

March 31, 2017

Cantel Medical Corp: CMD (Long)

John Garrity

Sector: Industrials

Industry: Medical Devices

Current Price: \$79.87

Target Price: \$85.00

Company Description:

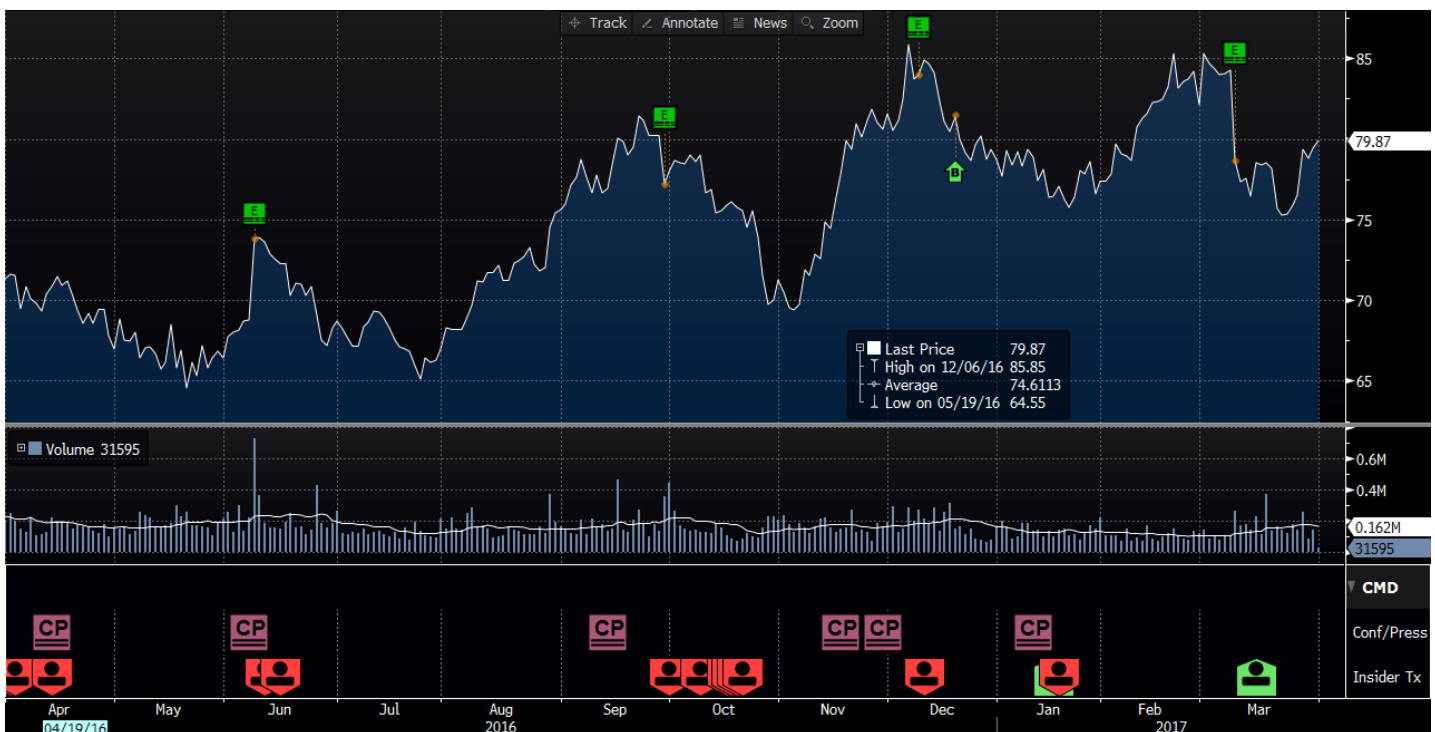
Cantel Medical Corp is a provider of infection prevention products and services in the healthcare market for patients, caregivers, and other health care providers. The company specializes in the Endoscopy, Water Purification/Filtration, Healthcare Disposables, and Dialysis segments. Cantel Medical provides medical device reprocessing systems, disinfectants, detergents, and other supplies in the Endoscopy segment. The Water Purification/Filtration segment includes water purification products and services, filtration and separation products, and decontamination products and services. The Healthcare Disposables segment includes single-use, infection prevention healthcare products. The Dialysis segment for Cantel Medical includes medical device reprocessing systems, sterilants/disinfectants, dialysate concentrates, and other supplies for renal dialysis. Cantel Medical also provides technical maintenance services, image and analysis hardware and software, and remote visual inspection devices. Cantel Medical employs an active acquisition strategy.

