

IDEXX **LABORATORIES**

IDEXX Laboratories Research (2/12/19)

Description: The company was founded in 1983 and is headquartered in Westbrook, Maine and develops, manufactures, and distributes products and services primarily for the animal veterinary, livestock and poultry, dairy, and water testing markets worldwide. It operates through Companion Animal Group; Water Quality Products; Livestock, Poultry and Dairy; and Other segments. The company provides point-of-care veterinary diagnostic products, including instruments, consumables, and rapid assay test kits; veterinary reference laboratory diagnostic and consulting services; practice management and diagnostic imaging systems and services for veterinarians; and biological materials testing, and laboratory animal diagnostic instruments and services for biomedical research community. It also offers diagnostic and health-monitoring products for livestock, poultry, and dairy markets; products that test water for various microbiological contaminants; and point-of-care electrolytes and blood gas analyzers that are used in the human point-of-care medical diagnostics market.

Ticker: IDXX

Price: \$209.50

Market Cap: \$18.1B

Performance: +21.1% Y/Y

Essentially what you're investing in here is the future of the pet care industry as IDXX is the industry leader in this space. Before we even look at the company specifically it's best we look at the industry first.

The discretionary consumer spending market on household pets that has grown a whopping 200%+ since 1996 to \$72B, according to American Pet Products Association (APPA) data and should surpass \$75B in 2019. As of March 2017, a total of 89.7 million dogs were estimated to live in U.S. households as pets. In 2017, some 68% of all households in the United States owned pets, up from 56% in 1988.

Get a load of these stats we dug up:

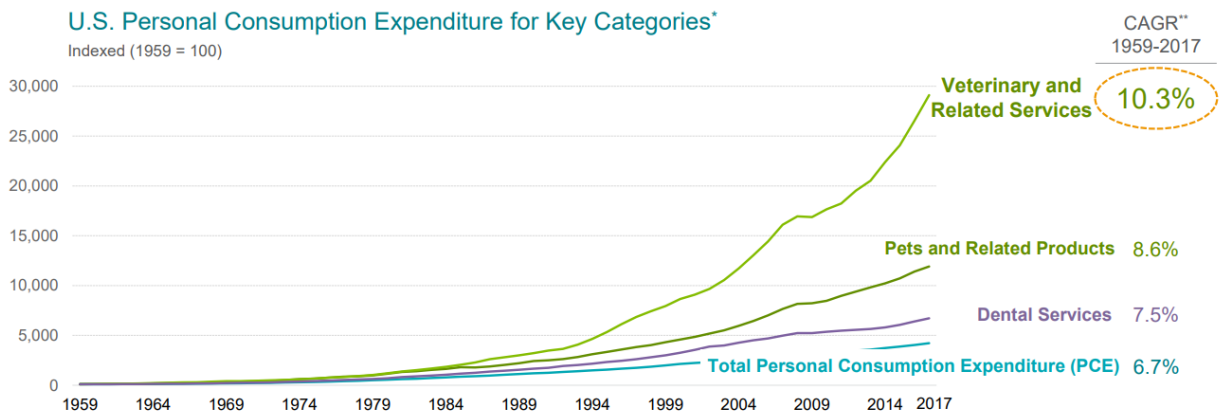
- Total spending on vet care in America in 2017 is estimated to reach \$16.62B, and that figure doesn't even include over the counter pet medication. The biggest expenses include:
 - Surgical vet visits which cost owners a yearly average of \$474 for dogs, \$245 for cats, and \$45 for birds.
 - Sick vet visits cost owners a yearly sum of \$204 for dogs, \$244 for cats, and \$138 for birds.
 - Emergency vet visits cost owners a yearly average of \$349 for dogs, \$154 for cats, \$107 for birds, and \$471 for horses.
 - Heartworm medication cost dog owners an average \$102 per year, while cat owners paid out \$65 per year. Horse owners paid an average of \$540 per year on hoofcare.
 - Routine vet visits which cost owners a yearly average of \$257 for dogs, \$182 for cats, \$102 for birds, and \$549 for horses.
 - Vitamins and supplements which cost a yearly average of \$58 for dogs, \$46 for cats, \$43 for freshwater fish, \$132 for saltwater fish, and \$40 for birds.
 - Medicated tick and flea control products cost dog owners an average of \$85 per year while cat owners paid \$77 per year. Bird owners paid \$49 per year on medicated shampoo and horse owners paid \$102 on insect control products.

