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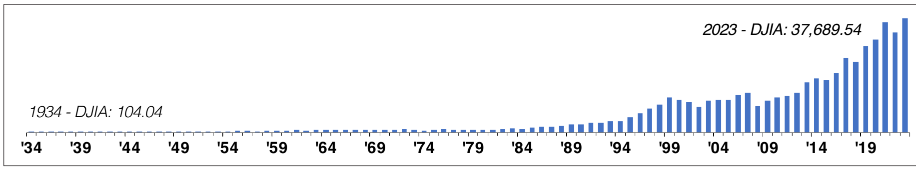
MARKET DIGEST



MONDAY, NOVEMBER 4, 2024

NOVEMBER 1, DJIA 42,052.19

UP 288.69

Good Morning. This is the Market Digest for Monday, November 4, 2024, with analysis of the financial markets and comments on **Norwegian Cruise Line Holdings Ltd., AbbVie Inc., Meta Platforms Inc., KLA Corp., Stryker Corp., Gentherm Inc., ONEOK Inc., Raymond James Financial Inc.** and **HF Sinclair Corp**.

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WEBINAR ANNOUNCEMENT:

Argus Research will host a webinar for clients at 11 a.m. ET on Wednesday, November 6, 2024. The webinar is titled Financial Services Sector Outlook. The webinar will be hosted by Argus Director of Research Jim Kelleher, CFA. Jim will be joined by Argus Director of Financial Services Research Stephen Biggar and Argus Fixed Income Strategist Kevin Heal.

During the call, we'll discuss the outlook for the fed funds rate and yield curve into 2025 and share forecasts for industry groups such as banks, brokers, insurers, exchanges, and financial data providers.

Listeners are encouraged to submit questions that we'll address in a Q&A session at the conclusion of formal remarks.

Please note that the CFP Board has accepted Argus' Monthly Webinar for one (1) hour of continuing education (CE) credit.

Please visit https://attendee.gotowebinar.com/register/4299896849254698078 to register. If you have any problems registering, please contact us at clientservices@argusresearch.com or by calling (212) 425-7500.

The webinar, as always, will be interactive with a question-and-answer period. We will be recording the webinar, and a rebroadcast will be available on the password-protected portion of our website. Slides related to the presentation will be posted on our website the day of the webinar and will be available via the webcast itself.

MARKET REVIEW:

Monday Tee Up: The Election and Interest Rates

This week features the election and a Federal Reserve interest-rate decision. Suffice it to say, the markets may be volatile. Last week, the Dow Jones Industrial Average was lower by 0.2%, the S&P 500 lost 1.4%, and the Nasdaq shed 1.5%. For the year, the Dow is higher by 12%, the S&P is up 20%, and the Nasdaq has gained 22%.

The earnings calendar is packed again. On Monday, Palantir Technologies, Marriott International, and American International Group all report. On Tuesday, Apollo Global Management, Yum! Brands, DuPont, Cummins, and Archer-Daniels Midland. On Wednesday, Qualcomm, McKesson, Novo Nordisk, Toyota Motor, and Take-Two Interactive. On Thursday, Motorola, Arista Networks, Airbnb, Becton, Dickinson, and Duke Energy. And on Friday, Paramount Global. So far, 349 (or 70%) of the S&P 500 companies have reported. Earnings are coming in 8.4% higher than in the prior-year quarter. Communication Services, up 24%, and Technology, up 19%, are leading, while Energy, down 27%, is underperforming. For full year, Argus forecasts earnings growth of 7%-9%.

On the economic calendar, the big day is Thursday, when the Federal Reserve comes out with its next decision on interest rates. Odds that the Fed will cut by 25 basis points (bps) are essentially at 100%, according to the CME FedWatch tool. Wall Street will focus on Chairman Powell's statement at the press conference immediately following the rate announcement. Meanwhile, Factory Orders will be updated on Monday; the U.S. Trade Deficit and ISM Services on Tuesday; and Consumer Sentiment on Friday.

Argus Chief Economist Chris Graja's Call of the Week is the Institute for Supply Management's Services Index for October. Chris has offered the following commentary. "This is an early and important indicator of 4Q economic activity. Consumer spending on services represents more than 45% of GDP. The huge category includes housing expenses, including rent, healthcare, transportation services, and food services and hotels. The Services Index printed at a healthy and expansionary 54.9 in September. We expect a small uptick to 55 in October, just above the consensus of 53, which suggests the economy is healthy and will keep growing." The services category grew 2.6% in 3Q and contributed 1.21 points of the 2.8% increase in 3Q GDP according to the U.S. Bureau of Economic Analysis.

Last week, the October jobs report delivered a mixed bag of information. Nonfarm Payrolls posted at 12,000 for October compared to a strong (but revised lower) 223,000 for September. The October number was impacted by the two recent hurricanes and the strike at Boeing, but still came in lower than expected. The Unemployment Rate was unchanged at 4.1%.

Mortgage rates jumped for a fifth consecutive week and are now at 6.72% for the average 30-year fixed-rate mortgage. Gas prices fell four cents to $3.10 per gallon for the average price of regular gas. The Atlanta Fed GDPNow indicator is forecasting for 3Q and calls for expansion of 2.3%. The Cleveland Fed CPINow indicator for November is 2.68%.

After this week's Fed rate decision, the next rate meeting is on December 18. If the Fed cuts this week, as is fully expected, the odds are at 83% for another 25-bps rate cut in December, again according to the CME FedWatch tool. We expect a rate cut this week and another in December, and then three more in 2025 (all by 25 bps).

NORWEGIAN CRUISE LINE HOLDINGS LTD. (NYSE: NCLH, $24.88) .... BUY

NCLH: Upgrading to BUY on strong advance bookings

* Digital bookings, increased occupancy (108% in 3Q), and higher ticket prices are benefiting results.
* Norwegian's new ship pipeline aims to expand capacity by 30% within three years.
* We are raising our EPS estimates to $1.70 from $1.54 for FY24 and increasing our FY25 estimate to from $1.84 from $1.80.

ANALYSIS

INVESTMENT THESIS

We are upgrading Norwegian Cruise Line Holdings Ltd. (NYSE:NCLH) to BUY from HOLD with a price target of $30. Increased occupancy (108% in 3Q), higher ticket prices and strong advance bookings for 2025 are benefiting results. In addition, Norwegian's new ship pipeline aims to expand capacity by 30% within three years.

Given the strides the company has made toward meeting its growth targets, the company raised its full-year guidance by 8% in 3Q24.

Based on growing demand for cruises and an 8% capacity increase in 1Q24, our long-term rating is BUY.

RECENT DEVELOPMENTS

On October 31, Norwegian reported adjusted 3Q24 earnings of $0.99 per share, above adjusted earnings of $0.75 per share in 3Q23 and the consensus estimate calling for earnings of $0.94 per share. Third-quarter revenue was $2.81 billion, up from $2.54 billion a year earlier and above the consensus of $2.77 billion. The above consensus revenue reflects strong demand for travel. Ticket sales rose to $1.94 billion from $1.73 billion, while onboard and other revenue rose to $862 million from approximately $802 million. Consensus estimates had called for ticket revenue of $1.91 billion and onboard and other revenue of $858 million. The relaunch of three cruise ships during the fourth quarter of 2023 helped to boost revenue, but has also led to higher operating costs. Total cruise operating expenses rose to $1.54 billion in 3Q24 from $1.48 billion a year earlier. Fuel expense fell to $165 million from $171 million a year earlier. The consensus estimate had called for fuel expense of $170 million.

Below the line, interest expense fell to $175.2 million from $181.2 million, driven by lower debt levels and declining interest rates. The share count rose to 515 million from 512 million a year earlier.

As discussed in a previous note, in 2023, revenue rose to $8.5 billion from $4.8 billion in 2022. Revenue benefited from occupancy that was just under 103%, and approximately 75% higher onboard and other revenue Adjusted EBITDA totaled $1.86 billion, slightly above management's guidance. Full-year adjusted earnings were $0.70 per share, reversing a loss of $4.64 per share in 2022.

EARNINGS & GROWTH ANALYSIS

In its 3Q earnings release, management forecast 2024 net yield growth in constant currency of 9.4%, up from a prior estimate of 8.2%, full-year adjusted EBITDA of $2.425 billion, up from $2.350 billion and adjusted earnings of $1.65.

For 2025, Norwegian Cruise Lines is seeing strong demand for all of its brands and itineraries.

Based on additional capacity, management's guidance and strong demand for cruises, we are raising our 2024 EPS to $1.70 from $1.54 and increasing our 2025 estimate to $1.84 per share from $1.80.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on NCLH is Medium, the middle rank on our five-point scale. Cash and cash equivalents totaled $333 million, down from $402 million at the end of 2023. Liquidity totaled $2.4 billion at the end of 3Q24. Long-term debt totaled $11.8 billion, down from $12.3 billion at the end of 2023. The long-term debt/capital ratio at the end of the quarter was 91.4%, down from 97.6% at the end of 2023 but well above the industry average of 59%.

The company does not pay a dividend and is unlikely to initiate one in the near term.

MANAGEMENT & RISKS

Harry J. Sommer became the company's president, CEO & director in July 2023, following the resignation of Frank Del Rio. David J. Herrera, who has served as Chief Consumer Sales and Marketing Officer of NCL since 2021, succeeded Sommer as President of NCL, effective April 1, 2023.

Norwegian Cruise Lines faces substantial risks from outbreaks of disease, as seen during the pandemic, as well as from terrorism or the threat of terrorism. The company is also vulnerable to unexpected increases in fuel costs, currency headwinds, and general economic weakness.

INDUSTRY

Our rating on the Consumer Discretionary sector is Market-Weight. The lagged effects from two years of high inflation and high interest rates are weighing on consumer spending, particularly in big-ticket categories such furniture, appliances and home improvement.

The creation of the Communication Services sector in 2018 removed companies in areas including theatrical filmed entertainment, publishing, advertising, broadcasting, and cable & satellite communications. We believe that the net impact of the change has been a moderate reduction in Consumer Discretionary EPS growth and a slight boost in the weighted dividend yield.

As of the end of September, the sector accounted for 10.1% of the S&P 500. Over the past five years, the weighting has ranged from 8% to 12%. The sector was underperforming the market, with a gain of 13.2%. It outperformed in 2023, with a gain of 41.0%, compared to a gain of 24.2% for the S&P 500.

The sector's P/E ratio on projected 2024 EPS was 24, above the market multiple. Yields of 0.6% were below the market average. The sector's smoothed earnings growth rate of 9% was below the market average.

COMPANY DESCRIPTION

Founded in 1966 and based in Miami, Norwegian Cruise Line Holdings offers cruises to approximately 450 destinations worldwide. NCLH sells its cruises through independent travel agents, wholesalers, and tour operators. The company went public on January 17, 2013. In 2014, Norwegian Cruise Lines acquired Prestige Cruise Holdings, the parent company of Oceania Cruises and Regent Seven Seas.

VALUATION

On October 31, NCLH shares rose after the company reported stronger-than-expected third-quarter revenue and earnings and raised its guidance. NCLH shares appear undervalued at a projected 2024 P/E of 13.5-times our revised 2025 earnings estimate, reflecting the company's strong advance bookings, ongoing high occupancy, and lower fuel costs. Norwegian has posted stronger results post-pandemic, and the near-term outlook appears promising. At current prices, our target, if achieved, offers investors the prospect of a 20% return.

On November 1, BUY-rated NCLH closed at $24.88, down $0.46. (John Staszak, CFA, 11/1/24)

ABBVIE INC. (NYSE: ABBV, $203.55).. BUY

ABBV: Upgrading to BUY as Skyrizi and Rinvoq drive new growth

* Immunology products Skyrizi and Rinvoq have succeeded Humira as key growth engines. During the third quarter, global Skyrizi sales rose 52% on an operational basis to $3.21 billion, while Rinvoq sales rose 47% to $1.61 billion.
* While Humira sales still represent 15% of the company's total revenues, the third quarter of 2024 was the first time that Skyrizi sales were higher, coming in at 22% of the company's total sales.
* Meanwhile, margins have stabilized, with the adjusted gross margin rising 90 basis points to 84.4% and the adjusted operating margin coming in flat year over year at 46.7%, bucking its prior trend of declines.
* Our target price of $220 implies a total return, including the dividend, of roughly 11%.

ANALYSIS

INVESTMENT THESIS

We are upgrading AbbVie Inc. (NYSE: ABBV) to BUY from HOLD with a target price of $220. Two of the company's key immunology products, Skyrizi and Rinvoq, have succeeded Humira as growth engines. During the third quarter, global Skyrizi sales rose 52% on an operational basis to $3.21 billion, while Rinvoq sales rose 47% to $1.61 billion. While Humira sales still represent 15% of the company's total revenues, the third quarter of 2024 was the first time that Skyrizi sales were higher, coming in at 22% of the company's total sales. Other products within the company's portfolio also continue to produce solid returns, leading to growth across both the Neuroscience and Aesthetics portfolios. Meanwhile, margins have stabilized, with the adjusted gross margin rising 90 basis points to 84.4% and the adjusted operating margin coming in flat year over year at 46.7%, bucking its prior trend of declines. Our target price of $220 implies a total return, including the dividend, of roughly 11%.

