# Edwards Lifesciences Corporation EW [XNYS] | ★★★

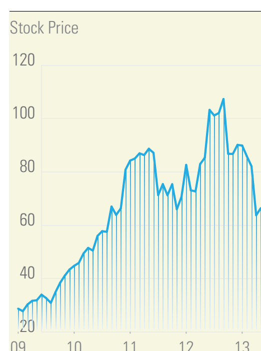
| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Stewardship | Morningstar Credit Rating | Industry |
|---|---|---|---|---|---|---|---|---|
| 71.95 USD | 78.00 USD | 46.80 USD | 120.90 USD | High | Narrow | Standard | | Medical Devices |

## Edwards Lifesciences Sees Slower Adoption of Sapien Valve in First Quarter

by Debbie S. Wang
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing as of Jun 13, 2013.
Rating as of Jun 13, 2013.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.




**Analyst Note** Apr. 24, 2013

Edwards Lifesciences EW released first-quarter performance containing more indicators that U.S. adoption of the Sapien transcatheter heart valve would be more gradual than management had originally expected. We have lowered our fair value estimate by $14 to $78 per share, after returning to valuation based on discounted cash flows and removing the probability of acquisition that we had incorporated into our fair value estimate earlier. We now think the likelihood of acquisition is lower because the slower adoption of Sapien means the head start that Edwards enjoys will not be quite as valuable as once thought. In turn, this makes Edwards a less attractive target. While the slower Sapien uptake holds implications for the timing and magnitude of cash flows, we do not think the adoption curve has any impact on Edwards' economic moat. The firm still enjoys a narrow moat that is rooted in innovative technology protected by patents and strong relationships with the physicians who use Edwards products.

The moderate uptake of Sapien seems to fit with the basic scenario we had projected, based on the substantial learning curve and cross-specialist teamwork this device requires, along with the tightly defined parameters for Medicare reimbursement. Additionally, mastering both the transfemoral and transapical methods of implanting Sapien translates into more complex training for the centers. Edwards trained approximately 150 centers in 2012, and had originally expected to have another 200 trained by the end of 2014. Now that goal looks rather ambitious, as some centers have delayed transapical training in the first quarter. We think it may be more realistic to expect training another 170 centers in that time frame. These factors have prompted Edwards' management to pull back full-year projections for Sapien. We have also trimmed our estimate for $716 million in Sapien sales this year, down from $735 million, though we note that this incremental change does not have a significant effect on projected cash flows for Edwards.

**Thesis** Apr. 24, 2013

Since spinning off from Baxter International in 2000, Edwards Lifesciences has maintained its dominance in tissue heart valves. Further, it has jump-started a relatively sleepy device category with its new minimally invasive heart valve therapy--one of the hottest areas in cardiac devices.

Edwards has done a good job of refocusing on higher-margin products and paying down its spin-off debt by selling noncore businesses. These efforts resulted in an impressive 27-percentage-point gross margin improvement since becoming a stand-alone company. Although the firm is significantly smaller than close competitors Medtronic and St. Jude in terms of sales, it remains the global leader in its core business of tissue heart valves, commanding more than 60% of the global market. The firm maintains a leadership position in critical-care monitoring equipment and has also sought to build out its cardiac surgical products that complement its heart valves.

However, Edwards historically has lagged its larger rivals because of its focus on slower-growing devices in mature markets--most notably surgical heart valves, which typically see sales growth in the midsingle digits. Edwards continues to derive approximately 40% of its total revenue from this product line. We expect the mature valve replacement market to grow slowly but steadily, as it is driven primarily by greater numbers of elderly people.

Nonetheless, Edwards has forged ahead with technological innovation to give the heart valve market a jolt by developing minimally invasive heart valves that can be installed through a catheter, thereby making the procedure and recovery much easier for patients. Currently, traditional valves require an extensive surgical procedure for implantation, which means an estimated half to one third of the elderly patients who need valve replacement are too frail and high-risk to undergo surgical valve replacement. We believe Edwards is bolstering its leadership position in tissue heart valves with its new Sapien transcatheter aortic valve, or TAVR, which is

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| Close Competitors | Currency (Mil) | Market Cap | TTM Sales | Oper Income | Net Income |
|---|---|---|---|---|---|
| **Medtronic, Inc.** | USD | 53,509 | 16,427 | 4,641 | 3,489 |
| **Boston Scientific, Inc.** | USD | 12,924 | 7,144 | -4,394 | -4,535 |
| **St Jude Medical, Inc.** | USD | 12,768 | 5,446 | 1,106 | 763 |

delivered either through the femoral artery (similar to an angioplasty) or through a small hole between two ribs. This minimally invasive therapy would potentially tap into about 1 million American patients who are currently not good candidates for traditional valve surgery.

