

DaVita Inc. (DVA)

\$83.19 (As of 01/24/20)

Price Target (6-12 Months): **\$87.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/06/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: B

Summary

DaVita is on track to acquire more dialysis centers in the United States. A win against the union-backed ballot in California indicates bright prospects. The recent divestment of the DMG unit to Optum is likely to enable the company to clear debts. A raised guidance for 2019 is an added positive. DaVita ended the third quarter on a strong note. Dialysis services in the United States showcased solid results during the quarter. Also, dialysis activities ramped up overseas. The stock outperformed the industry in a year's time. On the flip side, the Other business unit has been witnessing softness for a couple of quarters now. DaVita faces significant competition in the U.S. dialysis market, which is worrisome.

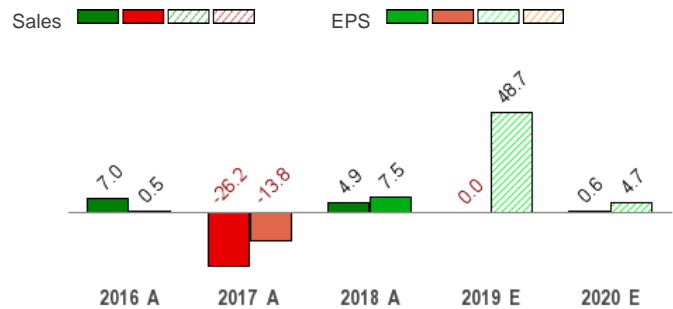
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$85.59 - \$43.40
20 Day Average Volume (sh)	889,918
Market Cap	\$10.7 B
YTD Price Change	10.9%
Beta	1.68
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Medical - Outpatient and Home Healthcare
Zacks Industry Rank	Bottom 35% (166 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	24.4%
Last Sales Surprise	1.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/12/2020
Earnings ESP	0.0%
P/E TTM	18.2
P/E F1	15.0
PEG F1	0.7
P/S TTM	0.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,769 E	2,854 E	2,898 E	2,926 E	11,481 E
2019	2,743 A	2,843 A	2,904 A	2,916 E	11,410 E
2018	2,849 A	2,887 A	2,847 A	2,821 A	11,405 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.27 E	\$1.43 E	\$1.42 E	\$1.47 E	\$5.56 E
2019	\$0.91 A	\$1.22 A	\$1.53 A	\$1.66 E	\$5.31 E
2018	\$1.05 A	\$1.05 A	\$0.56 A	\$0.90 A	\$3.57 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 01/24/2020. The reports text is as of 01/27/2020.

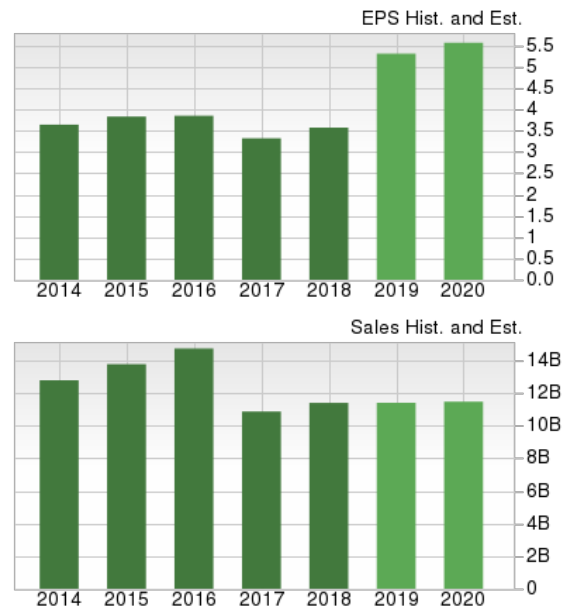
Overview

Founded in 1994 and headquartered in Denver, CO, **DaVita Inc.** is a leading provider of dialysis services in the U.S. to patients suffering from chronic kidney failure, also known as end stage renal disease (ESRD). The company operates kidney dialysis centers and provides related medical services primarily in dialysis centers and in contracted hospitals across the U.S. Its services include outpatient dialysis services, hospital inpatient dialysis services and ancillary services such as ESRD laboratory services and disease management services.