RECENT DEVELOPMENTS

Over the last three months, ABBV shares have outperformed the S&P 500, rising 9% compared to a 4% gain for the market. Over the past year, the stock has also outperformed the market, rising 44% versus a gain of 36% for the S&P 500. Over the past five years, the stock has gained 167% versus an advance of 87% for the S&P 500. The beta on ABBV is below the peer average.

AbbVie's 3Q24 results, reported on October 30, 2024, highlight the company's growing ability to diversify its revenue away from Humira following the emergence of biosimilar competition in the U.S. Adjusted EPS rose to $3.00 from $2.95, beating the consensus estimate by $0.08. Revenue rose 3.8% as reported and 4.9% on an operational basis to $14.46 billion, beating the consensus by $183 million. The adjusted gross margin was 84.4%, up 90 basis points from 3Q23. The adjusted operating margin was 46.7%, flat year over year.

Within the company's Immunology portfolio, Skyrizi and Rinvoq are succeeding Humira as growth engines. During the third quarter, global Skyrizi sales rose 52% on an operational basis to $3.21 billion, driven by 48% growth in the U.S. market and 76% in the International market. Meanwhile, Rinvoq sales rose 47% to $1.61 billion, driven by 46% growth in the U.S. and 52% growth in the International market. Conversely, global Humira sales fell 37% on an operational basis to $2.23 billion, driven by a 42% decline in the U.S. and an 8% decline in the International market. The decline in Humira sales was driven by the introduction of biosimilar competition. While Humira sales still represent 15% of the company's total revenues, the third quarter of 2024 was the first time that Skyrizi sales were higher, coming in at 22% of the company's total sales. Given the significant growth potential of Skyrizi and Rinvoq, as well as the continued impact of Humira's patent expiration, we expect that the company's reliance on its formerly highest revenue generating product will continue to decline.

Among the company's Oncology portfolio, which saw operational sales growth of 13% to $1.69 billion, growth was driven largely by Venclexta (up 18% globally to $677 million), as well as the recently approved Elahere and Epkinly. Growth in this portfolio was partially offset by a 9% operational decline in the sales of Imbruvica, which saw sales fall to $828 million.

The Aesthetics portfolio, which came with the Allergan acquisition, includes Botox and Juvederm. Botox is also used therapeutically to treat migraine. Botox Therapeutic revenue grew 14% in 3Q24 on an operational basis, while Botox Cosmetic revenue grew 10%. Other key products that came with the Allergan transaction include neuroscience products Vraylar (up 17% to $875 million), Ubrelvy (up 15% to $269 million), and Qulipta (up 34% to $176 million).

AbbVie's share price is driven in part by pipeline developments. On October 18, the FDA approved Botox Cosmetic for the temporary improvement in the appearance of moderate to severe vertical bands connecting the jaw and neck (platysma bands) in adults. Botox Cosmetic is the first and only product with four aesthetic indication areas: forehead lines, frown lines, crow's feet lines, and now platysma bands, making it the first product of its kind to go beyond the face. On a related note, on September 11, Allergan Aesthetics, an AbbVie company, launched Botox Cosmetic for the treatment of masseter muscle prominence (MMP) in China. The masseter is one of the muscles in the lower face involved in chewing, and prominence of the masseter muscle can result in a wide and square lower face shape.

Elsewhere in the company's portfolio, AbbVie announced on October 17 that the FDA approved Vyalev as the first and only subcutaneous 24-hour infusion of levodopa-based therapy for the treatment of motor fluctuations in adults with advanced Parkinson's disease (PD). According to Robert A. Hauser, M.D., MBA, Professor of Neurology and Director of the Parkinson's and Movement Disorder Center at the University of South Florida, "due to the progressive nature of the disease, oral medications are eventually no longer as effective at motor symptom control and surgical treatment may be required. This new, non-surgical regimen provides continuous delivery of levodopa morning, day and night." Among other potential treatments for Parkinson's disease, AbbVie announced positive topline results on September 26 from its pivotal Phase 3 trial for tavapadon as a monotherapy in early Parkinson's disease. Tavapadon is an investigational D1/D5 dopamine receptor partial agonist being studied as a once-daily treatment for Parkinson's disease. The company intends to use full results from this study to support regulatory submission for tavapadon.

On September 27, AbbVie submitted a Biologics License Application (BLA) to the FDA for accelerated approval of telisotuzumab vedotin (Teliso-V) in adult patients with previously treated, locally advanced or metastatic epidermal growth factor receptor (EGFR) wild type, nonsquamous non-small cell lung cancer (NSCLC) with c-Met protein overexpression. There are currently no approved anti-cancer therapies specifically for c-Met overexpressing NSCLC and, if approved, Teliso-V would be the first-in-class therapy for this patient population.

On September 20, the European Medicines Agency's (EMA) Committee for Medicinal Products for Human Use (CHMP) adopted a positive opinion recommending the marketing authorization of Elahere for the treatment of adult patients with folate receptor alpha (FRα)-positive, platinum-resistant, and high-grade serous epithelial ovarian, fallopian tube or primary peritoneal cancer, who have received one to three prior treatment regimens. Patients with ovarian cancer are often diagnosed with late-stage disease, undergo surgery, and are then primarily treated with platinum-based chemotherapy. Over time, patients may become resistant to platinum-based treatment and will require another therapy. The European Commission decision on this indication for Elahere is anticipated later in the 2024 year. Elahere was granted full FDA approval in the United States in March 2024.

On August 19, the European Commission granted conditional marketing authorization for Tepkinly as a monotherapy for the treatment of adult patients with relapsed or refractory (R/R) follicular lymphoma (FL) after two or more lines of prior therapy. With this approval, Tepkinly is the first and only subcutaneous T-cell engaging bispecific antibody approved to treat both R/R FL and R/R diffuse large B-cell lymphoma (DLBCL) in the EU, as well as Iceland, Liechtenstein, Norway, and Northern Ireland.

On July 26, the European Commission approved Skyrizi for the treatment of adult patients with moderately to severely active ulcerative colitis (UC) who have had an inadequate response to, lost response to, or were intolerant to conventional therapy or a biologic therapy. This marketing authorization marks the fourth approved indication for Skyrizi in the EU, joining its use as a treatment for plaque psoriasis, psoriatic arthritis, and Crohn's disease. For reference, UC is estimated to affect 5 million people around the world, and the incidence is increasing worldwide.

Meanwhile, the company has also established partnerships as a means to grow its business. On October 31, AbbVie and EvolveImmune Therapeutics announced a collaboration and option-to-license agreement to develop multispecific biologics for multiple targets in oncology. The discovery partnership will leverage EvolveImmune's T-cell engager platform to develop novel antibody-based therapies for solid and hematologic malignancies. Under terms of the agreement, EvolveImmune will receive $65 million in aggregate upfront fees and equity investment from AbbVie and is eligible for up to $1.4 billion in aggregate option fees and milestones, as well as tiered royalty payments on net sales. Earlier, on October 24, AbbVie announced a new discovery, co-development, and license agreement with Gedeon Richter Plc. ('Richter') to advance novel targets for the potential treatment of neuropsychiatric conditions. This collaboration expands upon the success of nearly two decades of partnership on central nervous system (CNS) projects, including globally launched products such as cariprazine (Vraylar / Reagila) and the discovery of investigational drug candidate ABBV-932 for the treatment of bipolar depression and generalized anxiety disorder. Under the terms of the agreement, the collaboration includes both preclinical and clinical R&D activities with shared financing by the parties. Richter will receive an upfront cash payment of $25 million, along with potential future development, regulatory, and commercialization milestones. In addition, Richter may also receive sales-based royalties.

AbbVie has also strived to grow through acquisitions. On October 28, AbbVie announced a definitive agreement to acquire Aliada Therapeutics, a biotechnology company advancing therapies using a novel blood-brain barrier (BBB)-crossing technology to address challenging CNS diseases. Aliada's lead investigational asset utilizing this delivery technology, ALIA-1758, is an anti-pyroglutamate amyloid beta (3pE-Aβ) antibody in development for the treatment of Alzheimer's disease. Under the terms of the agreement, AbbVie will acquire all outstanding Aliada equity for $1.4 billion in cash, subject to certain customary adjustments. This transaction is expected to close in 4Q24. Earlier, on August 1, AbbVie announced that it had completed its acquisition of Cerevel Therapeutics for approximately $8.7 billion. This acquisition aims to bolster AbbVie's neuroscience portfolio with Cerevel's assets focused on psychiatric and neurological disorders, including schizophrenia, Parkinson's disease, and mood disorders. Cerevel's clinical-stage pipeline, featuring the potential best-in-class asset emraclidine, complements AbbVie's existing portfolio and emerging neuroscience pipeline. AbbVie anticipates the acquisition to be accretive to its earnings beginning in 2030.

EARNINGS & GROWTH ANALYSIS

Along with the third-quarter results, AbbVie updated its guidance for 2024. The company expects to generate adjusted EPS of $10.90-$10.94, representing a decline of 1.5%-1.9% from 2023, but raised from earlier guidance for adjusted EPS of $10.67-$10.87. Management noted that both its revised and previous guidance include a negative impact of $0.64 per share related to acquired IPR&D and milestones expense incurred year-to-date through 3Q24. From a longer-term standpoint, management has previously shared its expectations for a high single-digit compound annual revenue growth rate through 2029, using 2024 as the base year in the compound annual growth rate calculation. It has also stated that it expects combined Skyrizi and Rinvoq 2027 revenues of more than $27 billion and peak combined Ubrelvy and Qulipta revenues of more than $3 billion.

We are raising our 2024 adjusted EPS estimate to $10.95 from $10.85, slightly above management's guidance range but implying a decline of about 1% for the year. Despite the expected decline in earnings for 2024, given the rising importance of Skyrizi and Rinvoq on the company's sales, as well as our expectation for further growth within other areas of the company's portfolio, we are raising our 2025 adjusted EPS estimate to $12.05 from $12.00, implying growth of 10% from our 2024 estimate.

FINANCIAL STRENGTH & DIVIDEND

We rate AbbVie's financial strength as Medium, the midpoint on our five-point scale.

AbbVie pays a dividend. In October 2024, the company raised its dividend by 5.8% to a quarterly payment of $1.64 per share, for an annualized payout of $6.56. Based on the stock's current price, the dividend holds a yield of approximately 3.2%. Our dividend estimates are $6.20 for 2024 and $6.56 for 2025.

MANAGEMENT & RISKS

Robert A. Michael serves as AbbVie's CEO, having succeeded former CEO Richard A. Gonzalez, who now serves as Executive Chairman of the board of directors, on July 1, 2024. Mr. Michael previously served as the company's president and chief operating officer. Scott T. Reents serves as Executive Vice President and CFO.

AbbVie faces a range of risks. The development of new drugs from initial discovery to approval for commercial distribution may take several years and cost hundreds of millions of dollars. Only a small percentage of drugs make it all the way from discovery to commercialization.

As noted above, Humira now faces the risk of competition from biosimilars, which will impact the product's profitability.

The company faces integration risks as it folds in acquired companies and assets. These include larger acquisitions, such as Allergan, and smaller tuck-in acquisitions.

COMPANY DESCRIPTION

AbbVie, a research-based biopharmaceutical company, was spun off from Abbott Laboratories in January 2013. The company is based in suburban Chicago. The shares are a component of the S&P 500.

INDUSTRY

Our rating on the Healthcare sector is Over-Weight. It includes companies in the pharmaceuticals, medical devices, healthcare services, and insurance industries. The industry is riding a tailwind in 2024 as the FDA approved nearly 50% more novel drugs (biologic and genomic medicines) in 2023 than in 2022. This trend and M&A activity in the sector could lead to increased investment in biotech companies.

Recent approvals include high-profile therapies in GLP-1 weight-loss drugs and Alzheimer's disease. The FDA also approved five gene therapies. On the MedTech side, we are looking forward to AI-enhancements to medical devices to deliver better outcomes, such shorter post-surgical recoveries. The healthcare environment is undergoing rapid transitions, and we now see as an unfolding period of significant promise and opportunity in the sector based.

While the Inflation Reduction Act (IRA) gives Medicare the authority to negotiate drug pricing, the long period of patent protection for innovative medicines will still give manufacturers the opportunity for large returns for their new drugs.

