Owens & Minor (OMI)

Updated August 7th, 2018 by Nick McCullum

Key Metrics

Current Price:	$15	**5 Year CAGR Estimate:**	25.6%	**Volatility Percentile:**	85.1%
Fair Value Price:	$26	**5 Year Growth Estimate:**	8.0%	**Momentum Percentile:**	1.6%
% Fair Value:	58%	**5 Year Valuation Multiple Estimate:**	10.9%	**Total Return Percentile:**	99.1%
Dividend Yield:	6.7%	**5 Year Price Target**	$38	**Valuation Percentile:**	99.7%

Overview & Current Events

Owens & Minor is a healthcare logistics company that provides packaged healthcare products for hospitals and other medical centers. The company has a market capitalization of $1.1 billion and distributes ~220,000 different medical and surgical supplies to ~4,400 hospital systems worldwide. Owens & Minor has increased its dividend for 19 consecutive years.

In early August, Owens & Minor reported (8/7/18) financial results for the second quarter of fiscal 2018. In the quarter, the company generated consolidated revenues of $2.46 billion, which represents an 8.5% increase over the $2.27 billion generated in the same period a year ago. Contributors to this strong revenue growth include $128 million from the acquisition of Byram Healthcare and two months of revenue contribution from Halyard Health's Surgical & Infection Prevention (S&IP) business. Moving down the income statement, Owens & Minor generated adjusted consolidated operating income of $46.6 million, a 12.6% increase year-on-year. Adjusted net income was $19.4 million, or $0.32 per share, which compares poorly to the $0.43 in earnings-per-share generated in the second quarter of 2017.

Owens & Minor also provided some very disappointing guidance for the remainder of the fiscal year. The company now expects to generate adjusted earnings-per-share between $1.40 and $1.50. This is well below our prior estimate of $2.00. We have updated our 2018 and 2023 earnings-per-share estimates accordingly. Likely due to this weak guidance, Owens & Minor's shares fell by as much as 17% on the first trading day following the earnings release.

Per-Share Growth

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.63	$1.75	$1.94	$1.94	$1.74	$1.76	$1.61	$1.65	$1.84	$1.61	***$1.45***	***$2.13***
DPS	$0.53	$0.61	$0.71	$0.80	$0.88	$0.96	$1.00	$1.01	$1.02	$1.03	***$1.04***	***$1.25***

Owens & Minor's earnings-per-share are currently lower than they were in 2008. With that said, this does not tell the whole story. Sales per share and free cash flow per share have both compounded at ~3% per year during that time period. Owens & Minor has recently completed a number of promising acquisitions that should fuel its growth for the foreseeable future. Last year, the company closed (8/1/17) on the acquisition of Byram Healthcare, a $380 million purchase that generate $450 million in sales for the company and be earnings accretive in 2018. More recently, Owens & Minor announced (11/1/17) the acquisition of Halyard Health's surgical & infection prevention (S&IP) business for $710 million – the largest acquisition in Owens & Minor's history. The transaction closed in 1Q2018. Earnings should rebound next year as these two acquisitions begin to impact the company's financial results. Beyond that, we believe Owens & Minor should compound its earnings in the high single digits – around 8% per year – moving forward.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.9	15.0	14.9	16.0	16.7	19.3	21.3	21.0	19.5	18.7	***10.7***	***18.0***
Avg. Yld.	1.8%	2.3%	2.4%	2.6%	3.0%	2.8%	2.9%	2.9%	2.8%	3.4%	***7.0%***	***5.0%***

Using the midpoint of Owens & Minor's new 2018 financial guidance, the company is trading at a price-to-earnings ratio of 10.7. If the company's valuation can revert to 18 times earnings (near its 10-year average of 18.2 times earnings) over

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the next 5 years, this will add 10.9% to the company's annualized returns during that time period. Undervaluation has also lead to a remarkably high dividend yield. Owens & Minor's 6.7% dividend yield has a comparably low payout ratio of ~65% due to low earnings multiple being assigned to the company by the markets.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	40.4%	46.6%	44.3%	44.0%	41.8%	48.1%	42.8%	43.8%	43.7%	34.7%	***35.0%***	***40.0%***
Int. Cov.	11.3	15.4	13.7	14.9	14.7	15.1	8.7	7.4	7.4	2.8	***3.0***	***5.0***
Payout	32.5%	34.9%	36.6%	41.2%	50.6%	54.5%	62.1%	61.2%	55.4%	64.0%	***71.7%***	***58.7%***
Std. Dev.	27.0%	33.3%	16.0%	23.7%	18.1%	14.5%	14.0%	13.3%	22.5%	35.3%	***30.0%***	***20.0%***
Debt/A	61%	56%	53%	53%	56%	56%	64%	64%	65%	70%	***65%***	***60%***

