

STERIS plc (STE)

\$157.59 (As of 07/15/20)

Price Target (6-12 Months): **\$134.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 07/14/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: D

Growth: A

Momentum: C

Summary

STERIS saw a decline in outsourced reprocessing business in the fiscal 2020 fourth-quarter due to fall in procedures due to COVID-19, which is worrying. Healthcare Products, mainly endoscopy products, faced the immediate impact of revenue loss. Fall in nonessential procedures across America also impacted the top line. Stiff competitive landscape, unstable global macroeconomy and customer consolidation are other headwinds. STERIS has been underperforming its industry for the past six months. Yet, solid revenue growth in the quarter across each of its operating segments despite the pandemic bodes well. Higher consumer demand and wider products and services portfolio are encouraging. Expansion in both margins is also promising. Rise in free cash flow despite increased capital spending instills optimism. Its fourth-quarter show was impressive.

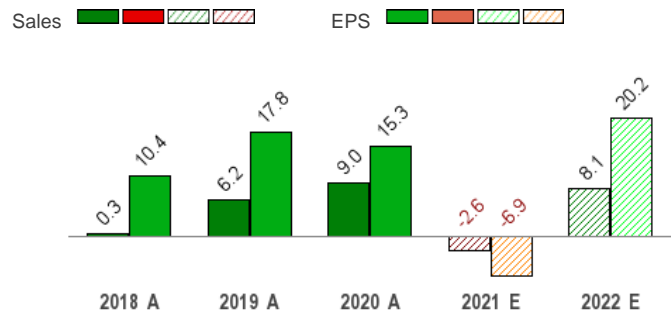
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$168.98 - \$105.69
20 Day Average Volume (sh)	567,637
Market Cap	\$13.4 B
YTD Price Change	3.4%
Beta	0.78
Dividend / Div Yld	\$1.48 / 0.9%
Industry	Medical - Instruments
Zacks Industry Rank	Bottom 41% (149 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.5%
Last Sales Surprise	4.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	08/03/2020
Earnings ESP	0.0%
P/E TTM	27.9
P/E F1	30.0
PEG F1	NA
P/S TTM	4.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	752 E	795 E	822 E	899 E	3,192 E
2021	621 E	711 E	768 E	853 E	2,953 E
2020	697 A	737 A	774 A	823 A	3,031 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.43 E	\$1.49 E	\$1.66 E	\$1.84 E	\$6.31 E
2021	\$0.92 E	\$1.20 E	\$1.41 E	\$1.67 E	\$5.25 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 07/15/2020. The reports text is as of 07/16/2020.

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:

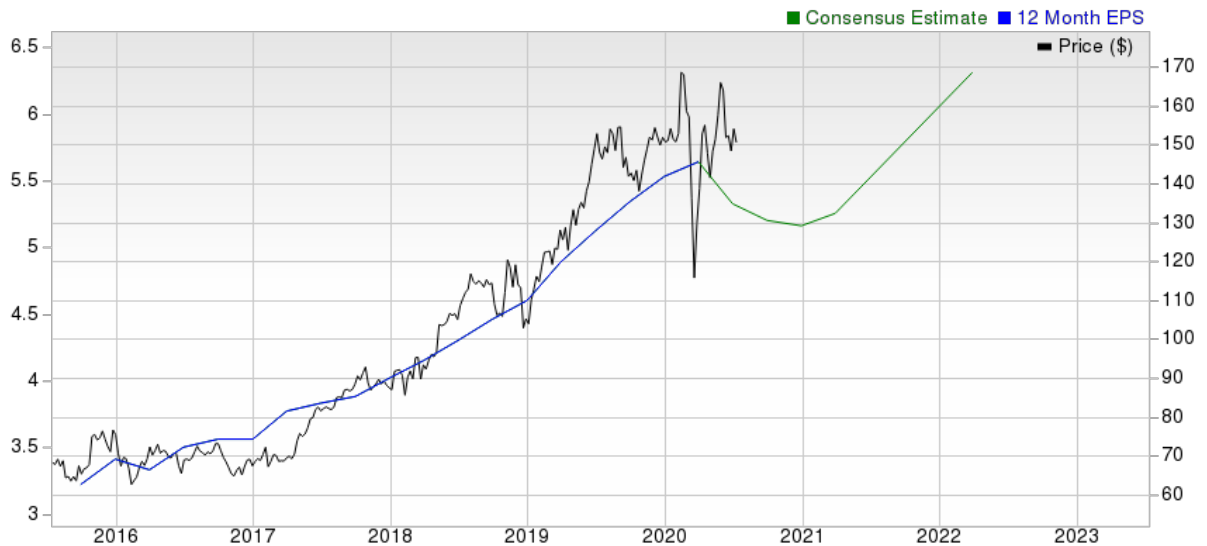
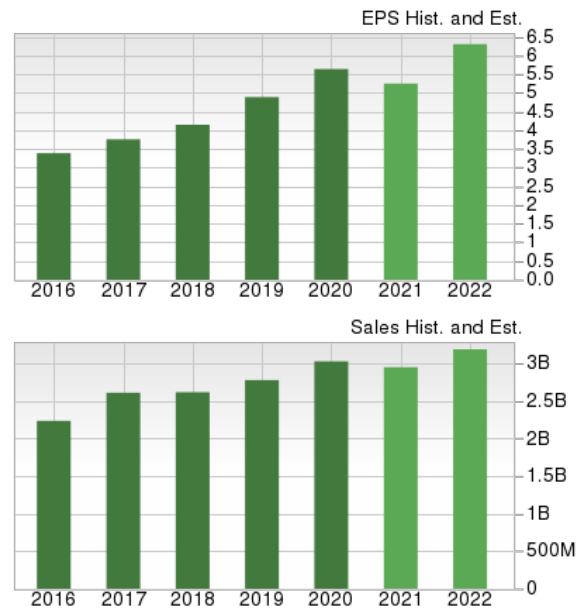
Healthcare Products (comprising 47.8% of total revenue in FY20): This is the biggest segment, which offers infection prevention and procedural solutions for global healthcare providers, including capital equipment and related maintenance and installation services, as well as consumables. In fiscal 2020,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

▼ **Share Price Performance:** Over the past six months, STERIS has underperformed the industry it belongs to. The stock has gained 2.2% compared with the industry's 3.3% rise. A decline in STERIS' outsourced reprocessing business resulting from a fall in procedures due to COVID-19 is concerning. Healthcare Products, especially endoscopy products, faced the immediate impact of revenue loss due to the pandemic. Fall in nonessential procedures across America also impacted the top line. 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.

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

▼ **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. 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.

Risks

- **Strong Segmental Businesses amid Pandemic:** In the fiscal fourth quarter, STERIS' instrument repair business was relatively insulated as many of the customers opted for more comprehensive maintenance of their instruments. Within consumables in Life Sciences, the company saw an upward spike in the fourth quarter, partially due to COVID-19. Some of the pharma customers appear to have stockpiled the products, resulting in 26% growth for the fourth quarter in Life Science consumables. The company has seen similar trend in April as well. Within Healthcare Products, organic growth continued to stem from new product launches, particularly in infection prevention, capital equipment and consumables franchise.
- **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 fiscal 2020 with cash and cash equivalents of \$320 million compared with \$199 million witnessed at the end of third quarter. Meanwhile, total debt came up to \$1.28 billion, a slight rise from the sequentially-last-reported figure of \$1.26 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 27.4% indicates slightly-leveraged balance sheet. It represented a sequential rise from the fiscal second quarter's 27.1%. This however stands below the industry-average of 32.1% indicating healthier financial structure compared to its industry average.

The company's fiscal fourth-quarter interest coverage stands at 13.4%, 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.

Last Earnings Report

STERIS Surpasses Q4 Earnings and Revenue Estimates

STERIS reported fourth-quarter fiscal 2020 adjusted earnings per share (EPS) of \$1.64, up 7.2% year over year. The metric beat the Zacks Consensus Estimate by 4.5%.

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 EPS was \$1.44, up 13.4% year over year.

Full-year adjusted EPS was \$5.64, reflecting a 15.3% increase from the year-earlier \$4.89. The metric topped the Zacks Consensus Estimate by 1.1%.

