# Market Research #004

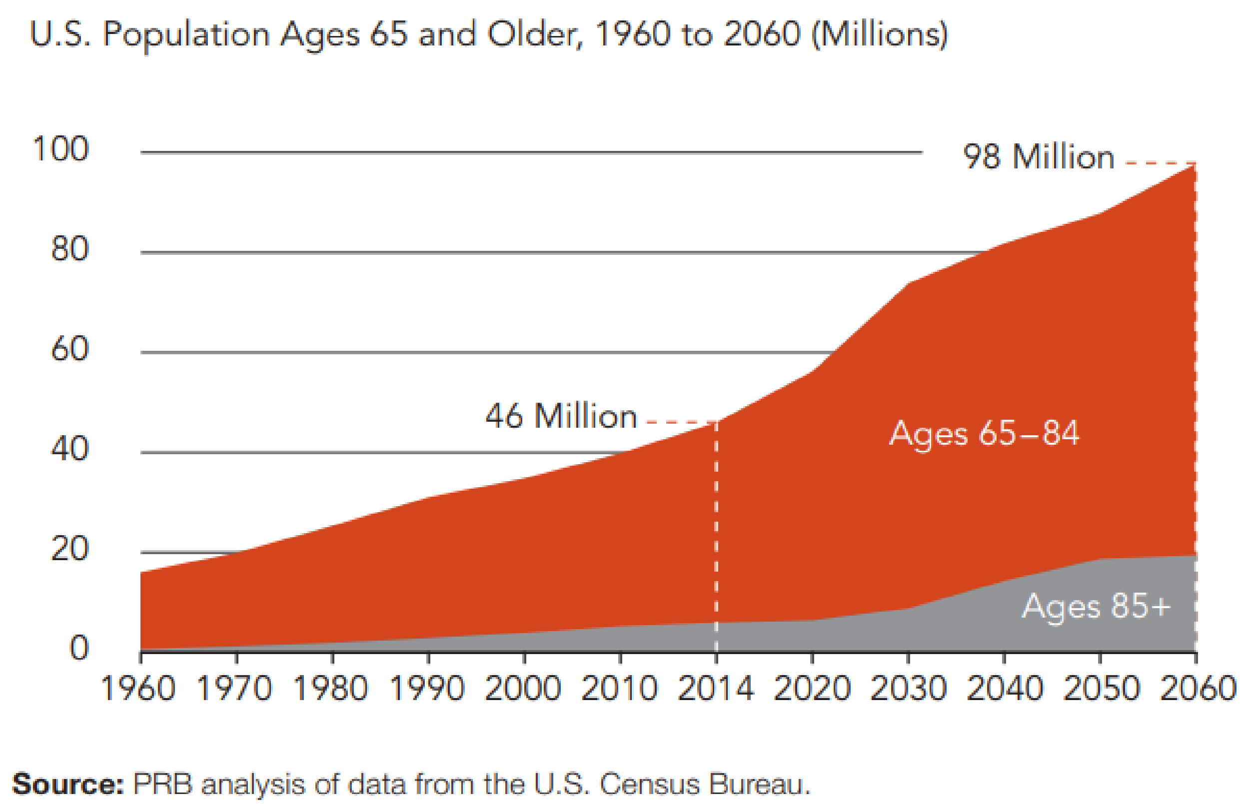
*This is the fourth in a series of Independent research produced by the Murray Wealth Group Research Team. The purpose of this series is to provide insight into our portfolio construction and how our research shapes our investment decisions. We welcome any feedback or questions you may have on these monthly commentaries.*

## US Medical Device Companies

*A profitable way to invest in the health care sector.*

A major theme that we believe will provide great investment opportunities is the aging population in Western society and, with it, the rising demand for health services over the next decade (Figure 1). There are numerous ways to gain exposure to the healthcare sector from direct product producers (medical supply or drug companies), health insurers and pharmacies. There are also indirect ways such as real estate firms focused on health care or retirement facilities. Each sub-sector offers its own unique risks and opportunities. In this piece, we look at the medical products field and why we think it provides interesting opportunities.

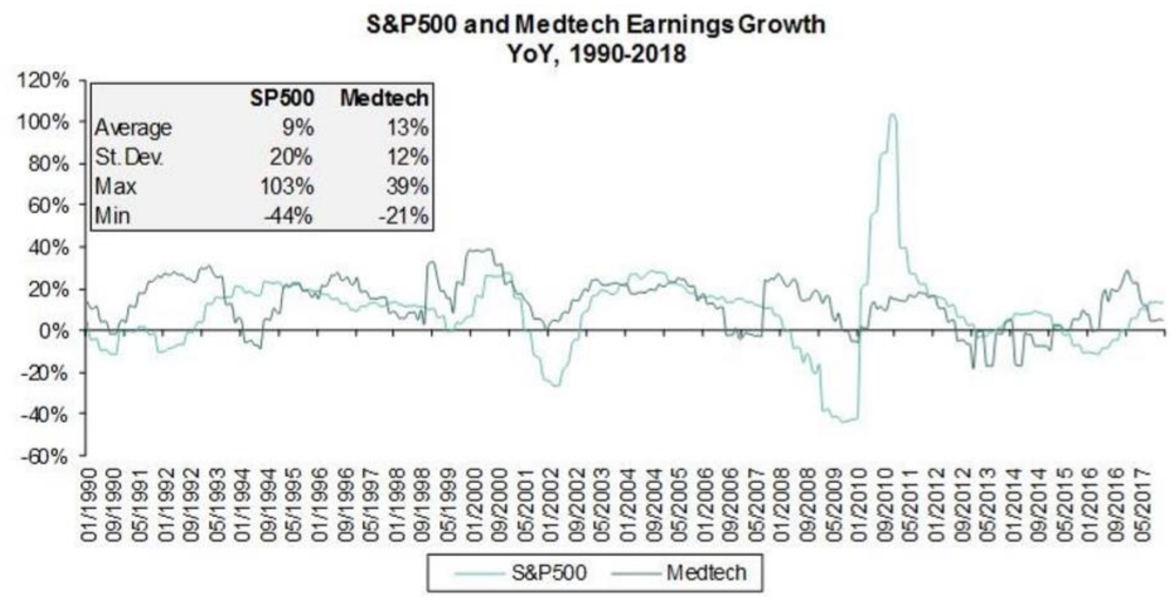
Figure 1: US Population ages 65 and over, Historical and Forecast