Moreover, last year Sapien expanded its indication to include high-risk patients eligible for traditional surgery, which bodes well for Edwards. We expect the shorter and less onerous recovery associated with transcatheter valve replacement to be extremely appealing to this group, who, like inoperable patients, are also quite elderly.

After Sapien received regulatory approval in Europe in 2007 and Edwards rolled out its next-generation Sapien XT there, this new technological advance has generated substantial excitement among interventional cardiologists, as well as cardiac surgeons. European sales have exceeded our expectations with strong double-digit growth through 2012. Considering the austerity measures in that area along with lack of widespread reimbursement, we expect more modest Sapien growth in the near term.

Since fall 2010, data published from the pivotal PARTNER trial has been impressive. Though there is a slightly higher risk of adverse events in the 30 days following Sapien implantation among inoperable patients, those same patients face a 50% probability of dying in the next 12 months if they remain untreated. The dramatic life-saving nature of this procedure laid the groundwork for the FDA's approval of Sapien last fall. Additional favorable data from the PARTNER trial's surgical patients also underscores the clinical benefits of this device for high-risk surgical patients. Best of all, we think Edwards will have the domestic transcatheter aortic-valve market to itself until mid-2014, when Medtronic is expected to enter the U.S. with its CoreValve product.

We think Edwards' prospects look positive as Sapien climbs the adoption curve. However, we note that there are still some open questions about the longer-term efficacy of transcatheter heart valves, the expected mortality from other causes among this extremely elderly patient population, and whether the economics behind transcatheter valves make sense. There is some evidence that relatively healthier patients who are implanted transfemorally get value out of the device, while the sicker transapical patients do not. As we have seen with drug-coated stents in 2006, there is the possibility that as the new technology is adopted and studies track the device's performance over longer periods, new risks or safety issues could emerge.

**Valuation, Growth and Profitability**

We are decreasing our fair value estimate to $78 per share, down from $92, as we return to valuing Edwards on the basis of discounted cash flows, and remove the probability we had baked in of a take-out scenario. Now that the adoption of Sapien is more gradual than originally anticipated, the head start that Edwards enjoys is not as valuable. This in turn makes Edwards a less attractive target. We still think Edwards eventually can capture close to 30% of the subsegment of high-risk surgical patients. We expect solid gross margin gains in 2013 to hold in 2014 thanks to the domestic adoption of Sapien. Our projections of Sapien performance remain at the heart of our valuation. We expect robust 30% Sapien growth in 2013, which takes into account narrowly defined CMS reimbursement and the time it takes to train new centers. Now that Germany and France have established reimbursement, we also anticipate solid European uptake to continue through 2013. Further, Edwards already has launched its thinner-profile Sapient XT product in Europe, giving the firm a tool with which to take share from Medtronic's ReValving system. The rollout of the transcatheter valves should drive 12% top-line growth for Edwards through 2017.

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We anticipate that the product mix shift toward premium-price transcatheter valves should push costs of goods down further. Edwards also should see some incremental benefit from moving manufacturing to its new facility in lower-cost Singapore. This should keep operating margin expanding; we expect it to reach 22% in 2014, though we expect the firm to partially give up some margin gains once Medtronic enters the domestic transcatheter valve market. In total, we think net income will grow about 13% compounded annually through 2017. We assume Edwards will maintain a slightly higher level of sales and marketing spending (37% of sales, compared with 33% historically) to support its upcoming product launches, as well as modestly higher research-and-development costs to support more large-scale trials for pipeline candidates.

