

Align Technology (ALGN)

\$296.54 (As of 01/09/20)

Price Target (6-12 Months): **\$311.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/23/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: A

Summary

Align Technology has continued to gain from the continued momentum in Invisalign volumes across all geographies. We are particularly encouraged by the solid worldwide Invisalign volume growth for teenage patient cases. We are also impressed with the robust performance by Invisalign Go and Invisalign First during the quarter. Launch of new Invisalign product offering is also an added positive. Strong revenue growth from iTero scanners and services is also encouraging. Reflective of these, the company has outperformed its industry in the past three months. On the flip side, Invisalign volumes in EMEA and iTero revenues declined sequentially in the reported quarter. Escalating expenses continue to build pressure on margins. Foreign currency headwinds also add to the woes.

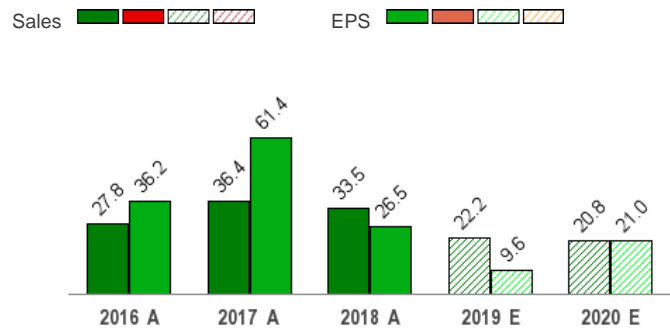
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$334.64 - \$169.84
20 Day Average Volume (sh)	589,094
Market Cap	\$23.4 B
YTD Price Change	6.3%
Beta	2.05
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical - Dental Supplies
Zacks Industry Rank	Top 37% (93 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.3%
Last Sales Surprise	2.5%
EPS F1 Est- 4 week change	0.5%
Expected Report Date	01/29/2020
Earnings ESP	0.0%
P/E TTM	57.0
P/E F1	45.5
PEG F1	1.9
P/S TTM	10.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	656 E	721 E	739 E	788 E	2,902 E
2019	549 A	601 A	607 A	645 E	2,402 E
2018	437 A	490 A	505 A	534 A	1,966 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.45 E	\$1.62 E	\$1.65 E	\$1.85 E	\$6.52 E
2019	\$0.89 A	\$1.83 A	\$1.28 A	\$1.39 E	\$5.39 E
2018	\$1.17 A	\$1.30 A	\$1.24 A	\$1.20 A	\$4.92 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/09/2020. The reports text is as of 01/10/2020.

Overview

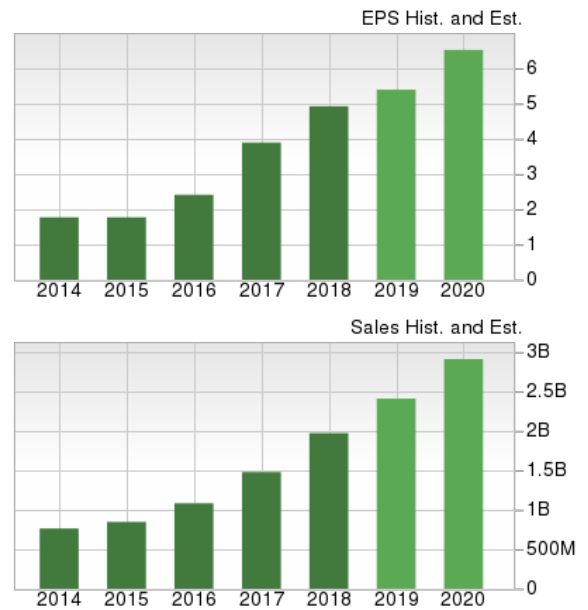
Align Technology, based in California, manufactures and markets a system of clear aligner therapy, intra-oral scanners and CAD/CAM (computer-aided design and computer-aided manufacturing) digital services used in dentistry, orthodontics, and dental records storage. The clear aligner system corrects malocclusion using nearly invisible and removable appliances that gently move the tooth to a desired final position.

Align presently has 2 operating segments, **Clear Aligner** (86% of total revenues in 2018), known as the Invisalign system and the **Scanner and Services** (13.9% of total revenues in 2018) which is known as the iTero intra-oral scanners and OrthoCAD services (which we earlier referred to as Scanner and CAD/CAM Services). In fiscal 2018, the Clear Aligner segment registered revenue growth of 29.2% from 2017, while the latter registered revenue growth of 67.5% from 2017.

