Value Investor INSIGHT
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Right Down the Fairway

The roll off of Covid-related impacts can make life difficult for analysts and shareholders contemplating a firm's long-term future. David Perkins explains why that dynamic may be creating opportunity in Thermo Fisher Scientific's stock.

When value investors talk about capital allocation, it's often in a negative context. A company is overpaying for an acquisition. Its capital-spending priorities are unclear or inconsistent. It should pay down debt rather than buy back stock. While management's capital-allocation skill is considered important, it isn't often lauded.

That's not the case when David Perkins of Ironvine Capital talks about Thermo Fisher Scientific. He certainly appreciates the company's leading positions in providing instruments, chemicals, lab supplies and value-added services to research organizations of all stripes. He values its highly recurring revenue streams, which account for over 80% of total sales. Its bias toward secular-growth markets like biopharma and life sciences is a clear benefit.

But what distinguishes the company in Perkins' eyes is the capital-allocation prowess of its management, led since 2009 by now 55-year-old CEO Marc Casper. Through a deft combination of organic growth and acquisition, Thermo Fisher has consistently under Casper expanded the products and services it offers, deepened its relationships with customers, and strengthened its competitive positions in attractive end markets. The proof is in the pudding. Organic revenue growth when Casper took over, says Perkins, was in the 3-5% annual range, while the company today expects that to be 7-9% over the next three to five years. By next year, he says, free cash flow per share is likely to have tripled over the past decade, from $7 to around $24 per share. Since Casper took over, the stock has been a 13-bagger.

While that doesn't seem like a fact pattern resulting in investor neglect, Perkins argues that the market is giving Thermo Fisher's stock short shrift. The culprit, he says, is worry about growth as Covid-related testing and treatment revenues roll off. Such revenues peaked in 2021 at $9.2 billion (out of $39 billion), but this year are expected to come in around $900 million (out of at least $45 billion). While short-term optics may suffer, he believes the company's long-term earnings power is intact – by 2024 he expects per-share growth in free cash flow to return to its historical low to mid-teens annual rate.

INVESTMENT SNAPSHOT

Thermo Fisher Scientific
(NYSE: TMO)

Business: Provides research instrumentation, equipment, consumables and services used in a wide variety of healthcare, life sciences and other enterprise applications.

Share Information (@3/30/23):

Price	**562.97**
52-Week Range	475.77 – 618.35
Dividend Yield	0.2%
Market Cap	$216.98 billion

Financials (TTM)

Revenue	$44.91 billion
Operating Profit Margin	19.1%
Net Profit Margin	15.5%

Valuation Metrics
(@3/30/23):

	TMO	S&P 500
P/E (TTM)	31.9	17.7
Forward P/E (Est.)	23.7	17.7

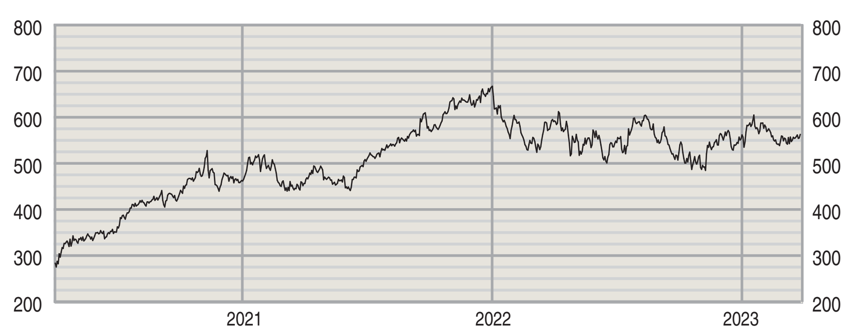
Largest Institutional Owners
(@12/31/22 or latest filing):

Company	% Owned
Vanguard Group	8.4%
BlackRock	8.0%
Capital Research & Mgmt	5.4%

Short Interest (as of 3/15/23):

Shares Short/Float	0.7%

TMO PRICE HISTORY



THE BOTTOM LINE

Management's uniquely impressive long-term record of creating value isn't adequately reflected in the company's current stock price, says David Perkins, who believes shareholder returns from today's level could compound at a mid-teens rate for many years to come.

Sources: Company reports, other publicly available information

One new component of that earnings power he highlights is the company's acquisition in December 2021 of pharmaceutical contract research organization PPD, Inc.: "They essentially took the windfall profits from Covid to make a $20 billion acquisition of a highly relevant and attractive business, turning something with a finite life into an enduring asset," he says. "That's a great example of the capital-allocation acumen here."

The stock at today's price of around $563 trades at a 4.3% free-cash-flow yield on Perkins' 2024 estimates. With that free cash flow growing at a 10% annual clip and with more than $25 billion in balance-sheet firepower, he believes shareholder returns could be in the mid-teens over the next several years. "This is right down the fairway of what we want to own and let compound," he says. VII

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