**Risk**

Most of Edwards' heart valves still require major surgery for implantation, while the medical industry has been moving toward minimally invasive procedures that cut down on recovery time and costs. Although Edwards has a two-year lead in the race to launch a nonsurgical catheter-based valve in the U.S., Medtronic is on track to roll out its CoreValve product in the U.S. in 2014. Medtronic's marketing might and deep pockets make CoreValve's technology a considerable threat. Medtronic also has its own version of transapical transcatheter valve replacement thanks to its acquisition of Ventor Technologies. Additionally, St. Jude Medical is on the warpath with its own Portico transcatheter valve. Though we think St. Jude trails Medtronic by two to three years, St. Jude has proved itself to be a formidable competitor in the cardiac device markets. Clinical outcomes of the Sapien valve over the longer term have yet to be assessed. Some preliminary data hints that a substantial portion of this elderly patient population would have expired anyway from independent causes within several years, even after implanting the Sapien valve. This raises questions about Medicare's appetite to reimburse this expensive device and puts pressure on TAVR manufacturers to demonstrate the economic value of the technology. Finally, Edwards could see more competition in its surgical tools business if minimally invasive surgical systems makers, such as Intuitive Surgical ISRG, enter the cardiac surgery market.

**Bulls Say**

- Edwards' efforts to focus on efficiency and higher-margin products have paid off, as gross margins increased from 47% in 2000 to 74% in 2012.
- Cardiothoracic surgeons tend to be fairly conservative and like to stick with proven devices and brands. As a pioneer in heart valves, Edwards continues to be seen as the gold standard.
- Edwards should benefit from an aging population, which experiences problems with heart valves and congestive heart failure with greater frequency.
- Edwards has correctly read the market trends and has a robust pipeline of minimally invasive projects for aortic valve replacement and valve repair. Success in these areas could give Edwards a big leg up on the competition.
- Excitement about transcatheter valve technology has dominated the discussion and presentations at cardiovascular conferences over the last few years. We think interventional cardiologists and cardiac surgeons are eager to climb the learning curve on these products.

**Bears Say**

- Edwards' ambitions to diversify into minimally invasive medical technologies place the firm in direct competition with much larger competitors, such as Medtronic and St. Jude Medical. Deep-pocketed rivals can easily bid up prices for emerging technologies that Edwards, with its smaller budget, couldn't match.

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- Edwards must navigate a delicate path with its Sapien transcatheter valve, as the device straddles the specialties of cardiac surgeons and interventional cardiologists, who are still sensitive to how the introduction of stents used by interventionalists cut severely into traditional bypass procedures done by surgeons. Although Edwards historically has built strong relationships with surgeons, it is seeking to establish new ones with interventionalists without alienating surgeons.
- If Sapien pricing remains high even after the entrance of rival Medtronic, practitioners and payers may opt for traditional surgical valve repair among the high-risk patients.
- The relatively-tightly defined limits for Medicare reimbursement on Sapien this could cut into the technology's potential and slow adoption.
- Paravalvular leaks following the implantation of Sapien continue to affect a sizable minority of patients. Edwards needs to address this side effect, especially as Medtronic and St. Jude pursue their own valves that could minimize this issue.

**Financial Overview**

Financial Health:Although Baxter saddled Edwards with considerable debt in the spin-off, Edwards has done a good job of using its cash flow to pay it down. Financial leverage had decreased to 1.5 at the end of 2012 from 2.5 in 2000. We expect the firm to generate approximately $280 million in free cash flow this year.

**Company Overview**

Profile: Spun off from Baxter International in 2000, Edwards Lifesciences designs, manufactures, and markets a range of medical devices and equipment for advanced stages of heart disease. Its key products include tissue heart valves, surgical clips, catheters and retractors, and monitoring systems used to measure a patient's heart function during surgery. The firm derives about 58% of its total sales from outside North America.

Management: We think Edwards' stewardship is solid. Previously a group vice president at Baxter, Michael Mussallem has been CEO and chairman of Edwards since the spin-off in 2000. Mussallem receives reasonable compensation, and we like that the goals for his bonus place more emphasis on revenue growth--a key objective for this company that has historically participated in slower-growing markets--and free cash flow. Growth in net income is also taken into consideration, but we think this can often be subject to accounting manipulations. We would like to see even greater detail on the specific measures on which Mussallem is judged. Furthermore, Edwards relies on restricted-stock units that don't vest for five years, rather than stock options alone, which encourages Mussallem to manage Edwards with an eye toward the longer term. We like that a succession-planning update is provided at each board meeting, ensuring that the board is highly involved in surveying management talent and potential for executive positions. We think the firm's overall corporate governance policies are well designed.

