

Financial Analysis Sample

Equity report to assess the fair value of stock through fundamental and quantitative analysis using DCF methods.

Bizcon Services

FINANCIAL ANALYSIS OF SYNERGETICS INC.

Parameters	Details
Founding year	1991
Office	Headquarters – Synergetics USA, Inc., 3845 Corporate Centre Drive, O'Fallon, Missouri, USA, 63368
Website	www.synergeticsusa.com
Incorporation type	Public (Nasdaq – Ticker: SURG)
Revenue (2015)	\$75.0 million
Market Capitalisation	\$171.2 million (as on 15 October 2015, last trading day)
No of employees	418 (as of July 2015)
Geographic presence	US, Australia, France, Germany, Italy, UK

Source: Company reports and secondary research

OVERVIEW

US based, Synergetics Inc. (formerly Valley Forge Scientific Corp) is primarily engaged in supply of precision surgical devices for ophthalmic and neurosurgery markets. The US is the company's key market, whereas disposable products are the focus segment with more than 87% contribution to total sales. Within the US, the company markets its products through direct field force, whereas in the international markets it follows a combination of direct as well as distributor sales model.

BUSINESS SEGMENTS AND THEIR PERFORMANCE

The company operates through two key segments — Ophthalmic and Neurosurgery. At the end of the fiscal year 2015, ophthalmic segment contributed about 56% of the total revenue while neurosurgery accounted for around 42%. Within the ophthalmic market, the company is focused primarily on providing surgical products and procedures for vitreoretinal surgery. It faces competition from big and small companies operating within the ophthalmic surgical devices and equipment including Bausch & Lomb (subsidiary of Valeant Pharmaceuticals), Alcon (subsidiary of Novartis) and Iridex Corporation. *Source: Company reports*

Figure 1: Business-wise revenue contribution

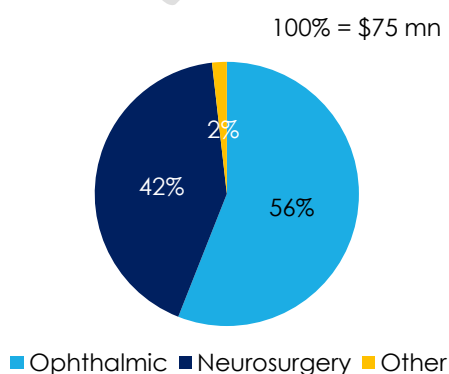
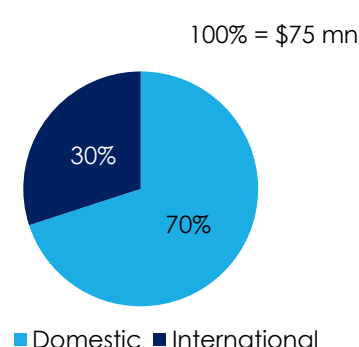


Figure 2: Region-wise revenue contribution



In the neurosurgery segment the company operates through OEM partners and distributors to drive sales of its products, with Codman and Stryker Corporation being two key long term contracts. Revenue derived from sales to Codman was 23% and from Stryker were 18% of the company's net sales in FY2015. In the neurosurgery segment, it faces competition for its bipolar electro-surgical systems and accessories sold by Codman from Valleylab division of Covidien Ltd., Kirwan Surgical Products, Inc., Erbe Elektromedizin GmbH and the Aesculap division of B. Braun Medical Inc. With respect to ultrasonic aspiration tips and accessories supplied to Stryker, the competition in this segment is from Integra Life Sciences Holdings, Corp., the manufacturer of the CUSATM and the SelectorTM ultrasonic aspirator systems, and Misonix, Inc.

SYNERGETIC'S RECENT ACQUISITIONS

With a history of growing in-organically, the company has expanded its markets and product portfolio through various targeted acquisitions. The most recent acquisition was of Sterimedix, pursuant to its strategy of further expanding its presence in the growing ophthalmic market.