Product portfolio:

Invisalign System – An exclusive method to treat malocclusion based on a series of doctor-prescribed, custom manufactured, clear plastic removable orthodontic aligners. The Invisalign system offers a range of treatment options, specialized services, and proprietary software for treatment visualization and comprises several phases.

The Clear Aligner products are Invisalign Full, Teen and Assist (Full Products), Express/Lite (Express Products), Vivera retainers, along with training and ancillary products for treating malocclusion.



Reasons To Buy:

- ▲ **Share Price Performance:** Align Technology has been outperforming its industry over the past three months. The stock has gained 48.2% compared to the industry's 9.6% rise. Solid prospects in its flagship Invisalign technology and significant international presence aids the stock.
- ▲ **Solid Growth Prospects:** In sync with its last-year performance, Align Technology continued with its streak of delivering a strong Invisalign Technology volume growth across the company's entire customer base.

Align Technology's recent product development, balanced growth observed across all channels and the company's consistent focus in international markets to drive growth and bolster our confidence in the stock.

In the third quarter, revenues at the Clear Aligner segment rose 20.9% year over year. Within the segment, Invisalign case shipments grew 20.7% year over year, primarily driven by continued adoption by teenage and younger patients as well as increased utilization among orthodontists and expansion of the company's global customer base.

During the quarter, Invisalign volumes were up 13% and 32.1% year over year in the Americas and International regions, respectively. Invisalign volume for teenage patients were up 31.5% year over year. Revenues from Scanner and Services improved a significant 16.5% on increased sales of iTero scanner and services.

Geographically, the company once again witnessed strength in North America as well as overseas. In North America, the company continued to witness an expanding GP Dentist customer base along with sustained strength in Invisalign utilization by orthodontists. Growth in North American teen patient market as well as strength in Latin American orthodontist market has contributed to the third-quarter top line. Internationally, we are encouraged by solid performance in the Asia Pacific (APAC) markets, particularly the teenage patient market in China. In EMEA, despite sequential decline in the reported quarter, the company is seeing strong growth across key expansion markets, led by stellar performances in Central and Eastern Europe and the Middle East and Africa.

- ▲ **Invisalign Portfolio Expansion:** Align Technology's Invisalign portfolio offers orthodontic treatment to straighten teeth without metal braces.

In the third quarter, Invisalign volumes witnessed strong double-digit growth year over year on continued momentum in Invisalign Go and Invisalign First treatment. At present, the company is successfully rolling out the Invisalign First clear aligners for treatment of younger patients with early mixed dentition in the United States, Australia, New Zealand, Japan, and the EMEA. This apart, another product in the company's portfolio — the Invisalign treatment with mandibular advancement — currently addresses roughly 45% of teen cases and is the only clear aligner to move the mandibular forward while straightening teeth at the same time. Both Invisalign First and Invisalign mandibular advancement are currently expanding well, leading to increased utilization for Invisalign treatment worldwide. Apart from this, the company's digital approach to teen market has continued to drive awareness among teenagers. Solid developments in Invisalign are likely to lend Align Technology a competitive edge in the U.S. MedTech space.

- ▲ **iTero in Focus:** Align Technology has been focusing on expanding work flow options of its leading iTero scanners. Cumulatively, 18 million orthodontic scans and 4.3 million restorative scans have started with iTero scanners. According to the company, use of the iTero scanners for Invisalign case submissions continues to grow and remains a positive catalyst for Invisalign utilization.

In the third quarter, iTero scanner and services revenues witnessed a 16.5% uptick year over year, reflecting consistent momentum across all geographies and customer channels, including large DSOs. Align Technology strongly believes that in another year or two, nearly all Invisalign cases will be submitted digitally — primarily through an iTero scanner.

In August, the company announced the commercial launch of the iTero Element 2 scanner in China with the first Made-in-China iTero Element 2 produced in its manufacturing facility in Ziyang. The launch signifies Align Technology continued investments to accelerate digital dentistry in China. We also look forward to the company's recently-linked global distribution deal with Zimmer Biomet Dental for the iTero Element suite of intra-oral scanners. The partnership will aid Align utilize Zimmer Biomet Dental's extensive direct global sales network of dental clinicians and laboratories which should enable further penetration of iTero scanners and services in the growing digital restorative market.