Key Statistics:

<u>Market Price:</u>	\$79.87	<u>ROE:</u>	14.75%
<u>Market Cap:</u>	\$3.33B	<u>Net Income</u>	
<u>WACC:</u>	8.98%	<u>Margin:</u>	13.17%
<u>ROIC:</u>	11.66%	<u>P/E:</u>	46.51x
<u>EBITDA Margin:</u>	18.32%	<u>Short Interest</u>	2.8%
<u>Ke:</u>	9.29%	<u>Short Interest:</u>	6.5x

Catalysts:

- > Focus on single use products
- > Transition from manual to automatic reprocessing in emerging markets
- > Heat based disinfecting technology
- > Higher compliance standards
- > Product development
- > Integrate, leverage, and grow acquired businesses
















Thesis:

Cantel Medical has gradually increased its exposure to the Endoscope Reprocessing segment, which now makes up slightly more than half of Cantel Medical's business. A key factor of the growth in the medical device industry can be attributed to endoscopy. Endoscopy is a nonsurgical procedure that examines a person's digestive tract. The demand for such products has increased in the past few years due to the minimal invasive procedure and its uses for treatment and diagnosis purposes. This demand not only reaches the aging population in the United States, but growing economies such as Brazil, Russia, India, and China as well due to an increasing middle class population with increased wealth. New product development is key to their business strategy, as half of their organic growth is determinant on these sales between 2015 and 2021. Another key driver for Cantel Medical is establish themselves outside the US. Domestic sales have been around 78.5 percent past two years, compared to 83.4 percent between 2013 & 2014. The fastest growing segment to Cantel, according to Bloomberg, is Europe/Africa/Middle East, with sales growing at 11 percent in 2015 and 13.3 percent in 2016. . The management team has been able to successfully acquire other businesses and mold them into their strategies in the past, and can anticipate this as being a big part of the company's growth. Management's goal is to double sales between 2016 and 2021, with international sales growing at almost double the rate of domestic sales. Today, physicians regard endoscopy as the primary method of diagnosis and treatment, trumping imaging scans. Cantel Medical has been able to grow at least 10 percent growth in 11 of their past 13 quarters, and are the self-proclaimed leading pure-play in the global infection prevention market.

Industry Outlook:

There are many different segments that make up the Medical Devices Industry, but Cantel focuses on Endoscopy, Water Purification/Filtration, and Healthcare disposables. Endoscopy is estimated at a 4.5 billion dollar market, and Cantel Medical saw revenues of 364 million in 2016. There are more than 80 million endoscopic procedures worldwide, and are growing at an estimated 7 percent CAGR. Colorectal cancer is the third most common cancer and the fourth leading cause of cancer deaths globally, and is an example of a common procedure that uses endoscopic procedures. Cantel medical is only pure play infection prevention provider in this market due to their full-circle product solutions for infections and 3 new AER platforms. Drivers in this market are the increasing use of single use-products and the transition from manual reprocessing to automated, specifically in emerging markets. The Water Purification/Filtration market is worth a billion dollars, and Cantel Medical owns slightly more than 18 percent of that market, and has been growing at around