While both the broad Healthcare sector ETF XLV and the biotech ETF XBI underperformed the broader market in 2023, we see the potential for lower interest rates to improve funding for the biotech industry.

On the managed-care side, both the Affordable Care Act and the national demographics of an aging population are expanding the addressable market of new members for the commercial and Medicare Advantage segments. We observe that some 26 million U.S. Baby Boomers will age into Medicare-eligibility from now through 2030.

As of the end of September, the sector accounted for 11.6% of the S&P 500. Over the past five years, the weighting has ranged from 10% to 15%. The sector was underperforming the market with a gain of 13.0%. It underperformed the market in 2023, with a gain of 0.3% compared to a gain of 24.2% for the S&P 500.

The sector's P/E ratio on projected 2024 EPS was 18, below the market multiple. Yields of 1.1% were below to the market average. The sector's smoothed earnings growth rate of 10% was equal to the market average.

VALUATION

ABBV shares trade at 19-times our 2024 EPS estimate, below the average multiple for our coverage universe of large-cap biotech/pharmaceutical stocks. Given the rapid growth of the immunology products Skyrizi and Rinvoq, their status as new growth drivers that more than offset the declining sales of Humira, growth across the rest of the portfolio, and the company's stabilizing margins, we believe that the stock is attractively valued at current levels. Consequently, we are upgrading our rating on the stock to BUY from HOLD. Our target price of $220 implies a total return, including the dividend, of roughly 11%.

On November 1, BUY-rated ABBV closed at $203.55, down $0.32. (Jasper Hellweg, 11/1/24)

META PLATFORMS INC. (NGS: META, $567.16) .... BUY

META: Strong 3Q, but concerns over GenAI costs

* EPS rose 28% on 19% revenue growth in 3Q24.
* Meta is benefiting from solid advertising revenue, improved profitability, and robust cash flow, though management continues to warn of higher expenses.
* At its recent developer conference, Meta outlined its product roadmap toward developing a fashionable wearable pair of glasses powered by GenAI.
* We are raising our 2024 GAAP EPS estimate to $22.47 from $20.89 and our 2025 forecast to $24.78 from $23.01. Our EPS estimates imply 31% growth over the next two years.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Focus List selection Meta Platforms Inc. (NGS: META) with a target price of $660. Meta is benefiting from a reacceleration in advertising revenue, significant margin expansion as a result of deep cost cuts, and robust cash flow. The market may well be spooked by the company's ramping investments in GenAI at it races with Microsoft, Alphabet and others to develop models and actual applications prior to monetization, though we note that Meta is already leaning on GenAI to improve targeted advertising, one of its critical monetization features. Meta typically builds an audience for new products before moving to monetization, and we think this is once again Mr. Zuckerberg's clearly-stated strategy around generative AI applications to Reality Labs hardware products. We also expect GenAI to pervade Meta's applications to provide another means of optimizing company performance and efficiency. We also note that Reality Labs losses continue to mount.

We give management kudos for rapidly delivering Threads, a Twitter/X competitor, as it looks to take share amid that company's self-inflicted wounds. Threads continues to gain demonstrable traction with users. Meta has developed new ad-targeting and measurement tools, as well as new social media platforms in Reels and now Threads. We need to caution investors that the regulatory threats against Meta in the U.S. and Europe are a material risk. Though the outcomes of myriad regulatory and legal challenges to Meta remain unclear, they have already led to large fines/settlements, and could eventually lead to more material fines and/or onerous regulatory actions including the possibility – remote, in our opinion – of breakup. Our long-term rating on META remains BUY.

RECENT DEVELOPMENTS

Meta posted 3Q24 results after the close on October 30. The company beat the consensus revenue estimate by $334 million and the consensus EPS forecast by $0.73. Revenue also beat the midpoint of management's rather wide guidance range by $839 million. With 3Q results, Meta lowered its 2024 total expense guidance by $500 million to $97 million at the midpoint of the new narrowed range. However, what Meta giveth with one hand it taketh away with the other, as the company increased its 2024 capital expenditure guidance by $500 million to $39 billion at the midpoint of the new range. Meta's new 2024 capex guidance implies and incremental $3 billion, or 39% increase over 2023. Management further expects "significant acceleration in infrastructure expense growth" in 2025. CEO Mark Zuckerberg has been consistently clear over the last few quarters that capex will ramp in support of generative AI opportunities. While current AI advancement may be more practical, particularly around improved advertising targeting, Mr. Zuckerberg has not given up on the metaverse concept, but rather sees GenAI and the metaverse converging at some point. META shares fell 3% on October 31.

Revenue rose 19% from the prior year, to $40.6 billion. Advertising revenues, the company's primary revenue stream, rose 19% to $39.9 billion. Both total revenue and advertising revenue decelerated year over year from 24% in 3Q23. The average price per ad increased a healthy 11%, while the more important ad impressions number increased 7%. Pricing growth was driven by increased advertiser demand, partially due to improved ad performance and partially offset by impression growth from lower-monetizing regions and platforms.

Meta reporting structure now separates its "Family of Apps" (Facebook Blue, Instagram, Messenger, WhatsApp, and other services) from its emerging "Facebook Reality Labs" segment (FRL), which is focused on the metaverse business. Family of Apps revenue rose 19% in 3Q, while FRL reported an inconsequential $434 million in revenue. While Family of Apps revenue is generated by advertising, FRL revenue comes from the sale of hardware; the Quest 3 virtual reality headset and Ray-Ban Meta augmented reality glasses.

Family of Apps operating income rose 24.5% to $21.8 billion in 3Q, while the FRL operating loss was $4.4 billion. The cumulative loss on FRL is now $555 billion. These losses might be expected from a startup business; however, the average recent operating loss of around $4 billion per quarter is a tough load for Meta to carry. Third-quarter consolidated income from operations increased 26% to $17.35 billion, while the operating margin increased by 250 basis points to 43%. While Meta has lapped the extraordinary margin expansion from the late 2022/early 2023 layoffs and restructuring, 3Q's margin expansion demonstrates the company's continued operating expense cost leverage. GAAP diluted EPS increased 28% to $6.03.

Meta held its Connect annual developer conference on September 25-26, 2024. As usual, the company announced a number of new products. CEO Mark Zuckerberg led off his keynote address with the latest iteration of the company's Quest mixed reality headset, the Meta Quest 3S. Perhaps the biggest improvement with the 3S is that it sells for more than $100 less than the Meta Quest 3, the previous version. In addition to the typical technological improvements around display resolution and field of view, the 3S includes a Microsoft Windows 11 PC extension, YouTube co-watching and takes another stab as the Horizon virtual reality experience. About as impressive as the technology is the number of application partners Meta has been able to enlist for the Meta Quest. While the market growth for mixed reality headsets may be limited to a small group of videogamers and very early adopters and is, therefore, disappointing for now, with the Apple Vision Pro headset listing at $3,500, the Meta Quest has no real competition. The base model 3S lists at $300 and ships October 15.

No technology conference would be complete without a bow to generative AI, and so Mr. Zuckerberg announced the new version of Meta's large language model Llama 3.2, which has multi-modal image capability in addition to text. While image and, presumably, video capabilities are or will indeed be important for Meta AI, we think Mr. Zuckerberg is more intently interested in natural voice. The company has hired a stable of actors to provide their voices and, even more impressive, Mr. Zuckerberg demonstrated real-time language translation using the company's Ray Ban style smart glasses. The Ray Ban smart glasses are another consumer-friendly product from Meta, listing at $300. We see a fairly clear product roadmap emerging. We think Meta plans to integrate its substantial generative AI capabilities into a wearable device, i.e. glasses, that also look fashionably cool – hence the Ray Ban license and ten-year partnership deal with eye-glass giant Luxottica – and have a wide consumer appeal. Toward this end, Mr. Zuckerberg also showed off the company's functioning prototype for true holographic glasses dubbed Orion. Meta noted that a pair of Orion glasses cost $10,000, so the project is not exactly close to becoming commercial yet, though Meta promises to continue to work on the cost issue. One could criticize Orion as vaporware, i.e., technology that may not end up in an actual product, though it does again demonstrate Meta's continued commitment to virtual- and mixed-reality applications – applications in a wearable device which will undoubtedly by powered by the company's advances in GenAI. Whether a Meta wearable will ever be able to compete with a smartphone and, in particular, an Apple iPhone, thereby freeing Meta from its dependence on Apple for distribution, remains an open question.

On September 17, Meta announced Instagram Teen Accounts. All teenagers on Instagram were immediately placed into Teen Accounts. Teen Accounts include privacy restrictions around who can contact a teen, what kind of content a teen can view, reminders around the time a teen spends on the platform, and more parental controls. Perhaps the biggest change is an age gate at 16, meaning that any teen under 16 will need parental permission to use less restrictive settings. Coupled with the age gate, Meta is developing technology to proactively identify teens under 16 who have lied about their identity and age in setting up an Instagram account, automatically placing them into Teen Accounts. This new identity technology will be in beta in the U.S. in early 2026.

Meta has been under attack for some years from government regulators, the media, academics, and Congress for the alleged harm that it may cause teenagers. In October 2023, a coalition of 42 U.S. states and territories sued Meta, alleging that it its social network platforms caused psychological and physical harm to "young people", and that it misled consumers on the extent of such harm. The suit followed an expose in the Wall Street Journal. CEO Mark Zuckerberg has also been hauled before a U.S. Congress and excoriated around this issue. We see Teen Accounts as certainly a positive, if much belated, step to ameliorate the barrage of the criticism. However, Meta may need to do more to address the issue than continue to point out inconsistencies in the data and research.

EARNINGS & GROWTH ANALYSIS

We are raising our 2024 GAAP EPS estimate to $22.47 from $20.89 and our 2025 forecast to $24.78 from $23.01. Our EPS estimates imply 31% growth over the next two years. Our long-term earnings growth rate forecast is 16%.

While advertising revenue decelerated year-over-year in 3Q24, 19% growth, strong profitability and robust cash flow are hardly anything to sniff at. However, investors also need to consider the company's continued ramp-up of expenses and investments in generative AI and the metaverse. Meta has gained traction on advertising sales through improved ad targeting and measurement, aided by its GenAI work. Management also noted that boosting monetization on Reels (a TikTok-like short-form streaming service) and user engagement with the new Threads application may also be key to company growth in the near term. On the 3Q call, management noted that Threads had about 200 million monthly active users, adding a remarkable 75 million users incrementally in 3Q24 at a pace of 1 million sign-ups per day. While CEO Zuckerberg continues to stick with the metaverse concept (and the costs that this initiative entails), GenAI technology has become management's chief focus. The company expects to integrate GenAI throughout its product set, including helping advertisers plan, launch, and measure campaigns while also using the technology to boost internal productivity and efficiency.

User growth and monetization remain key performance indicators for Meta. The company added 20 million Family Daily Active People in 3Q24, bringing its total base to 3.29 billion. The user base grew 4.8% year-over-year in 3Q, down from 7% in 3Q23, still a remarkable growth rate as Meta confronts the law of large numbers. Family average revenue per person was $12.29, up 12% from the prior year. A “Daily Active Person” is defined as a registered and logged-in user of one or more of the company’s Family products (Facebook, Instagram, Messenger, and WhatsApp) on a given day. Of course, monetization is not just dependent on adding users but also user engagement. Management flagged that it is seeing year-over-year daily usage growing across Facebook and Instagram, the company’s two most mature social media services, both globally and in the U.S.

Management’s rationale for the breakout of Facebook Reality Labs is to provide investors with visibility into what it views as its next-generation social media communications platform. Mr. Zuckerberg has had a fixation on virtual/augmented reality as the next technology platform even before Meta acquired Oculus VR in 2014. He sees AR/VR “presence,” commonly referred to as the metaverse, as the successor technology platform to the mobile web. Although Meta’s initial iteration of the metaverse, Horizon Worlds, was met with critical derision, we expect the company to continue to invest heavily in the metaverse concept.

Meta continues to rapidly iterate on its proprietary GenAI large language model, Llama 3. Llama 3 powers the company’s Meta AI chatbot and will be used to power search functions across its social media platforms. The company has previously made its Llama large-language model available on both the Microsoft Azure and Google Cloud platforms. Llama is open source — meaning that the software source code is available without charge to be redistributed and modified by outside developers. We note that both Microsoft, though its partnership with OpenAI, the purported leader in generative AI technology, and Google, with its Deep Mind division and partnership with Anthropic, are also in the race to develop GenAI technologies. Meta appears to be at least keeping pace with major generative AI competitors OpenAI, Microsoft, Alphabet, and Anthropic. However, most AI applications have remained proprietary rather than open source; Llama’s use of open source could thus become a point of differentiation and help speed development. Meta originally introduced its Llama technology on February 24, 2023.

