

## Owens &amp; Minor

## Investing for future growth as cash flow resets

Reiterate Rating: UNDERPERFORM | PO: 19.00 USD | Price: 21.52 USD

## Cash flow will normalize as company repositions for 2028

OMI exited 2023 with management laying out a clear long-term strategy and driving record cash flow. However, 2024 will likely represent an investment-heavy year as the company further positions toward its 2028 targets. We expect FCF will normalize considerably in 2024, driven by inventory investments in: (1) new wins; (2) product expansion; and (3) higher service levels. The company is also increasing headcount, which contributes to a steep EPS ramp in 2024. Overall, we like the potential of the Patient Direct business in the long-term model, but we see near-term stock performance likely driven by cash flow and the margin trajectory. These two items will likely be weighed down in the short term by inventory build and greater headcount. OMI's broader turnaround will require a delicate balance of driving down costs, improving working capital and de-levering the balance sheet while investing to drive growth in a distribution market that remains broadly challenged. This embeds a healthy level of execution risk in the model over the mid term. We reiterate our Underperform rating, but raise our PO to \$19 from \$16 on ~5.5x CY24e EBITDA (previously 6x).

## Adjusting our FY24 revenue/EBITDA/EPS estimates

We reduce our FY24 revenue estimate from ~\$10.8Bn to ~\$10.7Bn with the decrease driven by lower P&HS (Products & Healthcare Services) revenue. We lower our FY24 adj. EBITDA estimate from \$597.4MM to \$568.7MM to reflect lower revenue. Finally, we adjust our FY24 EPS estimate from \$1.52 to \$1.53. The increase in EPS is driven by lower interest expense and lower diluted shares. With this note, we roll out our FY24 quarterly and FY27 annual estimates.

## Key themes for FY24: Utilization and margins

On a short-term basis, we continue to track the pace of hospital supply purchasing trends and elective procedure trends. We also look at the pace of PPE demand and how that could accelerate outside core markets. Aside from that, the key focus remains on broader execution on the recently reset long-term strategy to address operational challenges, including growing the distribution customer base, cross-selling private label, driving growth in PD, and improving margins in the P&HS segment. Additionally, balancing investments while reducing debt and improving working capital efficiency will be important as OMI looks to improve its cash flow profile.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	2.41	1.36	1.53	2.03	2.58
GAAP EPS	0.71	(0.54)	0.18	0.89	1.45
EPS Change (YoY)	-41.8%	-43.6%	12.5%	32.7%	27.1%
Consensus EPS (Bloomberg)			1.55	1.90	2.29
DPS	0.01	0	0.01	0.01	0.01
Valuation (Dec)					
P/E	8.8x	15.6x	13.9x	10.4x	8.2x
GAAP P/E	29.9x	NM	117.8x	23.8x	14.6x
EV / EBITDA*	6.9x	7.1x	6.6x	6.0x	5.5x
Free Cash Flow Yield*	9.8%	32.8%	9.0%	14.5%	18.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 8.

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20 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	16.00	19.00
2024E EPS	1.52	1.53
2025E EPS	1.89	2.03
2026E EPS	2.36	2.58
2024E EBITDA (m)	597.4	568.7
2025E EBITDA (m)	661.2	623.6
2026E EBITDA (m)	721.6	677.5

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## Stock Data

Price	21.52 USD
Price Objective	19.00 USD
Date Established	20-Feb-2024
Investment Opinion	C-3-7
52-Week Range	11.79 USD - 23.66 USD
Mkt Val (mn) / Shares Out (mn)	1,646 USD / 76.5
Free Float	97.2%
Average Daily Value (mn)	14.79 USD
BofA Ticker / Exchange	OMI / NYS
Bloomberg / Reuters	OMI US / OMI.N
ROE (2024E)	12.4%
Net Dbt to Eqty (Dec-2023A)	200.7%
ESGMeter <sup>TM</sup>	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

PPE – Personal protective equipment

# iQprofile<sup>SM</sup> Owens & Minor

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	9.5%	6.2%	6.2%	7.5%	8.5%
Return on Equity	19.5%	11.3%	12.4%	14.9%	16.7%
Operating Margin	3.7%	2.9%	3.3%	3.7%	4.0%
Free Cash Flow	158	533	147	236	295