Table 2: Deals completed by Synergetics from 2013-15

Company	Focus	Deal Value	Period
Sterimedix Limited	Manufacturer of cannulas for ophthalmic and non-surgical procedures	\$13.2 million	December 2014
Private Company	Original equipment manufacturing	\$1.4 million	May 2014
M.I.S.S Ophthalmics Ltd.	Ophthalmic distribution company	\$2.8 million	July 2013

Source: Company reports

INDUSTRY DATA

OPHTHALMIC SURGICAL INSTRUMENTS MARKET

Technological advancements are the driving factor for growth within the global ophthalmic surgical instruments industry. Driven by an increase in ophthalmic surgeries (~4%) and increasing acceptance of micro-incision surgeries, the overall market is growing at a rapid pace. Within this industry disposable instruments are gaining more prominence and are expected to grow at a CAGR of 7.1% as per the estimates provided by the market research firm, Market Scope. Synergetics has a strong presence within the disposables market where it derives more than 85% of its sales for such products.

In the ophthalmic surgical market, vitreoretinal surgical market the focus area for Synergetics has been pegged at \$1.3 billion in 2014, and is expected to grow at a CAGR of 4% during the

period 2014-2019 (source: Alcon presentation, June 2015). The overall ophthalmic surgical market is estimated to grow at CAGR of 5% for the period 2014-2019, and includes three main categories – Cataract, Vitreoretinal, and Refractive.

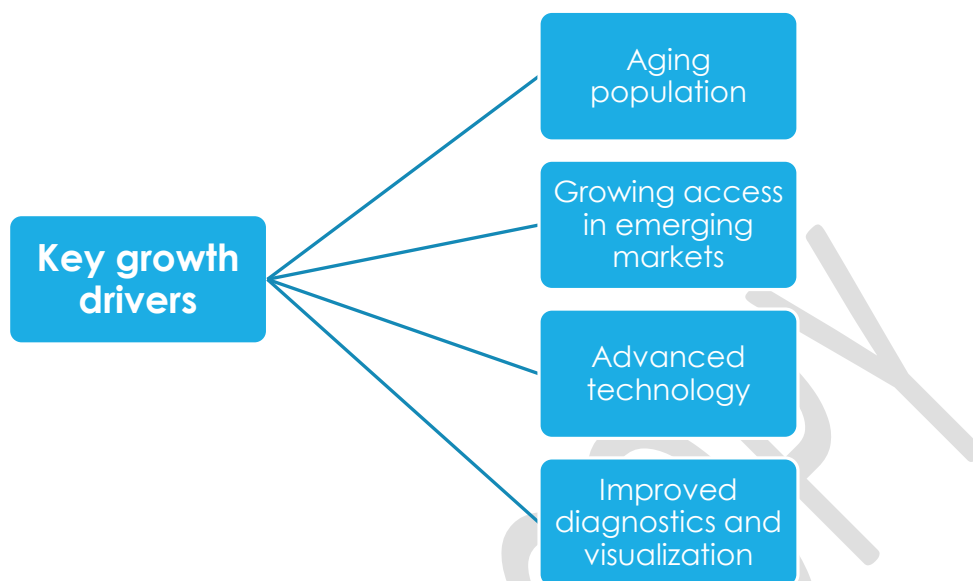


TABLE 4: KEY PLAYERS OPERATING IN OPHTHALMIC SURGICAL MARKET

Company	Region
Alcon Inc.	Switzerland
Abbott Medical Optics	US
Bausch & Lomb Inc.	US
Carl Zeiss Meditec AG	Germany
Haag Streit	Switzerland
Topcon Corporation	Japan
Johnson & Johnson	US
Essilor International S.A.	France
Nidek Co. Ltd.	Japan
Zeimer Ophthalmic Systems AG	Switzerland

Source: Ophthalmic Device Market Report by MarketsandMarkets.com dated April 2014

NEUROSURGICAL SURGICAL INSTRUMENTS MARKET

Global sales of neurological products are estimated to grow at ~4% driven by demand for advanced surgical techniques, an aging population and better technologies. The neurological surgical market is at present a small segment within the overall surgical instruments market. Synergetics at present derives more than 95% of its sales in the neurosurgery segment from its two supply agreements; one being with Codman and the other is Stryker Corporation.

