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BJORKLUND FUND

November 17, 2017

Hill-rom Holdings: HRC

Hunter Sanna

Sector: Healthcare
Industry: Healthcare Equipment
Current Price: $81.94
Target Price: $98.81

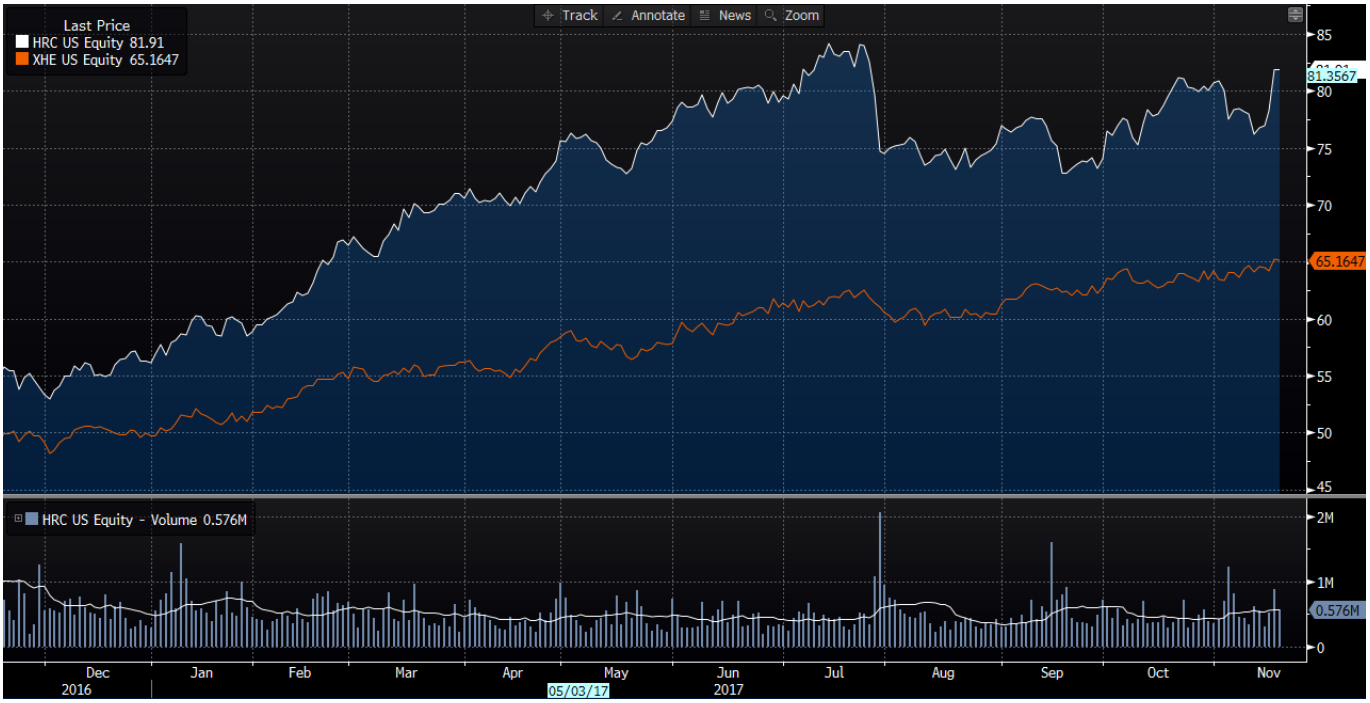
Company Description: Hill-rom Holdings operates as a medical technology company worldwide. They currently breakdown their portfolio into three segments, Patient Support Systems, Front Line Care, and Surgical Solution. They provide surgical beds, patient beds, lifts and other devices, non-invasive therapeutic products, communications technologies, software solutions, health care furniture, medical equipment management services and sells equipment service contracts for its capital equipment. HRC also offers patient monitoring and diagnostic product for products such as blood pressure, physical assessments, vital signs monitoring, and retinopathy screening and thermometry products.