Quarter Ending **03/2020**

Report Date	May 13, 2020
Sales Surprise	4.39%
EPS Surprise	4.46%
Quarterly EPS	1.64
Annual EPS (TTM)	5.64

Revenues in Detail

Revenues of \$822.9 million increased 7.1% year over year in the quarter, beating the Zacks Consensus Estimate by 4.4%.

Organic revenue growth at constant currency or CER was 8% year over year in the fiscal fourth quarter, mainly driven by growth across all segments on strong underlying customer demand and solid adoption of new products.

Full-year revenues totaled \$3.03 billion, reflecting an 8.9% increase from the year-ago period. Revenues beat the Zacks Consensus Estimate by 1.3%.

Quarter in Detail

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

Revenues at Healthcare Products increased 3% year over year to \$397.8 million (3% on a CER organic basis). In the quarter under review, service revenues grew 3% and consumable revenues rose 10%. Meanwhile, capital equipment revenues declined 1%.

Revenues in the Healthcare Specialty Services segment were up 10% to \$148.8 million (11% on a CER organic basis).

Revenues at Applied Sterilization Technologies climbed 14% to \$163.7 million (15% at CER organic basis) on increased demand from core medical device customers.

Revenues at the Life Sciences segment rose 9% to \$112.7 million (10% at CER organic basis) on 26% growth in consumable revenues along with a 5% rise in service revenues. However, capital equipment revenues declined 9%.

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

Margins

Adjusted gross profit (excluding costs and benefits of revenues for restructuring) in the reported quarter was \$363.9 million, up 8.5% from the prior-year quarter. Adjusted gross margin expanded 56 basis points (bps) year over year to 44.2% in the reported quarter.

STERIS witnessed a 9.2% year-over-year uptick in selling, general and administrative expenses to \$189.1 million. Research and development expenses increased 8.5% to \$17.2 million. Adjusted operating expenses of \$206.3 million rose 9.1% year over year.

Adjusted operating profit totaled \$157.6 million, reflecting a 7.7% rise from the prior-year quarter. Further, adjusted operating margin in the first quarter expanded 10 bps to 19.1%.

Financial Details

STERIS exited the year with cash and cash equivalents of \$319.6 million compared with \$220.6 million at the end of 2019.

Cumulative cash flow from operating activities at the end of 2020 was \$590.6 million compared with \$539.5 million at 2019-end.

The company's free cash flow at the end of fiscal 2020 was \$380.2 million compared with \$355.4 million at the end of fiscal 2019.

Fiscal 2021 Guidance

STERIS, in the wake of uncertainties arising from the pandemic and its duration and impact on its operations, is not issuing any financial outlook for 2021 at present.

Recent News

On **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 3.4% in the year to date period and up 6.6% in the trailing 12-month periods. Stocks in the Zacks sub-industry are up 6.9% while the Zacks Medical sector are down 0.7% in the year to date period. Over the past year, the Zacks sub-industry is up 9.9% and sector is up 4.8%.

The S&P 500 index is down 0.5% in the year to date period and up 7.9% in the past year.

The stock is currently trading at 28.3X Forward 12-months earnings, which compares to 42.3X for the Zacks sub-industry, 23.5X for the Zacks sector and 22.7X for the S&P 500 index.

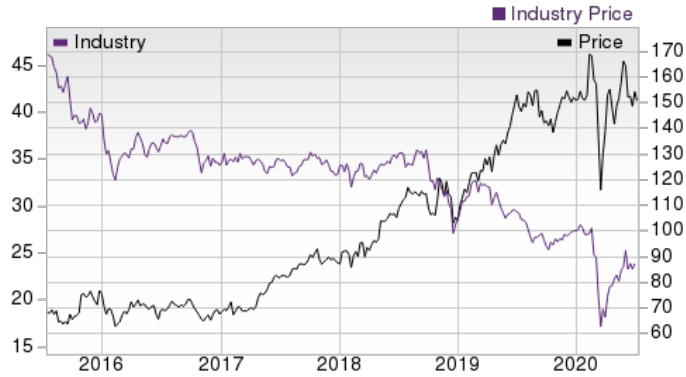
Over the past five years, the stock has traded as high as 28.9X and as low as 15.4X, with a 5-year median 20.4X. Our Underperform recommendation indicates that the stock will perform below the market. Our \$134 price target reflects 24.1X forward 12-months earnings.