In Millions of USD except Per Share 12 Months Ending	FY 2015 07/31/2015		FY 2016 07/31/2016	
 = Revenue	565.0	100.0%	664.8	100.0%
 Endoscope Reprocessing	248.7	44.0%	341.8	51.4%
 Water Purification and Filtration	173.8	30.8%	177.7	26.7%
 Healthcare Disposables (Dental)	106.9	18.9%	112.6	16.9%
 Dialysis	31.2	5.5%	32.8	4.9%
 Other	4.4	0.8%	0.0	
 = Operating Income	99.2	100.0%	97.3	100.0%
 Endoscope Reprocessing	40.9	41.2%	61.0	49.2%
 Water Purification and Filtration	30.6	30.8%	30.6	24.7%
 Healthcare Disposables (Dental)	19.9	20.1%	24.5	19.7%
 Dialysis	6.7	6.8%	7.9	6.4%
 Other	1.1	1.1%	0.0	
 General Corporate	-		-26.8	

5 percent per year. End Stage Renal Disease, or kidney failure, effects 3.6 people world-wide and grows at 3-4 percent annually. Unfortunately, a majority of ESRD clinics in the US still use old technology. Today the standard technology for

ESRD treatment and prevent use heat-based water disinfection technology, while opportunities are being

explored in filtration and chemical sterilants. Water Purification/Filtration products provide doctors, caretakers, and patients the ability to cope with the disease, and Cantel is the leader in Hemodialysis water treatment that provides US-based service centers that are available 24/7/365. Another billion dollar business is Healthcare Disposables, which experiences an annual growth of just under 3 percent. Products and services in this market are generally sold to dental practitioners, of which Cantel sold 122 million dollars to this segment in 2016. The single largest market is the United States for dental infection prevention products. The aging US population will only drive up the patient volumes. Cantel is a leading branded player in this dental infection prevention as well as education and training amongst the dental community, and are expanding their high margin, Circle of Protection products.

Products:

As of August 31, 2016, Cantel holds 55 US patents and 167 foreign patents, with 38 pending in the US, and 82 pending in foreign countries. These patents includes total of 1,941 trademark registrations in the US and other countries:

Medivators- this product portfolio for Cantel offers capital equipment, chemistries, consumables, and services used to pre-clean, leak test, clean, disinfect, store, and electronically track flexible endoscopes from the removal of one patient to the next patient. The flagship product in this product portfolio are automated endoscope reprocessors (AERs) and high-level disinfectant chemistries. The top selling Medivators AERs are Advantage Plus systems, which are single use systems designed to clean the endoscopes. In June and November of 2016, Cantel acquired Puricore International and International Medical Service, respectively. These acquisitions have helped Cantel gain a presence in the international markets. Other products in this market segment are RAPICIDE and ADASPOR disinfectants, leak detection devices, detergents and wipes, ENDODRY storage and drying cabinets, and ENDORA tracking systems. A new product Cantel intends to launch is AmplifEYE, which improves a physician's ability to examine colonoscopy.

Gambro- this product line includes systems that utilize either chemical or heat disinfection to sanitize equipment. These water purification systems are designed to produce biologically pure water designed for use in healthcare, life sciences, food and beverage and commercial industrial markets. Cantel has significant expertise in the water purification process, including designing systems capable of delivering water for hemodialysis to meet government standards.

FIBERFLO- Fiberflo filters remove impurities such as bacteria and other contaminants in medical environments to provide protection for the patient. Fiberflo filters are used in a variety of industries such as pharmaceutical manufacturing, food and beverage processing, cosmetic manufacturing, and electronic manufacturing.

Healthcare Disposables- Cantel is the leading manufacturer of single-use, infection prevention products including face masks, sterilization pouches, biological monitoring systems, towels/bibs, tray covers, germicidal wipes, surface barriers, hand care products, needles, and syringes. Cantel has recently been able to fill orders for US- manufactured masks, disinfectants, and other products to China and the Far East, mostly due to Middle East Respiratory Syndrome.