From a corporate-allocation standpoint, Edwards has made wise decisions. Unlike most of its larger rivals, Edwards does not rely as heavily on serial acquisitions. Instead, it as steadily plowed resources into internal innovation, which has kept its surgical heart valve business in a leadership position, despite the category's slow growth. The one major acquisition Edwards made was Percutaneous Valve Technologies for $155 million (including milestone payments) in 2004, which laid the foundation for Edwards' Sapien product line. The addition of PVT catapulted Edwards into the race to enter the U.S. TAVR market first. Edwards might have

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been lucky with this purchase, as there are many early-stage technologies that do end up as gutter balls. Nevertheless, Edwards enjoys a strong position in a category we project should grow to $3 billion.

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## Analyst Notes

**Edwards Caps Off 2012 With Strong Finish** Feb. 05, 2013
Edwards Lifesciences EW finished off 2012 on a strong note. As the fourth-quarter and full-year results were consistent with our expectations, we're standing behind our $92 fair value estimate. Fourth-quarter revenue grew 21% in constant currency, fueled primarily by stellar domestic growth in Sapien transcatheter valve sales. While adoption of Sapien in the United States remained moderate in the first half of 2012, the pace picked up by the end of the year thanks to more trained provider centers becoming operational, label expansion to include high-risk surgical patients, and regulatory approval of the transapical (entering between the ribs and threading up through the heart) approach. In the fourth quarter, nearly half of U.S. Sapien sales were transapical, which suggests a substantial number of inoperable patients are poor candidates for the transfemoral approach. In particular, management believed there was a backlog of transapical patients who finally gained access to Sapien in the fourth quarter. We were impressed that European sales of Sapien grew 10% in constant currency against a backdrop of widespread austerity.

As expected, the product mix shift toward more Sapien sales has also boosted profitability at Edwards. The firm saw its full-year operating margin grow 360 basis points, primarily due to the pricing premium Sapien commands. We think Edwards should be able to maintain these gains. The firm is on track to become the first TAVI entrant in Japan by the end of 2013, and next-generation Sapien III should receive European regulatory approval in the same time frame. Additionally, Edwards should roll out its thinner-profile Sapien XT in the U.S. during 2014. While Medtronic MDT is set to launch its CoreValve product in the U.S. next year, Edwards has plenty up its sleeve to protect its turf.

We remain wary of potentially unfavorable cost-benefit analysis of the transapical approach. While the data consistently suggest a cost-benefit advantage to transfemoral implantation of transcatheter aortic valves, the preliminary data on transapical implantation are not so clear or so favorable. This may be related to the general frailty of the two types of patients, with transfemoral patients healthier and more robust than transapical patients (who may be prone to dying sooner of other unrelated causes). It will take time for more data to be collected, which translates into a green light for transapical patients for now. However, considering the grassroots concerns of overuse bubbling up in Europe, we are cautious about longer-term reimbursement issues.

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The moderate uptake of Sapien seems to fit with the basic

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## Analyst Notes (continued)

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# Edwards Lifesciences Corporation(USD)
EW

| Last Close $ | Sales $Mil | Mkt Cap $Mil | Industry | Currency |
|---|---|---|---|---|
| $68.29 | $1,937 | $7,714 | Medical Devices | USD |

Edwards Lifesciences Corporation is a provider of products and technologies designed to treat advanced cardiovascular disease. Its products are categorized into four main areas: Heart Valve Therapy; Critical Care; Cardiac Surgery Systems; and Vascular.

| Morningstar Rating | Fair Value Uncertainty | Fair Value | Economic Moat | Style | Sector |
|---|---|---|---|---|---|
| ★★★ As of 06-11-2013 | High | $78.00 | Narrow | Mid Growth | |

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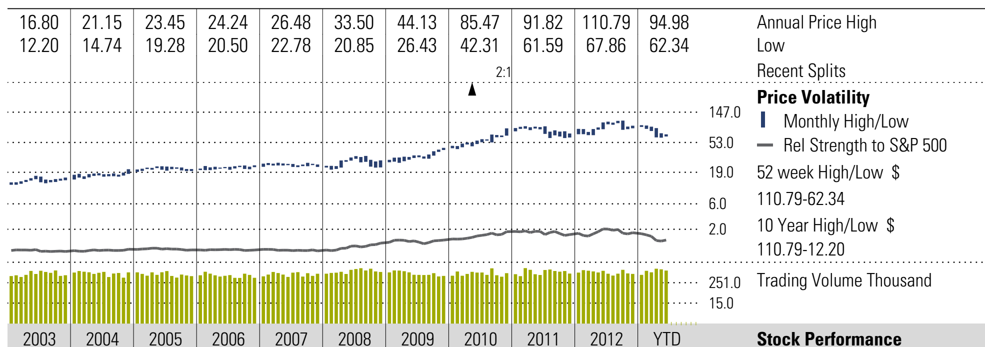
Website: http://www.edwards.com