- ▲ **International Focus to Drive Growth:** Align Technology has undertaken several strategies to improve adoption of Invisalign Technology that includes product/technology development, extending clinical effectiveness, extension of the Invisalign Technology brand and driving international growth. On a year-over-year basis, Align Technology's international Invisalign Technology volumes were up 32.1%, reflecting continued strength in both EMEA and APAC regions. Within APAC, third-quarter Invisalign volume surged year over year, led by strength in greater China and Japan markets. The company also continued to witness strong momentum from GP dentists, as it registered solid growth year-over-year, especially in Japan where adoption of Invisalign Go continued to surpass expectations. On a sequential basis, third-quarter Invisalign volume growth for APAC indicates continued momentum in China, and the teenage patient markets of Taiwan and Korea. The company also saw increased adoption of Invisalign First in Japan and ANZ in Taiwan as well as favorable outcomes of teenage professional marketing programs, which have been driving Invisalign growth.

The company also continued to witness solid growth across its key expansion markets as well, like that of Central and Eastern Europe, Middle East and Africa.

- ▲ **Strong Balance Sheet:** At the end of the third quarter, Align Technology had cash, cash equivalents and short-term marketable securities of \$341 million, compared with \$720.9 million at the end of the second quarter. In the reported quarter, Align Technology repurchased 1.1 million stocks for \$200 million under its existing buy-back authorization. The company currently has approximately \$200.5 million left under the May 2018 repurchase program

Reasons To Sell:

- ▼ **Invisalign Store Closure Hampers Growth:** Since April 2018 Align was engaged in an arbitration proceeding with the SDC Entities stemming from the claim that the company's Invisalign retail stores violate non-compete provisions applicable to the members of SDC Financial LLC, including Align. In March, Align Technology finally announced that the outcome of the proceedings did not come in favor of the company. As per the update, by Apr 3, 2019, Align had to close its Invisalign Stores, which were first piloted in Nov 2017 and expanded to a total of 12 stores by the end of 2018.
- ▼ **Competitive Landscape:** Align Technology faces significant competition from traditional orthodontic appliance (or wires and brackets) players such as 3M's Unitek, Danaher Corporation's Sybron Dental Specialties and Dentsply International. The company also competes with products similar to InvisAlign Technology, such as the products from Ormco Orthodontics, a division of Sybron Dental Specialties. Align Technology has witnessed a continuous decline in ASP primarily resulting from advantage rebate, promotional activity and product mix.
- ▼ **Economic Uncertainty:** The general slowdown in the U.S. and certain international economies is having a negative impact on consumer spending and affecting Align Technology's business fundamentals. Align Technology attributed the waning earnings to the macro economic crisis that affected the overall dental market and led to continued soft dental sales for Align Technology. Dental procedures are primarily elective in nature and are deferred when unemployment levels rise. Continued weakness in the global economy results in a challenging environment for dental technology sales; dentists may postpone investments in capital equipment, such as intra-oral scanners. Although we expect a gradual pickup in patient traffic, any hiccup in the recovery process will aggravate the situation.
- ▼ **Currency Headwinds:** The significant challenges arising from unfavorable foreign currency translation have been affecting Align Technology's financials over the past few quarters. Per management, significant currency fluctuations could have a material impact on revenues, cost of sales and operational results.
- ▼ **Overdependence on InvisAlign Technology System:** A vast majority of Align Technology's total net revenues largely depends on the sale of its InvisAlign Technology System, primarily InvisAlign Technology Full and InvisAlign Technology Teen, and the same trend is expected to continue at least in the near future. Thereby, continued and widespread market acceptance of InvisAlign Technology by orthodontists, GPs and consumers is critical to Align Technology's future success. Management fears that if orthodontists and GPs somehow experience a reduction in consumer demand for orthodontic services, or consumers become reluctant to adopt InvisAlign Technology as rapidly as management expects that might hurt the company's business heavily. Also, if consumers start to prefer a competitive product over InvisAlign Technology or if the average selling price of Align Technology product declines, the company's operating results will suffer a severe setback.

We remain concerned about the current economic uncertainty which continues to cast a negative impact on Align's dental procedures. The competitive landscape also remains an overhang.