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.8x	7.0x	3.1x	2.9x	2.5x
Asset Replacement Ratio	0.7x	0.7x	0.8x	0.8x	0.8x
Tax Rate	23.0%	26.1%	40.6%	37.7%	35.6%
Net Debt-to-Equity Ratio	255.2%	200.7%	167.7%	139.1%	111.6%
Interest Cover	2.9x	1.9x	2.4x	3.0x	3.6x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	9,955	10,334	10,664	10,938	11,211
% Change	1.7%	3.8%	3.2%	2.6%	2.5%
Gross Profit	1,919	2,125	2,234	2,297	2,377
% Change	26.8%	10.8%	5.1%	2.8%	3.5%
EBITDA	544	526	569	624	678
% Change	10.3%	-3.3%	8.2%	9.6%	8.6%
Net Interest & Other Income	(130)	(162)	(151)	(142)	(130)
<b>Net Income (Adjusted)</b>	<b>184</b>	<b>106</b>	<b>120</b>	<b>162</b>	<b>207</b>
<b>% Change</b>	<b>-40.5%</b>	<b>-42.7%</b>	<b>14.0%</b>	<b>34.6%</b>	<b>27.6%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	184	106	120	162	207
Depreciation & Amortization	229	287	280	282	286
Change in Working Capital	90	522	(7)	28	30
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(178)	(174)	(23)	(6)	(6)
Capital Expenditure	(167)	(208)	(224)	(230)	(220)
<b>Free Cash Flow</b>	<b>158</b>	<b>533</b>	<b>147</b>	<b>236</b>	<b>295</b>
<b>% Change</b>	<b>112.7%</b>	<b>236.3%</b>	<b>-72.5%</b>	<b>60.7%</b>	<b>25.3%</b>
Share / Issue Repurchase	0	0	0	(25)	(25)
Cost of Dividends Paid	(1)	0	(1)	(1)	(1)
Change in Debt	1,540	(417)	(192)	(115)	(75)

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	69	243	197	192	236
Trade Receivables	763	598	625	635	643
Other Current Assets	1,462	1,261	1,333	1,360	1,384
Property, Plant & Equipment	578	544	628	737	844
Other Non-Current Assets	2,513	2,447	2,317	2,268	2,257
<b>Total Assets</b>	<b>5,386</b>	<b>5,093</b>	<b>5,100</b>	<b>5,191</b>	<b>5,365</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	1,566	1,685	1,776	1,842	1,904
Long-Term Debt	2,483	2,098	1,905	1,790	1,715
Other Non-Current Liabilities	391	387	399	410	420
<b>Total Liabilities</b>	<b>4,441</b>	<b>4,169</b>	<b>4,081</b>	<b>4,041</b>	<b>4,039</b>
<b>Total Equity</b>	<b>946</b>	<b>924</b>	<b>1,019</b>	<b>1,150</b>	<b>1,325</b>
<b>Total Equity &amp; Liabilities</b>	<b>5,386</b>	<b>5,093</b>	<b>5,100</b>	<b>5,191</b>	<b>5,365</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 8.

## Company Sector

Healthcare Technology & Distribution

## Company Description

OMI is one of the largest medical and surgical supplies distributor in the US, including distribution as well as proprietary med-surg product assets. OMI's clients include hospitals, Integrated delivery networks (IDNs) and group purchasing organizations (GPOs), as well as home health agencies. OMI also offers various supply chain management services, logistics, and technology. The company is based in Mechanicsville, VA.

## Investment Rationale

Our Underperform rating is based on uncertainty tied to growth in Products & Healthcare Services and the ability to find a clear path for improvements. While the Patient Direct business trajectory remains solid, uncertainty on the core side leaves limited visibility into a return to total company outsized growth, in particular given what remains an uncertain broad-based demand environment for personal protective equipment (PPE).

## Stock Data

Average Daily Volume 687,444

## Quarterly Earnings Estimates

	2023	2024
Q1	0.05A	0.12E
Q2	0.18A	0.38E
Q3	0.44A	0.43E
Q4	0.69A	0.60E

# 4Q'23 call takeaways

## Prepared Remarks

- Closed 2023 with positive momentum and exited the year in a position of strength.
- Finished the year by launching a five-year strategic plan to drive growth and enhance profitability.
- During the year, delivered +\$40MM in operating model realignment benefits and exited the year at +\$100MM run rate.
- Patient Direct segment continued to outperform the market, showcasing the effectiveness of OMI's go-to-market strategies and healthy demand for home-based care.
- Products and Healthcare Services segment displayed sequential revenue and profit improvements from executing on strategic initiatives.
- In the Patient Direct segment OMI grew double digits, expanded profit contribution, furthered the integration of Apria, and invested in growth initiatives.
- In the Products and Healthcare Services OMI lowered costs, expanded services, and improved cash flow.
- 4Q'23 results:
  - Consolidated revenue of \$2.7Bn, up 4% y/y;
    - Patient Direct revenue of \$664MM, up 8% y/y driven by strong growth in a number of product categories;
    - Products & Healthcare Services revenue of ~\$2Bn, up 3% y/y with growth in both the Medical Distribution and Global Products divisions;
  - Operating income of \$60MM and adj. operating income of \$111MM;
  - GAAP operating income margin expanded by 436bps while adj. operating income margin expanded by 154 bps. This expansion was primarily driven by a larger income contribution from the Patient Direct segment;
  - Operating model realignment program annual run-rate of over \$100MM;
  - \$112MM of operating cash flow driven by strong working capital improvement and operating results;
  - Reduced total debt by \$49MM and net debt by \$76MM;
- FY24 guidance:
  - Revenue of \$10.5-\$10.9Bn;
  - Adjusted EBITDA of \$550-\$590MM;
  - Adjusted EPS of \$1.40-\$1.70;
  - Earnings trajectory to follow normal seasonal patterns