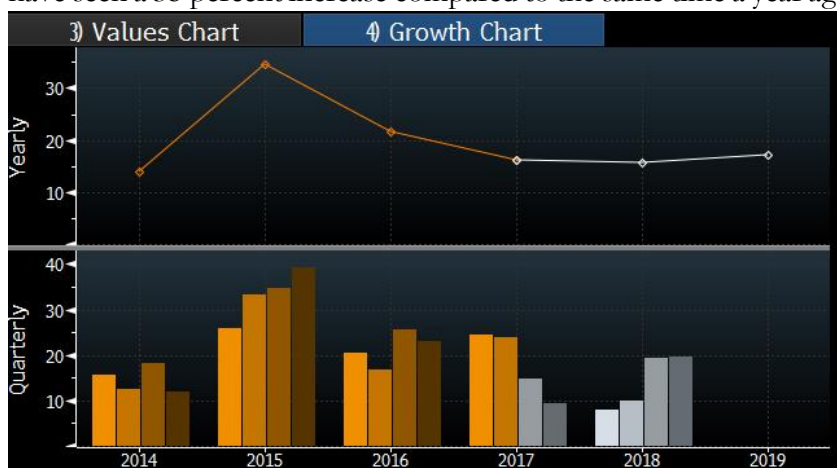
Dialysis Reprocessing Products- Cantel designs, manufactures, and sells reprocessing systems and sterilants for dialyzers, as well as other supplies needed for renal dialysis. This is one of the markets where Cantel is not

the leader, as they make reusable dialysis equipment, but the market is slowly shifting to single use dialysis equipment. This explains why it is a decreasing part of their business

Revenue:

YTD '16 Revenue	\$153.1	\$88.0	\$53.4	\$17.6	\$312.1
Organic	21.3%	10.6%	7.5%	-14.9%	13.9%
M&A	3.7%	0.0%	27.5%	0.0%	6.5%
FX	-2.1%	0.0%	0.0%	-0.1%	-1.0%
YTD '17 Revenue	\$188.2	\$97.3	\$72.1	\$15.0	\$372.5
Total Growth	22.9%	10.6%	35.0%	-15.0%	19.4%

Roughly 72 percent of Cantel's revenue came from organic growth, and 5.8 percent coming from acquisitions. As of the second quarter of 2017, their organic revenue growth hit double digits in 12 of the past 14 quarters. Net income has been growing at a rate just below 10 percent for the last few years. Most of this profitability has come through the Endoscopy segment, which posted double digit organic growth for its 15th consecutive quarter due to strong global demand for chemistry and procedural products. The Endoscopy segment experienced a 2.2% increase in gross margins, and 4.1% increase in the gross margin for Healthcare Disposables. Gross margins increased due to improving efficiency by increasing the R&D expense by almost 10 percent from 2016, as well as selling higher margin products. Cantel can expect more revenue from Water Purification & Filtration, as sales are up 36% in that segment, due to the acquisition of Accutron. Healthcare Disposables have seen a 35 percent increase compared to the same time a year ago. Sales increased 17.7 percent, with organic sales increasing 12.7 percent in 2016, while net income increased 25% under the GAAP rules. Cantel Medical's EPS has consistently beat out analysts estimates, and has grown every year including 25.2 percent over the past year to \$1.44. The chart to the right shows that ESP growth is expected to be around 16 percent through 2019. However, some of these factors were offset by an increase in the interest expense due to the acquisitions, the impact of atypical items like the retirement package for the CEO, and the strategic expansion into new markets in the Endoscopy, Healthcare Disposables, and Water Purification/Filtration segments.