FINANCIAL ANALYSIS

RATIO ANALYSIS

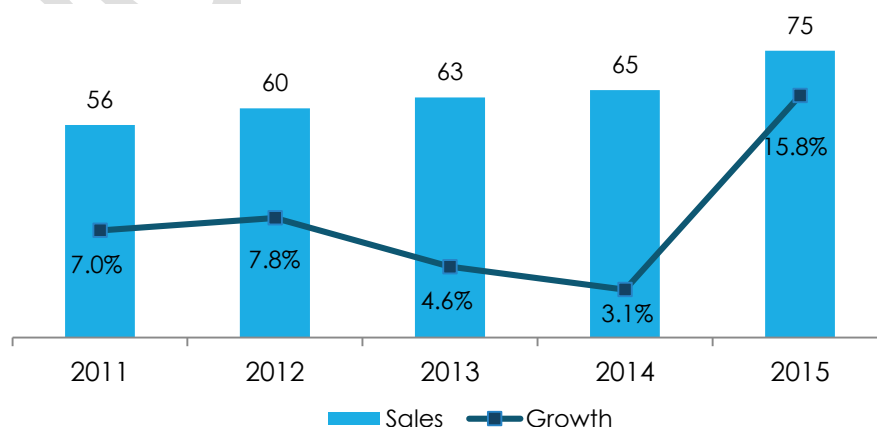
Ratios	2011	2012	2013	2014	2015
Current ratio	6.47	3.52	6.53	5.59	6.88
Quick ratio	6.24	3.31	6.21	5.21	6.41
Total assets to total debt	17.98	77.22	NM	NM	NM
Working capital turnover	2.96	3.89	2.60	2.58	2.49
Total asset turnover	0.71	0.68	0.76	0.76	0.76
Return on assets	0.08	0.07	0.07	0.03	0.04
Return on equity	0.13	0.11	0.10	0.04	0.05
Return on capital employed	0.12	0.10	0.10	0.04	0.05
Gross margin	57.6%	58.9%	57.5%	51.5%	55.9%
Operating margin	11.7%	15.0%	14.1%	5.9%	7.1%
Net margin	11.0%	10.1%	9.3%	4.1%	4.7%

Source: Calculated from reported consolidated company numbers

REVENUE ANALYSIS

The company's sales which had been growing in low single digits during the past two years, has seen a significant jump in FY2015 primarily driven by inorganic growth factors. Inclusion of the sales from the Sterimedix acquisition since December 2014 (Q2 2015) in the consolidated figures is the key reason for Synergetics to record a growth of 15.8% to \$75 million in sales during FY2015. Domestic sales grew by 9.9% in FY2015 vis-à-vis FY2014 due to higher OEM neurosurgery sales. In comparison international revenues jumped considerably (32.5%) in FY2015 as compared to last year due to addition on sales from the acquired Sterimedix business in the ophthalmic space.

Figure 3: Revenue and growth figures (\$, million)



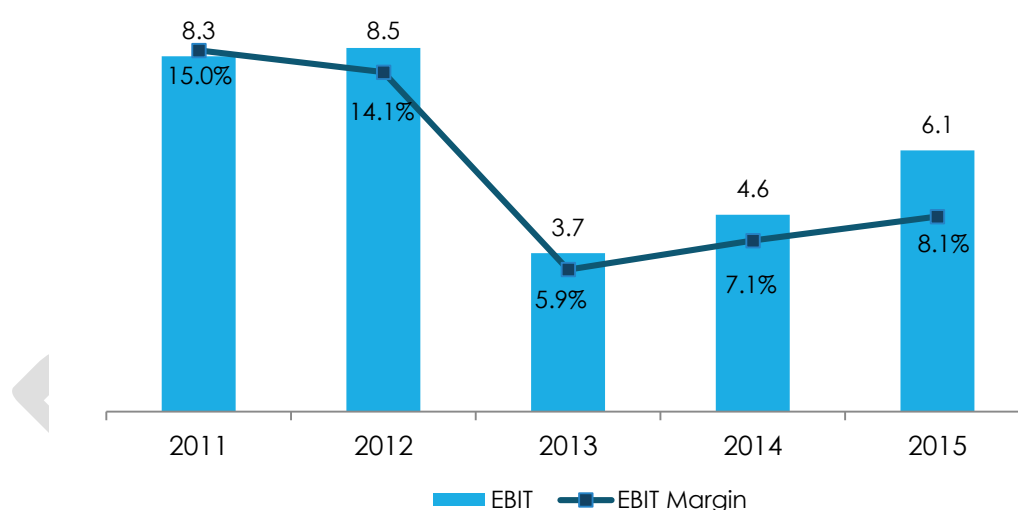
On the segmental analysis, ophthalmic sales recorded a growth of 12.1% in FY 2015 vis-à-vis FY2014, primarily backed by international sales (grew 28.3%) which contributed higher revenues due to addition of Sterimedix products. However, strong international growth was partially offset due to negative FX impact which led to otherwise lower foreign revenues from direct and distributor sales.

