Stryker Corporation (SYK)

Updated July 27th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$214	**5 Year CAGR Estimate:**	8.5%	**Volatility Percentile:**	20.7%
Fair Value Price:	$182	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	87.6%
% Fair Value:	113%	**5 Year Valuation Multiple Estimate:**	-2.5%	**Growth Percentile:**	90.4%
Dividend Yield:	1.0%	**5 Year Price Target**	$304	**Valuation Percentile:**	33.1%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	46.9%

Overview & Current Events

Stryker is a global leader in the medical device sector. The company's product lines include surgical equipment, neurovascular products and orthopedic implants. The company was founded in 1941 by Dr. Homer Stryker because he felt that products that the medical device industry offered were not meeting the needs of his patients. Today, the company employs more than 33,000 people worldwide. Stryker trades with a market capitalization of $79 billion and generates more than $14 billion in annual revenues.

The company completed its $1.4 billion purchase of K2M in November of 2018. This acquisition will help Stryker take greater market share in the spinal surgery market.

Stryker reported financial results for the second quarter on 7/25/2019. The company earned $1.98 per share, which was $0.04 above estimates and a 12.5% increase from the previous year. Revenue increased 9.9% to $3.7 billion, which was $52 million above estimates. The negative impact from currency exchange reduced revenues by 1.6%.

Each division within Stryker continues to show growth. Orthopedics grew 3.7% (5.6% organic growth). Stryker installed 44 Mako robots globally, which was an increase of 13% from last year; 35 of these robots were located in the U.S. The company has an install base of more than 700 robots worldwide. Mako Total Knee procedures increased 80%. Knee procedures overall improved 6.6% while hip procedures were up 5.4%. MedSurg improved 11.1% (11.5% organic growth). U.S. instrument sales were higher by 19% while endoscopy was up 8.2%. Endoscopy's video business benefited from the company's high performance cameras gains. Sales for the Neurotechnology and Spine segment increased 18.9% (7.4% organic growth and 13.4% acquisition related growth). This segment benefited from the K2M integration. Stryker raised its guidance for the remainder of 2019. The company expects sales to grow 7.5% to 8% for the year, up from a range of 6.8% to 7.5% previously. Earnings-per-share is expected to be between $8.15 and $8.25. The midpoint of this forecast would represent a 12.6% increase from 2018.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.77	$3.33	$3.72	$3.39	$2.63	$2.36	$3.78	$4.35	$6.49	$7.28	***$8.20***	***$13.21***
DPS	$0.25	$0.63	$0.75	$0.90	$1.10	$1.26	$1.42	$1.57	$1.70	$1.93	***$2.08***	***$3.35***
Shares	398	39	381	381	378	379	373	375	374	373	***372***	***368***

Stryker has grown earnings per share at a rate of 14% per year since 2008. The company was very resilient during the last recession, only seeing a $0.01 decline in earnings in 2009. The company did see earnings declines in 2013 and 2014 as well, but growth quickly returned in the ensuing years. We estimate that Stryker can continue to see earnings growth of 10% annually through 2024 due to revenue gains throughout the company's businesses. This growth rate is a slight discount to the company's historical growth rate.

Stryker has increased its dividend at an average rate of almost 15% per year over the past 10 years, though that growth has slowed recently. The company increased its dividend by 10.6% for the 1/31/2019 payment. We see the payout rising to $3.35 per share by 2024, up from the current $2.08.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.1	15.7	14.8	15.8	25.9	35.2	25.2	25.4	28.7	22	***26.1***	***23.0***
Avg. Yld.	0.6%	1.2%	1.4%	1.7%	1.6%	1.5%	1.5%	1.4%	1.2%	1.2%	***1.0%***	***1.1%***

Shares of Stryker have increased $29, or 15.7%, since our 4/25/2019 update. Based off of updated guidance for 2019, shares trade with an earnings multiple of 26.1. Given the organic growth that the company is producing and the benefit from acquisitions, we are raising our 2024 target P/E to 23 from 22.4 previously. If shares reverted to our new target price-to-earnings ratio by 2024, then valuation would be a 2.5% headwind to annual returns over this time period. If Stryker were able to return to its average growth rate (14%), then shares would likely command a greater multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	9%	19%	20%	27%	42%	53%	38%	36%	35%	27%	***25%***	***25%***