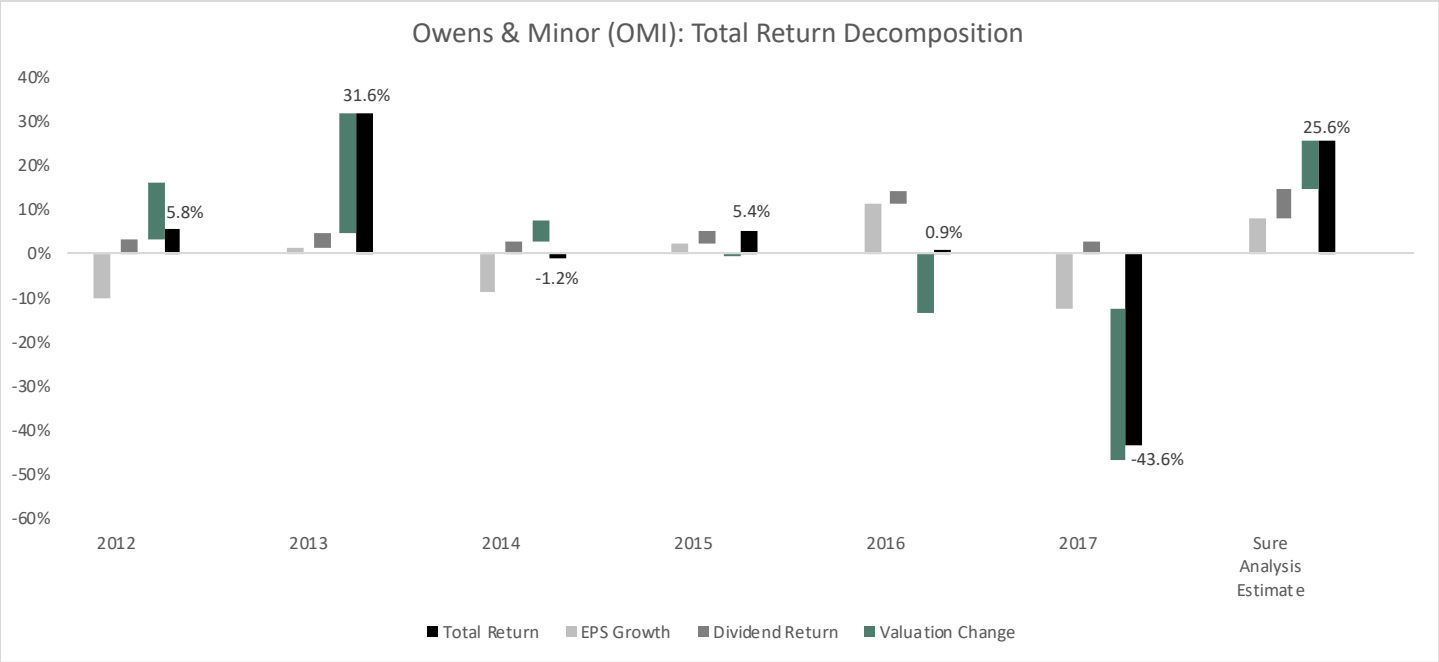
Owens & Minor has experienced a deterioration in several of its quality metrics in the last several years. Most notably, its dividend payout ratio has increased and its interest coverage ratio has fallen (because of the $450 million of new debt it acquired to fund the Halyard Health acquisition). These metrics should improve over the next several years.

Owens & Minor's competitive advantage comes from its entrenched position within the healthcare distribution industry and its strong relationships with customers. The company has a customer base of approximately 4,400 hospital systems and boasts an on-time delivery rate of 99%. Owens & Minor is also very recession-resistant. The company increased its adjusted earnings-per-share each year during the 2007-2009 financial crisis.

Final Thoughts & Recommendation

Owens & Minor's expected total returns are some of the highest in our coverage universe, driven by its potential for valuation expansion and its high dividend yield. With that said, some of the company's quality metrics have deteriorated in recent years. In particular, we find the company's recent drop in interest coverage – driven by debt issued to fund acquisitions – to be somewhat troublesome. If these acquisitions can be integrated successfully and if the corresponding cash flows are used to pay down the associated debt, Owens & Minor's stock should handsomely reward today's investors over the next 5 years. The company's strong total return potential combined with its leverage and recent poor operating performance make this stock a buy, but only for investors with a high risk tolerance.

Total Return Breakdown by Year



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