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Competitors:


The markets for the products Cantel Medical makes is highly competitive, and the long term position in their segments depends on success in product design, quality, safety, ease of use service, and cost. Cantel acknowledges that many of their competitors are much larger than they are, and with greater resources. But Cantel believes that their innovation and reputation for providing quality product service gives them a competitive advantage. In the Endoscopy market, Cantel Medical competes with Steris, Olympus, and a division of Johnson and Johnson called ASP, and Metrex, among others. In the United States, Cantel holds a significant advantage over competitors through acquisitions of both large and small companies. Cantel is attempting to bundle their products with kidney dialysis machine suppliers to gain a competitive advantage outside the US.





The Healthcare Disposables market includes a wide range of products, and no company competes with Cantel over all their products, but the main competitors are Steris, Amcor, and 3M, among others. Cantel’s successful Crosstex brand has proven to be a long-standing trusted product by dental and medical professionals around the world. Overall, Cantel is not the largest company competing in their markets, but for years they have been trusted around the world for their careful and efficient practices.

Acquisitions:

Acquiring existing companies is a large part of Cantel Medical’s business. The largest, recent acquisition was the purchase of Medical Innovations group for 79.5 million dollars. Medical Innovations provided Cantel with more resources needed to better compete in with endoscopy prevention products. In early 2016, Cantel Medical bought Sterility Assurance Monitoring Products division of North American Science Associates for 13.5 million. SAMP manufactured monitor sterilization effectiveness for industrial markets, which helped them improve the Healthcare Disposables segment. Also in 2016, Cantel bought certain assets from Vantage, including its Medivators product line, which is one of the largest foreign endoscopic products as well as the

acquisition of Accutron, which makes sedation equipment and single use nasal masks for dental procedures. Accutron cost Cantel 52.5 million and funded partly through debt, but has created opportunities to further broaden the brand. Between Vantage and Accutron, Cantel borrowed 61 million in July of 2016, but results have not been reported in 2016 fiscal year. Other companies acquired in recent years that have improved product lines and innovation are Sterilator Company, Jet Prep, PuriCore International, and Pure Water Solutions. In the

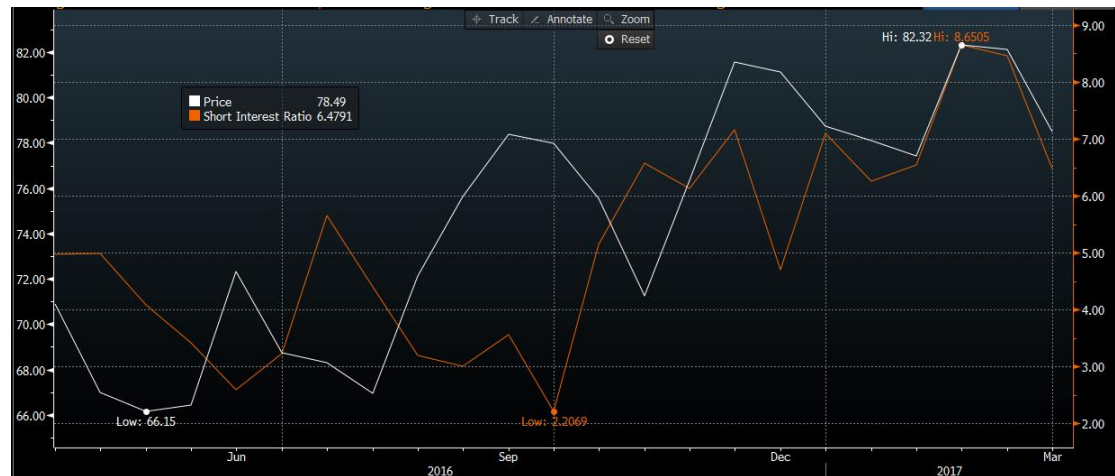
Strategic Acquisitions: 
 Proven ability to integrate, leverage and grow acquired businesses