On July 5, 2023, Meta social media site Instagram launched a new Twitter-like “micro-blogging” application called Threads. Posts on Threads can be up to 500 characters long, and may include links, photos, and videos up to five minutes in length. In a radical change from Meta’s typical operating procedure, i.e., essentially keeping its applications within a “walled garden,” management expects Threads to be open and interoperable with other social media networks. Threads was obviously designed to compete with Twitter, which has undergone massive layoffs, radical policy changes, and a massive loss of its advertiser base since Elon Musk’s takeover in October 2022. We give Meta management credit for seizing the opportunity to take share from an ailing competitor. Instagram chief Adam Mosseri has indicated that Threads will focus first on the user experience as it builds its user base. However, given Meta’s deep knowledge of advertising, we think that advertising will be the likely path to monetization for Threads at some point. Threads will have an advantage as it starts from the large Instagram user base, and will have access to Instagram data. Instagram has launched Threads in 100 countries on both iOS and Android.

FINANCIAL STRENGTH & DIVIDEND

We rate Meta’s financial strength as High, the highest rating on our five-point scale. Total debt at the end of 3Q24 was $28.8 billion, all of it long term. The company raised an incremental $10.5 billion in August 2024. Meta also had cash, equivalents, and marketable securities of $70.9 billion at the end of 3Q24, putting it in the rare and enviable position of being able to liquidate its debt any time it chooses. It generated $50.5 billion in trailing 12-month free cash in 3Q24, an incremental $13.6 billion, up 37% from 3Q23. Meta’s debt gets high-grade investment-grade ratings.

In March, Meta began paying a quarterly cash dividend of $0.50, or $2.00 on an annual basis. Our dividend estimates are $2.00 for 2024 and 2025. The forward dividend yield is just 0.35%, but it is a start – and rather remarkable for a Tech company. The company repurchased $30.125 billion of its Class A stock in the first nine months of 2024, more than doubling its pace during the same period in 2023, after buying back $19.8 billion in 2023 and $27.9 billion in 2022. It company repurchased $44.5 billion in 2021, $6.3 billion in 2020, and $4.2 billion in 2019. The share count declined by 1.6% or 41 million shares over the last year.

MANAGEMENT & RISKS

Meta is vulnerable to extreme regulatory backlash in the U.S. and globally related to antitrust; the spread of misinformation, including election interference; the spread of unlawful content in private groups and encrypted communications, e.g., child pornography, hate speech; illegal drug distribution, and the misuse of members’ private information, among others. We say “extreme regulatory backlash” since Meta is not only being charged with huge fines for alleged transgressions but faces the specter of a forced break-up of the company, given its social media market power.

Meta is appealing a decision and a record 1.2 billion-euro ($1.3 billion) fine levied by the European Data Protection Board in May 2023. The U.S. Federal Trade Commission antitrust lawsuits where break-up is a possible remedy have at a minimum increased headline risk for Meta, and will likely take substantial time to move through the courts.
Management distraction is another risk arising from the FTC suit, and from other regulatory litigation and investigations, particularly in the European Union.

In late 2022, the EU passed the Digital Services Act (DSA) and the Digital Markets Act (DMA), both aimed at severely regulating large online businesses, i.e., Meta and other large American tech companies. The DSA is aimed at regulating Meta's practices around content moderation/disinformation and user privacy, among other issues, and the company will be required to undergo outside audits of its practices and share algorithmic data with EU regulators. Penalties for noncompliance to the new law are severe.

In another regulatory salvo from the European Commission, the EC informed Meta of the EC's preliminary finding that Meta's advertising model fails to comply with the DMA. In response to the enactment of the DMA, Meta launched a revised advertising model in November 2023 giving European users the option of paying a monthly subscription fee for an advertising-free version of its social networks or, alternatively, access to an advertising-supported version that allows Meta to use personal data for advertising targeting. The EC's preliminary view, issued on July 1, is that Meta's new "pay or consent" advertising model still does not comply with the DMA as it presents users with a "binary choice" that "forces users to consent to the combination of their personal data and fails to provide them with a less personalized but equivalent version of Meta's social networks." The crux of the matter appears to be Meta not offering equivalent free versions of its social networks without personalized advertising targeting. If Meta is eventually found to be in violation of the DMA, the fines could be confiscatory: 10% of worldwide revenue for a first offense; 20% of worldwide revenue for repeated offenses; and, for "systemic noncompliance," a forced break-up, sale of the business, or banning of acquisitions. With Meta deriving 23% of its advertising revenue from Europe (with advertising making up almost all of the company's total revenue), pulling out of the region is not an option. The EC expects to conclude its investigation in March 2026.

On October 24, 2023, Meta was hit with a flurry of joint lawsuits brought by 41 states in federal court. Some state Attorneys General have also filed similar suits in their own state courts. The lawsuits allege that Meta has harmed the psychological health of children and adolescents by knowingly designing psychologically manipulative "technologies to entice, engage, and ultimately ensnare youth and teens." The suits allege that Meta lied to the public by minimizing the damaging impact of these technologies and violated the Children's Online Privacy Protection Act (COPPA) by unlawfully collecting "the personal data of its youngest users" without their parents' permission. The lawsuits seek injunctions to stop the alleged actions as well as monetary damages.

Like all advertising-dependent companies, Meta could be severely hurt by a decline in advertising. This risk is heightened by the uncertainty surrounding macroeconomic growth, which closely correlates with advertising growth. Meta may also be more resilient than other ad-reliant companies due to the secular trend of advertisers moving to digital from other channels and to its sophisticated ad audience targeting tools.

While user growth has migrated toward developing markets, the U.S., Meta's home market, is still its most lucrative. As such, a meaningful defection of U.S. users from the flagship Facebook site (other than to Facebook's own sister applications Instagram, WhatsApp, Reels, and Threads) could materially impact the company's performance and business model. A significant loss of advertisers would also be a material problem.

Meta is almost entirely dependent on advertising revenue, which has grown to about 98% of total revenue. The secular trend of advertisers devoting more and more of their advertising dollars to internet-based advertising has generally softened the effect of cyclical swings in the online advertising market. The flagship Facebook platform is at saturation in the U.S., meaning that growth in that platform will likely slow over time. Meta's emerging platforms, Instagram, Messenger, WhatsApp, Reels, and Threads have been building their respective user bases nicely, and are in various stages of monetization. Management has also warned that it is willing to sacrifice short-term margin expansion for long-term membership growth and increased member engagement.

Competition in the internet space is intense, and Meta is up against a number of larger companies with greater resources, including Google, Microsoft, and Apple. The company also competes with smaller virally popular social media companies like TikTok, Twitter, Snapchat, Reddit, and Discord. As Meta expands internationally, it must manage its entry into new markets, where it may have limited understanding of the local culture. It also faces pressure from "national champion" competitors, especially in China, from which it is currently banned. Government regulation and the possible censorship of site content could also become much more burdensome in the coming years, both in the U.S. and in international markets. The Snowden revelations involving the use of American internet company data by the NSA could make Meta's penetration of foreign markets much more difficult, and result in restrictions or outright bans by foreign governments.

Like any fast-growing tech company, Meta must successfully manage its growth trajectory. It must also ensure 24/7 system reliability in the face of increasingly toxic computer network attacks from malicious governments, organizations or individuals attempting to steal user information.

More than most internet start-ups, Meta is identified with its founder, chairman and CEO Mark Zuckerberg, and his possible loss would undoubtedly be a major blow to the company.

COMPANY DESCRIPTION

Meta Platforms operates the world's largest family of social networking websites, including the flagship Facebook site, Instagram, Facebook Messenger, WhatsApp, Reels and Threads. The sites enable users to communicate with friends and family by posting to the site; commenting on others' posts; sharing photographs, website links, and videos; and messaging and playing games. The company also partners with application developers to add functionality to the sites, and allows users to pay for virtual goods and services through its Payments function. Meta derives about 55% of its revenue from outside the U.S. and Canada. Facebook/Meta went public on May 18, 2012. Meta Platforms changed its ticker from FB to META on June 9, 2022.

VALUATION

META shares are up 68% year to date on a total return basis, compared to a 23% gain for the S&P 500, a 40% gain for the S&P Interactive Media & Services Industry Index, and a 38% gain for the NYSE Fang+ Index. Meta shares have rallied on a reacceleration in advertising revenue, substantial cost cuts, robust cash flow, and possible AI and other opportunities. The forward EV/EBITDA multiple of 16 is 6% below the peer average. We are maintaining our BUY rating on Meta to a target price of $660.

On November 1, BUY-rated META closed at $567.16, down $0.42. (Joseph Bonner, CFA, 11/1/24)

KLA CORP. (NGS: KLAC, $669.38).. BUY

KLAC: Solid growth continuing

* KLA Corp. exceeded consensus expectations while reporting year-over-year sales and non-GAAP EPS growth for fiscal 1Q25.
* Revenue and non-GAAP EPS grew on a year-over-year basis for the second straight quarter, after five quarters of negative comps.
* Memory demand continues to recover sequentially. We expect memory demand to grow year over year going forward.
* Demand continues to build for KLA's industry-leading solutions for process control and metrology, with wafer inspection tools outpacing overall industry revenue trends.

ANALYSIS

INVESTMENT THESIS

BUY-rated KLA Corp. (NGS: KLAC), formerly KLA-Tencor, sold off by 4% in a mixed market on 10/31/24, despite the company exceeding consensus revenue and non-GAAP EPS expectations for fiscal 1Q25 (calendar 3Q24). KLA's revenue and non-GAAP EPS grew on a year-over-year basis for the second straight quarter, after five quarters of negative comps.

KLA Corp. exceeded the midpoint of its guidance for fiscal 1Q25 revenue and non-GAAP EPS. Fiscal 1Q24 revenue rose 19%, reflecting double-digit annual growth in both services and products. Non-GAAP EPS rose more than 25%, aided by the resumption of volume leverage and mix.

After rising 39% in FY23, KLA's Foundry & Logic business declined 15% in fiscal 2024. Foundry bounced back with 44% revenue growth in 1Q25. Memory demand continues to recover, rising in high-teen percentages in FY24 after declining 18% in FY23. Memory sales declined annually in 1Q25, but grew in double digits sequentially. We look for both Foundry & Logic and Memory demand to grow in FY25 as generative AI and hybrid cloud continue to drive growth.

Regarding the WFE industry outlook for calendar 2024, management now expects overall industry demand to grow, after earlier guiding for little change from 2023 levels. Timing and magnitude of global demand recovery remains uncertain. We expect the second half of calendar 2024 to be stronger than the first for semiconductor capital equipment, and long-term demand to exceed pre-pandemic production levels in several markets.

KLA believes it is positioned to outperform peers in coming years, given that inspection tools have historically outperformed wafer fabrication tools in down years. KLA's process control market share exceeds 55%, four-times as high as its closest rival. KLA is tightening its focus, and in March announced plans to divest its flat panel business.

For the longer term, KLA stands to benefit from the CHIPS and Science Act and other global initiatives that recognize semiconductor production as a national strategic priority and a component of national security. Integrated semiconductor companies building new fabs in the U.S. and elsewhere turn to KLA for advanced metrology solutions, a niche where the company is building on its role as the market leader. Metrology tools will also be indispensable as demand surges to meet voracious semiconductor needs in large language models, training, inference, and other generative AI tasks.

The KLAC shares appear attractive at current levels. For the long-term investor, KLAC appears particularly attractive based on our discounted free cash flow model. We are reiterating our BUY rating with a 12-month target price of $875.

RECENT DEVELOPMENTS

KLAC is up 15% year-to-date in 2024, while immediate peers are up 208%. KLAC rose 54% in 2023, while the peer group of Argus-covered semiconductor capital equipment companies and merchant fabs advanced 57%. KLAC declined 12% in 2022, while peers fell a sharper 32%; rose 66% in 2021, while immediate peers advanced 53%; and appreciated 45% in 2020, while peers rose 49%.

For fiscal 1Q25 (calendar 3Q24), KLA Corp. posted revenue of $2.84 billion, which was up 19% annually and 11% sequentially. Revenue was above the $2.75 billion midpoint of management's guidance range of $2.60-$2.90 billion and exceeded the consensus forecast of $2.76 billion. Non-GAAP EPS of $7.33 rose 28% year over year and was up sequentially by $0.73 from fiscal 4Q24. Non-GAAP EPS was toward the upper end of management's wide $6.40-$7.60 non-GAAP EPS guidance range; EPS also topped the $7.05 consensus estimate.

CEO Rick Wallace noted that fiscal 4Q24 results reflected market conditions that have stabilized, and that KLA's business conditions are expected to continue improving as the calendar year progresses. Significantly, KLA's quarterly revenue and non-GAAP EPS grew for fiscal 4Q24 grew on a year-over-year basis for the first time since fiscal 3Q23.

