

# Stryker Corporation

United States of America/Equipment & Services

**19 April 2017**

**UBS Research**

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## Strength in Robotic Surgery Systems Positive for SYK

ISRGDa Vinci Q1 placement trends bode well for SYK's MAKO robotic system. Intuitive Surgical (ISRG not covered) reported 133 da Vinci robotic surgical systems placed in Q1, vs. consensus of 120, raising 2017 guidance for procedure growth to 12-14% from 9-12%. We view the above-consensus robot placements as positive for SYK and its prospects for robotic surgery placements and OR capital equipment, representing a constructive anecdote pointing to a healthy market for robotic surgery sales. Based on our UBS Evidence Lab robotic surgery survey and many calls and conversations with surgeons over the past year, we continue to expect SYK's recent MAKO total knee application launch to drive significant share gains over the next 12-24 months. We reiterate Buy and \$135 target on SYK.

MAKO systems appear to be tracking ahead of estimates

As a reminder, the company reported on March 14 that more than 350 MAKO systems had been placed in the U.S., which was well above our Q1 estimate of 340. Given the healthy pace of placements, and the fact that capital equipment sales in particular are often back-end loaded in the quarter, we would not be surprised to see a strong system placement print next week when the company reports.

Hospital capex survey points to healthy cap ex environment

In addition to these data points from today and last month regarding robotic surgery trends specifically, we also view our UBS Evidence Lab hospital capex survey as positive on the margin for capital budgets. While budget allocations for robotic surgery remain only a small portion of total hospital capex spending for respondents to our survey, interest in robotic surgery platforms for orthopaedics and spine is encouraging, which we see as positive for SYK (MAKO robotic arm-assisted orthopaedic surgery system), as well as for Buy-rated GMED (Excelsius robotic spine surgery system) and MZOR (not-covered, Mazor X robotic spine surgery system, partner of Buy-rated MDT).

|                       |                 |
|-----------------------|-----------------|
| 12-month rating       | <b>Buy</b>      |
| 12-month price target | <b>\$135.00</b> |
| Price                 | <b>\$130.91</b> |

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### Trading data and key metrics

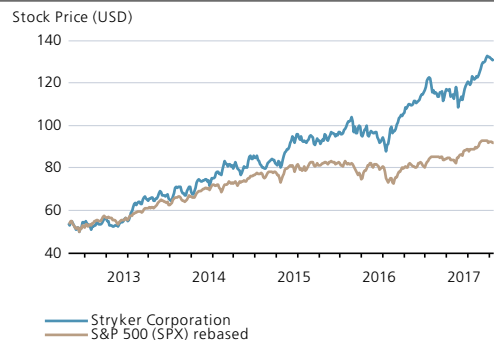
|                            |                   |
|----------------------------|-------------------|
| 52-wk range                | US\$132.83-106.68 |
| Market cap.                | US\$49.6bn        |
| Shares o/s                 | 379m (COM)        |
| Free float                 | 94%               |
| Avg. daily volume ('000)   | 328               |
| Avg. daily value (m)       | US\$41.9          |
| Common s/h equity (12/17E) | US\$11.0bn        |
| P/BV (12/17E)              | 4.4x              |
| Net debt / EBITDA (12/17E) | 0.4x              |
| RIC                        | SYK.N             |
| BBG                        | SYK US            |

Sources: UBS, Bloomberg

### EPS (UBS, diluted) (US\$)

|        | 12/17E |       |
|--------|--------|-------|
|        | UBS    | Cons. |
| Q1E    | 1.37   | 1.43  |
| Q2E    | 1.53   | 1.52  |
| Q3E    | 1.54   | 1.53  |
| Q4E    | 2.01   | 1.93  |
| 12/17E | 6.42   | 6.41  |
| 12/18E | 7.25   | 7.04  |
| 12/19E | 8.01   | 7.73  |

### Performance



Sources: Bloomberg, UBS

Definitions of terms and abbreviations are available in the appendix section of this report, and more extensively on internet at [www.ubs.com/glossary](http://www.ubs.com/glossary)

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# Stryker Corporation

## Company Profile: Stryker Corporation

Stryker is a global manufacturer and provider of medical devices and equipment for the treatment of musculoskeletal and spinal disorders, trauma, neurosurgery, endoscopy, general surgery and patient care.

