Align Technology, Inc.

Investment Proposal

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LISTING	SECTOR	INDUSTRY	CURRENT PRICE
NASDAQ	**Healthcare**	**Medical Devices**	**243.74**

REVENUE	MARKET CAP	BETA	PE RATIO
2.4B	**19.198B**	**1.97**	**10.22**

Align Technology, Inc. was founded in 1997 and is headquartered in San Jose, California, is a global medical device company, designs, manufactures, and markets **3D digital scanners** and **Clear aligners** used in orthodontics. Having setup its manufacturing units of the aligners in Juarez, Mexico and its scanners in Israel and China.

- **The Invisalign system** is the most advanced clear aligner system in the world, trusted by more than 8.3 million people worldwide to improve their smiles. It is used for straightening teeth with a series of custom-made aligners for each patient. It is a combination of proprietary virtual modelling software, rapid manufacturing processes and mass customization, and custom-made aligners with patented aligner material. Used to treat a wide range of clinical situations, Invisalign treatment options address simple to complex cases and post-treatment retention. The Invisalign system is powered by three key elements:
  - **SmartTrack material :** Align Technology's own patented aligner material that provides gentle, more constant forces to improve control of tooth movements. After testing 260 different materials, our material on average enables faster treatment.
  - **SmartStaging technology :** Programming each tooth movement in a certain sequence, at the right time to achieve optimal outcomes and greater predictability.
  - **SmartForce features : SmartForce features.** Attachments and features designed into the aligners deliver the precise forces when needed to achieve more predictable tooth movements. The Invisalign system is the only system in the world with features such as Bite Ramps, Precision Cuts, Power Ridge to help address a wide range of clinical situations.
- **iTero intraoral scanners** are designed to deliver speed, reliability, intuitive operations, and outstanding visualization capabilities for general practitioners or orthodontists. Its parallel confocal imaging technology uses optical and laser scanning to achieve accurate scans in colour. iTero Element empowers practices in both orthodontic and restorative dentistry with its innovative technology
  - iTero Time-Lapse compares records over time, visualizing tooth wear, movements and gingival changes. The tool automatically extrapolates past and current scans into an animated image that shows oral changes right on the screen.

Clear Aligners net revenues represented approximately 84% of worldwide net revenues for Align tech, while **Scanners** net revenues represented the remaining 16% of worldwide net revenues.

https://finance.yahoo.com/quote/ALGN/profile?p=ALGN
https://www.aligntech.com/

Strong Compensation Pay Practices :

- Core governance principles and practices are employed to align executive officer compensation with stockholder interests.
- They continue to carefully manage equity burn rates with an overall equity-based burn rate for 2019 at 0.5% and the adjusted gross burn rate at 1.2%.

Strong 2019 Company Performance :

- The stock price increased in 2019 and outperformed the NASDAQ Composite and S&P 500 Index.
- The three-year total stockholder return ("TSR") of 190% far exceeds the NASDAQ Composite Index three-year TSR of 67% and the S&P 500 Index three-year "TSR" of 44%. 2019 net revenues were a record $2.4 billion, a 22.4% increase from 2018.
- We shipped a record 1.5 million Invisalign cases, an increase of 24.2% compared to 2018. 2019 operating income was $542.5 million, up 16.3% compared to 2018, and 22.5% of net revenues

Industry Analysis:

•Positive outlook and upside trend projection during and post the covid19 for the healthcare industry in the leading global economies.

• RnD and Strict Regulations create high entry barriers to new entrants, despite the lucrative outlook for profit.

•Advancements in already existing medical devices with the adoption of improved technology and intense competition amongst rivals.

Company Analysis:

• Align Technology’s general corporate strategy is to establish Invisalign clear aligners as the standard method for treating malocclusion and to establish the iTero intraoral scanner as the preferred scanner for 3D digital dental imaging.

• Align has outperformed expectations when entering new markets like China, where they experienced a 23% growth in net revenues in Q4 of 2019.

Competitor Analysis:

•Most of Align’s competitors are involved in diverse domains in the Healthcare Industry.

• Align has a significantly lower risk from regulation than its competitors.

Technical Analysis:

•Align has almost no debt on its Balance Sheet.