Medtech, as the sector is often referred to, is made up of companies that create and build the products and devices used in health care facilities. We want to highlight the chart, courtesy of Bernstein Research, in Figure 2, showing that Medtech companies historically have not only generated stronger earnings growth than the market, but have also exhibited greater earnings stability. These earnings characteristics should be rewarded with a premium valuation multiple, and in many cases, they are. However, there are always stock specific factors that affect individual companies' valuation.

Figure 2: U.S. Medtech companies have historically grown earnings faster and with less volatility.

EXHIBIT 7: **Medtech earnings have historically grown ahead of the market, while being less volatile**




Source: Bernstein Quant team, Bernstein analysis.

Medical Technology companies produce a wide range of devices that can improve patient outcomes, ranging from simpler products such as surgical hand tools to complex products like robotic-assisted surgery systems. For lower-end commoditized products, competitiveness is dependent on quality, manufacturing and pricing. For more specialized and innovative products and systems, competitiveness is more dependent on safety and efficacy. Factors such as doctor preference, hospital buying practices and cost also impact purchasing decisions. Most companies invest heavily in R&D to maintain leadership in their respective product categories. As well, sales and marketing represent a significant portion of operating expenses.

Below we highlight two companies, Boston Scientific and Teleflex Inc., that together make up 4.5% of our Global Equity Growth Portfolio. Both companies are employing similar strategies, and their recent financial success shows it is a winning formula when properly executed. We will contrast their results with those of Medtronic PLC, the largest player in the space globally, which we sold partially to fund our new positions.

**Boston Scientific (BSX-N).** Boston Scientific has undergone a tremendous turnaround in the past five years under the new leadership of CEO Mike Mahoney. The company has recovered from operational deficiencies that caused tax and regulatory issues and "righted the ship", streamlining the company into seven business units, each with a strategy for market leadership within its category.

The company now has margins approaching industry average, with room for expansion as it consolidates its manufacturing base. As well, it is forecasted to produce high single digit annual revenue growth, with upside from new product launches and market share wins. Lastly, additional capital should be available to make tuck-in acquisitions (the company has made about one per year to add a new high growth product line to its suite). The company's capital position is expected to benefit from the end of payments towards past tax obligations and legal settlements (the final $1.5B will be paid in 2018).

We recently added BSX to our Global Growth Fund with a 3% position weight.

**Teleflex Inc. (TFX-N).** Like Boston Scientific, Teleflex's business strategy looks to augment low organic earnings growth from its legacy products with margin enhancement opportunities and tuck-in acquisitions. The company has partially delivered on its strategy as its two newly-acquired product lines have grown strongly since Teleflex brought them into its portfolio. (In the second quarter, NeoTract experienced 58% year-over-year growth and Vascular Solutions posted 17% year-over-year growth).

Rather than focusing on growth of the new product lines, investors focused on the weak results of its legacy portfolio, pushing the stock down 20%. We took advantage of the decline in the share price to double our position in Teleflex as we believe the long-term investment rationale remains sound. We currently have a 1.5% target weighting in Teleflex.

Below is a comparison of the valuation ratios of both companies with those of Medtronic.

| Company | Ticker | Price (US$) | Market Cap (US$B) | FWD Revenue Growth Rate ('17-20) | FWD EPS Growth Rate ('17-20) | 2019E P/E | PEG Ratio |
|---|---|---|---|---|---|---|---|
| Boston Scientific | BSX-N | 34.47 | 47.7 | 7.7% | 12.6% | 21.8 | 1.73 |
| Teleflex | TFX-N | 247.65 | 11.3 | 9.2% | 15.3% | 22 | 1.44 |
| MedTronic | MDT-N | 95.91 | 129.2 | 3.6% | 7.9% | 17.2 | 2.18 |

Looking at sales and earnings growth rates, both Teleflex and Boston Scientific are growing at much higher rates than Medtronic due to their product mix. Solely looking at the valuation levels, both are more expensive than Medtronic on a P/E basis. However, adjusting P/E ratios for growth, using the PEG ratio (the PEG ratio is simply the P/E ratio of a company divided by its expected growth rate of earnings per share), the companies are attractively valued vs. Medtronic, particularly if they can a) meet their expected earnings as forecasted by a broad number of Wall Street analysts (known as 'consensus') and b) maintain a strong growth profile in the future.

Execution will be key for both Teleflex and Boston Scientific and we will be closely monitoring their product launches and financial results to see if they can meet expectations. While Medtronic provides broad exposure and a lower risk profile than both companies, we think there is better relative value both Teleflex and Boston Scientific.