BUY

Current Price:	$81.94
Target Price:	$92.13
Market Cap:	$5.02B
Days to Cover Short:	1.91
Short Interest:	1.42%
EBITDA Margin:	18.15%
ROIC:	5.32%
WACC:	7.4%

Catalysts:

- Short Term: Continue rollout of innovated products to improve patient's outcomes and hospital productivity.
- Mid Term: Continue to divest in low margin low growth categories and diversify the portfolio to hold high margin products.
- Long Term: Expanding global presence to support growth in key focus areas.



Thesis:

Hill-Rom Holdings is a leading provider of medical technologies for the health care industry. HRC's goal is to enhance outcomes for patients and their caregivers by releasing new innovative products within hospitals and inside the comfort of your own home. As Hill-Rom continues their growth strategy of divesting in areas where there is low growth and low margins, it will expand their geographic presence, and continue to release new products; there will be an increase in stock price.

Earnings Performance:

HRC had a solid end to quarter four, producing a core growth rate of 3% over the quarter and 4% annually. Currently, Hil-Rom is stabilizing and diversifying their business trying to drive top line growth. They are currently exiting low growth, and low margin areas to put a larger focus on their main three segments, Patient Support Systems, Front Line Care, and Surgical Solutions. U.S. Patient support systems advanced 3% for the full year, including 5% growth from products and services. During this year, HRC made progress shaping their PSS portfolio to support higher margin platforms, as well as divesting nonstrategic businesses totaling to $75 Million in revenue. Front line care grew 10% this year, including Mortara. The first quarter was lagged but the recent nine months delivered revenue growth of 5%. Integrating Mortara encouraged strong order flow and backlog inventory, and has growth perspectives and financial benefits in the upcoming years. The surgical solutions segment grew 7%, which was driven by double digit growth in HRC's patient positioning and surgical equipment business. New products alone added $150 million in revenue and are expected to drive revenue growth and margin expansion looking forward. Fourth quarter revenues grew at 5%, totaling $738 million. Domestic revenue increased 3%, while international revenue increased 5%, which was driven by competitive wins in new geographic areas, particularly in the Middle-East.

	Fiscal Fourth Quarter				Fiscal Full Year			
Adjusted P&L	2016	2017	YOY Change		2016	2017	YOY Change	
Revenue	$706M	$738M	+4% *constant currency*	+3% *core growth**	$2,655M	$2,744M	+4% *constant currency*	+3% *core growth**
Gross Margin	49.2%	49.3%	+10 bps		48.1%	48.3%	+20 bps	
Operating Margin	18.6%	19.3%	+70 bps		15.3%	16.3%	+100 bps	

Revenue for patient support systems totaled $371 million, a decline of 4%, which was due to divesting in this segment. Adjusting for divesting in this segment, U.S. core revenue increased 2%. Product and services, which includes bed and patient handling systems, clinical workflow solutions, and services increase by 4%, which was offset by a decline in rental revenue. A portion of rental business pertains to lower growth segment which HRM is currently exiting from.

Front line care revenue was $245 million, an increase of 16%, which was primarily driven by Mortara. Excluding Mortara, revenues in the front line segment only grew 3%. Performance in this segment was strong

due to bringing new innovative products to market, strong grow of thermometry and blood pressure devices, and double digit growth in respiratory care. The U.S. segment of this segment lagged at a decline of 2.5%, but the overall growth was driven in international revenues, which total to 17% excluding Mortara. This international growth is impressive and was a result of expansion of HRM's geographic presence.

Surgical care solution revenues posted at $122 million, an increase of 7%. This segment gained the most domestic traction this quarter at 10% growth. This record quarter was driven by high demand for integrated table motion placements. Momentum in the Middle East drove international revenues grew to 3%.