KLA believes its business bottomed in the March quarter (fiscal 3Q24) and that growth from the June quarter should accelerate going forward. After a fiscal 4Q24 that "played out largely as expected" according to the CEO, KLA has begun FY25 amid signs of a strengthening market environment for leading-edge tools. Customers are reporting increasing demand across multiple end markets, which, in turn, is driving discussions about future investments in leading-edge capacity tools. Management is confident in its plan for steady demand and operational improvement through the remainder of the calendar year and into calendar 2025.

Regarding the WFE industry outlook for calendar 2024, management now expects overall industry demand growth in calendar 2024, after earlier guiding for little change from 2023 levels. Global WFE Spending could potentially reach the mid-$90 billion range, following a low-double-digit percentage decline in 2023 from 2022 levels. The company continues to expect the second half of 2024 to be stronger than the first half for WFE spending.

In foundry & logic end markets, the company is benefiting from long-term tailwinds including scaling and incorporation of new technologies as the age of on-device Gen AI gets underway, as well as rising capital intensity. In memory, the company expects a return to global growth given rising technology-development investments for high-bandwidth AI memory. Supply-demand is also coming into better balance for memory, KLA believes.

AI continues to be a "driver and enabler for KLA's business," according to the CEO. AI adoption is driving higher volume in wafer manufacturing, more complex designs, larger die and chip sizes, and an increase in advanced packaging demand. All these factors are supporting an increase in process control intensity, the company believes. The company raised its outlook for advanced packaging related to AI to $500 million in annualized revenue, up from an earlier $400 million estimate.

KLA is the market leader in metrology and inspection for wafer fabrication equipment (WFE). CEO Wallace noted that fiscal 4Q24 was another strong quarter for the company's fourth- and fifth-generation BBP (broadband plasma) patterned wafer inspection products. Management believes BBP's "significant differentiation" is keeping this product line at the forefront of the wafer inspection niche within WFE. Growth is forecast to carry across the remainder of calendar 2024 into 2025.

Another competitive advantage for KLA is its service business, which is expanding to reflect KLA's increased number of tools in the field. Rounding out the product revenue growth of 8% year over year in fiscal 4Q24, the services business grew 14% in the quarter.

For fiscal 1Q25, semiconductor process controls (SPC) revenue of $2.58 billion (91% of total) increased 21% annually and 12% sequentially. KLA is now reporting foundry & logic as one category to mute "noise" related to brief shifts in customer demand; this also aligns with peer-group reporting.

Within SPC, foundry & logic revenue (80% of SPC total) rose 44% annually and was up 9% sequentially. Memory revenue (20% of SPC total) was down 27% year- over year, but up 24% quarter over quarter from 4Q24. The memory business has a multitude of end-use demand drivers and can quickly pivot from inventory digestion at customers to growth within the space of a few quarters.

The current recovery in memory demand is based on revived edge device demand and easier comps. NAND and DRAM fabs have been at low utilization levels, but are now ramping as consumer demand shifts from tepid to moderately stronger. Once consumer activity is sufficient to utilize existing capacity, KLA expects to see new NAND and DRAM investments on a sustained basis.

Within memory, KLA's customer split has been approximately 55% NAND and 45% DRAM. Given consumer demand dynamics, and particularly given very weak DRAM dynamics throughout calendar 2023, KLA looks for DRAM demand to recover in calendar 2024 into 2025 meaningfully faster than NAND demand.

On a product basis for 1Q25, the core and largest business of wafer inspection (48% of revenue) was up 36% annually and 17% quarter over quarter from fiscal 4Q24. Patterning revenue (20% of total) was up 6% annually and 6% sequentially. Patterning, one of the fastest growing of KLA's SPC businesses, has been impacted by weak leading-node demand and the shift to lagging nodes within Chinese demand. We look for this business to accelerate in calendar 2H24 and into 2025 as the age of on-device Gen AI gets underway.

Services (23% of total) grew 15% year over year and 5% quarter over quarter. As KLA gets more machines in the field, we expect services growth to exceed the long-term top-line growth average. Among the other reportable product segments, specialty semiconductor processes revenue (4% of total) was up 1% year over year. PCB, display and content inspection (3% of total) rose 3% annually.

On a regional basis, leadership frequently shifts among the Asian semiconductor giants of Korea, Taiwan, Japan, and China, which has been dominant for the past year. China demand recovered in the fiscal 2023 second half and remained strong in KLA's FY24, as industry participants in PRC seek to secure equipment before technology export bans from the U.S. DoJ become even more restrictive.

For 1Q25, sales to China (42% of total) were up 16% year over year and 6% sequentially. China has rapidly pivoted to acquiring wafer fab equipment for mature nodes, as it seeks to build out its industrial and automotive capacity. China appears to have stockpiled lagging nodes capital equipment in advance of anticipated harsher restrictions and export bans.

Other WFE companies such as ASML have indicated that China sales will drop to a normalized level in the low to mid-20% range for the year ahead. Over time, we expect KLA's China revenue to decline to about 20% of total revenue, and to be comprised mainly of sales of mature WFE and metrology products.

Other Asian markets generally declined in the quarter. For 3Q24, Korea (7% of revenue) was down 58%; and Japan (7% of total revenue) was down 5%. Sales to Taiwan (20% of total revenue) rose 4%; 4Q24 was the only positive quarter for Taiwan in FY24.

Other Asian markets generally declined in the quarter. For 1Q25, Korea (8% of revenue) was down 5%; and Japan (7% of total revenue) was down 17%. Sales to Taiwan (16% of total revenue) rose 12%; Taiwan posted negative annual comps for three of the four quarters in KLA's FY24.

North America (18% of total revenue) was up 113% in 1Q25 and soared by 6% sequentially. Europe was down 15%. With the passage of the CHIPS Act in the U.S. and similar stimulative measures in Europe, along with declining sales to traditional Asian powers, we expect the non-Asian contribution to step up in coming years.

During fiscal 2Q24, KLA recognized impairment charges of $219 million for the PCB, Display, and Inspection business unit, reflecting the weak long-term outlook for the flat panel display (FPD) business. It also incurred $70 million in charges in 3Q24 to write off obsolete inventory, and $60 million to impair goodwill and intangibles.

After investigating strategic alternatives for FPD, which represents less than 2% of total sales, KLA in March 2024 announced a strategic decision to exit the business. The decision was based on multiple inputs, including cancellation of a new technology product by a major customer. KLA expects to complete the exit through the end of manufacturing of FPD products by December 31, 2024. We believe KLA will be a more profitable business without FPD, although the impact will be modest.

EARNINGS & GROWTH ANALYSIS

For fiscal 1Q25 (calendar 3Q24), KLA Corp. posted revenue of $2.84 billion, which was up 19% annually and 11% sequentially. Revenue was above the $2.75 billion midpoint of management's guidance range of $$2.60-$2.90 billion and exceeded the consensus forecast of $2.76 billion.

The non-GAAP gross margin tightened to 61.2% in fiscal 1Q25 from 62.4% a year earlier. The non-GAAP operating margin was 41.5% in fiscal 1Q25, up from 40.2% a year earlier.

Non-GAAP EPS of $7.33 rose 28% year-over-year and was up sequentially by $0.73 from fiscal 4Q24. Non-GAAP EPS was toward the upper end of management's wide $6.40-$7.60 non-GAAP EPS guidance range; EPS also topped the $7.05 consensus estimate.

For all of the June 2024 fiscal year, revenue of $9.8 billion decreased 7% from $10.5 billion for FY23. Non-GAAP EPS of $23.76 declined 6% from $25.32 in FY23.

For fiscal 2Q25, KLA projected revenue of $2.80-$3.10 billion, which, at the $2.95 billion midpoint, would be up 19% annually and 4% sequentially. KLA also projected non-GAAP EPS of $7.15-$8.35; at the $7.75 midpoint, EPS would be up 26% annually.

We are raising our non-GAAP EPS projection for FY25 to $31.62 per diluted share from $28.89. We are raising our preliminary non-GAAP EPS projection for FY26 to $33.56 per diluted share from $31.36. Our five-year earnings growth rate forecast is 11%. We regard our estimates as fluid and subject to revision based on timing of recovery in WFE and semiconductor end-use demand.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for KLAC is Medium-High. The company has strengthened its shareholder return policies and is an active repurchaser of its stock. In June 2023, S&P upgraded KLAC's credit rating by one notch to A-. KLA issued $750 million in new debt in fiscal 3Q24, and plans to use proceeds to pay down maturing debt and for general corporate purposes.

Cash & investments were $4.63 billion at the end of fiscal 1Q25. Cash was $4.50 billion at the end of fiscal 2024, $3.34 billion at the end of fiscal 2023, $2.79 billion at the end of fiscal 2022, and $2.50 billion at the end of fiscal 2021.

Debt was $5.88 billion at the end of fiscal 1Q25. Debt was $6.63 billion at the end of fiscal 202, $6.07 billion at the end of fiscal 2023, $6.89 billion at the end of fiscal 2022, $3.44 billion at the close of fiscal 2021, and $3.44 billion at the close of FY20.

Cash flow from operations was $3.31 billion in FY24. Cash flow from operations was $3.67 billion in FY23, $3.31 billion in FY22, $2.19 billion in FY21, and $1.78 billion in FY20.

During fiscal 2023, KLAC returned $2.0 billion to shareholders, including $1.3 billion in share repurchases and $733 million in dividends. During fiscal 2022, KLAC returned $5.5 billion to shareholders, reflecting $4.9 billion in share repurchases (including a $3 billion accelerated share buyback) and $640 million in dividends.

In September 2023, KLA raised its quarterly dividend by 12%, to $1.30 per share. Previously, KLA raised its quarterly dividend by 24%, to $1.30 per share, in 2022; by 17%, to $1.05 per share, in 2021; by 7%, to $0.90 per share, in 2020; and by 13%, to $0.85, in 2019. In 2014, KLAC declared a special cash dividend of $16.50 per share. Excluding the special dividend, KLA has grown its dividend at a mid-teens compound annual rate since 2007.

Our dividend estimates are $6.20 for FY25 and $6.60 for FY26.

MANAGEMENT & RISKS

CEO Rick Wallace has been with KLAC for 29 years, starting as an applications engineer in 1998 and subsequently serving in several management positions. Bren Higgins has been CFO since 2013. He joined KLAC in 1999 and was previously division controller and VP of corporate finance. Ahmad Khan is EVP of global products; as head of process controls, he may be in line to be the next CEO.

While the company is still working with U.S. DoJ to finalize an accurate total of embargoed business, KLA estimated that foregone China sales could total $600-$900 million in calendar 2023. KLA generated $2.7 billion in China revenue in FY22, which represented 29% of total revenue. We thus look for China revenue to decline to 16%-18% of total sales for calendar 2023. Given the 31% contribution from China in 1Q23, we look for China to represent 20% of FY23 sales while declining in mid-teen percentages from FY22.

The now completed acquisition of Orbotech carries numerous risks, including potential misalignment in corporate culture, and participation in weak-return industries. However, we believe that the deal makes strategic sense as it positions KLA-Tencor in adjacent industries within the electronics supply chain, with limited to no overlap in geography, customers, or product categories. We also believe the acquisition was reasonably priced.

KLAC is subject to the usual risks of cyclicality in the semiconductor-equipment industry. As revenues slow, margins also typically suffer, leading to sharp declines in earnings. Industry downturns may be precipitated by economic recessions, and may also be affected by changes in demand for consumer products (mobile phones, tablets, and PCs), as well as for data center communications systems, and industrial uses.

Similarly, the company must be ready with new products when the next cyclical upturn arrives — if new semiconductor equipment arrives too soon before the upturn, it may be viewed as out-of-date when semiconductor sales accelerate; if it arrives too late, it may result in the loss of equipment sales to competitors.

The company also faces customer-concentration risk, as it relies on a small number of large customers with significant bargaining power. KLAC also faces risks from regulation and unfavorable currency translation, as well as from the debt incurred to support capital expenditures and acquisitions. Like its peers, it also faces the challenge of attracting top technical talent.

COMPANY DESCRIPTION

KLA Corp. is a leading supplier of process-control and yield-management solutions for the semiconductor and related nanoelectronics industries. KLA provides chip and wafer manufacturing products, including defect inspection and review, metrology solutions, lithography software, and other offerings. In addition, KLA provides power device, LED, micromechanical systems, and other products for the display market. KLA Corp. was formerly known as KLA-Tencor Corp. and changed its name in 2019.

VALUATION

KLAC shares trade at 21.1-times our FY25 non-GAAP EPS forecast and at 19.8-times our FY26 projection; the two-year average forward P/E of 20.5 is above the five-year (FY20-FY24) trailing multiple of 18.5. The shares, which have historically traded at a 0.92 relative P/E, currently trade at a two-year forward relative P/E of 0.95. Other historical comparable signal undervaluation; our price-based historical comparable valuation points to a value in the $580s, in a rapidly rising trend and below current prices.