In the Neurosurgery OEM segment, sales increased by 18.1% driven by strong product sales across all categories to Codman, and strong product sales of disposable ultrasonic aspirator tips and related accessories to Stryker Corporation.

PROFITABILITY ANALYSIS

In FY2015, the company's operating margin increased by almost 100 basis points (bps) to 8.1% compared with 7.1% in FY2014. The margin expansion was primarily driven by considerable decrease in the R&D cost (was 5.7% of sales in FY2015 vis-à-vis 8.0% in FY2014) and improvement in sales and marketing expenses (lower in FY2015 to 20.5% of sales from 22.2% in FY2014). R&D expenses are expected to remain in the range of 6% to 8% from a going forward perspective as well as the company rationalises its product pipeline.

Figure 4: Operating profit and margin figures (\$, million)



The operating margin expansion was offset to some extent due to increase in cost of sales (from 44.1% of sales in FY2014 to 46.4% in FY2015) and higher administrative expenses (increased to 17.7% of sales in FY2015 from 16.9% in FY2014).

Net margin expanded considerably by 120 bps to 6.0% in FY2015 from 4.7% in FY2014. The improvement was a trickle down impact of the expansion in operating margin.

FINANCIAL POSITION

Total assets witnessed growth in 2015 to reach \$95.6 million, an increase of about 12.9% over 2014. The growth in total assets was largely attributable to significant increase in intangibles (from \$27.4 million to in 2014 \$38.8 million in 2015) and property and equipment (from \$8.8 million in 2014 to \$10.5 million in 2015) as a result of consolidation of the acquired Sterimedix assets. The growth was partially offset was a decrease in current assets (-4.5% y-o-y) mainly due a drop in cash balance (-22.9% y-o-y) which was used to pay for the acquisitions completed.

Liabilities in 2015 witnessed about 33.9% increase over 2014 to reach about \$27.2 million; the increase is largely due to 37.4% increase in current liabilities of the company, mainly accounts payables (61.2%) and accrued expenses (25.7% y-o-y). Despite the increase in current liabilities, current assets were more than sufficient to absorb the jump in 2015. Increase in total liabilities was also due to jump in long term liabilities (from \$13.2 million in 2014 to \$17.5 million in 2015) due to addition of a contingent acquisition liability to the tune of \$2.8 million.

FINANCIAL SUMMARY

(\$ thousand)	2011	2012	2013	2014	2015
Profit and Loss					
Net sales	52,010	55,657	60,014	62,796	64,769
Gross profit	29,960	32,781	34,519	32,371	36,229
Operating income	6,091	8,349	8,481	3,721	4,581
Net income	5,733	5,633	5,586	2,559	3,063
Balance Sheet					
Cash and cash equivalents	18,669	18,399	12,680	12,470	15,443
Total current assets	41,066	44,250	42,227	44,797	48,483
Property and equipment, net	8,044	8,561	9,239	8,962	8,785
Total assets	73,095	81,310	78,763	82,693	84,715
Total current liabilities	6,349	12,586	6,467	8,011	7,049
Total debt	4,065	1,053	-	-	-
Total liabilities	28,869	30,646	22,285	22,541	20,291
Total stockholder's equity	44,226	50,664	56,478	60,152	64,424
Total liabilities and equity	73,095	81,310	78,763	82,693	84,715
Cash Flow					
Cash from operating activities	27,309	4,787	(2,449)	3,665	5,666
Cash from investing activities	337	(2,341)	(2,034)	(3,758)	(2,560)
Cash from financing activities	(9,130)	(2,676)	(994)	137	97
Net change in cash balance	18,509	(270)	(5,719)	(210)	2,973
Closing cash balance	18,669	18,399	12,680	12,470	15,443

Source: Company reports

VALEANT PHARMACEUTICALS: DEAL STRUCTURE AND ANALYSIS

Valeant deal structure

Details	Comments
Date	Acquisition closed on October 14, 2015, and trading of Synergetics shares suspended
Acquisition price	\$6.5 per share, a premium of 48.1% over the stock's closing price prior to the deal being announced in September 2015
Total deal value	\$166 million
Mode	Cash deal
Additional payments	\$1 per share in milestones, with a 50¢-per-share bonus tied to an annual sales mark of \$55 million in ophthalmic products by June 30, 2018, and another 50¢ per share tied to annual ophthalmic sales of \$65 million by the same date; the 2nd milestone would be pro-rated for sales between the 2 targets

Source: Company press releases and research

DEAL RATIONALE

The acquisition of Synergetics has been undertaken by Valeant Pharmaceuticals to further leverage the position of its subsidiary company Bausch & Lomb's presence in the fast growing area of vitreoretinal (ophthalmic) surgery. Synergetics with its strong ophthalmic product portfolio was a strong fit for Valeant Pharmaceuticals, who intends on providing a broad array of surgical devices and instruments for catering to the needs of surgical retina patients and has been on a spending spree as a part of its growth strategy.

