

STERIS plc (STE)

\$148.25 (As of 05/08/20)

Price Target (6-12 Months): **\$156.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/29/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM: C

Value: C

Growth: B

Momentum: C

Summary

STERIS witnessed solid revenue growth across both its operating segments over the recent past. Contributions from elevated consumer demand, and a broader portfolio of products and services within Life Sciences bode well for the company. Several tuck-in acquisitions also buoy optimism for the company. Expansion of both margins during the quarter is encouraging. Further, an overall strong capital structure and increased fiscal 2020 guidance indicating a steady trend ahead instills investors' optimism. Overall, the company has been outperforming its industry for the past six months. However, a decline in free cash flow mainly due to increased capital spending and adverse foreign exchange impact on revenues are concerning. Also, the ongoing economic doldrums in the wake of global coronavirus outbreak is slashing down the stock price largely.

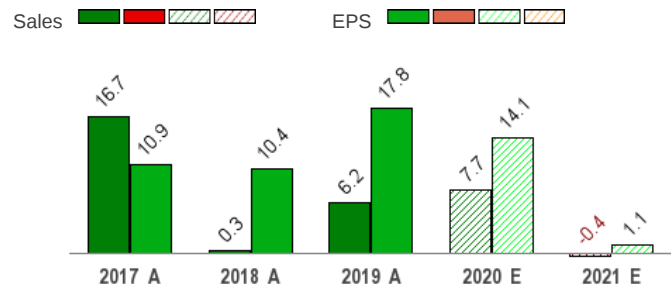
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$168.98 - \$105.69
20 Day Average Volume (sh)	635,396
Market Cap	\$12.6 B
YTD Price Change	-2.7%
Beta	0.75
Dividend / Div Yld	\$1.48 / 1.0%
Industry	Medical - Instruments
Zacks Industry Rank	Top 14% (36 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.4%
Last Sales Surprise	3.3%
EPS F1 Est- 4 week change	-8.9%
Expected Report Date	05/13/2020
Earnings ESP	-1.9%
P/E TTM	26.8
P/E F1	26.3
PEG F1	NA
P/S TTM	4.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	627 E	719 E	793 E	846 E	2,984 E
2020	697 A	737 A	774 A	788 E	2,996 E
2019	639 A	679 A	696 A	768 A	2,782 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.98 E	\$1.26 E	\$1.53 E	\$1.74 E	\$5.64 E
2020	\$1.23 A	\$1.32 A	\$1.45 A	\$1.57 E	\$5.58 E
2019	\$1.00 A	\$1.10 A	\$1.26 A	\$1.53 A	\$4.89 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 05/08/2020. The reports text is as of 05/11/2020.

Overview

STERIS plc, headquartered in Ohio, develops, manufactures and markets infection prevention, decontamination, microbial reduction, and surgical and gastrointestinal support products and services. The legacy company was originally known as STERIS Corporation. On Nov 2, 2015, STERIS completed the acquisition of Synergy Health plc following which it was re-registered under the name – STERIS plc.

Currently, STERIS serves healthcare, pharmaceutical, research, industrial and governmental customers across the globe. The majority of STERIS' revenues is derived from the healthcare and pharmaceutical industries. STERIS provides its products and services in more than 60 countries. The company's key areas of strategic focus include developing its customer base in Europe, the Middle East and the Asia Pacific region.

Post the combination with Synergy Health, STERIS now operates in four business segments:

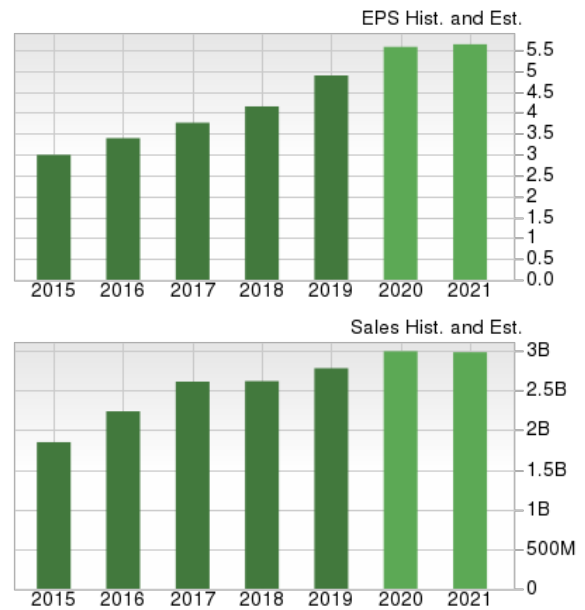
Healthcare Products (comprising 47.8% of total revenue in FY19): This is the biggest segment, which offers infection prevention and procedural solutions for global healthcare providers, including capital equipment and related maintenance and installation services, as well as consumables. In fiscal 2019, the segment registered 4.7% growth from fiscal 2018.