Millennial and Gen Z Are Highly Sensitive to the Needs of their Pets



So we know the amount of money spent on pets has been growing dramatically over the years. What does the future look like? We'd say the trend should continue and honestly in our view probably only increase. As you can see in the chart above and the ones below, the next generations care more about animals than ever before and this means not only more animals under their possession but also more willing to spend to keep them healthy and living as long as possible. This plays into IDXX strong suit big time.

U.S. Market Backdrop: Pet-related Spending Growth has Significantly Outpaced Personal Consumption



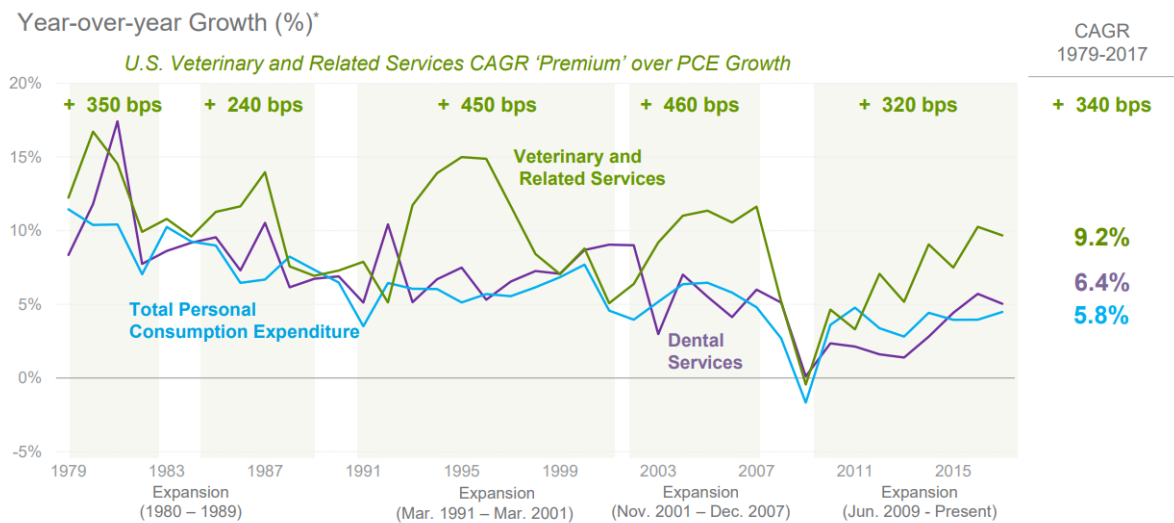
Yet, veterinary services, pets and related products together still comprise only ~1% of total consumption expenditure

* Analysis based on data from Bureau of Economic Analysis last revised on May 30, 2018. ** Compound Annual Growth Rate.

In the chart above, we see how much veterinary spending is outpacing other categories including total personal consumption. At a 10.3% compounded annual growth rate this trumps the 6.7% seen for total PCE.

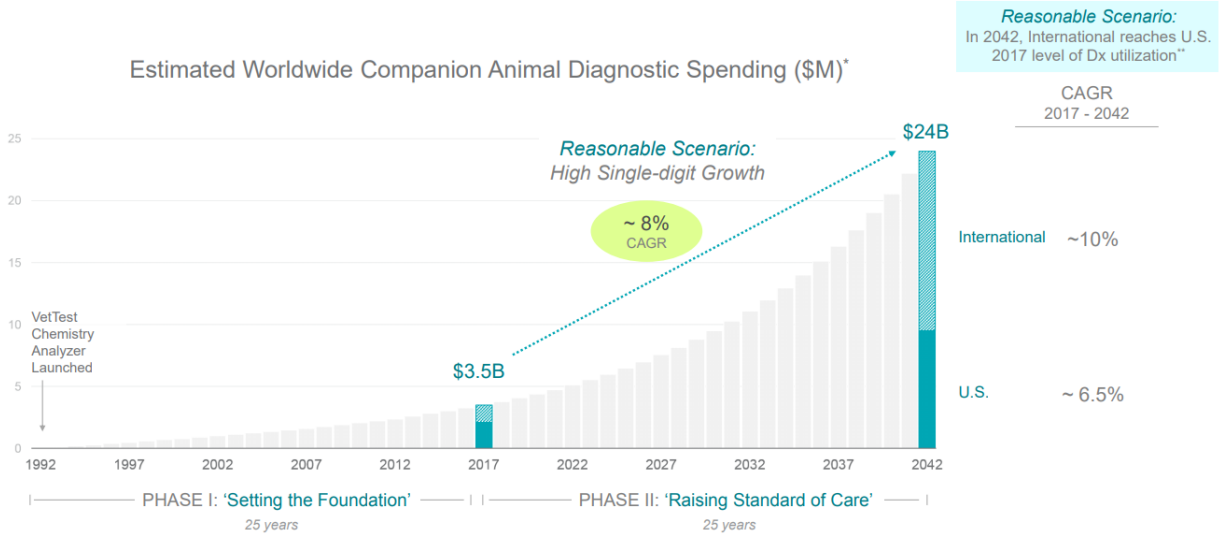
Looking ahead, how does spending in this field perform during market slowdowns? Not only has veterinary spending outpaced total personal consumption and spending since data dating back to 1979, it has also fallen less in recessions and gained more in expansions. As you can see in the chart below, over the last 40 years, veterinary spending has outpace total PCE and dental services by 3.4% and 2.8%, respectively. Also, during the last 40 years and including the Great Recession back in 2008/2009, veterinary spending never fell into negative territory. To make matters even crazier, in expansionary periods it severely outpaces the other two categories by 3-4% on average. In other words, there is less downside in this space when times are difficult and more upside when times are good – a very rare occurrence in today’s market.