The table below shows summary valuation data for STE.

Valuation Multiples - STE					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	28.33	42.33	23.49	22.72
	5-Year High	28.88	42.33	23.49	22.72
	5-Year Low	15.44	23.23	15.91	15.25
	5-Year Median	20.42	28.04	18.99	17.52
P/S F12M	Current	4.43	4.29	2.86	3.55
	5-Year High	4.59	4.29	3.74	3.55
	5-Year Low	1.83	2.49	2.22	2.53
	5-Year Median	2.86	2.98	2.90	3.02
P/B TTM	Current	3.93	4.23	4.41	4.38
	5-Year High	7.40	4.67	5.07	4.56
	5-Year Low	1.79	2.69	2.94	2.83
	5-Year Median	2.81	3.82	4.29	3.70

As of 07/15/2020

Industry Analysis Zacks Industry Rank: Bottom 41% (149 out of 251)



Top Peers

Company (Ticker)	Rec	Rank
Cantel Medical Corp. (CMD)	Neutral	3
CONMED Corporation (CNMD)	Neutral	4
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)	Underperform	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	5	-	-	3	5	3
VGM Score	C	-	-	C	F	A
Market Cap	13.39 B	138.16 M	22.66 B	2.11 B	60.13 B	91.65 B
# of Analysts	3	2	14	2	9	7
Dividend Yield	0.94%	0.00%	1.83%	0.42%	0.90%	3.69%
Value Score	D	-	-	B	F	C
Cash/Price	0.02	0.09	0.07	0.06	0.03	0.05
EV/EBITDA	19.47	-1.15	12.99	23.39	21.29	14.65
PEG Ratio	NA	4.40	2.97	NA	4.12	2.12
Price/Book (P/B)	3.92	3.66	3.12	3.06	6.79	8.98
Price/Cash Flow (P/CF)	19.66	22.15	12.14	14.76	22.39	13.25
P/E (F1)	30.02	48.42	22.04	37.83	43.19	20.15
Price/Sales (P/S)	4.42	3.99	2.38	2.06	4.01	2.83
Earnings Yield	3.33%	-4.71%	4.32%	2.64%	2.31%	4.96%
Debt/Equity	0.37	0.08	0.76	1.43	0.76	1.94
Cash Flow (\$/share)	8.02	-0.12	6.94	3.38	9.29	12.02
Growth Score	A	-	-	C	C	A
Hist. EPS Growth (3-5 yrs)	13.32%	13.32%	10.85%	10.84%	7.48%	5.11%
Proj. EPS Growth (F1/F0)	-6.86%	-4.68%	-9.64%	-44.30%	-17.30%	-13.09%
Curr. Cash Flow Growth	5.66%	5.35%	5.51%	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	2.40	2.60	1.30	2.46	1.51	1.65
Debt/Capital	27.07%	13.54%	44.46%	58.88%	43.22%	66.04%
Net Margin	13.45%	-14.56%	10.59%	2.75%	10.32%	15.37%
Return on Equity	16.34%	-14.83%	15.75%	12.32%	20.12%	50.24%
Sales/Assets	0.57	0.57	0.54	0.60	0.71	0.75
Proj. Sales Growth (F1/F0)	-2.56%	0.00%	-2.52%	7.97%	-14.48%	-5.31%
Momentum Score	C	-	-	F	F	B
Daily Price Chg	2.79%	1.87%	1.91%	9.47%	1.84%	0.50%
1 Week Price Chg	-2.27%	-0.67%	-0.41%	1.28%	-0.12%	-2.67%
4 Week Price Chg	1.71%	1.46%	1.88%	21.51%	1.38%	0.07%
12 Week Price Chg	4.45%	13.97%	16.37%	78.04%	18.96%	10.95%
52 Week Price Chg	6.59%	-11.65%	-4.22%	-36.87%	6.10%	-8.78%
20 Day Average Volume	567,637	292,766	2,266,132	721,811	1,417,180	2,375,988
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.69%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	-2.39%	0.00%
(F1) EPS Est 12 week change	-13.24%	-8.79%	-5.76%	-49.04%	-13.98%	-3.05%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-2.19%	0.00%

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	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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