

STERIS plc (STE)

\$160.51 (As of 08/12/20)

Price Target (6-12 Months): **\$169.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/12/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: C

Summary

STERIS exited first-quarter fiscal 2021 with better-than-expected results. A fall in STERIS' top line on dismal performance by two of its reporting segments is concerning. Gross margin contraction does not bode well. STERIS' decision to not provide any financial guidance for fiscal 2021 on pandemic-led macroeconomic uncertainty is also worrying. Stiff competitive landscape, unstable global macroeconomy and customer consolidation are other headwinds. STERIS has been underperforming its industry over the past six months. Yet, STERIS saw solid revenue growth across its Life Sciences segment despite the pandemic. Contributions from higher consumer demand and a broader portfolio of products and services are encouraging. Adjusted operating margin expansion in the quarter is also promising. An overall strong solvency position instills optimism.

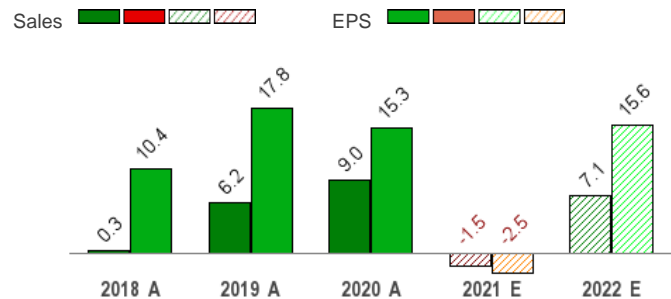
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$168.98 - \$105.69
20 Day Average Volume (sh)	432,501
Market Cap	\$13.7 B
YTD Price Change	5.3%
Beta	0.77
Dividend / Div Yld	\$1.60 / 0.9%
Industry	Medical - Instruments
Zacks Industry Rank	Bottom 32% (173 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	35.1%
Last Sales Surprise	4.6%
EPS F1 Est- 4 week change	4.8%
Expected Report Date	11/02/2020
Earnings ESP	0.0%
P/E TTM	28.1
P/E F1	29.2
PEG F1	NA
P/S TTM	4.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	744 E	781 E	810 E	904 E	3,198 E
2021	669 A	705 E	760 E	853 E	2,987 E
2020	697 A	737 A	774 A	823 A	3,031 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.39 E	\$1.45 E	\$1.60 E	\$1.80 E	\$6.36 E
2021	\$1.31 A	\$1.23 E	\$1.39 E	\$1.66 E	\$5.50 E
2020	\$1.23 A	\$1.32 A	\$1.45 A	\$1.64 A	\$5.64 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 08/12/2020. The reports text is as of 08/13/2020.

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:

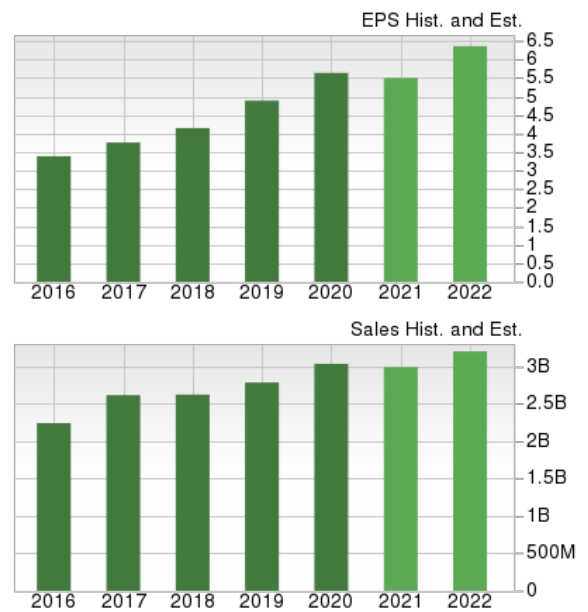
Healthcare Products (comprising 47.8% of total revenue in FY20): This is the biggest segment, which offers infection prevention and procedural solutions for global healthcare providers, including capital equipment and related maintenance and installation services, as well as consumables. In fiscal 2020, the segment registered 4.7% growth from fiscal 2019.