 Endoscopy	 Healthcare Disposables	 Water Purification & Filtration	 International
<ul style="list-style-type: none"> • Byrne Medical, PuriCore, IMS, Medical Innovations • Strategic Fit: New products & markets, manufacturing expansion & international presence 	<ul style="list-style-type: none"> • SPS Medical, DentalPure, NAMSA's Sterility Assurance Products division, Accutron • Strategic Fit: Leadership in dental IP, sterility assurance monitoring, dental waterline disinfection, conscious sedation 	<ul style="list-style-type: none"> • Roll-up of US-based water purification assets: Gambro Medical Water Systems, Eagle Pure Water Systems, Siemens • Strategic Fit: New technology, customer relationships & geographic footprint 	<ul style="list-style-type: none"> • UK: PuriCore, Medical Innovations • Italy: IMS • France: Medical Innovations • Canada: Vantage endoscopy assets

upcoming years, Cantel will be able to fully integrate all of their acquisitions into their business plan, which will provide significant growth across the globe.

Other:

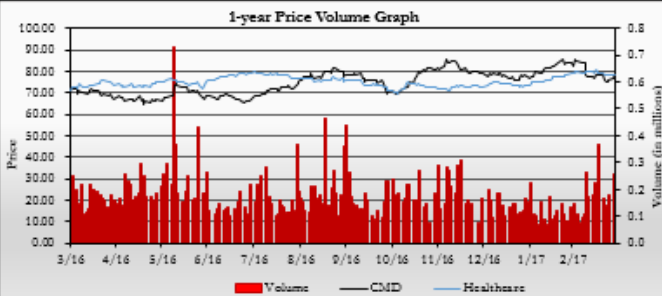
Cantel Medical have been actively acquiring companies, and have spent over 166 million on acquisition on the past two fiscal years on the Cash Flow statement. Cantel has also spent 59 million in the past two years for repayment of debt. Aside from these expenses, Cantel has increased cash the past



two years, thanks largely to the rapid growth in net income. The growth can be better displayed by showing the growth in key margins such as net income margin and gross margin in the recent years. With the increase in long term debt, Cantel Medical has seen a significant increase in short interest. Since September of 2016, short interest has increased from 2.2 to 6.5. This can be seen as an opportunity for bullish Cantel investors because it means it would take longer for those who are short to buy back their shares. A short squeeze could work in bullish investors favor, as Cantel keeps rising with higher short interest, demand increases, as supply for Cantel stock decreases, driving the price higher.

Conclusion:

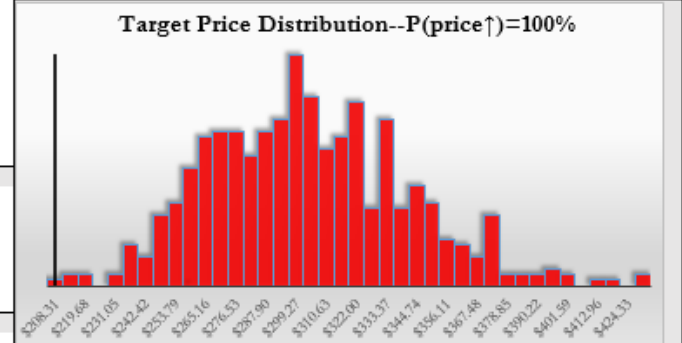
Cantel Medical is not one of the largest companies where they operate, but they are well trusted by their customers and suppliers. Cantel has a broad offering of products, and is continuing to increase in number and in quality through their active acquisition strategy. They have a stable brand in the United States and Canada, producing healthy sales, but the entrance into foreign markets can really spur growth. Cantel is a leader in infection prevention and cleanliness, and the recent entrance into new markets in the Middle East, China and Europe will further increase sales and margins. One of the biggest factors in Cantel Medical's growth will be the development of new products and the acceptance of new products in their respective markets. Cantel is a leader in quality with high standards, which will prove helpful when dealing with the larger competitors.

