BofA SECURITIES

Intuitive Surgical

da Vinci 5 brings underappreciated market expansion with Xi trades

Maintain Rating: BUY | PO: 450.00 USD | Price: 388.27 USD

Xi trades redeployed can expand ISRG's market too

We see ISRG's new robot dV5 accelerating robotic surgery penetration to standard of care, but we also see dV5 creating some new market expansion too. The Xi's traded-in can be re-deployed to new market segments (many smaller US hospitals/ASCs still do not have robots). If 2,000 Xi's are redeployed over 3-5 years it could open another 200-500k procedures (100-250/system) or add 3-5 points of procedure growth/yr. This also puts ISRG robots in the hands of cost-conscious customers ahead of competitive launches. We previously looked at how the new system could impact the model here.

Xi trade-ins likely still have long useful life given leases

This is the first upgrade cycle post leasing making Xi redeployment more impactful (e.g., more total trade-ins and newer systems traded-in). The 2,227 systems under leases (25% of installed base) are likely some of the first traded-in for dV5 as leases create less friction for technology upgrades. And most of these 2,227 leased systems are less than 5 years old (leased installed base was 350 in 2018). These systems likely have 10+ years of useful life with a low cost base (leases amortize over 5-7 years). ISRG must still see Xi as a productive piece of the ecosystem given the new Xi manufacturing being built in Atlanta where ISRG can use lower cost engineering talent.

ISRG says first robot bought on belief, second on evidence

ISRG's US installed base has grown by 1.5x since 2019 but IDNs with 20+ systems has doubled (2x) since 2019 and hospitals with 7+ systems tripled (3x) since 2019. Much of the system growth has come from larger centers who have made the decision to fully standardize on robotic surgery (they have the analytics to see ROI/clinical value). With 6k plus US hospitals and ISRG's 5k systems very concentrated there are likely thousands of untapped centers. A lower cost Xi can help begin the process of validating the ROI of robotics and a gateway to eventual standardization too. As ISRG says the first robot is bought on belief and the second on evidence.

ASCs and international also opportunities

We see the most obvious Xi redeployment being US hospitals that have yet to take the first step. But international markets and ASCs are also obvious market segments where cost matters. As ISRG mentioned in our Sept 2023 CEO call (transcript here) the Xi is an incredibly efficient system and the architecture does not need to change for an ASC. The key drivers in an ASC are total efficiency of the program, total economics available to the ASC, and the types of procedures that get done. We think ISRG can likely make Xi more efficient over time to increase utilization. We maintain our Buy rating as we see ISRG EPS moving much higher as Da Vinci 5 scales and procedure growth expanding.

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Stock Data

Price	388.27 USD
Price Objective	450.00 USD
Date Established	24-Jan-2024
Investment Opinion	B-1-9
52-Week Range	222.65 USD - 392.00 USD
Mrkt Val (mn) / Shares Out (mn)	136,699 USD / 352.1
Free Float	99.5%
Average Daily Value (mn)	668.15 USD
BofA Ticker / Exchange	ISRG / NAS
Bloomberg / Reuters	ISRG US / ISRG.OQ
ROE (2023E)	16.7%
Net Dbt to Eqty (Dec-2022A)	-14.3%
ESGMeter™	High

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Abbreviations:

ASC: ambulatory surgery center
IDN: integrated delivery network
ROI: return on investment
dV5: da vinci 5 ISRG's new robot
Xi: da vinci Xi ISRG's current robot
ISRG: Intuitive Surgical

Timestamp: 27 February 2024 05:45AM EST

Excerpt on ASCs from our Sept 2023 ISRG CEO call

Travis Steed: When you think about other opportunities, you've got site of care as well inpatient, outpatient. I don't know if you have a sense for how many of your 5,000 US systems or even in an ASC or outpatient facility, but was curious how you think about the types of procedures going to being done in the ASC outpatient. How does robotics lend itself to those procedures, and is that an area that could be a bigger opportunity moving forward?