- 1/3 and 2/3 split from an earnings perspective from 1H and 2H and improvement in each sequential quarter.

- Patient Direct:
  - Technology investments include e-commerce enhancements and digital marketing;
  - Focus to grow outside of traditional areas and adjacencies;
  - Investments and execution will drive Patient Direct to grow above market rates.
- Products and Healthcare Services:
  - Scale in geographies and adjacencies;
  - Lowering cost to serve;
  - Optimizing distribution footprint and driving efficiencies.

## Q&A

- Personal protective equipment (PPE) inventory levels in hospitals:
  - Saw growth in both parts of the business in the quarter;
  - Within Products and Healthcare Services, seeing it level out within products services;
  - Demand has been consistent and starting to see a slight uptick;
  - Some customers have additional stock and is helping customers burn through that;
  - In 2024 expect to see a ramp in the upward direction;
  - Some categories seeing faster growth than others (surgical) and demand for PPE beginning to escalate.
- Key initiatives for model realigning plan is the manufacturing footprint- impact of the Red Sea?
  - Manufacturing footprint should not be in one geographic location;
  - Footprint today is primarily in the Americas (North America and Central America), gloves in Thailand;
  - Shipping channel is not impacted by issues in the market today;
  - Go through the Panama Canal to get to the east coast (OMI has pre-set slots to get through);
  - Have seen a one- to three-day delay at most;
  - Overall, the current situation in the Suez Canal is not an impact given OMI doesn't use this as a primary channel.
- EBITDA guidance for FY24 and assumptions (cost savings realignment):

- Operating model realignment – savings gained from that in addition to the run rate, the vast majority will be reinvested back into the business;
- Comfortable with the range of EBITDA and EPS for 2024;
- Patient Direct – aggressively adding commercial people and as OMI scales, this can drive long-term growth; continuing to add people in 1Q and 2Q. Teammates break even in 12 months before showing positive return
  - Focusing on the sleep journey;
- Product and Healthcare Services – investing in category management, expanding proprietary portfolio, investing in services such as data and analytics;
- Heading into 2024, feel good about where OMI reset (which reflects investments, normalization of personal protective equipment (PPE) pricing;
- Expect last in first out (LIFO) and stock-based compensation to normalize this year.
- Free cash flow and expectations for 2024 (directional guidance around working capital):
  - In 2024 expect cash flow to normalize, had an extraordinary year in 2023;
  - Expect to end the year with debt paydown slightly more than 3x;
  - Will be some investments of inventory in 2024 (new win implementation, proprietary product portfolio expansion, and driving ability to provide higher levels of service).
- New SKU launches highlighted during Investor Day to be more of a contributor in 2025 or near term:
  - More of a long-term driver.
- New medical customer win and contribution to guidance:
  - Start implementing in March;
  - Have not quantified the dollar amount, but is a meaningful win that will end up being a top 10 customer overall.
- Potential changes to continuous glucose monitor (CGM) reimbursement from Centers for Medicare & Medicaid Services (CMS)
  - Continue to watch;
  - Don't expect findings until 2025;
  - Don't expect implications at this point.
- Cadence of long-term guidance:

- Not linear;
  - Investments being made (around commercial and technology) – both will have associated benefits after they are implemented;
  - These have meaningful paybacks +12 months out;
  - Redeploying operating model savings;
  - Network optimization will take time to execute on;
  - 2024 is an investment year (midpoint of range still provides double digit growth) which will be balanced with investments in long-term and providing returns in the short term;
  - Beyond 2024, the network optimization could bleed into 2025;
  - Ramp should accelerate faster in the out years.
- Normalized free cash flow:
    - As OMI sees investments take place, should start to see improved cash flow;
    - Not sure it would be exactly linear, but would be a fair approximation.
- EBITDA add-backs:
    - ~\$50MM of add backs combined.

