

Embecta

Fiscal Q1 beat doesn't change full year outlook as its more timing related

Reiterate Rating: UNDERPERFORM | PO: 17.00 USD | Price: 16.26 USD

FQ1 beat more a pull forward from FQ2

FQ1 WW revenue of \$277m (-0.3% y/y) was \$12m (5%) above Street. Of the \$12m beat, \$2m-\$3m was on better FX and \$9m-\$10m was pull-forward from FQ2 as US/Canada customers ordered ahead of EMBC's new ERP implementation. Pricing added about a point (\$3.4m) to growth. The US declined -0.5% in FQ1 but grew +0.9% ex-contract manufacturing headwinds. China grew mid-to-upper single-digits and EMBC expects to resume Chinese production for the China market later in FQ2.

FY24 guide broadly consistent; FQ2 lower on FQ1 beat

EMBC's FY24 organic revenue/margin guide is unchanged (flat to -2.0% CC revenue, 63-64% GM, 23.75-24.75% op margin, and 29.5-30.5% EBITDA margin). FY24 EPS guide increased to \$1.95-\$2.15 (from \$1.90-\$2.10) on FX/contract manufacturing revenue. EMBC's commentary suggests around \$265m in FQ2 revenue as pull-forward in FQ1 will reverse in FQ2. For FQ2, GM of ~63% and op margin of ~21-22% seem reasonable given the lower revenue base, and EMBC expects a step up in R&D from FQ1 to FQ2. For FQ2, interest/other expense of \$28m-\$29m and a ~21% tax rate suggests FQ2 EPS of \$0.35-\$0.40. FQ2 op margin will be the lowest of the year.

Patch pump; how EMBC sees it impacting the PNL

EMBC's open loop patch pump is in the early stages of FDA review and EMBC continues to work on the closed loop patch pump. EMBC has been working on setting up commercial production and has already selected a contract manufacturer to help. It also has a pilot production line already making devices at its R&D site. We estimate EMBC is spending ~\$80m on patch pump R&D today. Post approval, these R&D dollars likely get reallocated to closed loop clinical studies. EMBC doesn't think it will need to initially add a lot of sales people at launch. It will eventually need to add call centers / support / other infrastructure, but this spend will be more in FY25+ vs a FY24 event.

We update our model for FQ1 results

We update our model for FQ1 results. Our FY24 EPS goes to \$2.05 and FY25 EPS to \$2.12. We reiterate our Underperform rating as EMBC's cash flow value looks fully reflected in the current valuation.

Estimates (Sep) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.87	3.00	2.05	2.12	2.21
EPS Change (YoY)	-46.1%	-22.5%	-31.7%	3.4%	4.2%
Consensus EPS (Bloomberg)			2.25	2.21	2.44
DPS	0.15	0.60	0.60	0.60	0.60
Valuation (Sep)					
P/E	4.2x	5.4x	7.9x	7.7x	7.4x
Dividend Yield	0.9%	3.7%	3.7%	3.7%	3.7%
EV / EBITDA*	6.4x	5.9x	6.9x	6.8x	6.6x
Free Cash Flow Yield*	41.5%	4.4%	1.0%	16.5%	16.6%

* For full definitions of *IQmethod*SM measures, see page 5.

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11 February 2024

Equity

Key Changes

(US\$)	Previous	Current
2024E Rev (m)	1,094.7	1,105.2
2025E Rev (m)	1,099.9	1,110.4
2026E Rev (m)	1,105.0	1,115.6
2024E EPS	2.00	2.05
2025E EPS	2.13	2.12
2026E EPS	2.23	2.21

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Stock Data

Price	16.26 USD
Price Objective	17.00 USD
Date Established	18-Oct-2023
Investment Opinion	C-3-7
52-Week Range	12.72 USD - 33.88 USD
Mkt Val (mn) / Shares Out (mn)	936 USD / 57.6
Free Float	98.4%
Average Daily Value (mn)	6.34 USD
BofA Ticker / Exchange	EMBC / NAS
Bloomberg / Reuters	EMBC US / EMBC.OQ
ROE (2024E)	NA
Net Dbt to Eqty (Sep-2023A)	NA
ESGMeter TM	NLA

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".

Acronym glossary pg. 2

iQprofileSM Embecta

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	38.3%	31.0%	22.6%	20.3%	18.9%
Return on Equity	NM	NM	NM	NM	NM
Operating Margin	36.6%	38.7%	35.1%	35.5%	36.0%
Free Cash Flow	389	41	10	154	155

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.8x	0.4x	0.3x	1.6x	1.5x
Asset Replacement Ratio	0.7x	0.8x	0.7x	1.3x	1.1x
Tax Rate	12.9%	23.0%	22.0%	22.5%	22.5%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	NA	NA	NA	NA	NA

Income Statement Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	1,130	1,121	1,105	1,110	1,116
% Change	-3.1%	-0.8%	-1.4%	0.5%	0.5%
Gross Profit	775	751	702	711	720
% Change	-3.1%	-3.1%	-6.5%	1.2%	1.3%
EBITDA	360	386	333	339	346
% Change	-33.8%	7.1%	-13.6%	1.8%	2.2%
Net Interest & Other Income	(53)	(107)	(116)	(116)	(116)
Net Income (Adjusted)	224	173	119	123	129
% Change	-46.1%	-22.8%	-30.9%	3.1%	4.7%