KLAC trades at a modest premium to peers on price/sales, and in line with or below peers on absolute and relative P/E and EV/EBITDA. Peer-indicated value is around $770, reflecting the ongoing rally in tech stocks and underlying solid fundamentals at KLAC. Our discounted free cash flow analysis values the stock above $1,200, in a now-rising trend and well above current prices.

Our blended valuation estimate, which over-weights DFCF, is around $1,110. Appreciation to our 12-month target price of $875 along with the 0.8% annual yield, implies a risk-adjusted return in excess of our total forecast return for the broad market and is thus consistent with a BUY rating.

On November 1, BUY-rated KLAC closed at $669.38, up $3.15. (Jim Kelleher, CFA, 11/1/24)

STRYKER CORP. (NYSE: SYK, $367.15).. BUY

SYK: Raising target to $410

* Stryker's Mako robotic surgical platform is driving market-share gains in the orthopedic segment.
* Tuck-in acquisitions and new product launches are supporting future growth.
* Health growth in procedure volumes provides a tailwind to demand for orthopedic surgeries and for hospitals to add O/R capital equipment to expand capacity.
* We are raising our estimates for adjusted EPS to $12.05 from $12.00 for 2024 and to $13.55 from $13.50 for 2025.

ANALYSIS

INVESTMENT THESIS

BUY-rated Stryker Corp. (NYSE: SYK) has delivered strong operating results through solid execution and robust demand for its Mako Robotic Surgical system for orthopedic procedures. Mako is driving market share gains for Stryker.

The company is also strengthening its market position through M&A and new product launches. Stryker is a leader in orthopedic implants and in instruments and tools for the surgical operating room. Our target price is $410 (raised from $380).

RECENT DEVELOPMENTS

Stryker delivered strong results for 3Q24 (reported October 29). Adjusted EPS was $2.87, beating the consensus estimate by $0.10 and increasing by 16.7%. GAAP net income was $834 million, or $2.16 per share, compared to $$692 million, or $1.80 per share, a year ago. Sales were $5.5 billion, increasing 11.9% reported and 11.5% organic. Organic growth excludes the impact of foreign exchange and acquisitions.

Solid performances from both the MedSurg and the Orthopedics & Spine segments contributed to the financial results. MedSurg sales grew 12.7% organic. Orthopedics & Spine segment sales grew 9.7% organically. There was one extra selling day in 3Q24, which we estimate to have contributed less than 100 basis points to growth in the quarter.

By metrics of profitability, the adjusted gross margin was 64.5%, down 20 basis points. The adjusted operating margin was 24.7%, up 130 basis points.

Year-to-date in 2024, Stryker completed seven M&A transactions for a total of $1.6 billion. These acquisitions are expected to contribute some $300 million in revenue in 2025.

Stryker continues to put in place Mako robotics systems for orthopedics. These robots, which assist in knee and hip replacement surgeries, are installed as purchase, leased or rental transactions. Stryker recently launched Mako for spine surgeries.

EARNINGS AND GROWTH ANALYSIS

Stryker updated its 2024 guidance. It raised the low end of both its revenue range and adjusted EPS range. It now expects organic revenue growth of 9.5%-10.0%, compared to a prior view of 9.0%-10.0%. It also now expects adjusted EPS of $12.00-$12.10, compared to a prior view of $11.90-$12.10.

We are raising our estimates for adjusted EPS to $12.05 from $12.00 for 2024 and to $13.55 from $13.50 for 2025.

FINANCIAL STRENGTH AND DIVIDEND

Our financial strength rating on Stryker is Medium, the middle peg on our five-point scale. Cash flow from operations was $2.311 billion in the first nine months of 2024, compared to $2.183 billion a year earlier.

Stryker pays an annualized dividend of $3.20 per share for a yield of 0.90%. It raised the dividend 6.7% in December 2023. Our dividend estimates are $3.20 for 2024 and $3.40 for 2025.

MANAGEMENT AND RISKS

Kevin Lobo has served as CEO since October 2012, and Glenn Boehlein has served as CFO since April 2016.

Stryker faces risks, as its manufacturing operations are affected by supply-chain issues. Coming out of the pandemic, shortages in some components, including semiconductors and electronics, caused production delays, raised costs and delayed deliveries. The company noted on the 2Q24 earnings call that cost pressures from components have eased, thus contributing to higher gross margin. Stryker also faces operational risks as it integrates acquired businesses.

Prior to commercial release, Stryker's products must be approved by the FDA and regulatory agencies in overseas markets.

COMPANY DESCRIPTION

Based in Kalamazoo, Michigan, Stryker manufactures and markets medical devices, primarily in the orthopedic market. The Orthopedics segment sells joint reconstructive products (hips, knees and shoulders) and trauma implants. The MedSurg Equipment segment sells powered surgical instruments, surgical navigation systems, endoscopic products, medical video imaging equipment, and hospital beds and patient-handling systems. The Neurotechnology unit includes the neurovascular business as well as the interventional spine and spinal implants business.

VALUATION

SYK is trading at 26.3-times our 2025 EPS estimate, above the average multiple of 22.7 for our coverage universe of MedTech stocks. We believe that Stryker's growth opportunities in its Orthopedics, MedSurg, and Neurotechnology businesses and success in integrating acquisitions support a higher valuation. In addition, we expect the company to post stronger growth as elective procedure volumes continue to recover, and supply-chain issues ease further. We also see the Mako robotic surgical system as a clear differentiator in orthopedic surgery and a means for Stryker to gain market share. Our new target price is $410.

On November 1, BUY-rated SYK closed at $367.15, up $10.87. (David Toung, 11/1/24)

GENTHERM INC. (NGM: THRM, $43.27) .... HOLD

THRM: Waiting for a more favorable entry point

- On October 30, Gentherm Inc. reported adjusted 3Q24 net income of $23.6 million or $0.75 per diluted share, up from $21.4 million or $0.64 per diluted share in the prior-year quarter.
- The higher earnings reflected stronger revenue growth in both the Automotive and Medical businesses, as well as higher gross margins. This more than offset weaker pricing and start-up costs for new plant openings. Additionally, share repurchases ($20 million) benefited results.
- Gentherm lowered its guidance for the remainder of 2024 based largely on weaker-trending light vehicle rates of production, which (negatively) impacts the content they provide on vehicle platforms.
- The company now expects product revenue of $1.45-$1.47 billion (compared to $1.50-$1.60 billion previously) and an adjusted EBITDA margin near the midpoint of 12.5%-13.5%, compared to above the midpoint of 12.5%-13.5% previously.

ANALYSIS

INVESTMENT THESIS

Our rating on Gentherm Inc. (NGM: THRM), a small-cap company that provides its proprietary thermal management and pneumatic comfort technologies to the automotive (its largest business) and medical industries, is HOLD.

Global vehicle production rates have been on the downswing now for the past 6-12 months, as OEM car manufacturers have been cutting back on production due to slower consumer demand. Elevated interest rates are curbing consumer purchasing power and elevated rates of inflation has affected both the cost of a new vehicle, along with associated financing options, further depressing demand.

These factors, among others, have necessitated that automakers align their production rates with moderating demand, which has negatively impacted the operating and financial results at Gentherm. Both top-line and bottom-line growth has been slowing and with it, the company has had to lower its “forward-looking” financial guidance. While longer-term, we view THRM as well positioned strategically in its key business markets, which should drive revenue growth and margin expansion over time, we believe that until light vehicle demand improves and shows signs of sustainable growth, THRM is unlikely to outperform the current market and remain under pressure on both a sales and earnings perspective. As a result, we believe a HOLD-rating is appropriate at the present time.

RECENT DEVELOPMENTS

On October 30, Gentherm Inc. reported adjusted 3Q24 net income of $23.6 million or $0.75 per diluted share, up from $21.4 million or $0.64 per diluted share in the prior-year quarter. EPS results beat our estimate of $0.70 and the quarterly Street consensus forecast of $0.66 per share.

The higher earnings reflected stronger revenue growth in both the Automotive and Medical businesses, as well as higher gross margins. This more than offset weaker pricing and start-up costs for new plant openings. Additionally, share repurchases ($20 million) benefited results.

Revenue for the third quarter of 2024 increased 2% to $371.5 million, versus $366.2 million in the year-ago quarter. Sales missed the Street consensus estimate of $374.5 million. For the quarter, gross margin increased to 25.5% (from 23.5% in 3Q23) reflecting supplier cost reductions and non-core divestments.

Gentherm currently operates in two business segments: Automotive (97% of 3Q24 sales) and Medical (3%). Results for the third quarter of 2024 are summarized below:

Automotive segment revenue increased 1% in the third quarter of 2024, led by improvements in Lumbar and Massage Comfort Solutions (up 47%) and Steering Wheel Heaters (up 12%).

Medical segment sales improved 11% from the prior-year period, primarily the result of strength in the Blanketrol product and the U.S. Med-Equipment partnership.

EARNINGS & GROWTH ANALYSIS

Following third-quarter 2024 financial results, Gentherm lowered its guidance for the remainder of 2024 based largely on weaker-trending light vehicle rates of production, which (negatively) impacts the content they provide on vehicle platforms. The company now expects product revenue of $1.45-$1.47 billion, down from $1.50-$1.60 billion and an adjusted EBITDA margin near the midpoint of 12.5%-13.5%, compared to above the midpoint of 12.5%-13.5% previously.

We are lowering our 2024 EPS estimate to $2.55 from $2.90 per share to reflect management’s downwardly revised financial guidance, which lowers our full-year 2024 revenue forecast by approximately 6%.

At the same time, we are reducing our 2025 EPS estimate to $2.93 from $3.40 per share to reflect our expectations for continuing soft production rates with most global OEM manufacturers, as trends in dealer inventories suggest that new vehicle sales are moderating amid slower consumer demand.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Gentherm is Medium-High, the second-highest rating on our five-point scale. The company’s debt is not rated by any of the major credit report agencies at this time.

Cash and cash equivalents at the end of the third quarter of 2024 totaled $150.6 million, compared to $149.7 million at the end of the third quarter of 2023. Net cash provided by operating activities for the nine months ended 3Q24 was $73.1 million compared to $80.0 million for the nine months ended 3Q23.

Total debt for the third quarter of 2024 was $259.2 million, comprising short-term debt of $15.1 million and long-term borrowings of $244.1 million, compared to total debt of $232.0 million at the end of the third quarter of 2023.

The company repurchased $20 million of its common shares during 3Q24, with their board of directors authorizing (in 2Q24) a new stock repurchase program of $150 million for the next three years. The company does not pay a dividend.

MANAGEMENT & RISKS

Phillip Eyler is the president and CEO of Gentherm. Mr. Eyler previously worked at Harman, a subsidiary of Samsung. Francois Castaing is the company’s chairman. On August 6, 2024, the company announced that CFO/Treasurer Matteo Anversa, had resigned effective September 1, 2024 to accept the role of Chief Financial Officer of Logitech International. He was previously CFO at Myers Industries. Gentherm has initiated a CFO succession process, chaired by the President and CEO, and will provide updates as appropriate.

The company’s strategy is to achieve focused growth by improving comfort for drivers in its automotive business and expanding patient thermal solutions in its medical segment. Its financial goals for 2026 include revenue of $2.05-$2.35 billion and an adjusted EBITDA margin in the high teens.

The company has a growth-by-acquisition strategy. In 2022, Gentherm acquired Germany-based Alfmeier, a leader in automotive lumbar and massage comfort solutions, for $165 million. Alfmeier's revenue run rate was $215 million. Gentherm management has targeted $10 million in annual run-rate cost savings from the acquisition.

Investors in THRM shares face risks related to supply-chain issues, tax matters, and trade policies. The company may also face pressure from weak consumer spending and new regulatory requirements.

COMPANY DESCRIPTION

Gentherm is a global market leader of innovative thermal management and pneumatic comfort technologies for the automotive industry and a leader in medical patient temperature management systems. Automotive products include variable temperature Climate Control Seats, heated automotive interior systems (including heated seats, steering wheels, armrests and other components), battery performance solutions, cable systems, lumbar and massage comfort solutions, valve system technologies, and other electronic devices. Medical products include patient temperature management systems. The company is also developing a number of new technologies and products that will help enable improvements to existing products and to create new product applications for existing and new markets. Gentherm has more than 14,000 employees.

VALUATION

We believe that THRM shares are fairly valued at recent prices near the $41-$44 price range, below the company's midpoint of their 52-week range of $39.86-$62.93.

Gentherm shares are currently trading at 16-times our 2024 EPS estimate and xx-times our 2025 EPS estimate compared to their five-year range of 12-22. The price/sales multiple is 1.1, with a five-year range of 1.1-2.2. We believe that these are fair valuations, given the company's prospects for the next 6-12 months. If management shows progress in meeting new profitability benchmarks and industry fundamentals improve, we may consider moving the THRM shares back to our BUY list.

