficiencies.
- The Hospital segment is the growth story. Hemostasis management (the assessment of bleeding and related risks) generates ~$66mm of revenue for HAE and it's TEG product is the leading product in a ~$350mm market (the next largest player is

- Instrumentation Laboratory: Rotem/Accriva). It is expected to see a mid-to-high-teens (15%+) CAGR over the next 3-4 years, and management believes the total market potential is >$1bn.
    - Within the hospital segment, Cell Salvage and Transfusion Management are of lesser importance, but HAE has #1 or #2 share in most markets.

HAE's new TEG products are in the early stages of adoption, and the presenter said having first-mover advantage is important because the rest of the market is fragmented.

- HAE's Blood Center unit is expected to see a flat-to-down 3% top line trend, but 87% of revenue is disposables. This segment had been a drag overall because the prior team failed to cut costs. However, Simon et al have been focused on cutting costs here, and the presenter thinks they have a good plan to stabilize the business and maximize its profitability.
- Fundamentally, HAE has a self-help opportunity because it's operating margins are just ~13% (gross margin is ~45%). The presenter said this is a function of not doing simple things over many years (i.e., minimizing freight costs related to orders), and with better procedures and a focus on costs margins should rise. Given the percentage of revenue derived from single-use consumables and gross margin profile, the presenter reasons the operating margin should reach the 20% target Simon has laid out.
    - Management's stated long-term goals are to double adjusted operating income and quadruple FCF (from $113mm in fiscal '17) by fiscal 2021. If Plasma grows 10-13%, Hospital revenue 13-15%, and Blood Center down ~5% (all 4-year CAGRs), then HAE should hit $1.1-1.2bn of revenue and operating income could reach the $240mm target.
- If the presenter's model is accurate, HAE should earn $3.50/ share (FY Mar '21), which is $0.50 ahead of Street estimates. If he assumes "a little" benefit from capital deployment, the EPS target moves to $3.75. At $39, HAE presently trades at 25x forward year earnings (and 22x FY'19 estimates), but assuming the stock can trade at 20x his $3.50 forecast, the stock could see $70 in 24-30 months, or $75+ with capital deployment.
    - There is optionality around an eventual sale of the company, but this is not baked into the presenter's base case.
- Regarding management, the presenter likes Simon and Burke, and said Simon previously led the global medical products practice at McKinsey & Company (he noted that he led the management consultancy review of Haemonetics, and was able to "hit the ground running"). Burke is the former Chief Integration Officer at Medtronic, and was responsible for the integration of Covidien.
    - Additionally, management's compensation and bonus payouts are tied to EBIT growth. For a 100% payout/ incentive, EBIT needs to be $170mm in fiscal 2019 (versus a consensus estimate of ~$138mm).
- When asked about HAE's Plasma unit and the growth opportunity, the presenter explained that the company has an opportunity to improve yield per collection (which is very important to customers) and patient experience. Part of the bear thesis relates to costs associated with managing HAE's equipment in the field and the rollout of its new PCS 300 device, but the presenter thinks management has options and can execute.
    - HAE has filed for 510(k) clearance with the FDA, and in his opinion the company could potentially use a third-party to help alleviate some of the costs associated with managing the rollout. The upside from reducing processing time, under draws, and incomplete donations is meaningful as the customer experience and yield are improved.

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