Industry Outlook:

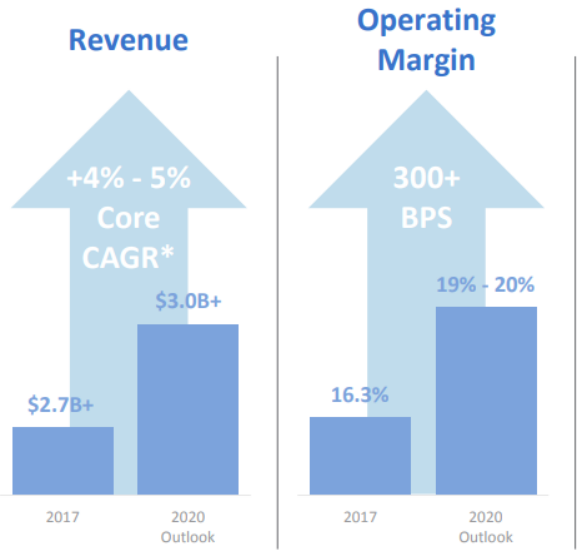
Healthcare spending recently has been growing at a very fast rate and is expected to stay constant through next year. Currently in America, there is an aging demographic, which will continue to fuel this trend. Around 65,000 people turn 65 every day in America (Fidelity). Around 20% of the current population identify as a Baby Boomer, who are currently in between the ages of 51-69, which is when health risks tend to arise. As this demographic becomes older and older, these patients may need skilled care, which is where HRC will ease the pain of becoming older and make a suitable environment for these patients. This market can reap benefits when hospital capital spending remains stable, as well as global spending for the healthcare market remains stable. Homecare medical equipment has been widely accepted, and has been useful in many scenarios, which should keep the trend of people buying products, such as heart rate monitors, home dialysis machines and Electronic thermometers, growing.

This industry is continuing to grow because individuals will get diseases that have no permanent solution to fix the problem, so they have to treat the individuals' symptoms. The homecare market is also evolving to be more cost efficient as technology in this field grows. The home care medical equipment market alone is valued at $21,912 million in 2016, and only has room for more expansion (PRN Newswire). From 2017 to 2023, the expected CAGR is around 7.1%, which is relatively high for an industry that will always be relevant.

Hill-Rom. Enhancing outcomes for patients and their caregivers.

Growth Strategy:

HRC current strategy entails growing inside and outside the hospital. This entails advancing their strong brands, as well as their geographic footprint as HRC starts to gain traction internationally. They also need to participate in the larger growing market to meet customer's needs with innovated products. Currently, revenues for new products for 2017 totaled $150 million, and by 2020 HRC plans to roll out 13 new products. To stay on the cutting edge of the industry, HRC is consistently innovating products to enhance outcomes for patients and their caregivers. Research and development is a key factor in designing and implementing these products. R&D expenses for HRC have remained flat year over year spending $32 million, or 4.9% as a percentage



of revenue. As HRC is divesting in products that have low margins and growth rates, they are expanding in transforming their portfolio through select mergers and acquisitions that present attractive financial returns. By investing in M&A, they plan to diversify their portfolio to optimize the best returns possible. Another key area of focus is to drive core revenues and expand their operating margin 300 bps by 2020. Previous growth strategies have made operating margins increase 450 bps and increased core revenue by 3%; therefore, upper management has the room to further increase their returns.

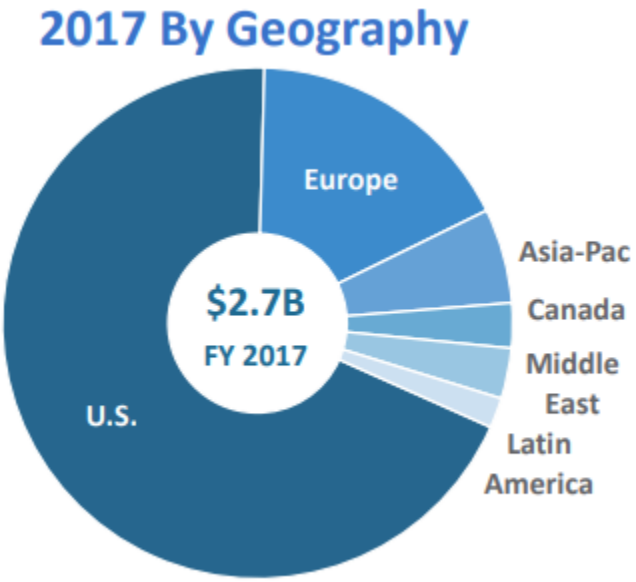
Business Segments:

As HRC diversifies their portfolio within their stable market, they set a solid foundation to accelerate revenue growth in the upcoming years. Patient support systems last year made up about 52% of their total business. This segment consists of bed systems and mobility and makes up a market size of $8 billion and a predicted growth rate of around 1% in the next year. This growth rate may be low, but HRC is planning on rolling out many more products in the following year, and also diversifies themselves in other markets to continue growth overall. The operating margins in this segment are 18.54%, and with the current divesting in this segment, should increase in the future. Through 2020, HRC plans to roll out four more products to continue growth and optimize patient needs. Some key achievements in the recent years for patient support systems was the launch of their Envella Air Fluidized Therapy bed, Accella bed system for higher acute patients in acute care settings, and the Centrella Smart bed, which is aimed at transforming care by providing increased patient safety, satisfaction and caregiver efficiency.

The front line care segment for 2017 made up about 32% of their total revenue. Front line care consists of physical assessment, patient monitoring and respiratory care products, which make up an aggregate market of $15 billion with growth rate around 2% - 4% in the upcoming year. These products are in consistent demand, and new innovative products will continue to drive growth within this segment. New product launches in this segment through 2020 total at seven products, and with operating margins at 24.96%, we could see value creation through this segment as the Mortara system synergizes within the company. The Mortara system has already increased gross margins by 20 bps. With this product line being the most aggressive, HRC should see solid revenue growth as well as front line care making up more of their total performance. In the most recent year, their front line care segment launched the Monarch Airway clearance systems, as well as Welch Allyn home blood pressure monitor.

Surgical solutions consist of surgical supplies and surgical products with an operating margin at 11.32%. The current size of this market is around $12 billion, and has a weighted grow rate of 3% - 4%. This is currently the smallest segment of the company, making up 16% of their total business, but has room to grow. In the most recent year, growth was not at its full potential due to the hurricane that impacted their surgical manufacturing plant. The main product driver in the previous year for this segment was the TruSystem 3000 mobile operating table, which should see some tailwinds looking forward.

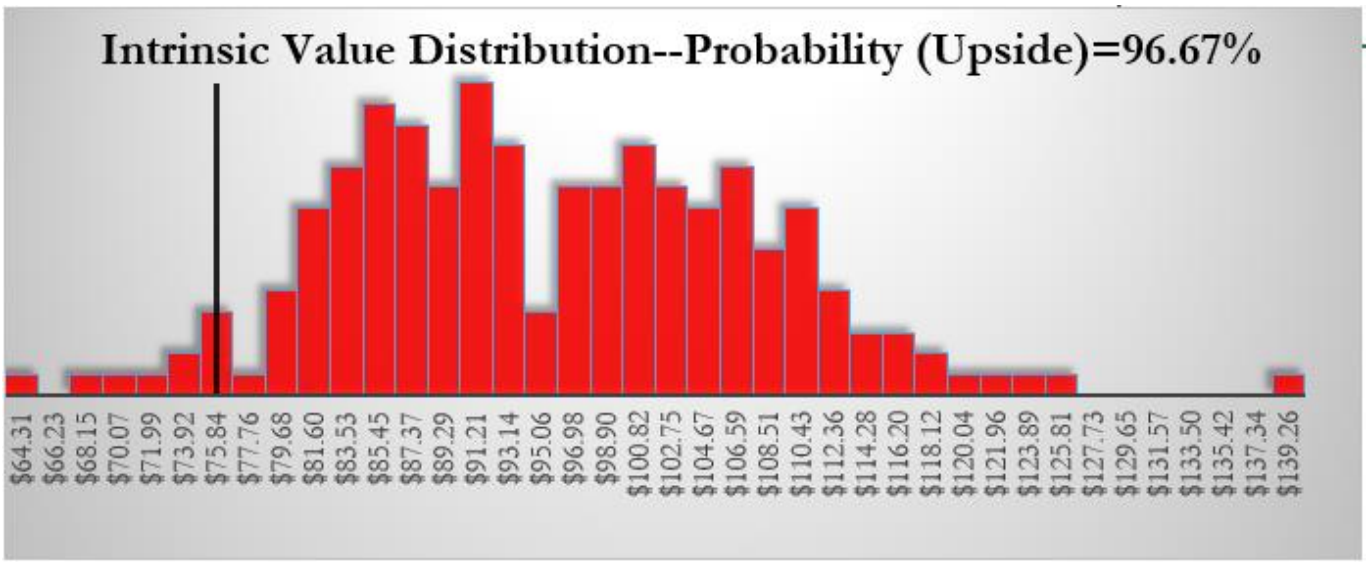
Geography Breakdown:



A part of HRC's growth strategy is to expanded internationally to diverse their portfolio and participate in the recent international healthcare market growth. The growth within this sector is stabile; therefore, diversifying internationally is a low risk move. Currently, revenue is driven mainly in the United States, accounting for about 69% of total revenue. International revenue makes up approximately 31% of total business and has been decreasing year over year due to divesting out of low margin and low grow sectors. The idea for HRC is to continually expand their footprint and expand the size of the market to gain as much traction as possible. Although their international business has been decreasing over the years, the total growth this year has been 5%, and domestic growth was 3%. Within the front line care segment; international revenue growth was 17% excluding Mortara. The reason for the growth in this sector was for competitive wins across this segment as well as the geographic expansion. The Middle East market was the main driver for the growth in this quarter, which offset softness in the European and Asian markets. Geographic expansion will be a significant key contributor to growth looking forward as HRC continues to expand and gain market share.

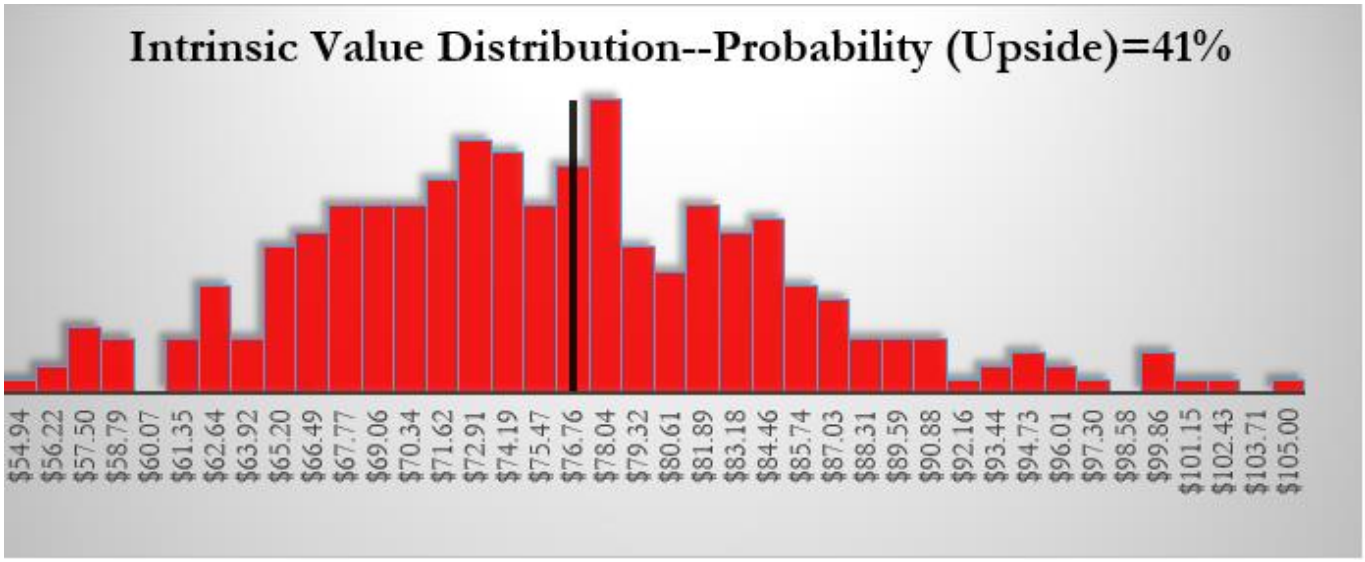
What-if Analysis:

Realistic Case:



The realistic case for HRC is to have revenue grow within guidance at 2.5%, and have operating margins converge to 76.7%, which is only a 3% reduction from the current target. I believe this is realistic because they have continued to reduce margins year over year and have seen strong revenue growth above 2.5% for many quarters. Historical operating margins have stayed relatively flat, but as HRC continues to divest out of low margin areas, their operating margins will increase. This case offers a 29.13% one-year return for a target price at $98.81.