Healthcare Specialty Services (18.3%): This segment provides a range of specialty services for healthcare providers including hospital sterilization services, instrument and scope repairs and linen management. In fiscal 2019, the segment registered 10.9% growth from fiscal 2018.

Life Sciences (13.3%): This segment offers capital equipment and consumable products and equipment maintenance and specialty services for pharmaceutical manufacturers and research facilities. In fiscal 2019, the segment registered 2.8% growth from fiscal 2018.

Applied Sterilization Technologies (19.8%): This segment offers contract sterilization and laboratory services for medical device and pharmaceutical customers and others. In fiscal 2019, the segment registered 10.9% growth from fiscal 2018.

STERIS divested the Synergy Health Healthcare Consumable Solutions ("HCS") business in fiscal 2018.



Reasons To Buy:

- ▲ **Share Price Movement:** Over the past six months, STERIS has been outperforming its industry. The stock has climbed 1.8% against the 0.1% fall of the industry. We are impressed with the company's consistently strong organic growth performance across its operating segments. Healthcare Products, Healthcare Specialty Services, Applied Sterilization Technologies and Life Sciences segments registered growth of 8%, 12.6%, 14.3% and 16.4%, respectively. Elevated consumer demand, and a broader portfolio of products and services have also driven the stock.

STERIS has been demonstrating strong top-line gains on favorable underlying market growth, resulting from customer adoptions along with new product and service offerings. The company's service maintenance revenues have recorded growth, primarily driven by installation revenues due to strong capital shipments in the first half of the year. STERIS has also made certain acquisitions and organizational changes, which are expected to better align with its operations.

- ▲ **STERIS' Infection Prevention and Sterilization Wing Grows Well Globally:** With the acquisition of U.K.-based outsourced sterilization services provider Synergy Health, STERIS has become the new global leader in infection prevention and sterilization. The company is currently providing improved healthcare services to medical device companies, pharma companies, hospitals and other healthcare facilities across the globe.

The sector registered robust growth (up 14.3%) on strong adoptions by the company's global core medical device customer base. The company continues to benefit from the acquisition of Synergy Health. The consolidation, since its inception has boosted STERIS' presence in the international markets as it combines STERIS' strong presence in North America with Synergy's solid footprint across Europe. It has also provided STERIS an opportunity to better serve the emerging markets of Asia-Pacific and Latin America.

- ▲ **High Potential in Healthcare and Pharmaceutical Industries:** The bulk of STERIS' revenues are obtained from the healthcare and pharmaceutical industries. Growth in these industries is primarily driven by the aging of the global population, as an increasing number of individuals are entering their prime healthcare consumption years. Further these industries are dependent upon advancement in healthcare delivery, acceptance of new technologies, government policies and general economic conditions. With life expectancy on the rise globally, a larger aging population increases the demand for medical procedures. This, in turn, translates into higher consumption of single use medical devices and surgical kits processed by STERIS.

During the third quarter of fiscal 2020, revenues at the Healthcare Specialty Services segment rose 12.6% (up 13.9% on a constant-currency organic basis). The segment recorded robust growth, driven by steady improvement in the repair business and continued contributions from new outsourced reprocessing centers. The completion of eight tuck-in acquisitions in 2019 has also driven growth of the segment.

- ▲ **Strong Balance Sheet Position:** STERIS exited the fiscal third quarter with cash and cash equivalents of \$199.2 million compared with \$225.5 million witnessed at the end of second-quarter fiscal 2020. Cumulative cash flow from operating activities was \$391.3 million at the end of the fiscal third quarter compared with \$360.6 million in the year-ago period.