DaVita's Dialysis and related lab services business segment provides inpatient as well as outpatient dialysis services, routine laboratory testing for ESRD patients and management services to outpatient dialysis centers.

The company's other ancillary services and strategic initiatives segment includes its international dialysis services, pharmacy services, infusion therapy services, disease management services, vascular access services, ESRD clinical research programs and physician services.

For investors' notice, the company's major segment — DaVita Medical Group ("DMG") — has been divested to Optum, a subsidiary of UnitedHealth Group Inc. for a deal value of \$4.3 billion. The results of DMG business' operations have been reported as discontinued.



2018 at a Glance

On a full-year basis, revenues totaled \$11.40 billion.

Net dialysis and related lab patient revenues for the year totaled \$10.66 billion (93.5% of net sales) and Other revenues totaled \$744.5 million (6.5%).



Reasons To Buy:

- ▲ **Shares Up:** Over the past year, shares of DaVita have rallied 48.3% against the industry's 15% decline. The current level outpaced the S&P 500 index's 23.8% gain.

DaVita is set to gain significantly from calcimimetics in 2019 and hence has issued an impressive guidance for the year. Also, solid prospects in the Kidney Care wing aids the stock.

- ▲ **DaVita Kidney Care:** DaVita Kidney Care, the major revenue-generating segment of DaVita, specializes in a broad array of dialysis services, thereby significantly contributing to the company's topline.

As an operating division of DaVita, DaVita Kidney Care focuses on setting worldwide standards for clinical, social and operational practices in kidney care. DaVita saw solid results from the Kidney Care business. Of the major services that DaVita provides, the company's in-center hemodialysis, home hemodialysis, peritoneal dialysis, kidney transplant, urology, diabetology and vascular access surgery deserve a mention.

Notably, third-quarter U.S. dialysis and related lab services revenues grossed \$2.78 billion, up 4.5% on a year-over-year basis.

- ▲ **Guidance Impressive:** DaVita raised its guidance for 2019.

Notably, the company now expects adjusted operating income between \$1.74 billion and \$1.77 billion compared with the previous guidance of \$1.64-\$1.70 billion.

Adjusted earnings per share are expected in the range of \$5.25-\$5.75 compared with the previous expectation of \$5-\$5.50.

- ▲ **Gain From Calcimimetics:** Per management, the company benefited significantly from calcimimetics in the third quarter. The company generated third-quarter operating income of \$74 million from calcimimetics. Notably, DaVita benefited from multiple launches of generic oral drugs, which led to a drop in acquisition prices.

For the rest of 2019, management expects operating income benefit from calcimimetics of \$220 million.

- ▲ **DMG Divestment:** For investors' notice, DaVita recently completed the divestment of the DaVita Medical Group division to Optum, a subsidiary of UnitedHealth Group, for a deal value of \$4.34 billion. It is encouraging to note that the company used the full \$4.47 billion in preliminary net proceeds received at closing to repay its outstanding debt.

- ▲ **Proposition 8 Victory:** The defeat of the Proposition 8 in California has been a major milestone for DaVita in recent times. Notably, Proposition 8's major aim was to adversely affect the earnings of two major chains of dialysis clinics, DaVita Kidney Care and Fresenius Medical Care, that have resisted efforts by SEIU-UHW to organize their workers. A broad coalition of over 160 members had worked to defeat the union-backed ballot initiative. The coalition included the California Medical Association, the California Hospital Association, the American Nurses Association of California, the American College of Emergency Room Physicians and California Chamber of Commerce. Although it led to incurring of costs in recent times, the company will continue providing free-flowing and life-saving dialysis services to customers.

- ▲ **Acquisition of Dialysis Centers:** Acquiring dialysis centers and businesses that own and operate dialysis centers as well as other ancillary services is DaVita's preferred business strategy. These strategies have boosted the company's top line to a large extent.

In 2018, DaVita's Kidney Care Business opened a 150,000 square-foot campus for DaVita Labs, its diagnostic laboratory that serves DaVita dialysis clinics and their patients. In the recent past, DaVita HealthCare Partners also announced that HealthCare Partners, a unit within its medical group, has entered into a strategic partnership with Cigna, a global health insurance service company.