### Statement of Risk

Our \$135 price target is based on a 13.5x EV/EBITDA multiple on projected 2018E EBITDA of \$3.8 bil. Risks to our price target include an unexpected slowdown in surgical volumes; pitfalls in integration of recent acquisitions; and greater than expected pricing pressure.

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| Highlights (US\$m)        | 12/14 | 12/15 | 12/16   | 12/17E  | 12/18E | 12/19E | 12/20E | 12/21E |
|---------------------------|-------|-------|---------|---------|--------|--------|--------|--------|
| Revenues                  | 9,675 | 9,946 | 11,325  | 12,321  | 13,217 | 13,986 | 14,669 | 15,327 |
| EBIT (UBS)                | 2,226 | 2,271 | 2,572   | 2,935   | 3,204  | 3,470  | 3,765  | 4,049  |
| Net earnings (UBS)        | 1,810 | 1,949 | 2,193   | 2,400   | 2,669  | 2,917  | 3,179  | 3,432  |
| EPS (UBS, diluted) (US\$) | 4.73  | 5.11  | 5.79    | 6.42    | 7.25   | 8.01   | 8.83   | 9.64   |
| DPS (US\$)                | 1.28  | 1.42  | 1.55    | 1.71    | 1.89   | 2.09   | 2.31   | 2.56   |
| Net (debt) / cash         | 1,027 | 57    | (2,945) | (1,415) | 330    | 2,281  | 4,427  | 4,427  |
| Profitability/valuation   | 12/14 | 12/15 | 12/16   | 12/17E  | 12/18E | 12/19E | 12/20E | 12/21E |
| EBIT margin %             | 23.0  | 22.8  | 22.7    | 23.8    | 24.2   | 24.8   | 25.7   | 26.4   |
| ROIC (EBIT) %             | 28.9  | 28.3  | 24.6    | 23.6    | 25.9   | 28.3   | 30.9   | 33.4   |
| EV/EBITDA (core) x        | 11.7  | 13.4  | 14.1    | 14.8    | 13.2   | 11.8   | 10.5   | 9.6    |
| P/E (UBS, diluted) x      | 17.6  | 18.7  | 19.1    | 20.4    | 18.1   | 16.3   | 14.8   | 13.6   |
| Equity FCF (UBS) yield %  | 4.9   | 1.7   | 4.4     | 4.7     | 5.2    | 5.7    | 6.2    | 6.7    |
| Net dividend yield %      | 1.5   | 1.5   | 1.4     | 1.3     | 1.4    | 1.6    | 1.8    | 2.0    |

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied.

Valuations: based on an average share price that year, (E): based on a share price of US\$130.91 on 18 Apr 2017 18:44 EDT

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| UBS 12-Month Rating | Rating Category | Coverage <sup>1</sup> | IB Services <sup>2</sup> |
|---------------------|-----------------|-----------------------|--------------------------|
| Buy                 | Buy             | 45%                   | 29%                      |
| Neutral             | Hold/Neutral    | 39%                   | 27%                      |
| Sell                | Sell            | 15%                   | 16%                      |

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2016.

| UBS 12-Month Rating | Definition                            |
|---------------------|---------------------------------------|
| Buy                 | FSR is > 6% above the MRA.            |
| Neutral             | FSR is between -6% and 6% of the MRA. |
| Sell                | FSR is > 6% below the MRA.            |

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#### Global Equity 12-Month Rating Definitions

**Buy:** FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

#### Key Definitions

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

#### Exceptions and Special Cases

**Core Banding Exceptions (CBE):** Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified the Companies Mentioned or Company Disclosure table in the relevant research piece.