On November 1, HOLD-rated THRM closed at $43.27, up $1.32. (Bill Selesky, 11/1/24)

ONEOK INC. (NYSE: OKE, $93.36)..HOLD

OKE: Waiting for a more attractive entry point

* On October 29, after the closing bell, ONEOK reported adjusted 3Q24 net income of $693 million or $1.18 per diluted share, up from $454 million or $0.99 per diluted share in the prior-year quarter.
* The higher earnings reflected higher NGL and natural gas processing volumes in the Rocky Mountain region, increased transportation services in the Natural Gas Pipelines segment and contributions from the Refined Products and Crude segment.
* OKE raised its guidance for the rest of 2024 (stand-alone basis), based on synergy expectations (from earlier acquisitions) and strength in fee-based earnings growth. The company now expects consolidated net income of $2.87-$3.02 billion and adjusted EPS of $4.63-$5.40 per share.
* We are lowering our 2024 EPS estimate to $5.02 from $5.06. We note that our $5.06 estimate had been overly aggressive on expected stock repurchases for the third quarter.

ANALYSIS

INVESTMENT THESIS

Our rating on ONEOK Inc. (NYSE: OKE) is HOLD. The company has taken on enormous amounts of debt, both long-term and short-term, over the past few years to support its capital investment program and currently holds a debt/cap ratio of about 57%, which is meaningfully above its peer-group average.

We believe this is excessive, particularly in a high interest rate environment and note that the recent acquisition of Magellan Midstream Partners includes the assumption of significant amounts of additional debt. On the encouraging side, OKE retired $1.3 billion of long-term debt in 2023. However, we do believe the shares offer value, as it does support a dividend yield of about 4.09% in the current energy environment. We would look to upgrade the shares once we see a more concerted effort by management to lower its debt load over the next 12-24 months.

RECENT DEVELOPMENTS

On October 29 after the closing bell, ONEOK reported adjusted 3Q24 net income of $693 million or $1.18 per diluted share, up from $454 million or $0.99 per diluted share in the prior-year quarter. EPS results missed our estimate of $1.24 and the Street consensus forecast of $1.23.

The higher earnings reflected higher NGL and natural gas processing volumes in the Rocky Mountain region, increased transportation services in the Natural Gas Pipelines segment and contributions from the Refined Products and Crude segment. Total revenue for the third quarter of 2024 increased 20% to $5.023 billion.

ONEOK engages in gathering, processing, fractionation, storage, transportation, and marketing of natural gas and natural gas liquids (NGL) in the United States. It operates through four business segments. For the third quarter of 2024, business segment results are summarized below.

The Natural Gas Liquids segment posted adjusted EBITDA of $624 million, up from $616 million a year earlier. The improvement was attributable to higher volumes in the Rocky Mountain region, higher average fee rates, and benefits (from the Medford incident) due to lower third-party fractionation costs.

In the Natural Gas Gathering and Processing Segment, adjusted EBITDA decreased to $318 million from $323 million a year earlier. The modest decline mostly reflected lower realized natural gas liquids (NGL's) prices and the negative impact of the sale of certain Kansas assets in the second quarter of 2024. This more than offset volume growth in the Rocky Mountain region (higher production).

In Natural Gas Pipelines, adjusted EBITDA increased to $166 million from $136 million a year earlier, due to higher firm and interruptible rates and earnings from unconsolidated affiliates due primarily to increased volumes on the Northern Border Pipeline;

The Refined Products and Crude Segment reported 3Q24 adjusted EBITDA of $441 million, down from $1.289 billion in the prior-year quarter. Higher operating costs (due primarily to the allocation of corporate costs, planned asset maintenance and higher property tax accruals) and a decrease in transportation and storage fees due to lower seasonal volumes negatively impacted results.

Lastly, in other business news, OKE announced on October 31, 2024 that it completed its acquisition of Medallion Midstream (announced August 28) from Global Infrastructure Partners (GIP's), for cash consideration of $2.6 billion. The privately-held company, provides crude oil gathering and transportation services in the Permian basin and has more than 1,200 miles of crude oil gathering pipelines providing 1.3 million barrels per day of capacity and approximately 1.5 million barrels of crude oil storage.

Additionally, the company also entered into another transaction with Global Infrastructure Partners to acquire GIP's entire interest in EnLink Midstream, consisting of 43% of EnLink's outstanding common units for $14.90 per unit and 100% of the interests in the managing member for $300 million (for total cash consideration of $3.3 billion). The closing of the transaction is expected in 4Q24.

EARNINGS & GROWTH ANALYSIS

Following third-quarter 2024 results, OKE raised its guidance for the rest of 2024 (stand-alone basis), based on synergy expectations (from earlier acquisitions) and strength in fee-based earnings growth. The company now expects consolidated net income of $2.87-$3.02 billion (up from $2.73-$3.03 billion) and adjusted EPS of $4.63-$5.40 per share (up from $4.56-$5.27 per share).

We are lowering our 2024 EPS estimate to $5.02 from $5.06 to be in sync with current company guidance. We note that our earlier $5.06 estimate had been overly aggressive, based largely on expected stock repurchases for the third quarter.

At the same time, we are reaffirming our 2025 EPS estimate of $5.58, implying year-over-year earnings growth of approximately 11%. Our model assumes higher year-over-year revenue growth and generally supportive oil and gas market conditions.

FINANCIAL STRENGTH & DIVIDEND

We rate OKE's financial strength as Medium, the midpoint on our five-point scale. The company's debt is rated Baa2/stable by Moody's and BBB/stable by S&P. Both ratings are investment grade.

At the end of 3Q24, the total debt/capitalization ratio was 56.9%, down from 64.0% at the end of 3Q23. The ratio remains well above the peer average. It has averaged 66.3% over the past five years.

Total company debt was $21.973 billion at the end of the quarter, comprised of $1.634 of short-term debt and $20.339 billion of long-term borrowings. This compares to total company debt of $12.867 billion at the end of 3Q23. The increase is attributable to asset expansions and recent acquisitions (Magellan).

Cash from operating activities for the 9 months ended September 30, 2024, was $3.277 billion, compared to $2.913 billion for the 9 months ended September 30, 2023. OKE had cash and equivalents of $579 million at the end of 3Q24, compared to $284 million at the end of 3Q23. The company also has an undrawn $2.5 billion revolving credit facility.

On January 17, 2024, the company increased its quarterly dividend by 4% to $0.990 per share or $3.96 annually. The current yield is about 4.09%. Our dividend estimates are $3.96 for 2024 and $4.00 for 2025.

MANAGEMENT & RISKS

Pierce H. Norton II is president and chief executive officer of ONEOK and is a member of the ONEOK Board of Directors. Previously, Norton was president and chief executive officer of ONE Gas, Inc. for more than seven years and served as a member of the ONE Gas board. Norton worked for ONEOK for almost 10 years, having joined the company in 2004. Prior to the separation of ONE Gas in January 2014, Norton served as executive vice president, commercial, of ONEOK and ONEOK Partners.

ONEOK's biggest risks involve liquidity, credit and regulatory issues; bad weather; and changes in demand for natural gas, NGLs, and crude oil. In addition, rising interest rates may increase the company's capital costs. The tax treatment of MLPs may also make investors hesitant to own the stock.

COMPANY DESCRIPTION

ONEOK Inc. is one of the largest energy midstream service providers in the United States, connecting supply basins with key market centers. It owns and operates one of the nation's premier natural gas liquids systems and is a leader in the gathering, processing, storage and transportation of natural gas and refined products. ONEOK's operations include a 50,000-mile integrated network of NGL and natural gas pipelines, processing plants, fractionators and storage facilities in the Mid-Continent, Williston, Permian, and Rocky Mountain regions. The company now has four (4) business segments: Natural Gas Gathering and Processing, Natural Gas Liquids, Natural Gas Pipelines and Refined Products and Crude.

VALUATION

OKE common shares have traded between $63.33 and $98.43 per share over the past 52 weeks and are currently trading more than 15% above the midpoint of this range. To value the stock on a fundamental basis, we use peer group and historical multiple comparisons, as well as a dividend discount model.

With reference to valuation metrics, the shares are currently trading at 18.6-times our 2024 EPS estimate and at 16.7-times our 2025 forecast, compared to a 13-year annual average price/earnings range of 17-29. Using other standard valuation metrics, the shares are trading below the low end of the range for price/book (3.1 versus a range of 4.0-16.0), above the high end of the range for price/sales (2.3 versus a range of 1.0-1.8) and above the midpoint of the range for price/cash flow (10.3 versus a range of 6.9-12.1). They are also trading at a price/EBITDA multiple of 9.0, below the midpoint of the range of 7.6-11.9.

On November 1, HOLD-rated OKE closed at $93.36, down $2.53. (Bill Selesky, 11/1/24)

RAYMOND JAMES FINANCIAL INC. (NYSE: RJF, $144.29).. BUY

RJF: Raising target on leading broker-dealer

* On October 23, Raymond James reported record fiscal 4Q24 adjusted EPS of $2.95, up from $2.13 a year earlier, reflecting higher asset management fees and investment banking revenues.
* Over the past year, RJF shares have risen 52%, versus a 37% advance for the S&P 500 and a 51% increase for the IAI broker-dealer and securities ETF.
* The 4Q return on equity was 18.9%, and the return on tangible common equity was 23.3%.
* Our revised target price of $155 implies a multiple of 14-times our FY25 EPS estimate.

ANALYSIS

INVESTMENT THESIS

We are maintaining our BUY rating on Raymond James Financial Inc. (NYSE: RJF) and raising our target price to $155, having surpassed our prior target of $134. We expect revenues in fiscal 1Q25 to increase in the Private Client and Asset Management segments due to higher valuations at the end of fiscal 4Q, offset by higher expenses. We also look for the net interest margin to remain stable near 2.50%-2.75% at RJ Bank, supported by higher rates and the TriState loans. We expect the company to remain in expansion mode as it brings additional advisers to its platform and makes strategic acquisitions that fit within its long-term plan.

RECENT DEVELOPMENTS

Over the past year, RJF shares have risen 52%, versus a 37% advance for the S&P 500 and a 51% increase for the IAI broker-dealer and securities ETF. Approximately 15.4% of the RJF shares are held in various ETFs and make up approximately 3.6% of the IAI. The beta on RJF is 1.04.

On October 23, Raymond James reported record fiscal 4Q24 adjusted EPS of $2.95, up from $2.13 a year earlier, reflecting higher asset management fees and investment banking revenues. Record net revenues were up 13% to $3.46 billion. Operating expenses rose 9% to $2.70 billion due to higher compensation and other expenses. The number of advisors was 8,787, up 75 advisors from the prior-year quarter. The 4Q return on equity was 18.9% and the return on tangible common equity was 23.3%.

For FY24, RJF reported adjusted earnings of $10.05, up from $8.30 in FY23. Revenue rose 10% to $12.82 billion from $11.62 in FY23.

In March 2024, RJF named current CFO Paul Shoukry as president and as the successor to CEO Paul Reilly. Mr. Reilly has served as the CEO since 2010. The company also announced other leadership changes effective October 2024. COO Jeff

Dowdle announced his retirement; Raymond James Financial Private Client Group President Scott Curtis will become COO of Raymond James Financial; current Raymond James & Associates CEO Tash Elwyn will become president of the Private Client Group; and Global Equities & Investment Banking President Jim Bunn will become president of the Capital Markets segment.

RJF has been on an acquisition tear over the past couple years, expanding its wealth management, investment banking, and financing capabilities.

In July 2022, RJF acquired SumRidge Partners, a technology-based fixed-income market maker specializing in corporate bonds, municipal bonds, and institutional preferred securities.

In June 2022, Raymond James acquired TriState Capital Holdings Inc. for $1.1 billion. The business continues to operate under the TriState name, providing private banking services and securities-based lending to high-net-worth clients.

In January 2022, the company acquired U.K.-based wealth manager Charles Stanley. Charles Stanley continues to operate as a separate division.

In May 2021, RJF announced the acquisition of private equity advisor Cebile Capital. Cebile is a private fund placement agent and secondary market adviser to middle-market and private capital firms.

In March 2021, the company acquired Financo, a boutique investment bank that advises on middle-market consumer transactions.

EARNINGS & GROWTH ANALYSIS

RJF organizes its businesses into four segments: Private Client Group, Capital Markets, Asset Management, and Raymond James Bank. We look at recent trends and outlooks for these segments below.

Private Client Group posted record fiscal 4Q net revenues of $2.48 billion, up 9% from the prior year and 2% from fiscal 3Q. The results reflected higher asset management and related administrative fees. Assets under administration were up 25% to a record $1.51 trillion, and assets in fee-based accounts rose 28% to a record $875.2 billion.