## Price objective basis & risk

### Owens & Minor (OMI)

Our \$19.00 price objective is based on approximately c.5.5x our CY24 EBITDA estimate. We think that this is the appropriate methodology to use given the company's elevated debt level, with the multiple at the low end of the historical trading range. We view this as appropriate given an uncertain growth reboot and margin pressures. On an EV/EVITDA basis, our PO is in line with the five-year average.

Downside risks to our PO are incrementally worse medical-surgical supplies pricing and volume pressure (including tied to the Covid outbreak), increased competition creating gross profit headwinds, the risk of Amazon or another disruptive force further disrupting the market, the inability to integrate the Apria deal on a timely basis, and the incrementally more difficult comps/growth from PPE.

Upside risks are any potential volume pickup, increases in buy-side/sell-side spreads, and further opportunities for synergy rationalization and cost savings beyond management's plan.

## Analyst Certification

I, Allen Lutz, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Healthcare Technology & Distribution Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Accolade	ACCD	ACCD US	Allen Lutz, CFA
	American Well Corp	AMWL	AMWL US	Allen Lutz, CFA
	Cencora Inc	COR	COR US	Allen Lutz, CFA
	CVS Health	CVS	CVS US	Allen Lutz, CFA
	Definitive Healthcare Corp	DH	DH US	Allen Lutz, CFA
	dentalcorp	YDNTL	DNTL CN	Allen Lutz, CFA
	Envista	NVST	NVST US	Allen Lutz, CFA
	HealthEquity Inc	HQY	HQY US	Allen Lutz, CFA
	Hims & Hers	HIMS	HIMS US	Allen Lutz, CFA
	McKesson	MCK	MCK US	Allen Lutz, CFA
	Omniceil Inc.	OMCL	OMCL US	Allen Lutz, CFA
	Patterson Companies	PDCO	PDCO US	Allen Lutz, CFA
	Progyny	PGNY	PGNY US	Allen Lutz, CFA
	R1 RCM	RCM	RCM US	Allen Lutz, CFA
<b>NEUTRAL</b>				
	Cardinal Health	CAH	CAH US	Allen Lutz, CFA
	Dentsply Sirona, Inc.	XRAY	XRAY US	Allen Lutz, CFA
	Doximity Inc	DOCS	DOCS US	Allen Lutz, CFA
	Teladoc Health	TDOC	TDOC US	Allen Lutz, CFA
<b>UNDERPERFORM</b>				
	GoodRx	GDRX	GDRX US	Allen Lutz, CFA
	Henry Schein	HSIC	HSIC US	Allen Lutz, CFA
	Owens & Minor	OMI	OMI US	Allen Lutz, CFA
	Premier, Inc.	PINC	PINC US	Allen Lutz, CFA
	Walgreens Boots Alliance	WBA	WBA US	Allen Lutz, CFA



## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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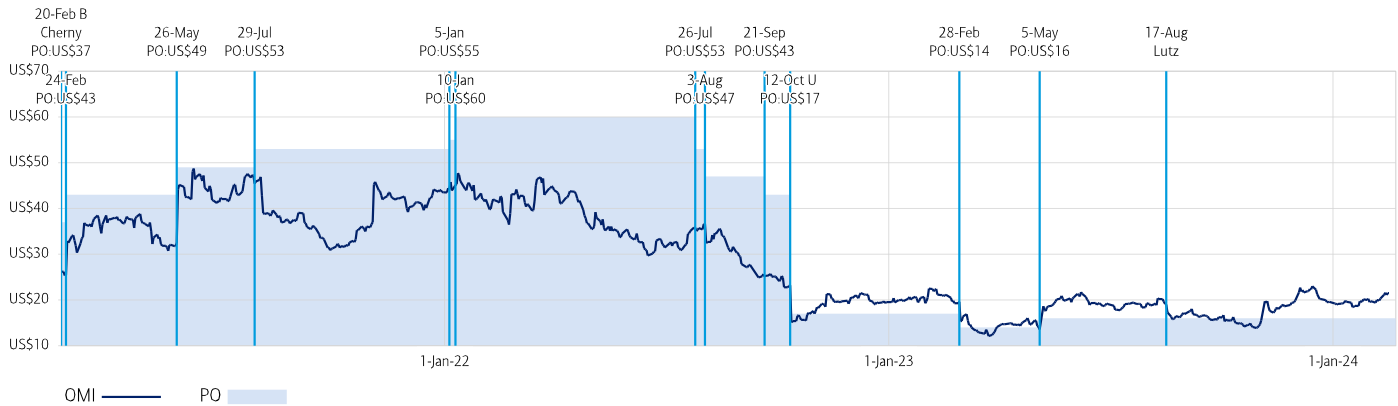
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# Disclosures

## Important Disclosures

### Owens & Minor (OMI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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