Cantel Medical Corp. (CMD)
CENTER FOR GLOBAL FINANCIAL STUDIES
BULLISH
Analysis by John Garrity
Current Price:
\$79.77
Intrinsic Value
\$281.24
Target 1 year Return: 271.09%
4/1/2017
Dividend Yield:
0.3%
Target Price
\$295.74
Probability of Price Increase: 100%


Description	
Cantel Medical Corp. provides infection prevention products and services for patients, caregivers, and other healthcare providers worldwide.	
General Information	
Sector	Healthcare
Industry	Healthcare Equipment and Supplies
Last Guidance	November 3, 2015
Next earnings date	June 6, 2017
Estimated Country Risk Premium	1.22%
Effective Tax rate	31%
Effective Operating Tax rate	31%

Market Data	
Market Capitalization	\$3,313.31
Daily volume (mil)	0.02
Shares outstanding (mil)	41.72
Diluted shares outstanding (mil)	41.47
% shares held by institutions	74%
% shares held by investments Managers	75%
% shares held by hedge funds	5%
% shares held by insiders	13.83%
Short interest	2.25%
Days to cover short interest	6.98
52 week high	\$88.81
52-week low	\$64.52
Levered Beta	1.38
Volatility	26.50%

Past Earning Surprises			Peers	
Quarter ending	Revenue	EBITDA		
1/31/2016	1.36%	0.95%	Steris Plc	
4/30/2016	6.46%	-0.30%	Masimo Corporation	
7/31/2016	-1.30%	-8.45%	COMMED Corporation	
10/31/2016	0.52%	-5.33%	Hill-Rom Holdings, Inc.	
1/31/2017	-3.50%	-7.80%	DexCom, Inc.	
Mean	0.71%	-4.18%	Analogic Corporation	
Standard error	1.7%	1.9%	Teleflex Incorporated	
			NuVasive, Inc.	



Management		Position		Total compensations grow		Total return to shareholders	
Diker, Charles	Chairman and Member of Office	5.07%	per annum over 5y	12.98%	per annum over 5y		
Hansen, Jorgen	Chief Executive Officer, Pre	14.69%	per annum over 3y	21.49%	per annum over 3y		
Clifford, Peter	Chief Financial Officer, Exe	38.34%	per annum over 1y	22.21%	per annum over 1y		
Nodiff, Eric	Executive Vice President, Ge	7.29%	per annum over 5y	12.98%	per annum over 5y		
Helms, Paul	Executive Vice President of	N/M		N/M			
Anaya, Steven	Chief Accounting Officer and	-100%	per annum over 1y	22.21%	per annum over 1y		

Profitability		CMD (LTM)		CMD (5 years historical ave Industry (LTM))	
ROIC	25.1%	30.11%	8.90%		
NOPAT Margin	15%	16.67%	16.9%		
Revenue/Invested Capital	1.68	1.81	0.53		
ROE	38.2%	52.86%	10.10%		
Adjusted net margin	14%	16.10%	15.3%		
Revenue/Adjusted Book Value	2.65	3.28	0.66		

Invested Funds		CMD (LTM)		CMD (5 years historical ave Industry (LTM))	
Total Cash/Total Capital	2.6%	4.2%	19%		
Estimated Operating Cash/Total Capital	2.6%	3.9%	N/A		
Non-cash working Capital/Total Capital	12.7%	12.1%	9%		
Invested Capital/Total Capital	53.5%	50.8%	77%		

Capital Structure		CMD (LTM)		CMD (5 years historical ave Industry (LTM))	
Total Debt/Common Equity (LTM)	0.06	0.07	0.18		
Cost of Existing Debt	3.82%	3.46%	3.07%		
Estimated Cost of new Borrowing	4.64%	4.51%	3.07%		
CGFS Risk Rating	CC	CC	BB		
Unlevered Beta (LTM)	1.33	1.39	0.77		
WACC	5.58%	5.39%	4.73%		