Capital Markets net revenue rose 42% from the prior year and 46% from 3Q to $483 million, reflecting higher investment banking revenues. The pipeline remains robust, activity is picking up, and expectations remain optimistic heading into fiscal 2025.

Asset Management net revenue rose 17% and 4% from fiscal 3Q to a quarterly record of $275 million; record assets under management of $244.8 billion were up 25%, driven by net inflows into fee-based accounts and stronger equity markets.

At Raymond James Bank, net revenue fell 4% to $433 million due to a lower NIM. The NIM declined by 25 bps to 2.62% as clients moved cash into higher-yielding securities. Net loans rose 4% to $45.1 billion. Provisions for credit losses fell to $22 million from $36 million in the prior year, reflecting the brighter economic outlook. The allowance for loan losses fell to 0.99% of loans. Nonperforming assets rose to 0.28% of loans from 0.21% in the prior-year quarter.

Intersegment eliminations totaled $233 million.

Based on fiscal 4Q results, quarter-end asset valuations and ongoing share repurchases, offset by higher funding costs and uncertain capital markets activity, we are raising our FY25 estimate to $10.93 from $10.25 and setting a FY26 estimate of $11.70.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on Raymond James is Medium-High. The company scores well above average on our three main measures of financial strength: leverage based on debt/cap, profitability, and interest coverage.

In fiscal 4Q, total assets rose 6% to $83 billion, while tangible book value rose 21% to $48.43 per share. The Tier 1 capital ratio rose to 22.8% from 21.4% in the prior quarter.

During the quarter, the company repurchased 2.6 million shares at an average price of $115, totaling $300 million. In November 2023, the board authorized a new $1.5 billion share-repurchase plan, and has approximately $645 million remaining.

In November 2023, the company boosted its quarterly dividend by 7% to $0.45 per share, or $1.80 annually, for a yield of about 1.2%. Our dividend estimates are $2.00 for FY25 and $2.20 for FY26.

MANAGEMENT & RISKS

Paul Reilly is the company's chairman and CEO. He has served as CEO since 2010 and has been a member of the board since 2006. The current CFO, Paul Shoukry, is set to become CEO in fiscal 2025, succeeding Paul Reilly, with Shoukry serving as interim president and maintaining his current duties until assuming the CEO position, while Reilly transitions to executive chair of the board of directors. Butch Oorlog is the new CFO.

Investors in RJF shares face numerous risks.

The company's performance is affected by market volatility and the level of adviser retention. It has relatively high fixed costs, and would suffer significant margin erosion if asset values decline and advisers leave the firm.

RJF also faces intense competition from other financial firms, which is likely to increase in the near term. To maintain its competitive position, the company needs to invest heavily in new technology and in recruiting and retaining advisers. We note that many advisers are approaching retirement, which could make it more difficult for the company to maintain a stable asset base. In addition, RJF must continue to grow its businesses organically or through acquisitions. The financial services industry is also subject to legal and regulatory developments that could raise the overall cost of doing business.

COMPANY DESCRIPTION

Raymond James Financial Inc. is a diversified financial services company. The company's businesses provide capital markets, asset management, private client, banking and other services to individuals, corporations and municipalities. The company was founded in 1962 and went public in 1983. RJF has over 8,700 advisers in the U.S. and total client assets of $1.5 trillion.

VALUATION

At current prices near $144, RJF shares are trading near the high point of their 52-week range of $94-$149. The shares are trading at 13-times our revised FY25 EPS estimate, reflecting volatility in equity and bond markets, and close to the mid-point of the historical range of 9-19. However, we believe that a higher multiple is warranted, based on the company's long-term growth prospects. Our revised target price of $155 implies a multiple of 14-times our revised FY25 EPS estimate as RJF expands through organic growth and future acquisitions. We think that investors will continue to focus on the company's growth in assets under management, strategic acquisitions, and efforts to expand the number of advisers, though a drop-off in capital markets activity and equity volatility could be headwinds in the near term.

On November 1, BUY-rated RJF traded at $144.29, down $3.93. (Kevin Heal, 11/1/24)

HF SINCLAIR CORP. (NYSE: DINO, $38.70) ....HOLD

DINO: Looking for a more favorable entry point

* On October 31, HF Sinclair reported an adjusted 3Q24 net profit of $96.5 million or $0.51 per diluted share, down from $760.4 million or $4.06 per diluted share in the prior-year quarter.
* The lower earnings reflected lower adjusted refinery gross margins (in both the West and Mid-Continent regions) as a result of high refinery utilization rates across the industry, which were partly offset by higher refinery product sales volumes.
* We are lowering our 2024 EPS estimate to $2.67 from $5.39 to partly reflect third-quarter results, which missed our estimate by $0.69 per share and our expectations for slightly moderating consumer demand (gasoline) for the remainder of the year.
* We are also lowering our 2025 EPS estimate to $2.80 from $5.59 to reflect our lower forecast for refining margin growth performance during the year, citing generally weaker consumer demand and higher costs for operational (refinery maintenance) programs.

ANALYSIS

INVESTMENT THESIS

Our rating on HF Sinclair Corp. (NYSE: DINO) is HOLD. Thus far in 2024, on a year-to-date basis (ending 10/31/24), the Refining segment of the S&P 500 Energy index is down 3.8% compared to the overall S&P 500 Energy index, which is up 6.4%. The underperformance in Refining (which had been beating the S&P 500 for the first six months of 2024) is largely attributable to weaker consumer demand and softer crude oil prices. Recent commentary from refining sector executives continue to highlight muted refining industry capacity (supply) growth and lower-trending capital expenditure budgets, but at the same time, they are also indicating that while current demand remains fairly solid, they remain "cautious" that 2025 will be stronger (in demand terms) than 2024. HF Sinclair common shares are down 30.7% since the beginning of the year. As a result, we look for a more favorable entry point for the shares before returning DINO to our BUY list.

Despite the underperformance, we view HF Sinclair as a highly formidable competitor within the Refining industry, with significant advantages in refining capacity and renewable diesel production. In addition, we believe the recent "buy-in" of the remaining interest in Holly Energy Partners is a smart one: it not only provides the company with additional market expansion opportunities, but also increases profits, as the "buy-in" was immediately accretive to earnings. In addition, we see the recent increase in the annual dividend (a boost of 11%) as a sign of confidence in both near-term company strategy and the refining industry.

RECENT DEVELOPMENTS

On October 31, HF Sinclair reported an adjusted 3Q24 net profit of $96.5 million or $0.51 per diluted share, down from $760.4 million or $4.06 per diluted share in the prior-year quarter. EPS fell short of our estimate of $1.20 per share but beat the consensus forecast of $0.29 per share.

The lower earnings reflected lower adjusted refinery gross margins (in both the West and Mid-Continent regions) as a result of high refinery utilization rates across the industry, which were partly offset by higher refinery product sales volumes. Revenue for the third quarter of 2024 decreased 19% from the prior year to $7.207 billion.

Third-quarter 2024 refinery throughput averaged 649,750 barrels per day, up 1% from the third quarter of 2023, mostly the result of decreased turnaround activities and improved reliability at all of the company's refining assets. Sales of refined products were led by gasoline (52% of total sales) and diesel fuel (31%). The remaining sales came from jet fuel, fuel oil, and asphalt.

The consolidated (adjusted) refinery gross margin was $10.79 per produced barrel, down 59% from $26.27 in 3Q23. Operating expenses per throughput barrel increased 1% in the third quarter of 2024, to $8.12 per barrel. Operating expenses per barrel were $8.06 in the third quarter of 2023, down 2% compared to the prior year period. The improvement was attributable to ongoing cost reduction initiatives.

As discussed previously, HollyFrontier and Holly Energy Partners acquired Sinclair Oil Corp. and Sinclair Transportation Co. on March 14, 2022. As part of the merger, HF Sinclair Corp. replaced HollyFrontier as the new public company and now trades on the NYSE under the DINO ticker. The value of the transaction was approximately $1.8 billion.

More recently, HF Sinclair had submitted a proposal to acquire all of the outstanding common units of Holly Energy Partners not beneficially owned by HF Sinclair or its affiliates. At the time, DINO had owned about 47% of the HEP common units. On December 1, 2023, HF Sinclair completed the acquisition of the remaining Holly Energy Partners (HEP) units, and now owns 100% of the company.

EARNINGS & GROWTH ANALYSIS

HF Sinclair Corporation does not typically provide any "forward-looking" full-year financial guidance as part of its overall corporate strategy. However, CEO Tim Go noted on the third-quarter earnings call "looking forward we remain focused on executing our strategy as we continue to improve reliability, optimize and integrate across our portfolio, all while generating strong cash flows to deliver returns to our shareholders."

We are lowering our 2024 EPS estimate to $2.67 from $5.39 to partly reflect third-quarter results, which missed our estimate by $0.69 per share and our expectations for slightly moderating consumer demand (gasoline) for the remainder of the year.

We are also lowering our 2025 EPS estimate to $2.80 from $5.59 to reflect our lower forecast for refining margin growth performance during the year, citing generally weaker consumer demand and higher costs for operational (refinery maintenance) programs.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating on HF Sinclair is Medium-High, the second-highest rank on our five-point scale. Moody's rates the company's debt at Baa3/stable while S&P and Fitch rate it BBB-/stable.

At the end of 3Q24, the total debt/capitalization ratio was 23.2%, down from 26.1% a year earlier. The debt/cap ratio is modestly below the current peer-group average. It has averaged 30.4% over the past five years.

Total outstanding debt was $2.536 billion at the end of 3Q24, comprised of $136.0 million of short-term debt and $2.400 billion of long-term debt. This compares to total debt of $3.56 billion at the end of 3Q23.

HF Sinclair had cash and cash equivalents of $1.354 billion at the end of 3Q24, down from $2.220 billion at the end of 3Q23. Net cash provided by operations was $708 million in 3Q24, down from $1.399 billion in 3Q23.

The company buys back its common shares. On May 3, 2024, it authorized a new $1 billion share repurchase program, replacing all existing programs, of which approximately $1 million remained (under the prior $1 billion program authorized in August 2023). During the third quarter of 2024, the company spent $127 million on share repurchases.

On February 14, 2024, the company announced an 11% increase in its quarterly dividend to $0.50 per share or $2.00 annually. The current yield is 5.17%. Our dividend estimates are $2.00 for 2024 and $2.12 for 2025.

MANAGEMENT & RISKS

Tim Go became the company's new CEO on May 9, 2023, succeeding Mike Jennings. Mr. Go, 56, had been president and COO of HF Sinclair since November 2021. He was previously CEO and general partner of Calumet Specialty Products and head of operations at Koch Industries' Flint Hills Resources. He also worked at Exxon for nearly two decades.

Refining is a volatile and environmentally high-risk business. Earnings can swing drastically from quarter to quarter, and the risk of environmental problems is high. As a result, investors must be prepared for the possibility of lawsuits against the company. In addition, refineries often have unexpected downtime, and even small operational changes can be dramatically amplified in a refiner's quarterly results.

The actual prices of both the feedstock used by Sinclair and the finished goods it produces are also dependent on many factors that are beyond its control, including general economic conditions, seasonal and weather-related factors, and government regulations and policies. The company's inability to control such factors through hedging can make margins, cash flow, and earnings unpredictable.

COMPANY DESCRIPTION

HF Sinclair Corporation, headquartered in Dallas, Texas, is an independent energy company that produces and markets light crude products such as gasoline, diesel fuel, jet fuel, renewable diesel and other specialty products. The company owns and operates refineries located in Kansas, Oklahoma, New Mexico, Wyoming, Washington and Utah. HF Sinclair provides petroleum products and crude oil transportation, terminaling, storage and throughput services to its refineries and the petroleum industry and supplies fuels to more than 1,500 branded stations and licenses the use of the Sinclair brand at more than 300 additional locations throughout the country.

VALUATION

DINO shares have traded between $38.25 and $64.16 over the past 52 weeks and are currently below the midpoint of this trading range. To value the stock on a fundamental basis, we use peer-group and historical multiple comparisons, as well as a dividend discount model.

The shares are trading at 14.5-times our 2024 EPS estimate and at 13.8-times our 2025 forecast, compared to a 13-year annual average price/earnings range of 7-15. On other valuation metrics, the shares are trading at a price/book multiple of 1.0 (versus a range of 1.0-1.7); a price/sales multiple of 0.3 (versus a range of 0.3-0.6); and a price/cash flow ratio of 4.0 (versus a range of 4.8-9.7). They are also trading at a price/EBITDA multiple of 3.4, at the low end of the range of 3.3-9.1. Overall, we consider these valuation metrics as generally attractive, but not in the context of a challenged Refining industry.

On November 1, HOLD-rated DINO closed at $38.70, up $0.09. (Bill Selesky, 11/1/24)