#### Company Disclosures

| Company Name   | Reuters | 12-mo rating | Price      | Price date  |
|----------------|---------|--------------|------------|-------------|
| Stryker        | SYK US  | Buy          | US\$130.91 | 18 Apr 2017 |
| Medtronic      | MDT US  | Buy          | US\$80.33  | 18 Apr 2017 |
| Globus Medical | GMED US | Buy          | US\$30.42  | 18 Apr 2017 |

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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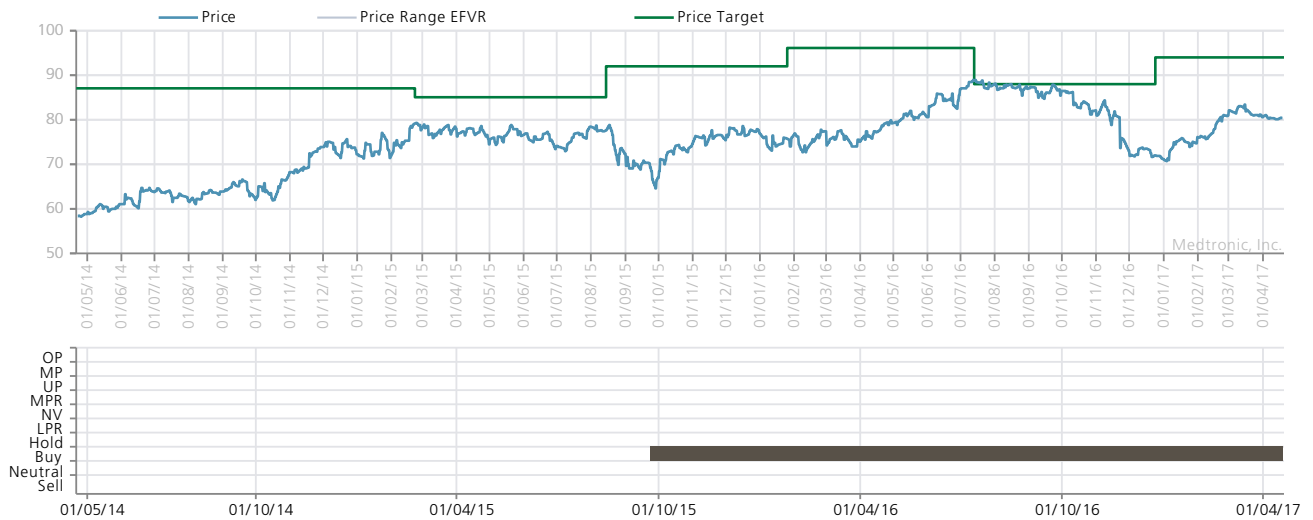
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## Global rating history -- Globus Medical, Inc. Class A, GMED US