Free Cash Flow Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	224	173	119	123	129
Depreciation & Amortization	32	33	35	35	35
Change in Working Capital	92	(80)	(121)	11	1
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	64	(58)	(1)	29	29
Capital Expenditure	(24)	(27)	(23)	(44)	(39)
Free Cash Flow	389	41	10	154	155
% Change	0.5%	-89.4%	-76.9%	NM	0.6%
Share / Issue Repurchase	0	0	0	0	0
Cost of Dividends Paid	(9)	(34)	(35)	(35)	(35)
Change in Debt	1,405	(11)	(10)	(10)	(10)

Balance Sheet Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	331	327	321	431	542
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	334	423	476	464	462
Property, Plant & Equipment	302	300	296	305	309
Other Non-Current Assets	120	165	197	197	197
Total Assets	1,086	1,214	1,289	1,396	1,510
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	301	354	295	295	295
Long-Term Debt	1,598	1,594	1,586	1,576	1,567
Other Non-Current Liabilities	79	89	92	92	92
Total Liabilities	1,978	2,036	1,973	1,963	1,953
Total Equity	(891)	(822)	(684)	(566)	(443)
Total Equity & Liabilities	1,086	1,214	1,289	1,396	1,510

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Medical Technology

Company Description

Embecta (EMBC) is a global medical device company focused on providing solutions to people with diabetes. The company has a broad portfolio of products including a variety of pen needles, syringes and safety devices, which are complemented by digital applications designed to assist people with managing their diabetes.

Investment Rationale

EMBC is the market leader in insulin pen needles, syringes, and injection safety products but these markets are mature and until EMBC diversifies into new product areas it will be challenging for EMBC to see much growth. EMBC has high margins and generates good cash flow which could allow it to invest in new areas but with a balance sheet 3x levered and a market where innovation takes time we see no near term growth drivers. We think the market is already pricing in EMBC cash flows.

Acronym glossary

WW = worldwide

FX = foreign exchange

ERP = enterprise resource planning

CC = constant currency

GM = gross margin

Op = operating

FDA = Food & Drug Administration

R&D = research and development

PNL = profit and loss

Stock Data

Average Daily Volume

390,197

Quarterly Earnings Estimates

	2023	2024
Q1	0.96A	0.61A
Q2	0.75A	0.38E
Q3	0.69A	0.57E
Q4	0.59A	0.48E

FY24 guide – other details

EMBC raised revenue guidance to \$1,094-\$1,116 (from \$1,085-\$1,105) for FY24, which now assumes \$2m-\$5m in contract manufacturing revenue (from \$0m-\$5m prior) and FX headwind of -0.4% (from about -1% FX headwind prior).



Price objective basis & risk

Embecta (EMBC)

Our price objective of \$17 is based on 8x CY2025 EPS a discount to large cap value medtech that trades at 10-13x EPS given EMBC's structural declining market.

Upside risks to our PO are: 1) Multiple Daily Injection (MDI) patients decline slower than expected, 2) faster growth in emerging markets, 3) pipeline comes to market quicker than expected, and 4) larger opportunity in Type 2 patient population. Downside risks are: a negative material change in EMBC's cash flow driven by a need to invest more or a slowdown in its markets or further pricing pressure

Analyst Certification

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US - Medical Technology & Devices Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Abbott Laboratories	ABT	ABT US	Travis Steed
	Axonics	AXNX	AXNX US	Travis Steed
	Bausch & Lomb	BLCO	BLCO US	Craig Bijou
	Becton Dickinson	BDX	BDX US	Travis Steed
	Boston Scientific	BSX	BSX US	Travis Steed
	Dexcom	DXCM	DXCM US	Travis Steed
	Inari Medical	NARI	NARI US	Travis Steed
	Inspire Medical	INSP	INSP US	Travis Steed
	Insulet	PODD	PODD US	Travis Steed
	Intuitive Surgical	ISRG	ISRG US	Travis Steed
	Medtronic	MDT	MDT US	Travis Steed
	Paragon 28	FNA	FNA US	Craig Bijou
	Procept BioRobotics Corporation	PRCT	PRCT US	Craig Bijou
	RxSight	RXST	RXST US	Craig Bijou
	Shockwave Medical	SWAV	SWAV US	Travis Steed
	Si-Bone	SIBN	SIBN US	Craig Bijou
	Stryker	SYK	SYK US	Travis Steed
	The Cooper Companies	COO	COO US	Craig Bijou
NEUTRAL				
	Baxter International Inc	BAX	BAX US	Travis Steed
	Conmed	CNMD	CNMD US	Travis Steed
	Edwards Lifesciences	EW	EW US	Travis Steed
	GE HealthCare	GEHC	GEHC US	Craig Bijou
	Integer Holdings Corporation	ITGR	ITGR US	Craig Bijou
	Merit Medical	MMSI	MMSI US	Craig Bijou
	Teleflex Incorporated	TFX	TFX US	Craig Bijou
	Zimmer Biomet	ZBH	ZBH US	Travis Steed
UNDERPERFORM				
	Embecta	EMBC	EMBC US	Travis Steed
	Globus Medical	GMED	GMED US	Craig Bijou
	Integra Lifesciences	IART	IART US	Craig Bijou
	Nevro	NVRO	NVRO US	Travis Steed
	Outset Medical	OM	OM US	Travis Steed
	Silk Road Medical	SILK	SILK US	Travis Steed
	Tandem Diabetes Care	TNDM	TNDM US	Travis Steed

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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Embecta (EMBC) Price Chart



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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	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 ^{R1}	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%

^{R1} 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 ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} 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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