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | YTD | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 16.80 | 21.15 | 23.45 | 24.24 | 26.48 | 33.50 | 44.13 | 85.47 | 91.82 | 110.79 | 94.98 | Annual Price High |
| 12.20 | 14.74 | 19.28 | 20.50 | 22.78 | 20.85 | 26.43 | 42.31 | 61.59 | 67.86 | 62.34 | Low |
| | | | | | | | | 2:1 | | | Recent Splits |




**Price Volatility**
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low $
110.79-62.34
10 Year High/Low $
110.79-12.20
Trading Volume Thousand

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | YTD | Stock Performance |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 17.1 | 37.2 | 0.8 | 13.0 | -2.2 | 19.5 | 58.1 | 86.2 | -12.5 | 27.5 | -24.3 | Total Return % |
| -11.6 | 26.3 | -4.1 | -2.7 | -7.7 | 56.5 | 31.6 | 71.1 | -14.7 | 11.5 | -39.4 | +/- Market |
| -7.7 | 26.3 | -5.6 | 16.4 | 1.4 | 53.3 | 21.2 | 83.4 | -8.5 | 14.3 | -43.1 | +/- Industry |
| — | — | — | — | — | — | — | — | — | — | — | Dividend Yield % |
| 1783 | 2453 | 2474 | 2723 | 2608 | 3059 | 4933 | 9297 | 8065 | 10306 | 7714 | Market Cap $Mil |

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | TTM | Financials (USD) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 861 | 932 | 998 | 1037 | 1091 | 1238 | 1321 | 1447 | 1679 | 1900 | 1937 | Revenue $Mil |
| 58.2 | 60.3 | 62.5 | 64.0 | 65.3 | 66.1 | 69.8 | 71.8 | 70.8 | 74.0 | 74.7 | Gross Margin % |
| 138 | 61 | 174 | 173 | 173 | 173 | 302 | 284 | 300 | 408 | 432 | Oper Income $Mil |
| 16.1 | 6.6 | 17.5 | 16.7 | 15.8 | 14.0 | 22.8 | 19.7 | 17.9 | 21.5 | 22.3 | Operating Margin % |
| 79 | 2 | 79 | 131 | 113 | 129 | 229 | 218 | 237 | 293 | 373 | Net Income $Mil |
| 0.65 | 0.02 | 0.64 | 1.05 | 0.94 | 1.10 | 1.95 | 1.83 | 1.98 | 2.48 | 3.16 | Earnings Per Share $ |
| — | — | — | — | — | — | — | — | — | — | — | Dividends $ |
| 122 | 124 | 125 | 128 | 125 | 119 | 117 | 119 | 119 | 118 | 118 | Shares Mil |
| 5.36 | 5.28 | 5.80 | 6.47 | 7.36 | 7.89 | 10.19 | 11.38 | 11.73 | 12.94 | 14.09 | Book Value Per Share $ |
| 142 | 181 | 137 | 231 | 210 | 153 | 165 | 251 | 315 | 374 | 492 | Oper Cash Flow $Mil |
| -38 | -43 | -51 | -59 | -63 | -78 | -64 | -63 | -91 | -128 | -133 | Cap Spending $Mil |
| 104 | 138 | 86 | 171 | 148 | 75 | 101 | 188 | 224 | 246 | 359 | Free Cash Flow $Mil |

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | TTM | Profitability |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 7.5 | 0.2 | 6.8 | 10.5 | 8.7 | 9.4 | 15.2 | 12.9 | 12.6 | 14.0 | 17.4 | Return on Assets % |
| 13.5 | 0.3 | 12.0 | 18.1 | 14.3 | 15.0 | 22.5 | 17.7 | 17.9 | 20.8 | 25.0 | Return on Equity % |
| 0.82 | 0.84 | 0.85 | 0.84 | 0.84 | 0.90 | 0.88 | 0.86 | 0.90 | 0.90 | 0.90 | Asset Turnover |
| 9.2 | 0.2 | 7.9 | 12.6 | 10.4 | 10.4 | 17.3 | 15.1 | 14.1 | 15.4 | 19.3 | Net Margin % |
| 1.7 | 1.8 | 1.8 | 1.7 | 1.6 | 1.6 | 1.4 | 1.4 | 1.5 | 1.5 | 1.4 | Financial Leverage |