- ▲ **Overall Strong Capital Structure:** STERIS exited the fiscal third quarter with cash and cash equivalents of \$199.2 million compared with \$225.5 million witnessed at the end of second-quarter fiscal 2020. Meanwhile, total debt came up to \$1.26 billion, a slight reduction from the sequentially-last-reported figure of \$1.30 billion. Although, the quarter's total debt was much higher than the corresponding cash and cash equivalent level, the company has insignificant current-year-payable debt on its balance sheet. This is good news in terms of the company's solvency level as, at least during the year of global pandemic when the companies are majorly facing manufacturing and supply halt. STERIS' total debt level remains low compared to the industry average of \$2.93 billion.

The quarter's total debt-to-capital of 27.1% stands at a moderately high level right now. However, it represented a sequential drop from the fiscal second quarter's 28.7%. In fact, the current quarter's debt-to-capital stands lowest among the last three consecutive quarters. This also stands below the industry-average of 32.1% indicating healthier financial structure compared to its industry average.

The company's fiscal second-quarter interest coverage stands at 12.6%, the highest in the past four quarters buoying optimism. This stands significantly above the industry average of 5.5%.

STERIS' capital deployment policy is based on the return of shareholder's money through dividends and share buybacks. The company's current payout ratio stands at a 0.26, much above the industry average of 0.07. Amid the pandemic-led economic crisis, if production and supply halt along with lockdowns continue through the next few months, the company might find paying its regular quarterly dividends to be over-burdened.

With the Synergy Health deal now over, STERIS' combined business is expected to gain larger market share overseas. Additionally, STERIS' strong cash balance position is also encouraging.

Reasons To Sell:

▼ **Competitive Landscape:** STERIS competes for pharmaceutical, research and industrial customers against several large companies that have robust product portfolios and global reach, as well as a number of small companies with limited product offerings and operations in one or a few countries. In the Healthcare segment, STERIS' notable competitors include 3M, Belimed, Cantel Medical, Ecolab, Getinge, Go Jo, Johnson & Johnson, Kimberly-Clark, Skytron and Stryker. STERIS' Life Sciences segment operates in highly regulated environments where the most intense competition results from technological innovations, product performance, convenience and ease of use, and overall cost-effectiveness. Competitors from pharmaceutical segment include Belimed, Ecolab, Fedegari, Getinge, MECO, Stilmas, and Techniplast. The Isomedix segment operates in a highly regulated industry and competes in North America with Sterigenics International, Inc., and other smaller contract sterilization companies and manufacturers that sterilize products in-house.

We are concerned about the current customer consolidation scenario which will continue to adversely impact STERIS if not checked immediately. The competitive landscape and weak cost reduction initiatives al

The company expects to face continued competition in the future as new infection prevention, sterile processing, contamination control, gastrointestinal and surgical support products and services enter the market. Moreover, management believes STERIS' existing or potential competitors might have greater resources than it, which might allow them to succeed in developing and commercializing products at a faster pace than STERIS. This might hamper STERIS' growth.

▼ **Macroeconomic Problems:** The current macroeconomic environment across the globe has adversely affected STERIS' financial operations. Governments and insurance companies continue to look for ways to contain the rising cost of healthcare. This might put pressure on players in the healthcare industry with STERIS being no exception. Increases in prices or decreases in availability of raw materials and oil and gas might impair STERIS' procurement of necessary materials for product manufacture, or might increase production costs. During the third quarter of fiscal 2020, currency fluctuations partially affected STERIS' revenues, exhibiting the negative effects of the strengthening dollar which has been hurting companies like STERIS in the overseas markets. In addition, economic and market volatility have been affecting the investment portfolio of STERIS' legacy defined benefit pension plan. We are concerned that lingering macroeconomic softness might hamper STERIS' growth.

▼ **Customer Consolidation:** A number of STERIS' customers are undergoing consolidation, partly due to healthcare cost reduction measures initiated by competitive pressures as well as legislators, regulators and third-party payors. Moreover, some of STERIS' customers have reduced their production costs and subsequently their product prices to attract more customers. This, in turn, has caused greater pricing pressure and in some cases, has resulted in customer loss for the company. Additional consolidation will result in loss of a greater number of customers or create significant pricing pressure for STERIS. In fact, recent healthcare legislation and unfavorable economic conditions might enforce larger consolidation. If the company fails to check the rate of its customer consolidation now, it will adversely affect STERIS' business performance as well as financial conditions, going forward.

Last Earnings Report

STERIS Surpasses Q3 Earnings Estimates, Ups FY20 View

STERIS reported third-quarter fiscal 2020 adjusted earnings per share of \$1.45, up 15.1% year over year. The metric beat the Zacks Consensus Estimate by 1.4%.