In the third quarter of 2019, the company provided dialysis services to 233,300 patients at 2,985 outpatient dialysis centers. Of the total, 2,736 centers were located in the United States and 249 centers were located in nine other countries.

During the quarter, DaVita opened a total of 24 new dialysis centers and acquired two centers in the United States. Overseas, the company acquired other two dialysis centers in the quarter.

- ▲ **Overseas Growth:** DaVita is steadily expanding in the international markets. In the past few years, the company has strengthened its position in the emerging and developing markets of Brazil, China, Colombia, Germany, India, Malaysia, Netherlands, Poland, Portugal and Saudi Arabia through strategic alliances as well as acquisitions of dialysis centers.

These are expected to help DaVita deliver more efficient patient care. Currently, DaVita is seeking to expand in major European and Asian countries via acquisitions and partnerships.

DaVita realized around \$1 million of operating income from its international operations in the third quarter and also a \$3-million foreign exchange gain.

DaVita's incessant efforts to upgrade services, global expansion initiatives and active acquisitions remain impressive and are supported by the company's strong financial position.

Reasons To Sell:

- ▼ **Issues in DaVita Rx:** Earlier this year, management at DaVita announced that certain unfavorable changes in the oral pharmacy space, including reimbursement reductions, have hurt the economics of DaVita Rx. For investors notice, DaVita Rx is a full-service pharmacy specializing in kidney care and dedicated to the safety of patients. Because of the sluggishness in the DaVita Rx unit, management plans to outsource the customer service and fulfillment functions of DaVita Rx.

However, in 2019 and beyond, no significant net financial impact from DaVita Rx is expected.

High debt levels, adverse effects of healthcare reforms, and an increase in MA beneficiaries are concerns.

- ▼ **Strict Regulatory Environment:** DaVita's operations are subject to extensive federal, state and local government laws and regulations, such as Medicare and Medicaid payment rules and regulations, federal and state anti-kickback laws, the Stark Law and analogous state self-referral prohibition statutes, the False Claims Act (FCA), the Civil Monetary Penalty statute, the Foreign Corrupt Practices Act (FCPA) and federal and state laws regarding the collection, use and disclosure of patient health information. A violation or departure from any of these legal requirements may result in government audits, lower reimbursements, significant fines and penalties, the potential loss of certification, recoupment efforts or voluntary repayments, among other things.

In addition, failure to report and return overpayments within 60 days of when the overpayment is identified can lead to a violation of the FCA and associated penalties, as described in further detail below, and exclusion and penalties under the federal Civil Monetary Penalty statute, including civil monetary penalties of up to \$20,000 (adjusted for inflation) for each item or service for which a person received an identified overpayment and failed to report and return such overpayment.

- ▼ **Integration Risks:** DaVita's business strategy includes growth through acquisitions of dialysis centers and other businesses, as well as entry into joint ventures. The company may engage in acquisitions, mergers, joint ventures or dispositions or expand into new business models, which may affect its results of operations, debt-to-capital ratio, capital expenditures or other aspects of the business.

Per management, businesses that DaVita acquires may have unknown or contingent liabilities or liabilities that are in excess of the amounts that the company had originally estimated. Further DaVita can face other issues related to internal controls over financial reporting or issues that could affect the company's ability to comply with healthcare laws and regulations and other laws applicable to the company's expanded business.

- ▼ **Cash Flow to Reduce After DMG Divestment:** After the divestment of DaVita's DMG segment, management expects the company's cash flows to be reduced accordingly.

Management at DaVita confirmed that it will provide no assurances to generate sufficient cash flows from operations in the future to finance debts or to fund other liquidity needs. Management also said that if the company is unable to generate sufficient funds to finance its outstanding indebtedness or to meet other liquidity needs, DaVita might refinance, restructure, or otherwise amend some obligations, sell assets, change the company's intended or announced uses or strategy for capital deployment, including stock repurchases, reduce capital expenditures or planned expansions or raise additional cash through the sale of DaVita's equity.

