Stryker Corp. (SYK)
Stryker Analyst Meeting: Margins, Mako, and Mandates

Key Takeaway

Addressing the elephant in the room, SYK noted that it does not anticipate significant disruption from the possibility of an ACA repeal—though questions are likely to linger. The company laid out a 5-year model where it plans to leverage its above market top-line growth (5%+) into 30-50bps of annual leverage for at least 9% EPS growth. SYK also peeled the onion a bit on Mako, but whether the robot has broad resonance remains to be seen.

5-year outlook: best-in-class mid-single digit top-line with at least +9% EPS growth. Although SYK did not issue 2017 guidance, it did provide a longer-term outlook that calls for sustained top-line growth cat the high end of its peers (5%+) coupled with several cost control and efficiency initiatives to drive 30-50bp of annual op margin expansion and at least +9% EPS growth over the next 5 years. Top-line drivers will include Mako (more detail below) and other product initiatives, continued focus on M&A, and growth in several OUS markets where Canada was called out as accelerating and China was viewed as bottoming. On the cost side, product cycle management (with the goal of 20% of products account for 80% of sales through rationalization of legacy SKUs) and manufacturing and supply chain optimization were called out as a key GM drivers; shared services and ERP implementation were called out as key SG&A drivers. These various cost programs are designed to drive the aforementioned 30-50bps or annual margin expansion over the next 5 years, with the early years seeing lower contribution and ramping higher over time. The net of this translates to nearly $15n in revenues and north of $9 in EPS in 2021, which is largely reflected in our current forecasts.

Mako update: ultimate value still up for debate. To date, just over 300 Makos have been sold in the US, bringing hospital penetration to ~10%, with select sites having adopted multiple systems. Our key takeaway from the user panel was that the increased total procedure time can still be up to 15 minutes/case. The physicians on the analyst day panel were convinced that Mako did improve surgical outcomes, but the data to support this is still lacking and there is no way around the increased procedure time. In a busy practice of 5-7 procedures/day, the increased time can add an hour or more—resulting in potentially one fewer procedure (and the associated reimbursement) per day. Stryker is sponsoring a study that seeks to develop best practices using two physician cohorts: those with experience with Mako experience, but none on the Triathlon knee and visa-versa. Looking ahead, the company hopes to use the findings from the study to support the broader launch of Mako at next year’s AAOS meeting. Data on longer-term clinical outcomes to assess if there is a clinical benefit from using Mako remain years away. As such, the true value of the robot (clinical outcomes/cost) remain unproven and we remain skeptical on broad adoption.

On the election. With the Trump and broader GOP victories resulting in significant volatility across Healthcare and Medical Device on the notion that a repeal of the ACA is a foregone conclusion, Stryker addressed the issue by saying that it that in never saw a notably spike in either procedure volumes or capital spending following the implementation of the ACA; therefore a potential repeal does not necessarily represent a material headwind. Moreover, the company has successful competed and thrived under a variety of evolving payment models in the US and international markets and does not shy away from the uncertainty we are potentially heading into. The big questions under an ACA repeal scenario is what happens to the ~12mn newly insured and by association, procedure volumes? Lower insured volumes could equate to less healthcare service consumption which translates to more constrained hospital capital budgets. On the capital side, Stryker’s business model is diversified with only 15% of its overall revenues tethered to large and small capital purchases. Still discussions with management at the meeting did support the idea that hospitals have been on a healthier footing the past few years and demand for capital has been steady. It seems likely that the question on whether a disruption in the ACA will causes any softness around the margin for SYK and other equipment providers will remain a lingering concern.
Company Description

Stryker is the #3 player in the worldwide orthopedics market. Its sales are split 60/40 between reconstructive implants and Medical Surgery equipment (MedSurg).

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