Last Earnings Report

Align Technology Beats on Q3 Earnings

Align Technology's third-quarter 2019 earnings per share came in at \$1.28, reflecting a 3.2% increase from a year ago. The figure beat the Zacks Consensus Estimate by 12.3%.

Revenues

Revenues grew 20.2% year over year to \$607.3 million in the quarter, surpassing the Zacks Consensus Estimate by 2.5%.

The robust top-line growth was led by a double-digit increase in Invisalign case shipments from the year-ago quarter. Moreover, increased revenues from iTero scanner contributed substantially.

Segments in Detail

In the third quarter, revenues at the Clear Aligner segment rose 20.9% year over year. Within the segment, Invisalign case shipments amounted to 385,000, up 20.7% year over year. The upside was primarily driven by continued adoption by teenage and younger patients as well as increased utilization among orthodontists and expansion of the company's global customer base.

During the quarter, Invisalign volumes were up 13% and 32.1% year over year in the Americas and International regions, respectively. Invisalign volume for teenage patients was 130,000 cases, up 31.5% year over year.

Revenues from Scanner and Services improved a significant 16.5% to \$91.1 million on increased sales of iTero scanner and services.

Margins

Gross margin in the quarter under review contracted 153 basis points (bps) year over year to 72% on account of a 27.2% rise in cost of net revenues.

During the quarter, Align Technology witnessed a 29.8% year-over-year increase in selling, general and administrative expenses to \$277.5 million and a 21.3% rise in research and development (R&D) expenses to \$39.7million. Accordingly, adjusted operating margin contracted 496 bps to 19.8% in the quarter under review.

Financial Details

At the end of the third quarter, Align Technology had cash, cash equivalents and short-term marketable securities of \$782.4 million, compared with \$720.9 million at the end of the second quarter.

In the reported quarter, Align Technology repurchased 1.1 million stocks for \$200 million under its accelerated stock repurchase agreement, introduced last July. The company currently has approximately \$200.5 million left under its May 2018 repurchase program.

Q4 Guidance

For the fourth quarter of 2019, the company projects earnings per share of \$1.35 to \$1.42 on revenues to \$640 million to \$650 million (indicating 20-22% growth from a year ago). The company estimates Invisalign case shipments in the band of 400,000-407,000 suggesting a 20-22% rise from a year ago.

Meanwhile, the Zacks Consensus Estimate for fourth-quarter earnings per share is pinned at \$1.38 on revenues of \$648.9 million. Both the earnings and revenue estimates lie within their respective projected bands.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	2.51%
EPS Surprise	12.28%
Quarterly EPS	1.28
Annual EPS (TTM)	5.20

Recent News

On **Oct 31, 2019**, Align Technology launched a new Invisalign product offering to empower doctors with new tools and technology which can help them better serve the rapidly expanding market for clear aligner treatment.

On **Oct 16, 2019**, Align Technology partnered with Covestro to showcase the jointly developed Material Solution, Invisalign clear aligner system for straightening teeth, made with patented SmartTrack material, at the K 2019 Plastics Trade Fair in Düsseldorf, Germany to be held between Oct 16 – 23, 2019.

Valuation

Align Technology shares are up 4.9% in the six months period and up 49.6% in the trailing 12-month periods. Stocks in the Zacks sub-industry are down 12.3% while the Zacks Medical sector rose 4.9% in the six months period. Over the past year, the Zacks sub-industry is up 2.1% and sector is up 4.4%.

The S&P 500 index is up 9% in the six months period and up 24.4% in the past year.

The stock is currently trading at 45.2X Forward 12-months earnings, which compares to 17.7X for the Zacks sub-industry, 21.5X for the Zacks sector and 18.8X for the S&P 500 index.

Over the past five years, the stock has traded as high as 69.2X and as low as 25.1X, with a 5-year median 35.9X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$311 price target reflects 47.4x forward 12-months earnings.

The table below shows summary valuation data for ALGN.