- ▼ **Dependence on Commercial Payers:** A significant portion of DaVita's dialysis and related lab services revenues are generated from patients who have commercial payers as the primary payers. The payments received from commercial payers are the primary generators of profit. However, there remains a risk of people shifting from commercial insurance schemes to government schemes due to the wide disparity in payment rates in case of a rise in unemployment. In fact, the mix of treatments reimbursed by non-government payers, as a percentage of total treatments, has been falling consistently over the years.

A large percentage of DaVita's patients already use Medicare or Medicaid programs. The overall increase in Medicare Advantage beneficiaries in the U.S. is likely to increase this percentage further, leading to additional pressure on the company's profitability, as inadequacy of government reimbursements could force it to close a number of centers.

- ▼ **Competition:** DaVita operates in a strictly competitive environment. Notably, the U.S. dialysis industry has a number of bigwigs operating, like, Baxter, Abbott, Boston Scientific which pose significant rivalry for DaVita.
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Last Earnings Report

DaVita Q3 Earnings Beat Estimates, 2019 View Impressive

DaVita reported third-quarter 2019 adjusted earnings per share of \$1.53, beating the Zacks Consensus Estimate of \$1.23. The bottom line increased from the year-ago quarter's figure of 56 cents.

Total revenues in the quarter moved up 2% year over year to \$2.90 billion, beating the Zacks Consensus Estimate of \$2.85 billion.

Third-quarter adjusted operating income totaled \$462 million, up 47.1% year over year.

Segment Details

Net dialysis and related lab patient service revenues in the third quarter totaled \$2.78 billion, up 4.5% on a year-over-year basis. Other revenues were \$126 million, down 32.7% from the year-ago quarter's figure.

Per management, total U.S. dialysis treatments for the third quarter were 7,673,191 or an average of 97,129 treatments per day. The figure represents a per day increase of 2.7% on a year-over-year basis.

Moreover, the company provided dialysis services to 233,300 patients at 2,985 outpatient dialysis centers. Of the total, 2,736 centers were located in the United States and 249 centers were located in nine other countries.

Financial Condition

DaVita exited the third quarter with operating cash flow of \$641 million.

Guidance

DaVita raised its guidance for 2019.

Notably, the company now expects adjusted operating income between \$1.74 billion and \$1.77 billion compared with the previous guidance of \$1.64-\$1.70 billion.

Adjusted EPS is expected in the range of \$5.25-\$5.75, higher than the previous expectation of \$5-\$5.50.

Quarter Ending **09/2019**

Report Date	Nov 05, 2019
Sales Surprise	1.81%
EPS Surprise	24.39%
Quarterly EPS	1.53
Annual EPS (TTM)	4.56

Valuation

DaVita's shares are up 39.4% in the past six months and up 48.3% in the trailing 12-month periods. Stocks in the Zacks sub-industry are down 23.1% while the Zacks Medical Sector is up 5.8% in the past six months. Over the past year, stocks in the Zacks sub-industry are down 15% while that in the sector are up 5.3%.

The S&P 500 index is up 9.5% in the past six months period and up 23.8% in the past year.

The stock is currently trading at 14.77X Forward 12-months earnings, which compares to 22.05X for the Zacks sub-industry, 21.22X for the Zacks sector and 18.93X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.86X and as low as 9.37X, with a 5-year median 16.24X.

Our Neutral recommendation indicates that the stock will perform better than the market. Our \$87 price target reflects 15.5X forward 12-months earnings.

The table below shows summary valuation data for DVA.

Valuation Multiples - DVA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.77	22.05	21.22	18.93
	5-Year High	22.86	22.05	21.23	19.34
	5-Year Low	9.37	14.67	15.85	15.17
	5-Year Median	16.24	17.87	18.91	17.44
P/S F12M	Current	0.93	4.09	2.82	3.52
	5-Year High	1.3	4.09	3.82	3.52
	5-Year Low	0.62	0.73	2.43	2.54
	5-Year Median	0.9	0.96	2.94	3
P/B TTM	Current	4.24	6.82	4.61	4.5
	5-Year High	4.79	6.86	5.03	4.55
	5-Year Low	1.77	1.99	3.43	2.85
	5-Year Median	2.71	2.5	4.29	3.62