Gary Guthart: Yeah, we're seeing dynamics evolve in the US around those just to touch the definitions as we see them briefly. Inpatient in hospital, clearly, there's a lot of robotic-assisted surgery done that way. There's outpatient, but done in hospital settings. That is a very large fraction of what's done today. So outpatient indications done by hospital customers, it is huge. I don't know the exact number our team does, but it's not de minimis. It's a large fraction of what's done. And then there's ambulatory surgery centers, which are partnered-owned, sometimes have hospital partnerships, sometimes physician partnerships and da Vinci systems, and our products are in those settings too. Clearly, outpatient is growing relative to inpatient, and ASC is slowly growing relative to outpatient and inpatient differentially, in other words growing faster. You look at ASC environments, which is I think the thing that gets a lot of attention, and robotics works fine in environments. The same kinds of surgery are done, the actual physical tasks are completed. What the ORs look like is not all that different from what a hospital OR looks like. And what you're really looking for in those environments are a couple of things. One is that the economics and reimbursement have to work for everybody involved. So throughput and efficiency are really important. So we care about that, support our customers who do that. I think patient selection in those environments is highly important in terms of who's an appropriate patient to go into those settings. So we're exposed to it. We're excited by it. We don't think that there's some foundational thing that keeps it from happening or going faster. Some people think the robot architecture itself has to change to succeed in an ASC and I don't think that that's foundationally true, right. I think there are product design things that can help in the ASC, but it isn't foundational, it's not a key driver. The key drivers are total efficiency of the program, total economics available to the ASC, and the types of procedures that get done. The thing that I think is interesting there is robotic-assisted surgery has increased the volume of high quality, minimally invasive surgery available, and that actually makes procedures that used to be inpatient, available to be outpatient, and procedures that used to be outpatient hospital-based available to be well-known in an ASC. So robotics as a whole has given us some fuel to that transition, and product design will go with it. Workflow analysis will go with it and some reimbursement negotiation also goes with it. So I think it's an enabler. I don't think it's something that's a light switch that you flip the switch, and it goes. I think you have to do a lot of little things right to get it done, and we'll participate in that activity.

Travis Steed: So it sounds like you don't really need a new architecture, if you will for ASC, you can just make the system more efficient, and work on utilization, and all that. That's the right read on the ASC opportunity, in other words, the Gen 4 platform is what can be successful in that environment?

Gary Guthart: Yeah, the current XI version of Gen 4 is an incredibly efficient system. We sometimes hear you shouldn't use a tree or a cart it's going to be better off if it's on individual carts or rolling around. None of that is determinant for an ASC. Those aren't the real constraints. The real constraints are speed and efficiency period. Now if we and others can innovate around speed and efficiency however we do that, that will help ASC. So I'm not saying there isn't work to be done there is. It's just that there's some confusion that gets put into the market about what the determinants are. And its really not is it a tree or is it not a tree? It's really around the speed turnover efficiency to get that done. So do I think there's innovation there available? I do. Do I think it's as characterized sometimes in the broader landscape, media landscape? I don't.

Price objective basis & risk

Intuitive Surgical (ISRG)
Our $450 PO is based on roughly 50x our 2026E EPS. We think the premium multiple relative to average large cap peers is justified given ISRG's expected mid-teens top-line growth over the next several years, nearly 3x that of the medtech market, and ISRG is well ahead vs competition in one of the most significant growth markets in medtech (soft tissue robotics). ISRG pipeline also justifies our multiple as ISRG is spending over $500m a year in R&D and it's a matter of time before the fruits of these investments show up in estimates.

Downside risks are 1) lower surgical volumes due to covid, 2) slowdown in hospital capital spending, 3) other competitive entrants and 4) supply chain headwinds.

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Intuitive Surgical (ISRG) Price Chart

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Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

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