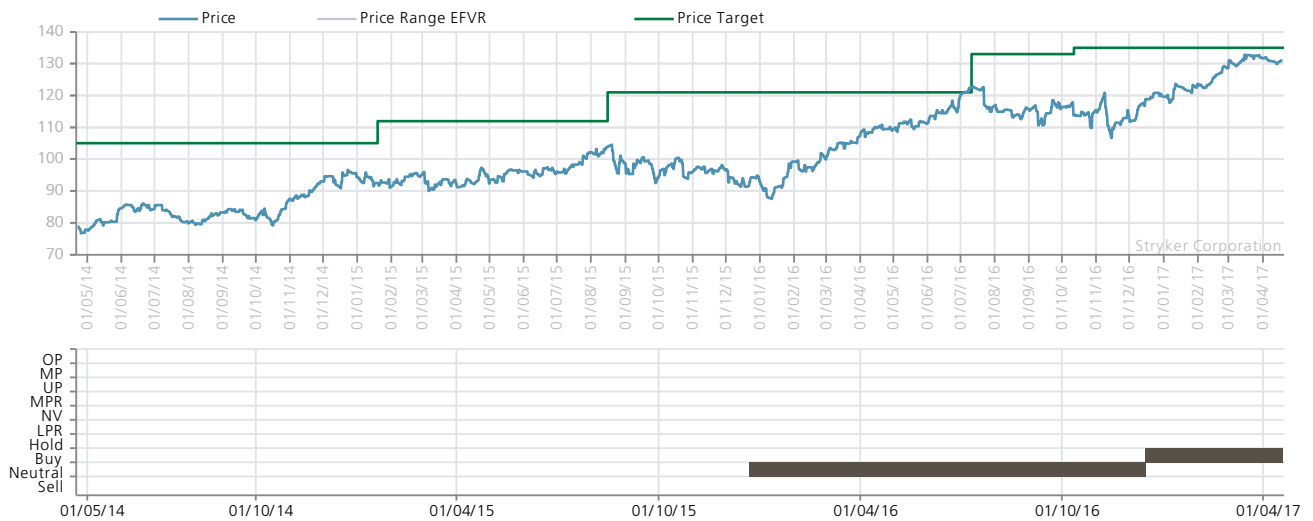
Source: UBS CIO as of 19 April 2017

## Global rating history -- Medtronic, Inc., MDT US



Source: UBS CIO as of 19 April 2017

## Global rating history -- Stryker Corporation, SYK US



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| Term / Abbreviation | Description / Definition | Term / Abbreviation | Description / Definition |
|---------------------|--------------------------|---------------------|--------------------------|
|---------------------|--------------------------|---------------------|--------------------------|

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| Term / Abbreviation              | Description / Definition   | Term / Abbreviation              | Description / Definition  |
|----------------------------------|--|----------------------------------|---|
| 1H, 2H, etc. or 1H11, 2H11, etc. | First half, second half, etc. or first half 2011, second half 2011, etc.   | 1Q, 2Q, etc. or 1Q11, 2Q11, etc. | First quarter, second quarter, etc. or first quarter 2011, second quarter 2011, etc.  |
| 2011E, 2012E, etc.               | 2011 estimate, 2012 estimate, etc.   | A                                | actual i.e. 2010A   |
| ADR                              | American depositary receipt  | ARPU                             | Average Revenue Per User  |
| AUM                              | Assets under management = total value of own and third-party assets managed  | Avg.                             | average   |
| bn                               | Billion  | bp or bps                        | Basis point or basis points (100 bps = 1 percentage point)  |
| BVPS                             | Book value per share = shareholders' equity divided by the number of shares  | CAGR                             | Compound annual growth rate   |
| Cant Inc/Capita                  | Cantonal income per capita (Switzerland only)  | Capex                            | Capital expenditures  |
| CF                               | Cash flow  | CFO                              | 1) Cash flow from operations, 2) Chief financial officer  |
| COGS                             | Cost of goods sold   | COM                              | Common shares   |
| Cons.                            | Consensus  | Core Tier 1 Ratio                | Tier 1 capital minus tier 1 hybrid securities   |
| Cost/Inc Ratio (%)               | Costs as a percentage of income  | CPI                              | Consumer price index  |
| CR                               | Combined ratio = ratio of claims and expenses as a percentage of premiums (for insurance companies)                  | CY                               | Calendar year   |
| DCF                              | Discounted cash flow   | DDM                              | Dividend discount model   |
| Dividend Yield (%)               | Dividend per share divided by price per share expected i.e. 2011E  | DPS                              | Dividend per share  |
| E                                |  | EBIT                             | Earnings before interest and taxes  |
| EBIT Margin (%)                  | EBIT divided by revenues   | EBITDA                           | Earnings before interest, taxes, depreciation and amortization  |
| EBITDA Margin (%)                | EBITDA divided by revenues   | EBITDA/Net Interest              | EBITDA divided by net interest expense  |
| EBITDAR                          | Earnings before interest, taxes, depreciation, amortization and rental expense                                       | EFVR                             | Estimated fair value range  |
| EmV                              | Embedded value = net asset value + present value of forecasted future profits (for life insurers)                    | EPS                              | Earnings per share  |
| Equity Ratio (%)                 | Shareholders' equity divided by total assets   | EV                               | Enterprise value = market value of equity, preferred equity, outstanding net debt and minorities  |
| FCF                              | Free cash flow = cash a company generates above outlays required to maintain/expand its asset base                   | FCF Yield (%)                    | Free cash flow divided by market capitalization   |
| FFO                              | Funds from operations  | FY                               | Fiscal year / financial year  |
| GDP                              | Gross domestic product   | Gross Margin (%)                 | Gross profit divided by revenues  |
| H                                | half year  | h/h                              | Half-year over half-year; half on half  |
| hist av.                         | Historical average   | Interbank Ratio                  | Interbank deposits due from banks divided by interbank deposits due to banks  |
| Interest Coverage                | Ratio that expresses the number of times interest expenses are covered by earnings                                   | Interest exp                     | Interest expense  |
| ISIN                             | International securities identification number   | K                                | One thousand  |
| LLP/Net Int Inc (%)              | Loan loss provisions divided by net interest income  | LLR/Gross Loans (%)              | Loan loss reserves divided by gross loans   |
| LPR                              | Least Preferred: The stock is expected to both underperform the relevant benchmark and depreciate in absolute terms. | Market cap                       | Number of all shares of a company (at the end of the quarter) times closing price   |
| m/m                              | Month-over-month; month on month   | mn or m                          | Million   |
| M and A                          | Merger and Acquisition   | MP                               | Marketperform: The stocks expected performance is in line with the sector benchmark   |
| MPR                              | Most Preferred: The stock is expected to both outperform the relevant benchmark and appreciate in absolute terms.    | n.a.                             | Not available or not applicable   |
| NAV                              | Net asset value  | Net Debt                         | Short- and long-term interest-bearing debt minus cash and cash equivalents  |
| Net DPS                          | Net dividends per share  | NIM or Net Int Margin (%)        | Net interest income divided by average interest-bearing assets  |
| Net Margin (%)                   | Net income dividend by revenues  | NV                               | Neutral View: The stock is expected to neither outperform nor underperform the relevant benchmark nor significantly appreciate or depreciate in absolute terms. |
| n.m. or NM                       | Not meaningful   | NPL                              | Non-performing loans  |
| OP                               | Outperform: The stocks is expected to outperform the sector benchmark  | Op Margin (%)                    | Operating income divided by revenues  |
| p.a.                             | Per annum (per year)   | P/BV                             | Price to book value   |
| P/E or PE                        | Price to earnings / Price Earnings Ratio   | P/E Relative                     | P/E relative to the market  |
| P/EmV                            | Price to embedded value  | PEG Ratio                        | P/E ratio divided by earnings growth  |