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 2020, the segment registered 10.9% growth from fiscal 2019.

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 2020, the segment registered 2.8% growth from fiscal 2019.

Applied Sterilization Technologies (19.8%): This segment offers contract sterilization and laboratory services for medical device and pharmaceutical customers and others. In fiscal 2020, the segment registered 10.9% growth from fiscal 2019.

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



Reasons To Buy:

- ▲ **Strong Segmental Business Amid Pandemic:** In the fiscal first quarter, STERIS' Life Sciences segment rose 21.5% at CER organic basis driven by 34% growth in consumable revenues, 6% rise in service revenues and 14% improvement in capital equipment revenues. The segment put up a robust performance on increased demand from pharma customers focused on vaccines and biologics.

Life Sciences consumables grew 34% year over year despite pandemic-led business disruptions. The uptick was driven partly by customers' aim of building their inventory.

- ▲ **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 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.

- ▲ **Overall Strong Solvency Position:** STERIS exited the first quarter of fiscal 2021 with cash and cash equivalents of \$255.6 million compared with \$320 million witnessed at the end of fiscal 2020. Meanwhile, total debt came up to \$1.06 billion, a slight decline from the sequentially-last-reported figure of \$1.28 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 (\$35 million). 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.

The quarter's total debt-to-capital of 0.23 indicates slightly-leveraged balance sheet. It represented a sequential decline from the fiscal 2020 fourth quarter's 0.27.

The company's fiscal first-quarter interest coverage stands at 13.9%, the highest in the past four quarters buoying optimism. It also represents a sequential increase from the fiscal 2020 fourth quarter's 13.4%.

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 25.9%, representing a sequential increase from the fiscal 2020 fourth quarter's 25.7%. The company approved a quarterly interim dividend of 40 cents per share to shareholders, which is the 15th consecutive year of dividend increases.

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:

▼ **Share Price Performance:** Over the past six months, STERIS has underperformed the industry it belongs to. The stock has lost 4.8% against the industry's 11.3% rise. A decline in STERIS' top line on disappointing performance by two reporting segments is concerning. Healthcare segment was adversely impacted by the pandemic-led fall in nonessential procedures. Reduced volumes from the Applied Sterilization Technologies segment's core medical device customers are worrying. Contraction in gross margin does not bode well either. The company's decision to not provide any financial guidance for fiscal 2021 is also worrying.

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. 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. A tough competitive landscape and current macroeconomic environment across the globe are other headwinds for the company.

▼ **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.

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.

Currency fluctuations partially affects 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.

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

Last Earnings Report

STERIS' Earnings & Revenues Surpass Estimates in Q1

STERIS reported first-quarter fiscal 2021 adjusted earnings per share of \$1.31, up 6.5% year over year. The metric beat the Zacks Consensus Estimate by 35.1%.

The adjustment excludes the impact of certain non-recurring charges like COVID-19-led incremental costs, amortization of acquired intangible assets, acquisition and integration related charges and amortization of property "step up" to fair value.

The company's GAAP earnings per share was \$1.03, up 4% year over year.

Quarter Ending **06/2020**

Report Date	Aug 03, 2020
Sales Surprise	4.55%
EPS Surprise	35.05%
Quarterly EPS	1.31
Annual EPS (TTM)	5.72

Revenues in Detail

Revenues of \$668.9 million declined 3.9% year over year in the quarter. However, the metric exceeded the Zacks Consensus Estimate by 4.5%. The year-over-year drop was led by decline in sales in two of the company's three reporting segments.

Organic revenues at constant currency or CER fell 3.4% year over year in the fiscal first quarter.

Quarter in Detail

The company operates through three segments — Healthcare, Applied Sterilization Technologies and Life Sciences. For investors' note, the earlier-reported Healthcare Products and Healthcare Specialty Services segments have been combined and reported as one segment, Healthcare (effective Apr 1, 2020).