Valuation Multiples - ALGN					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	45.19	17.67	21.49	18.82
	5-Year High	69.22	19.99	21.49	19.34
	5-Year Low	25.06	13.70	15.91	15.17
	5-Year Median	35.93	16.67	18.98	17.44
P/S F12M	Current	8.01	0.36	2.82	3.49
	5-Year High	13.81	0.36	3.80	3.49
	5-Year Low	4.44	0.23	2.42	2.54
	5-Year Median	6.74	0.28	2.93	3.00
P/B TTM	Current	17.90	4.48	4.50	4.44
	5-Year High	26.31	4.93	5.01	4.45
	5-Year Low	5.34	2.53	3.42	2.85
	5-Year Median	10.69	3.45	4.27	3.61

As of 01/09/2020

Industry Analysis Zacks Industry Rank: Top 37% (93 out of 254)



Top Peers

CONMED Corporation (CNMD)	Neutral
Danaher Corporation (DHR)	Neutral
Endologix, Inc. (ELGX)	Neutral
Henry Schein, Inc. (HSIC)	Neutral
3M Company (MMM)	Neutral
Merit Medical Systems, Inc. (MMSI)	Neutral
Patterson Companies, Inc. (PDCO)	Neutral
DENTSPLY SIRONA Inc. (XRAY)	Neutral

Industry Comparison Industry: Medical - Dental Supplies				Industry Peers		
	ALGN Neutral	X Industry	S&P 500	HSIC Neutral	PDCO Neutral	XRAY Neutral
VGM Score	B	-	-	A	A	B
Market Cap	23.37 B	1.45 B	23.94 B	9.71 B	2.07 B	12.80 B
# of Analysts	8	6	13	9	8	8
Dividend Yield	0.00%	0.00%	1.78%	0.00%	4.80%	0.70%
Value Score	D	-	-	A	A	C
Cash/Price	0.04	0.06	0.04	0.01	0.07	0.02
EV/EBITDA	43.41	11.31	13.97	10.89	11.64	28.29
PEG Ratio	1.96	2.05	2.03	2.01	2.40	1.82
Price/Book (P/B)	17.90	3.76	3.33	2.81	1.42	2.55
Price/Cash Flow (P/CF)	52.13	11.97	13.73	11.97	9.65	6.84
P/E (F1)	45.73	21.77	18.79	17.86	15.26	21.21
Price/Sales (P/S)	10.20	1.49	2.64	0.91	0.37	3.22
Earnings Yield	2.20%	4.06%	5.32%	5.60%	6.55%	4.71%
Debt/Equity	0.03	0.32	0.72	0.30	0.49	0.30
Cash Flow (\$/share)	5.69	1.80	6.94	5.53	2.24	8.42
Growth Score	A	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	32.16%	8.77%	10.56%	8.77%	-12.79%	-4.15%
Proj. EPS Growth (F1/F0)	20.92%	13.35%	7.49%	7.41%	1.43%	10.51%
Curr. Cash Flow Growth	27.89%	9.29%	14.83%	10.44%	-11.19%	-27.39%
Hist. Cash Flow Growth (3-5 yrs)	25.81%	12.65%	9.00%	8.23%	-3.58%	31.76%
Current Ratio	1.73	1.72	1.23	1.63	1.59	2.08
Debt/Capital	3.21%	26.85%	42.99%	27.89%	32.97%	23.13%
Net Margin	18.28%	3.65%	11.08%	4.66%	1.01%	4.08%
Return on Equity	28.76%	15.73%	17.16%	15.93%	8.97%	10.08%
Sales/Assets	1.02	1.02	0.55	1.43	1.67	0.46
Proj. Sales Growth (F1/F0)	20.80%	5.42%	4.20%	3.48%	0.83%	2.95%
Momentum Score	A	-	-	A	D	B
Daily Price Chg	3.69%	0.00%	0.53%	-2.55%	-0.37%	0.07%
1 Week Price Chg	1.01%	0.00%	-0.30%	-0.03%	0.74%	-0.95%
4 Week Price Chg	10.49%	0.73%	1.92%	-3.81%	-1.41%	1.07%
12 Week Price Chg	38.62%	4.41%	6.54%	4.17%	23.97%	4.73%
52 Week Price Chg	46.34%	5.69%	22.58%	-16.71%	0.28%	43.73%
20 Day Average Volume	589,094	234,749	1,580,816	1,124,993	1,142,215	1,009,283
(F1) EPS Est 1 week change	-0.09%	0.00%	0.00%	-0.06%	0.00%	0.00%
(F1) EPS Est 4 week change	0.50%	0.00%	0.00%	-0.06%	0.00%	0.47%
(F1) EPS Est 12 week change	-1.10%	-0.22%	-0.50%	-1.13%	3.18%	1.60%
(Q1) EPS Est Mthly Chg	1.05%	0.00%	0.00%	0.00%	0.00%	0.30%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	A
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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