The company's GAAP (reported) earnings per share were \$1.23, up by a huge margin of 119.6% year over year.

Revenues of \$774.3 million increased 11.2% year over year in the quarter, beating the Zacks Consensus Estimate by 3.3%.

Quarter Ending **12/2019**

Report Date	Feb 10, 2020
Sales Surprise	3.27%
EPS Surprise	1.40%
Quarterly EPS	1.45
Annual EPS (TTM)	5.53

Quarter in Detail

Organic revenue growth at constant currency or CER was 12% year over year in the fiscal third quarter, mainly driven by growth across all segments, backed by strong underlying customer demand.

The company operates through four segments — Healthcare Products, Healthcare Specialty Services, Applied Sterilization Technologies and Life Sciences.

Revenues at **Healthcare Products** increased 8% year over year to \$365.4 million (up 8.1% on a CER organic basis). In the quarter under review, service revenues grew 9% and capital equipment revenues rose 3%. Meanwhile, consumable revenues grew 13%.

Revenues at the **Healthcare Specialty Services** segment were up 12.6% to \$143.9 million (up 13.9% on a CER organic basis).

Revenues at **Applied Sterilization Technologies** climbed 14.3% to \$156.3 million (up 15.1% at CER organic basis), backed by increased demand from core medical device customers.

Revenues at the **Life Sciences** segment increased 16.4% to \$108.8 million (up 17% at CER organic basis) on 13% growth in consumable revenues along with a 6% rise in service revenues and 36% growth in capital equipment revenues.

The company approved a quarterly interim dividend of 37 cents per share to shareholders.

Margins

Adjusted gross margin (after excluding cost of revenues for restructuring) expanded 38 basis points (bps) year over year to 42.9% in the reported quarter.

STERIS witnessed an 8.4% year-over-year decline in selling, general and administrative expenses to \$172.9 million. Research and development expenses flared up 8.7% to \$16.5 million. Overall, adjusted operating margin expanded 338 bps year over year to 18.4% in the quarter.

Financial Details

STERIS exited the fiscal third quarter with cash and cash equivalents of \$199.2 million compared with \$225.5 million witnessed at the end of second-quarter fiscal 2020.

Cumulative cash flow from operating activities was \$391.3 million at the end of the fiscal third quarter compared with \$360.6 million in the year-ago period.

Guidance

The company raised the projection for fiscal 2020 adjusted earnings per share, which is now at the high-end of the previously mentioned \$5.50-5.65. The Zacks Consensus Estimate for fiscal 2020 adjusted earnings per share is pegged at \$5.58.

Organic revenue growth at CER is now expected to be 9%, marking a rise from 7.5-8.5% stated earlier. The Zacks Consensus Estimate for fiscal 2020 revenues is pegged at \$2.99 billion.

The company also anticipates a negative impact of \$20 million on reported revenues in fiscal 2020, resulting from currency fluctuations. Earlier, it predicted an impact of \$25 million.

Valuation

STERIS' shares are down 2.7% in the year to date period and up 18.5% in the trailing 12-month periods. Stocks in the Zacks sub-industry are down 0.9% while the Zacks Medical sector are down 3.7% in the year to date period. Over the past year, the Zacks sub-industry is up 7.7% and sector is up 3.6%.

The S&P 500 index is down 8.9% in the year to date period and up 4.1% in the past year.

The stock is currently trading at 25.9X Forward 12-months earnings, which compares to 39X for the Zacks sub-industry, 22.2X for the Zacks sector and 21.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.8X and as low as 15.4X, with a 5-year median 20.3X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$156 price target reflects 27.3X forward 12-months earnings.

The table below shows summary valuation data for STE.