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| Term / Abbreviation | Description / Definition       | Term / Abbreviation  | Description / Definition   |
|---------------------|--------------------------------|----------------------|--|
| PPI                 | Producer price index           | Prim Bal/Cur Rev (%) | Primary balance divided by current revenue (total revenue minus capital revenue)                   |
| Profit Margin (%)   | Net income divided by revenues | q/q or QQQ           | Quarter-over-quarter; quarter on quarter   |
| R and D             | Research and development       | ROA (%)              | Return on assets   |
| ROAE (%)            | Return on average equity       | ROCE (%)             | Return on capital employed = EBIT divided by difference between total assets & current liabilities |
| ROE (%)             | Return on equity               | ROIC (%) or ROI      | Return on invested capital   |
| Shares o/s          | Shares outstanding             | Solvency Ratio (%)   | Ratio of shareholders' equity to net premiums written (for insurance companies)                    |
| sotp or SOTP        | Sum of the parts               | Tax Burden Index     | Swiss tax index; 100 = average tax burden of all cantons   |
| tgt                 | Target                         | Tier 1 Ratio (%)     | Tier 1 capital divided by risk-weighted assets; describes a bank's capital adequacy                |
| tn                  | Trillion                       | UP                   | Underperform: The stock is expected to underperform the sector benchmark                           |
| Valor               | Swiss company identifier       | WACC                 | Weighted average cost of capital   |
| CIO                 | UBS WM Chief Investment Office | x                    | multiple / multiplier  |
| y/y or YOY          | Year-over-year; year on year   | yr                   | Year   |
| YTD                 | Year-to-date                   |                      |  |

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