Worst Case:



For the worst-case scenario, I predicted to have revenue grow at a low 1% and have operating margins stay the same as previous year at 79.9%. There is a very low chance of this scenario to happen because HRC should see some strong grow due to geographic expansion. As HRC's portfolio is diversifying, upper management is adding high margin product to drive growth in the future. The one-year return for this case is -3.75% with a target price at $73.52.

Conclusion:

As Hill-Rom continues their growth strategy, there will be value creation, especially in the front line care segment. This segment has the highest operating margins and is a growing segment of the business. By 2020, Hill-Rom is releasing most of their products within the front line care segment. New products are a huge revenue driver, and with a solid R&D team, they will continue to get more market share and increase revenues.

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Hill-Rom Holdings, Inc. (HRC)

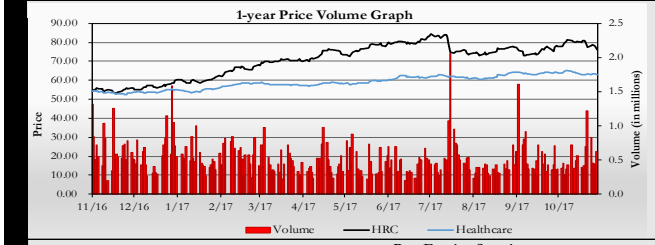
CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Hunter Sanna
11/17/2017

Current Price:	$76.93	Intrinsic Value	$85.04
Divident Yield:	0.7%	Target Price	$98.81

Target 1 year Return: 29.13%
Probability of Price Increase: 99.33%



Description

Hill-Rom Holdings, Inc. operates as a medical technology company worldwide.

General Information

Sector	Healthcare
Industry	Healthcare Equipment and Supplies
Last Guidance	November 3, 2015
Next earnings date	November 18, 2017
Estimated Country Risk Premium	4.88%
Effective Tax rate	35%
Effective Operating Tax rate	35%

Market Data

Market Capitalization	$5,068.20
Daily volume (mil)	0.32
Shares outstanding (mil)	65.88
Diluted shares outstanding (mil)	67.23
% shares held by institutions	84%
% shares held by investments Managers	72%
% shares held by hedge funds	4%
% shares held by insiders	0.63%
Short interest	1.42%
Days to cover short interest	1.91
52 week high	$84.65
52-week low	$52.58
Volatility	21.93%

Past Earning Surprises

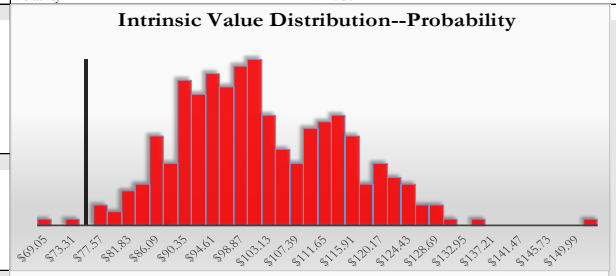
Quarter ending	Revenue	EBITDA
9/30/2016	0.47%	-47.94%
12/31/2016	0.06%	-2.95%
3/31/2017	4.55%	1.46%
6/30/2017	-0.72%	-0.96%
9/30/2017	1.00%	-4.36%
Mean	1.07%	-10.95%
Standard error	0.9%	9.3%

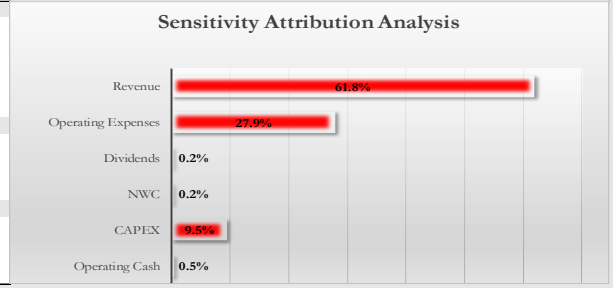
Peers

Intuitive Surgical, Inc.
Steris Plc
Teleflex Incorporated
Edwards Lifesciences Corporation
Hologic, Inc.
ResMed Inc.
Stryker Corporation
C. R. Bard, Inc.