U.S. Market Backdrop: Pet Healthcare Bounces Back Faster and Thrives during Expansions



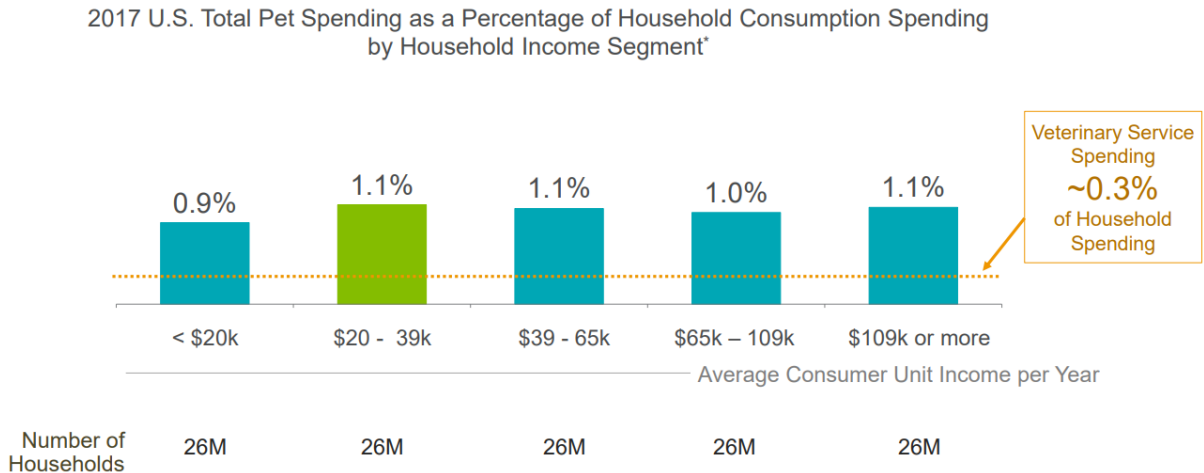
* Analysis based on data from Bureau of Economic Analysis, Personal Consumption Expenditure, last revised on January 26, 2018.

All Signs Point to a Second 25-Year Generational Macro-Cycle of Global Growth



As you can see in the chart above, IDXX believes the industry is just getting warmed up and actually sees international spending outpacing U.S. revenue by 3.5% at 10%. This is great for IDXX because they also have a large international presence and will capitalize on the growth in both regions.

Vet Healthcare Spending Averages 0.3% of Total Household Spending



* Analysis based on Bureau of Labor Statistics Personal Consumption Expenditure Survey, for 12 months ended June, 2017. Total Spending = \$7.4T USD.

Now that we covered the industry let's talk about IDXX itself. The best way to begin would be to go over their most recent earnings report on February 1st:

The company posted Q4 GAAP EPS of \$0.98 beating by \$0.08 on revenue of \$549.39M (+8.5% Y/Y) beating by \$3.04M.