Revenues at **Healthcare** fell 10.3% year over year to \$399.7 million (down 9.8% on a CER organic basis). In the quarter under review, service revenues declined 10% and consumable revenues fell 28%. Meanwhile, capital equipment revenues rose 6%.

Revenues at **Applied Sterilization Technologies** fell 1.2% to \$152.4 million (down 0.2% at CER organic basis). CER organic revenues reflected increased demand for personal protective equipment products, which offset the impact of reduced volumes from the segment's core medical device customers.

Revenues at the **Life Sciences** segment rose 20.8% to \$116.9 million (21.5% at CER organic basis) on 34% growth in consumable revenues, 6% rise in service revenues and 14% improvement in capital equipment revenues. The segment was driven by continued robust performance from increased demand from pharma customers focused on vaccines and biologics.

Margins

Gross profit in the reported quarter was \$285.6 million, down 6.9% from the prior-year quarter adjusted gross profit (excluding costs and benefits of revenues for restructuring). Gross margin contracted 133 basis points (bps) year over year to 42.7% in the reported quarter.

STERIS witnessed a 13.2% year-over-year contraction in selling, general and administrative expenses to \$155.2 million. Research and development expenses increased 4.1% to \$16.2 million. Adjusted operating expenses of \$171.4 million fell 11.8% year over year.

Adjusted operating profit totaled \$114.2 million, reflecting a 1.6% rise from the prior-year quarter. Further, adjusted operating margin in the first quarter expanded 94 bps to 17.1%.

Financial Details

STERIS exited the fiscal first quarter with cash and cash equivalents of \$255.6 million compared with \$319.6 million at the end of 2020.

Net cash flow from operating activities at the end of the fiscal first quarter was \$134.1 million compared with \$109.3 million a year ago.

The company's free cash flow at the end of first-quarter fiscal 2021 was \$67.4 million compared with \$59.6 million in the year-ago period. Capital expenditure of the company at the end of the reported quarter was \$66.9 million, up from \$49.8 million in the year-ago period.

The company approved a quarterly interim dividend of 40 cents per share to shareholders, which is the 15th consecutive year of dividend increases.

Guidance

STERIS, due to uncertainties tied to the duration and impact of the pandemic on its operations, is not issuing any financial outlook for fiscal 2021 at the moment.

Recent News

STERIS Receives EUA for Respirator Decontamination: May 26, 2020

STERIS announced that the FDA has issued another Emergency Use Authorization (EUA) for respirator decontamination. The EUA enables healthcare providers to decontaminate surgical N95 respirators by utilizing certain AMSCO Steam Sterilizers that have been upgraded with STERIS's new Decon cycle.

Valuation

STERIS' shares are up 5.3% in the year to date period and up 5.8% in the trailing 12-month periods. Stocks in the Zacks sub-industry are up 17.3% while the Zacks Medical sector are up 1.4% in the year to date period. Over the past year, the Zacks sub-industry is up 25.3% and sector is up 11.1%.

The S&P 500 index is up 3.3% in the year to date period and up 17.5% in the past year.

The stock is currently trading at 27.6X Forward 12-months earnings, which compares to 38.8X for the Zacks sub-industry, 22.2X for the Zacks sector and 22.6X for the S&P 500 index.

Over the past five years, the stock has traded as high as 29X and as low as 15.4X, with a 5-year median 20.5X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$169 price target reflects 29X 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	27.58	38.84	22.24	22.60
	5-Year High	29.04	41.71	23.17	22.62
	5-Year Low	15.44	23.21	15.89	15.25
	5-Year Median	20.46	28.06	18.97	17.58
P/S F12M	Current	4.45	4.42	2.84	3.65
	5-Year High	4.59	4.47	3.41	3.65
	5-Year Low	1.83	2.52	2.22	2.53
	5-Year Median	2.89	3.09	2.89	3.05
P/B TTM	Current	3.91	4.61	4.42	4.64
	5-Year High	7.40	4.77	5.07	4.68
	5-Year Low	1.79	2.75	2.94	2.83
	5-Year Median	2.81	3.89	4.30	3.74