As of 01/24/2020

Industry Analysis Zacks Industry Rank: Bottom 35% (166 out of 255)



Top Peers

Amedisys, Inc. (AMED)	Outperform
Chemed Corporation (CHE)	Neutral
Quest Diagnostics Incorporated (DGX)	Neutral
Encompass Health Corporation (EHC)	Neutral
Fresenius Medical Care AG & Co. KGaA (FMS)	Neutral
Hanger Inc. (HNGR)	Neutral
LHC Group, Inc. (LHCG)	Neutral
Elanco Animal Health Incorporated (ELAN)	Underperform

Industry Comparison Industry: Medical - Outpatient And Home Healthcare				Industry Peers		
	DVA Neutral	X Industry	S&P 500	DGX Neutral	EHC Neutral	ELAN Underperform
VGM Score	A	-	-	C	C	F
Market Cap	10.66 B	961.45 M	24.13 B	14.52 B	7.77 B	11.78 B
# of Analysts	6	2	13	9	1	6
Dividend Yield	0.00%	0.00%	1.78%	1.97%	1.42%	0.00%
Value Score	A	-	-	B	B	F
Cash/Price	0.14	0.05	0.04	0.03	0.06	0.03
EV/EBITDA	12.14	12.46	14.02	12.32	12.46	31.37
PEG Ratio	0.68	2.59	2.03	2.12	2.41	2.91
Price/Book (P/B)	5.31	4.22	3.30	2.57	4.65	2.10
Price/Cash Flow (P/CF)	11.44	13.51	13.52	13.25	13.77	15.86
P/E (F1)	14.96	30.98	18.92	16.01	21.31	27.33
Price/Sales (P/S)	0.94	1.38	2.65	1.90	1.72	3.82
Earnings Yield	6.68%	2.79%	5.28%	6.24%	4.69%	3.64%
Debt/Equity	4.26	0.48	0.72	0.56	1.94	0.43
Cash Flow (\$/share)	7.27	1.98	6.94	8.14	5.72	1.99
Growth Score	A	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	-0.06%	13.13%	10.60%	9.46%	15.79%	NA
Proj. EPS Growth (F1/F0)	4.83%	12.22%	7.59%	3.66%	-5.85%	9.48%
Curr. Cash Flow Growth	-14.54%	20.06%	13.90%	9.93%	24.32%	9,351.95%
Hist. Cash Flow Growth (3-5 yrs)	-2.15%	9.79%	9.00%	4.34%	10.83%	NA
Current Ratio	1.81	1.11	1.22	0.88	0.97	3.12
Debt/Capital	82.68%	51.70%	42.99%	36.60%	67.34%	29.85%
Net Margin	3.68%	3.20%	11.35%	9.58%	7.07%	3.04%
Return on Equity	19.95%	16.02%	17.10%	15.32%	23.89%	7.79%
Sales/Assets	0.57	0.91	0.55	0.65	0.79	0.35
Proj. Sales Growth (F1/F0)	0.63%	5.60%	4.03%	2.33%	5.67%	0.56%
Momentum Score	B	-	-	F	F	D
Daily Price Chg	3.34%	-0.19%	-1.01%	-0.19%	-0.18%	-2.11%
1 Week Price Chg	4.63%	2.44%	2.29%	0.20%	11.96%	4.42%
4 Week Price Chg	11.26%	4.17%	1.02%	1.22%	13.52%	8.27%
12 Week Price Chg	41.96%	15.31%	6.85%	6.46%	23.15%	16.84%
52 Week Price Chg	47.53%	13.82%	20.39%	25.92%	19.76%	4.43%
20 Day Average Volume	889,918	99,608	1,536,379	602,564	640,227	6,797,132
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.16%	0.00%	-0.21%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.12%	-2.33%	-6.94%
(F1) EPS Est 12 week change	4.15%	-0.06%	-0.23%	-0.12%	-1.77%	-9.92%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-0.76%	-3.85%

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	A
Growth Score	A
Momentum Score	B
VGM Score	A

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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