DEAL ANALYSIS

Based on our analysis of the company we conclude the deal was undervalued by approximately 40% at the present acquisition price. Based on our understanding the deal value should have been concluded around \$9.1 per share based on our valuation factoring in the company's strong fundamentals and high market potential in which it operates.

KEY INPUTS AND DRIVERS TO OUR VALUATION – **OPTIMISTIC**

Parameters	Details
Revenue	Grows at a CAGR of 7.8% for a five year period 2015-2020
Operating margin	Expands ~ by 200 bps to 10% in 2020 from 8% in 2015
Cost of equity	6.0%
WACC	5.9%
Terminal growth	2.0%
Intermediate growth	4.0%

Source: Model assumptions

DCF VALUATION - OPTIMISTIC

(\$, thousands)	Simplified forecasts										Terminal value
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	
EBIT	7,142	8,242	9,309	10,387	10,906	10,803	11,235	11,684	12,151	12,637	
Tax expense	1,680	1,832	2,205	2,337	2,454	2,431	2,528	2,629	2,734	2,844	
NOPLAT	5,461	6,411	6,411	7,104	8,050	8,372	8,707	9,055	9,417	9,794	
<i>Adjustments:</i>											
Depreciation and amortization	2,974	3,242	3,469	3,677	3,861	4,015	4,176	4,343	4,517	4,697	
Changes in working capital	-719	2,310	574	1,646	1,590	1,654	1,720	1,789	1,860	-1,935	
Capital expenditure	1,260	1,374	1,470	1,558	1,636	1,701	1,770	1,840	1,914	-1,990	
Free cash flow	6,456	5,969	7,836	7,578	8,685	9,032	9,393	9,769	10,160	10,566	2,73,204
Discount factor	0.94	0.89	0.84	0.79	0.75	0.71	0.67	0.63	0.59	0.56	0.56
Discounted free cash flow	6,094	5,318	6,589	6,015	6,507	6,387	6,270	6,155	6,042	5,931	1,53,350

Currency: USD \$

Total Value	2,14,657
Less: Debt	1,925
Add: Cash	18,315
Total value to shareholders	2,32,971
No of shares outstanding	25,362
Fair price per share	9.19

Reflects the deal was undervalued at \$6.5 in spite of a premium of more than 45% to the prevailing share price

DCF VALUATION - PESSIMISTIC

(\$, thousands)	Simplified forecasts										Terminal value
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	
EBIT	6,217	7,235	8,231	9,244	9,707	9,522	9,807	10,102	10,405	10,717	
Tax expense	1,680	1,832	2,205	2,337	2,454	2,407	2,479	2,554	2,630	2,709	
NOPLAT	4,537	5,403	5,403	6,026	6,907	7,115	7,328	7,548	7,774	8,007	
<i>Adjustments:</i>											
Depreciation and amortization	2,974	3,242	3,469	3,677	3,861	3,977	4,096	4,219	4,346	4,476	
Changes in working capital	-719	-2,310	-574	-1,646	-1,590	-1,638	-1,687	-1,738	-1,790	-1,843	
Capital expenditure	-1,260	-1,374	-1,470	-1,558	-1,636	-1,685	-1,736	-1,788	-1,841	-1,897	
Free cash flow	5,532	4,961	6,828	6,500	7,542	7,768	8,002	8,242	8,489	8,743	2,26,070
Discount factor	0.94	0.89	0.84	0.79	0.75	0.71	0.67	0.63	0.59	0.56	0.56
Discounted free cash flow	5,221	4,420	5,742	5,159	5,651	5,494	5,341	5,192	5,048	4,908	1,26,894

Currency: USD \$

Total Value	1,79,070
Less: Debt	1,925
Add: Cash	18,315
Total value to shareholders	1,97,384
No of shares outstanding	25,362
Fair price per share	7.78

Reflects the deal was undervalued at \$6.5 in spite of a premium of more than 45% to the prevailing share price