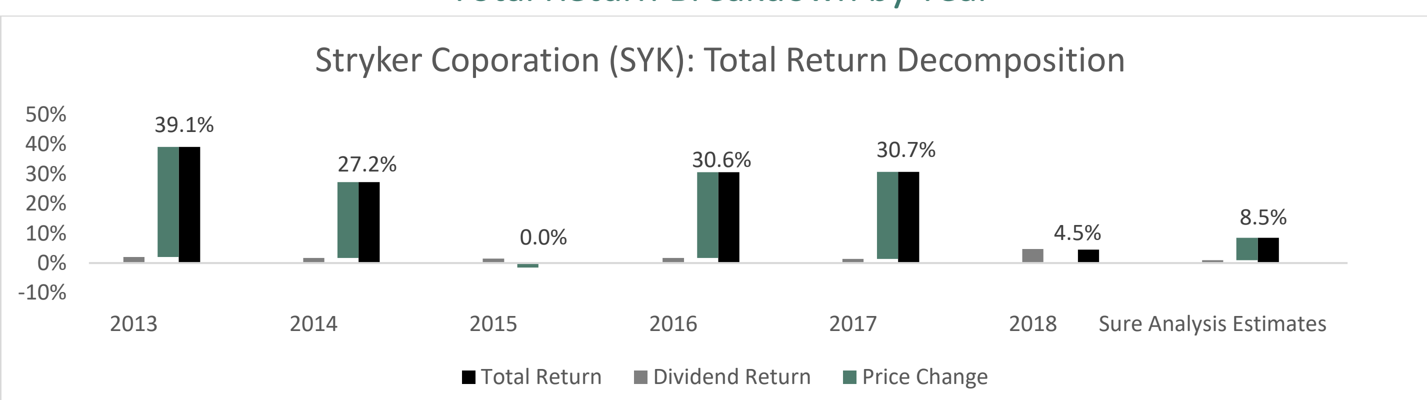
Stryker's strength during the most recent recession should give shareholders the confidence that the company can thrive in a difficult economic climate. As the leader in the medical device sector, Stryker's products are in demand around the world. For example, the company continues to see growth in its Mako robot installations, as well as a higher number of procedures performed. In addition, Stryker trained ~1,600 surgeons on using its robot during 2018. These figures are likely to grow as more surgeons become comfortable with using a robot during surgery.

Another competitive advantage Stryker has over its peers is its organic growth. Over the past 4 years, Stryker has averaged 6.4% organic growth while the medical device sector has averaged 4.2%. Investors are willing to pay up for that type of growth, which is why the company's price-to-earnings ratio has been higher than normal in recent years.

Final Thoughts & Recommendation

After second quarter results and the significant stock price increase since our previous update, we now expect shares of Stryker to return 8.5% through 2024, down from our previous estimate of 10.7%. While currency remains a slight headwind to results, Stryker continues to show high rates of growth throughout its business. The company's dominance in knee and hip procedures gives it an edge over its competitors. The Mako Robot continues to see an increase in uptake rates as more doctors and patients become comfortable using the device. Acquisitions are also adding to growth as seen in the Neurotechnology and Spine segment. The stock is slightly outside of our buy range, but we would encourage investors to consider purchasing Stryker on any pullback. We have increased our 2024 price target $11 to $304 due to guidance revisions and a higher multiple target. For now, Stryker is rated a hold.

Total Return Breakdown by Year



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Disclosure: This analyst has a long position in the security discussed in this research report.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	6723	7320	8307	8657	9021	9675	9946	11325	12444	13601
Gross Profit	4539	5034	5496	5876	6019	6356	6602	7495	8173	8938
Gross Margin	67.5%	68.8%	66.2%	67.9%	66.7%	65.7%	66.4%	66.2%	65.7%	65.7%
SG&A Exp.	2506	2707	3150	3367	3467	3547	3610	4137	4552	5099
D&A Exp.	385	223	282	277	307	378	397	546	642	723
Operating Profit	1661	1875	1762	1915	1878	2007	2157	2324	2463	2560
Operating Margin	24.7%	25.6%	21.2%	22.1%	20.8%	20.7%	21.7%	20.5%	19.8%	18.8%
Net Profit	1107	1273	1345	1298	1006	515	1439	1647	1020	3553
Net Margin	16.5%	17.4%	16.2%	15.0%	11.2%	5.3%	14.5%	14.5%	8.2%	26.1%
Free Cash Flow	1329	1365	1208	1447	1691	1549	711	1425	961	2038
Income Tax	517	456	341	407	206	645	296	274	1043	-1197

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	9071	10895	12146	13206	15743	17279	16223	20435	22197	27229
Cash & Equivalents	659	1758	905	1395	1339	1795	3379	3316	2542	3616
Accounts Receivable	1147	1252	1417	1430	1518	1572	1662	1967	2198	2332
Inventories	943	1057	1283	1265	1422	1588	1639	2030	2465	2955
Goodwill & Int. Ass.	1592	1775	3514	3566	5833	6204	5930	9864	10645	12726
Total Liabilities	2476	3721	4463	4609	6696	8684	7712	10885	12217	15499
Accounts Payable	200	292	345	288	314	329	410	437	487	N/A
Long-Term Debt	18	1021	1768	1762	2764	3973	3998	6914	7222	8486
Shareholder's Equity	6595	7174	7683	8597	9047	8595	8511	9550	9966	11730
D/E Ratio	0.00	0.14	0.23	0.21	0.31	0.46	0.47	0.72	0.72	0.72

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	13.3%	12.8%	11.7%	10.2%	7.0%	3.1%	8.6%	9.0%	4.8%	14.4%
Return on Equity	18.5%	18.5%	18.1%	15.9%	11.4%	5.8%	16.8%	18.2%	10.5%	32.8%
ROIC	18.4%	17.2%	15.2%	13.1%	9.1%	4.2%	11.5%	11.4%	6.1%	19.0%
Shares Out.	397.9	391.1	381	380.5	377.9	378.8	373.0	375.0	374.4	373.3
Revenue/Share	16.83	18.32	21.33	22.60	23.61	25.27	26.11	29.92	32.74	35.76
FCF/Share	3.33	3.42	3.10	3.78	4.43	4.05	1.87	3.76	2.53	5.36

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.