- **Revenues by segment:**
 - Companion Animal Group: \$479M (+10.5% Y/Y)
 - Water: \$30.3M (+4.8% Y/Y)
 - Livestock, Poultry and Dairy: \$33.9M (-8.9% Y/Y)
- **Net Income: \$85.6M** (+123.5% Y/Y)
- **EPS: \$0.98** (+127.9% Y/Y)
- **Cash Flow From Operations: \$400.1M** (7.2% Y/Y)
- **Gross profits increased 10%**, and gross margin increased to 54.7% from 53.8% in the prior year period
- **Operating margin was 21.0% in the quarter**, 170 basis points higher than the prior year period results
- **2019 revenue outlook of \$2,385 million - \$2,425 million**, supported by reported revenue growth of 8% - 9.5% and organic revenue growth of 9.5% - 11%. At the foreign exchange rate assumptions in 2019 noted above, we continue to estimate that the effect of the stronger U.S. dollar will reduce full year 2019 reported revenue growth by approximately 1.5%, EPS growth by approximately 1%, and EPS by an estimated \$0.03 per share, including the net impact of projected hedge gains of approximately \$10 million in 2019.
- **Increased 2019 EPS outlook to \$4.66 - \$4.78 per share**, an increase of \$0.04 at the midpoint of the earlier guidance range, or targeted growth of 9% - 12% on a reported basis and 15% - 18% on a comparable constant currency basis. The Company is projecting free cash flow at approximately 60% - 65% of net income in 2019, including a projected \$70 million of capital spending related to completion of our Westbrook, Maine headquarters expansion and the relocation and expansion of our core laboratory in Germany. Spending for these two major projects was \$42 million in 2018. For 2019, the Company projects total capital spending, including these major projects, of approximately \$160 million - \$175 million.

Overall, they beat on pretty much every metric. Can't ask for much more from a company that posts a beat on revs, beat on EPS, growing margins, and a raised guidance.

As per usual, IDXX guides for another year of 10% rev growth:

Amounts in millions except per share data and percentages

	Guidance Range	Growth Definition	Year-over-year Growth
Revenue	\$2,385 - \$2,425	Reported	8 % - 9.5 %
		Organic Revenue Growth	9.5 % - 11 %
EPS	\$4.66 - \$4.78	Reported	9 % - 12 %
		Comparable Constant Currency	15 % - 18 %
Operating Cash Flow	~ 100% - 105% of net income		
Free Cash Flow	~ 60% - 65% of net income		
Capital Expenditures	~ \$160 million - \$175 million		

Let's now tackle the fundamentals here and compare them to similar companies in Neogen (NEOG) who provides a full line of consumable products dedicated to animal safety and Heska (HСКА) who provides core companion animal products, vaccines and pharmaceuticals:

	IDXX	NEOG	HСКА
Trailing P/E	49.2x	50.4x	129.6x
Forward P/E	44.4x	50.1x	49.2x
Forward Enterprise Value/Sales	7.8x	6.8x	5.0x
Rev Growth Average Last 4 Q's	10%	7.8%	-1.25%
PEG	2.4x	3.5x	2.0x
3 Year Performance	+211%	+77%	+197%

Alright, so what we're noticing here is that anyone pretty much attached to this industry has taken off. We only posted their 3 year returns but just for the sake of IDXX it is up 23,000% since they IPO'd in 1991....

So where do we go from here?

IDXX is a company that when we started research on we were baffled at how it trades at such a pricey valuation but the more research we did the more it became apparent that it does deserve a premium valuation for multiple reasons:

1. IDXX is by far the leader in the veterinary space
2. Consistent revenue growth of 10% over the greater part of a decade
3. Increasing margins
4. Growing industry
5. Shareholder friendly
6. Recurring revenue makes up large portion of total revs
7. Strong growth in bottom line
8. Top-notch management that meets and exceeds guidance regularly

Overall, we think IDXX is a pretty strong buy. It has climbed back in recent months after falling from \$254 to \$176 in December and is now back in the \$209 level. As far as trying to time an entry, there is support at \$196 as it is the 50 day moving average and some resistance at \$217.53 as that is the 200 day moving average. Right now the technical indicators like RSI, MFI, and Williams %R are showing its neither overbought nor oversold but we can see a small pull back to retest \$200 which in the grand scheme of things isn't too much percentage wise. We wouldn't try going crazy timing this as it is most likely best used as a long-term hold in ones portfolio.

Somethings to keep track of that can hurt this investment include any kind of slip up on managements part, shrinking margins, missed guidance, slowdown in revs/earnings, etc. as the 40x+ P/E is there because of how well management has been executing in this growing space and investors will have little tolerance for any mess ups given the premium valuation.