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 03-13 | Financial Health (USD) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 256 | 267 | 316 | 236 | 62 | 176 | 90 | 0 | 150 | 189 | 193 | Long-Term Debt $Mil |
| 635 | 628 | 690 | 749 | 835 | 879 | 1158 | 1308 | 1338 | 1479 | 1592 | Total Equity $Mil |
| 0.40 | 0.43 | 0.46 | 0.31 | 0.07 | 0.20 | 0.08 | — | 0.11 | 0.13 | 0.12 | Debt/Equity |
| 193 | 172 | 320 | 305 | 206 | 433 | 599 | 695 | 833 | 945 | 1060 | Working Capital $Mil |

| 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | TTM | Valuation |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 23.3 | 1428.6 | 32.8 | 22.4 | 24.6 | 25.1 | 22.3 | 44.2 | 35.7 | 36.4 | 21.6 | Price/Earnings |
| 0.0 | 0.8 | — | — | 0.0 | 0.0 | 0.0 | 0.0 | — | 0.0 | 1.3 | P/E vs. Market |
| 2.1 | 2.7 | 2.7 | 2.9 | 2.6 | 2.6 | 3.9 | 6.7 | 5.0 | 5.6 | 4.2 | Price/Sales |
| 2.8 | 3.9 | 3.6 | 3.6 | 3.1 | 3.5 | 4.3 | 7.1 | 6.0 | 7.0 | 4.8 | Price/Book |
| 15.0 | 14.2 | 19.5 | 13.0 | 13.7 | 21.4 | 30.9 | 38.3 | 27.0 | 28.6 | 16.4 | Price/Cash Flow |

## Growth Rates Compound Annual

| Grade: B | 1 Yr | 3 Yr | 5 Yr | 10 Yr |
|---|---|---|---|---|
| Revenue % | 13.2 | 12.9 | 11.7 | 10.4 |
| Operating Income % | 36.1 | 10.6 | 18.8 | 22.9 |
| Earnings/Share % | 25.3 | 8.3 | 21.5 | 18.5 |
| Dividends % | — | — | — | — |
| Book Value/Share % | 10.4 | 8.3 | 11.9 | 11.2 |
| Stock Total Return | -22.4 | 8.3 | 18.2 | 15.9 |
| +/- Industry | -50.4 | -3.2 | 14.2 | 12.2 |
| +/- Market | -49.5 | -8.4 | 11.9 | 8.8 |

## Profitability Analysis

| Grade: C | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Return on Equity % | 25.0 | 18.8 | 13.3 | 19.6 |
| Return on Assets % | 17.4 | 12.8 | 7.5 | 8.1 |
| Revenue/Employee $K | 236.2 | 211.9 | — | 1025.9 |
| Fixed Asset Turns | 5.6 | 5.6 | 5.8 | 7.1 |
| Inventory Turns | 1.8 | 2.3* | 2.3 | 12.1 |
| Gross Margin % | 74.7 | 70.5 | 66.8 | 42.8 |
| Operating Margin % | 22.3 | 19.2 | 18.2 | 18.5 |
| Net Margin % | 19.3 | 14.5 | 12.9 | 13.2 |
| Free Cash Flow/Rev % | 18.5 | 10.6 | 14.2 | 11.6 |
| R&D/Rev % | 15.3 | 13.7 | 8.3 | — |

## Financial Position (USD)

| Grade: B | 12-12 $Mil | 03-13 $Mil |
|---|---|---|
| Cash | 311 | 402 |
| Inventories | 281 | 289 |
| Receivables | 348 | 330 |
| Current Assets | 1292 | 1361 |
| Fixed Assets | 373 | 385 |
| Intangibles | 452 | 446 |
| Total Assets | 2222 | 2297 |
| Payables | 115 | 115 |
| Short-Term Debt | 0 | 0 |
| Current Liabilities | 347 | 300 |
| Long-Term Debt | 189 | 193 |
| Total Liabilities | 742 | 705 |
| Total Equity | 1479 | 1592 |

