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ValueInvestor INSIGHT

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Intelligence Gathering

Long-term investors love sustainable competitive moats. Even better is when those moats are getting stronger, which Daniel Fields and Todd Morris of Polen Capital think is the case for medical-equipment titan Siemens Healthineers.

Investment manager Polen Capital has built a thriving business with what it calls a "defensive growth" approach, focused on identifying competitively advantaged companies capable of sustaining above-average growth over time horizons beyond what the typical investor considers. So it's worth noting when the managers of the firm's International Growth strategy, Daniel Fields and Todd Morris, highlight the increasingly sophisticated use of data as a way a number of their portfolio companies are widening and deepening their competitive moats. "In a world where the ability to capture and process data is greater than it's ever been, we see a number of companies we already find interesting using that ability to strengthen the connection they have with their customers," says Morris.

For fast-fashion retailer Inditex [Madrid: ITX], that means using real-time data from store managers, point-of-sale systems, product-tracking technology and an increasing proportion of e-commerce sales to better inform product design and distribution efforts. The payoff: creating high-demand, localized products that have better sell-through and require fewer discounts. Global athletic footwear and apparel company Adidas [Xetra: ADS] is investing in higher-margin, direct-to-consumer sales efforts through company-owned stores and online, using the vast amount of data captured from those outlets to drive product-development decisions and create deeper and more interactive relationships with customers. Contract researcher Icon [ICLR], which runs drug trials for biotech and pharmaceutical companies, has developed its proprietary "One Search" system to tap into electronic-medical-record data from a few key data partners to target geographic areas with the highest density of potential clinical-trial participants for any given study. This can reduce the time to successful trial conclusion, increasing the value of its outsourced services to customers.

Another firm using data to increase the

INVESTMENT SNAPSHOT

Siemens Healthineers
(Xetra: SHL)

Business: Global provider of products and services in the areas of laboratory and point-of-care diagnostics, molecular medicine, and diagnostic and therapeutic imaging.

Share Information
(@8/28/20, Exchange Rate: $1 = €0.84):

Price	**€$38.16**
52-Week Range	€28.50 –€47.27
Dividend Yield	2.1%
Market Cap	€38.11 billion

Financials (TTM):

Revenue	€14.73 billion
Operating Profit Margin	14.6%
Net Profit Margin	10.1%

Valuation Metrics
(@8/28/20):

	SHL	S&P 500
P/E (TTM)	25.7	36.2
Forward P/E (Est.)	20.5	26.7

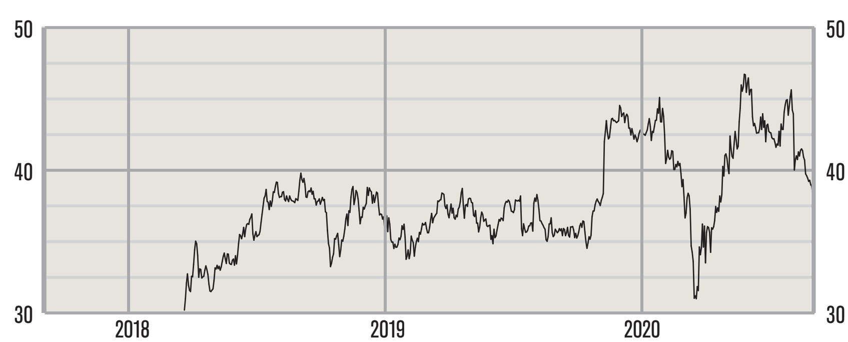
Largest Institutional Owners
(@6/30/20 or latest filing):

Company	% Owned
Primecap Mgmt	0.6%
Norges Bank Inv Mgmt	0.5%
Invesco Adv	0.4%
Vanguard Group	0.4%
T. Rowe Price	0.3%

Short Interest (as of 8/15/20):

Shares Short/Float	n/a

SHL PRICE HISTORY



THE BOTTOM LINE

While already poised to benefit from strong market positions and positive cyclical and secular trends, Todd Morris and Daniel Fields believe the company will also increasingly use its storehouse of proprietary data and images to further increase the value it delivers to customers. All in, they estimate its shares can deliver 12-13% compounded returns.

Sources: Company reports, other publicly available information relevance of its products and improve its competitive position is Siemens Healthineers, the medical equipment arm of Siemens AG that was spun off publicly in March 2018. The company has many fundamental attributes the Polen Capital managers already find compelling. Its most-important business – accounting for 60% of total revenues – is in medical imaging, where it's the leader in an oligopolistic global market that includes Philips and General Electric. It is also a large-scale player in diagnostics equipment and image-guided interventional tools, which like the company's imaging equipment are often sold with attached software and service contracts that generate highly recurring revenue from large installed bases. The company invests heavily in research and development to foster consistent product innovation, and its products typically have strong intellectual property protection.

The secular and cyclical backdrops for the company are attractive as well. Developing markets continue to spend incrementally more on healthcare. The increasing prevalence of cancer and heart disease in aging population bases should drive greater use of Siemens' equipment, says Fields, as should an increasing recognition in the medical and healthcare communities that preemptive imaging and diagnostics to catch diseases at an earlier point can lead to better patient outcomes with lower long-term cost. In imaging equipment, the average age of the installed base of machines in the U.S. is now over 10 years – two to three years past the recommended replacement age – which he expects to be a positive cyclical growth driver for the company once the stress on hospital budgets from the pandemic crisis starts to abate.

Morris and Fields also believe the company's recently announced $16.4 billion acquisition of California-based Varian Medical Systems makes considerable strategic sense. Varian primarily makes linear-accelerator equipment used to treat cancerous tumors with radiation. Integrating its product line into Siemens Healthineers' extensive global sales organization should result in both cost and revenue synergies, they say, and Siemens' expertise in building software and services revenues beyond equipment sales should transfer well to Varian's ongoing business. "The sell side seems to think doing a deal now isn't the best timing," says Fields. "Looking five to ten years out, as we do, we think the timing is going to turn out to be quite good." [*Note*: While Siemens AG currently owns 85% of Healthineers outstanding shares, the free float will increase as a result of the Varian acquisition because Siemens will not buy any of the new shares issued to complete the deal.]

For the moment, the company is best utilizing real-time data on its vast installed base to identify potential maintenance issues before they happen and to otherwise establish for customers predictive maintenance schedules that increase equipment uptime and decrease unexpected repair costs. More potentially game-changing longer-term are efforts to utilize its database of the more than 350 million images its machines have taken over the years to help doctors better interpret what they're seeing and offer them highly informed suggested potential courses of action based on the historical record. "That type of data access can significantly increase the value of being a long-term customer," says Morris, "making an already high-quality business even more so."

How does all of this translate into upside for Siemens Healthineers' stock, now trading at just over €38, nearly 20% off its 52-week high? Morris and Fields believe the company can deliver at least mid-single-digit revenue growth, which through operating leverage and an increased share of higher-margin services' revenues can yield double-digit bottom-line growth. Combined with a dividend yield of approximately 2% and the fact that the stock today trades at a "very fair" valuation, says Morris, he expects that to translate over several years into 12-13% annual total shareholder returns. VII

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This discussion is not intended as a guarantee of profitable outcomes. Any forward-looking estimates are based on certain expectations and assumptions that are susceptible to changes in circumstances.