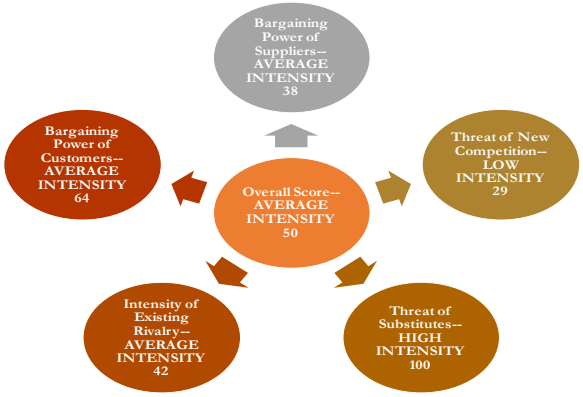
Management	Position	Total compensations growth	Total return to shareholders
Greisch, John	CEO, President & Director	5.5% per annum over 5y	1.45% per annum over 5y
Strobel, Steven	CFO & Senior Vice President	5.84% per annum over 1y	20.52% per annum over 1y
Rasin, Deborah	Chief Legal Officer, Senior	N/M	0% per annum over 0y
Shader, Alton	Senior Vice President, Presi	2.42% per annum over 2y	23.74% per annum over 2y
Lawrence, Timothy	Senior Vice President of Ope	N/M	N/M
Richardson, Jason	Chief Accounting Officer, Vi	N/M	N/M

Profitability	HRC (LTM)	HRC (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	6.1%	3.38%	11.36%
Operating Margin	8%	4.69%	13.06%
Revenue/Capital (GAAP)	0.81	0.72	0.87
ROE (GAAP)	7.9%	4.3%	12.6%
Net margin	4.4%	3.1%	13.1%
Revenue/Book Value (GAAP)	1.81	1.36	0.96
Invested Funds	**HRC (LTM)**	**HRC (5 years historical average)**	**Peers' Median (LTM)**
Cash/Capital	5.7%	6.6%	18.6%
NWC/Capital	11.1%	17.8%	9.5%
Operating Assets/Capital	40.1%	51.6%	48.5%
Goodwill/Capital	43.2%	24.0%	23.4%
Capital Structure	**HRC (LTM)**	**HRC (5 years historical average)**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.60	0.35	0.37
Cost of Existing Debt	3.9%	3.2%	3.4%
CGFS Rating (F-score, Z-score, and default Probability)	A	BBB	A
WACC	6.6%	7.5%	8.1%





Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	3%	12.5%	0.70
9/30/2018	4%	-3.5%	0.64
9/30/2019	4%	-2.8%	0.64
9/30/2020	4%	-0.8%	0.66
9/30/2021	4%	-0.4%	0.67
9/30/2022	4%	14.3%	0.68
9/30/2023	3%	14.2%	0.62
9/30/2024	3%	14.1%	0.58
9/30/2025	3%	14.0%	0.55
9/30/2026	3%	13.9%	0.52
9/30/2027	2%	13.8%	0.49
Continuing Period	3%	13.7%	0.47

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	8.8%	6.6%	$84.49
9/30/2018	-2.2%	7.7%	$98.36
9/30/2019	-1.8%	7.2%	$108.79
9/30/2020	-0.6%	7.5%	$119.65
9/30/2021	-0.2%	7.4%	$130.51
9/30/2022	9.7%	7.3%	$141.28
9/30/2023	8.9%	7.3%	$152.01
9/30/2024	8.2%	7.4%	$162.90
9/30/2025	7.6%	7.2%	$173.50
9/30/2026	7.2%	7.5%	$184.47
9/30/2027	6.7%	7.4%	$195.33
Continuing Period	6.4%	7.5%	