## Valuation Analysis

| | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Price/Earnings | 21.6 | 32.7 | 57.1 | 16.9 |
| Forward P/E | 18.0 | — | — | 14.4 |
| Price/Cash Flow | 16.4 | 29.2 | 13.2 | 10.1 |
| Price/Free Cash Flow | 22.4 | 45.2 | 16.4 | 30.1 |
| Dividend Yield % | — | — | 1.3 | 2.2 |
| Price/Book | 4.8 | 5.6 | 2.8 | 2.4 |
| Price/Sales | 4.2 | 4.8 | 2.7 | 2.7 |
| PEG Ratio | 0.9 | — | — | 1.9 |

*3Yr Avg data is displayed in place of 5 Yr Avg

## Quarterly Results (USD)

| Revenue $Mil | Jun | Sep | Dec | Mar |
|---|---|---|---|---|
| Most Recent | 482.0 | 447.0 | 510.0 | 496.0 |
| Previous | 431.0 | 412.0 | 430.0 | 459.0 |

| Rev Growth % | Jun | Sep | Dec | Mar |
|---|---|---|---|---|
| Most Recent | 11.8 | 8.5 | 18.7 | 8.2 |
| Previous | 18.1 | 18.3 | 9.6 | 13.5 |

| Earnings Per Share $ | Jun | Sep | Dec | Mar |
|---|---|---|---|---|
| Most Recent | 0.57 | 0.58 | 0.77 | 1.24 |
| Previous | 0.48 | 0.43 | 0.53 | 0.55 |

## Close Competitors

| | Mkt Cap $Mil | Rev $Mil | P/E | ROE% |
|---|---|---|---|---|
| Medtronic, Inc. | 52789 | 16427 | 15.9 | 19.9 |
| Boston Scientific, Inc. | 12735 | 7144 | -2.9 | -50.7 |

## Major Fund Holders

| | % of shares |
|---|---|
| American Funds Growth Fund of Amer A | 8.09 |
| American Funds AMCAP A | 3.09 |
| American Funds Fundamental Invs A | 2.45 |

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## Morningstar's Approach to Rating Stocks

**Our Key Investing Concepts**

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

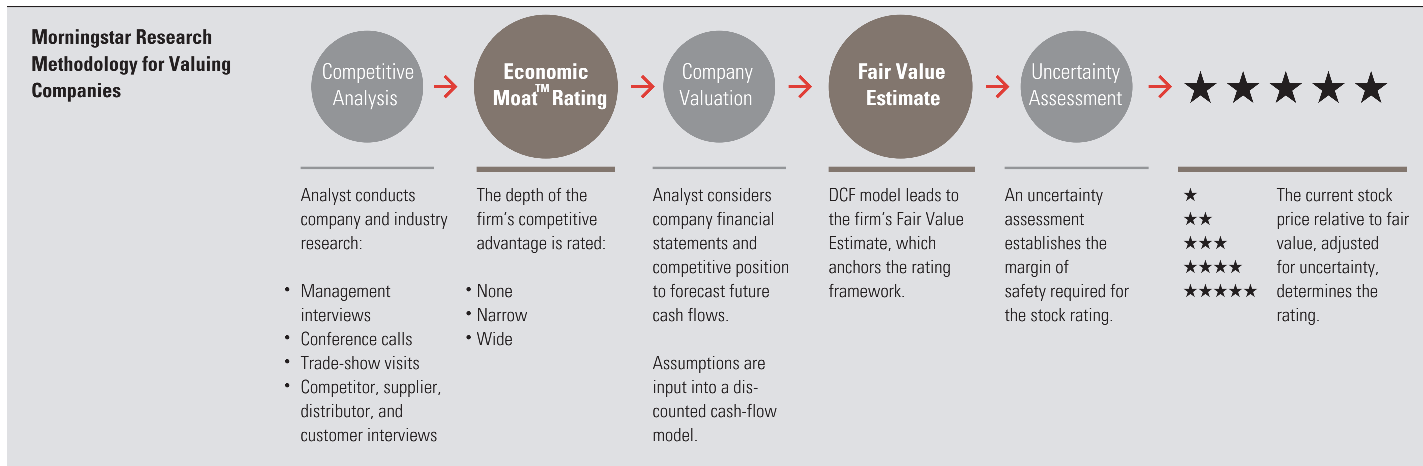
Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

### Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

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economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

**Discounted Cash Flow**
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

**Discount Rate**
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

**Fair Value**
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

**Uncertainty**
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

**Margin of Safety**
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

**Consider Buying/Consider Selling**
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

**Stewardship Grades**
Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

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