As of 08/12/2020

Industry Analysis Zacks Industry Rank: Bottom 32% (173 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Cantel Medical Corp. (CMD)	Neutral	3
CONMED Corporation (CNMD)	Neutral	3
HillRom Holdings, Inc. (HRC)	Neutral	3
JohnsonJohnson (JNJ)	Neutral	3
3M Company (MMM)	Neutral	3
Stryker Corporation (SYK)	Neutral	3
Teleflex Incorporated (TFX)	Neutral	3
Ecolab Inc. (ECL)	Underperform	5

Industry Comparison Industry: Medical - Instruments				Industry Peers		
	STE	X Industry	S&P 500	CMD	ECL	MMM
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	3	-	-	3	5	3
VGM Score	B	-	-	C	D	B
Market Cap	13.65 B	146.09 M	23.75 B	2.31 B	56.70 B	94.62 B
# of Analysts	3	2	14	2	8	7
Dividend Yield	0.92%	0.00%	1.68%	0.38%	0.95%	3.58%
Value Score	C	-	-	B	F	B
Cash/Price	0.02	0.10	0.07	0.05	0.02	0.05
EV/EBITDA	19.76	-1.39	13.35	24.97	20.27	15.06
PEG Ratio	NA	4.12	2.98	NA	4.82	2.10
Price/Book (P/B)	3.91	3.37	3.20	3.35	9.63	8.67
Price/Cash Flow (P/CF)	20.02	23.70	12.97	16.16	21.40	13.66
P/E (F1)	28.94	45.83	22.17	27.55	48.34	19.96
Price/Sales (P/S)	4.55	4.55	2.54	2.26	4.08	3.02
Earnings Yield	3.43%	-2.83%	4.31%	3.64%	2.07%	5.01%
Debt/Equity	0.33	0.11	0.77	1.43	1.15	1.82
Cash Flow (\$/share)	8.02	-0.13	6.94	3.38	9.29	12.02
Growth Score	A	-	-	C	B	B
Hist. EPS Growth (3-5 yrs)	13.44%	10.12%	10.41%	10.84%	7.09%	4.06%
Proj. EPS Growth (F1/F0)	-2.42%	7.33%	-6.32%	50.38%	-29.38%	-9.58%
Curr. Cash Flow Growth	5.66%	5.04%	5.22%	1.57%	8.14%	-11.15%
Hist. Cash Flow Growth (3-5 yrs)	20.19%	11.09%	8.55%	17.24%	4.49%	1.67%
Current Ratio	2.29	2.66	1.33	2.46	1.60	1.94
Debt/Capital	24.74%	17.45%	44.59%	58.88%	53.41%	64.56%
Net Margin	13.69%	-25.57%	10.13%	2.75%	-6.17%	16.38%
Return on Equity	16.24%	-19.20%	14.59%	12.32%	18.80%	46.86%
Sales/Assets	0.56	0.53	0.51	0.60	0.68	0.70
Proj. Sales Growth (F1/F0)	-1.44%	0.00%	-1.40%	12.99%	-20.16%	-1.43%
Momentum Score	C	-	-	D	D	C
Daily Price Chg	1.13%	0.00%	0.67%	0.89%	1.26%	0.54%
1 Week Price Chg	-3.39%	0.95%	2.30%	10.54%	4.18%	5.22%
4 Week Price Chg	1.85%	2.28%	4.87%	9.51%	-4.43%	3.09%
12 Week Price Chg	1.57%	7.54%	13.54%	55.24%	-1.86%	9.74%
52 Week Price Chg	5.81%	3.01%	6.06%	-38.33%	-1.46%	3.43%
20 Day Average Volume	432,501	249,618	2,006,991	394,131	1,277,907	2,834,203
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	4.76%	1.22%	1.95%	0.00%	-15.20%	4.05%
(F1) EPS Est 12 week change	-2.94%	0.87%	2.72%	-3.17%	-18.00%	3.90%
(Q1) EPS Est Mthly Chg	2.51%	0.00%	0.84%	0.00%	-14.41%	4.90%

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	A
Momentum Score	C
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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