Valuation Multiples - STE					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	25.98	39.02	22.24	21.15
	5-Year High	27.78	39.02	22.24	21.15
	5-Year Low	15.44	23.30	15.81	15.19
	5-Year Median	20.31	27.75	18.81	17.45
P/S F12M	Current	4.18	3.68	2.73	3.30
	5-Year High	4.52	3.68	3.84	3.44
	5-Year Low	1.83	2.18	2.24	2.54
	5-Year Median	2.80	2.60	2.96	3.02
P/B TTM	Current	3.70	3.38	3.73	3.85
	5-Year High	7.40	4.23	5.05	4.55
	5-Year Low	1.79	2.47	2.92	2.84
	5-Year Median	2.81	3.35	4.28	3.64

As of 05/08/2020

Industry Analysis Zacks Industry Rank: Top 14% (36 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Cantel Medical Corp (CMD)	Neutral	4
Ecolab Inc (ECL)	Neutral	4
HillRom Holdings Inc (HRC)	Neutral	3
JohnsonJohnson (JNJ)	Neutral	3
3M Company (MMM)	Neutral	3
Stryker Corporation (SYK)	Neutral	4
Teleflex Incorporated (TFX)	Neutral	3
CONMED Corporation (CNMD)	Underperform	3

Industry Comparison Industry: Medical - Instruments				Industry Peers		
	STE	X Industry	S&P 500	CMD	ECL	MMM
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	4	3
VGM Score	C	-	-	B	F	B
Market Cap	12.57 B	120.08 M	20.19 B	1.57 B	56.99 B	85.42 B
# of Analysts	4	2	14	2	11	7
Dividend Yield	1.00%	0.00%	2.12%	0.57%	0.95%	3.96%
Value Score	C	-	-	B	F	C
Cash/Price	0.02	0.09	0.06	0.04	0.03	0.05
EV/EBITDA	21.26	-0.82	11.95	19.16	20.26	13.80
PEG Ratio	NA	3.30	2.60	NA	3.77	1.98
Price/Book (P/B)	3.70	3.39	2.75	2.17	6.43	8.37
Price/Cash Flow (P/CF)	19.49	21.02	10.78	10.88	21.30	12.35
P/E (F1)	26.29	38.03	19.85	19.74	39.06	18.82
Price/Sales (P/S)	4.22	3.20	2.03	1.55	3.80	2.64
Earnings Yield	3.80%	-3.20%	4.83%	5.08%	2.56%	5.31%
Debt/Equity	0.37	0.09	0.75	1.28	0.76	1.94
Cash Flow (\$/share)	7.61	-0.13	7.01	3.38	9.29	12.02
Growth Score	B	-	-	B	D	B
Hist. EPS Growth (3-5 yrs)	13.35%	13.78%	10.87%	13.54%	7.48%	5.11%
Proj. EPS Growth (F1/F0)	1.12%	3.55%	-9.87%	-21.31%	-13.01%	-13.28%
Curr. Cash Flow Growth	20.51%	4.95%	5.88%	1.57%	8.14%	-11.15%
Hist. Cash Flow Growth (3-5 yrs)	23.55%	11.44%	8.55%	17.24%	4.49%	1.67%
Current Ratio	2.34	2.64	1.24	2.15	1.51	1.65
Debt/Capital	26.76%	14.81%	44.23%	56.22%	43.22%	66.04%
Net Margin	13.21%	-15.86%	10.68%	2.02%	10.32%	15.37%
Return on Equity	16.33%	-15.66%	16.36%	14.80%	20.12%	50.24%
Sales/Assets	0.57	0.58	0.55	0.68	0.71	0.75
Proj. Sales Growth (F1/F0)	-0.40%	0.00%	-2.26%	14.05%	-7.88%	-5.03%
Momentum Score	C	-	-	F	C	B
Daily Price Chg	3.05%	0.00%	2.40%	9.23%	1.88%	1.90%
1 Week Price Chg	-4.34%	0.39%	0.53%	21.82%	5.51%	1.09%
4 Week Price Chg	-2.91%	10.91%	2.68%	-3.89%	9.95%	0.49%
12 Week Price Chg	-11.23%	-12.31%	-19.20%	-43.97%	-4.49%	-7.04%
52 Week Price Chg	14.12%	-24.78%	-8.44%	-47.25%	9.41%	-15.27%
20 Day Average Volume	635,396	206,461	2,398,409	756,911	1,271,528	3,218,267
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.04%	0.18%
(F1) EPS Est 4 week change	-8.89%	-0.85%	-6.95%	-27.99%	-11.36%	-6.52%
(F1) EPS Est 12 week change	-7.77%	-12.73%	-15.68%	-33.39%	-21.46%	-17.03%
(Q1) EPS Est Mthly Chg	-27.70%	0.00%	-13.12%	-50.35%	-31.33%	-13.04%

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	C
Growth Score	B
Momentum Score	C
VGM Score	C

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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