•Align currently has a PE Ratio of approximately 10, ALGN is on its lowest valuation since the IPO, although long-term growth drivers remain intact

•The stock price has already recovered and rose 69% from its low since the lows due to COVID19.

http://www.viewproxy.com/aligntech/2020/ProxyStatement2020-AnnualReport2019.pdf

Industry Trends

- Companies in the Healthcare Equipment and Supplies industry have outperformed the S&P 500 YTD, 'XHE' generating YoY returns of upto 15.09% in comparison to the 'S&P500' generating about 11.3%.
- The global orthodontic supplies market is expected to reach USD 6.63 Billion by 2023 from USD 4.32 Billion in 2018, growing at a CAGR of 8.9%. The growing number of patients with malocclusions, jaw diseases, tooth decay/tooth loss, and jaw pain; increasing disposable incomes and expanding middle-class population in developing countries; increasing awareness about advanced orthodontic treatments; and ongoing research and technological advancements in orthodontic products are the key factors driving the growth of this market.

Key Market Insights

- The post-COVID-19 situation has led to the almost complete shutdown of all routine dental work, other than emergency care in the UK, as per the government's advice.
- Hence, the dental device industry has also come to a grinding halt, with no sales of dental materials, equipment of consumables.
- The global invisible orthodontics market is expected to grow at a CAGR of over 23% during the period 2019-2025 , giving Align Technology an edge in the market as it is the lead in the Clear aligner product lines addressing 80% of the orthodontic market..
- The global orthodontics industry is expected to witness significant growth due to the rapid shift from traditional & visible metal braces to invisible ones such as lingual and clear aligners. Several orthodontic solutions are being introduced due to the growing demand for treatment from the teenager and young adult population segment.

Invisible Orthodontics Market Segmentation

- The clear aligners segment is expected to grow at the fastest CAGR during the forecast period due to the increasing number of tooth misalignment disorders. In the US, over 70 million adults and teenagers visit the dentist to fix issues to traditional brackets. They prefer clear aligners as they are nearly invisible, removable, easy to clean, and offer a reduced chance of tooth decay. The increasing need for looking attractive with safe orthodontic products is expected to drive the growth of the segment.
- Increase in the customer base of GPs (general practitioners), favourable dental reimbursement policies and the presence of well-established orthodontic clinics in are likely to boost the clear aligners market share in North America, followed by Europe and is forecasted to occupy a majority in the asian economies especially China and India.

Growth Insights

- The growth of the Orthodontic supplies is set to continue in the future.
- M&A activity to remain strong as pressure on suppliers to reduce costs and increase production rates continues. For ex. On April 1, 2020, Align acquired privately held exocad Global Holdings GmbH (exocad) for a cash purchase price of approximately $430 million

FY2019 Annual Report, Y-Charts, Yahoo Finance

Porter's 5 Forces

- **COMPETITIVE RIVALRY - HIGH**

  The Healthcare Equipment and Supplies industry operates in a fast-evolving market where technological innovations oftentimes dictate company differentiation. For companies operating within this industry, it is a constant race for competitive advantage through product innovation, in order to ultimately meet consumer demand. For ex, it launched ClinCheck® "In-Face" visualization tool for the Invisalign Go system, Align's innovative tooth movement system designed for general dentists enhances the digital treatment planning experience for doctors and their patients by incorporating a front-facing smile image of a patient's face into their ClinCheck treatment plan.

  In addition, in the face of ever-changing government regulation, it can be somewhat difficult for companies operating in this industry to stay on top of such regulation while also maintaining focus on evolving customer needs.

- **THREAT OF ENTRANTS - MODERATE**

  As for most firms in the healthcare sector, Research and Development (R&D) costs are extremely high, also the smaller manufacturers have difficulties competing with the larger healthcare supply manufacturers due to various factors such as Purchasing Power, Sales force, and advertising expenses. Thus, the barriers to entry are moderately high .The regulations raise the barriers to entry for firms that look to produce devices. Furthermore, all firms must register their establishment with the FDA, and pay a registration fee. But, due to high demand and vertical application there is always threat of new applicants.

- **THREAT OF SUBSTITUTES - HIGH**

  Firms in the Healthcare Equipment and Supplies industry have a high risk of substitute products capturing market share. High margins in the industry, along with a changing technological environment, enable companies to produce more products that have the capability of becoming substitutes. A clear substitute for Align's products are of course traditional braces; four million people in the U.S. alone wear braces. However, Align has a major competitive advantage in the clear aligner space when it comes to the threat of substitutes because of their patents protecting their cutting-edge treatment of moderate-to-severe malocclusion.

- **BARGAINING POWER OF BUYERS - MODERATE**

  For most Healthcare Equipment and Supplies companies operating in the dental/orthodontic space, the power of buyers is considered moderately high due to the competitive outlay from a variety of options given by providers. Align's customers, on the other hand, have few choices if they are looking to begin using clear aligners, especially if they suffer from moderate-to-severe malocclusion. For a buyer to gain bargaining power over Align, they must be willing to accept using traditional braces.

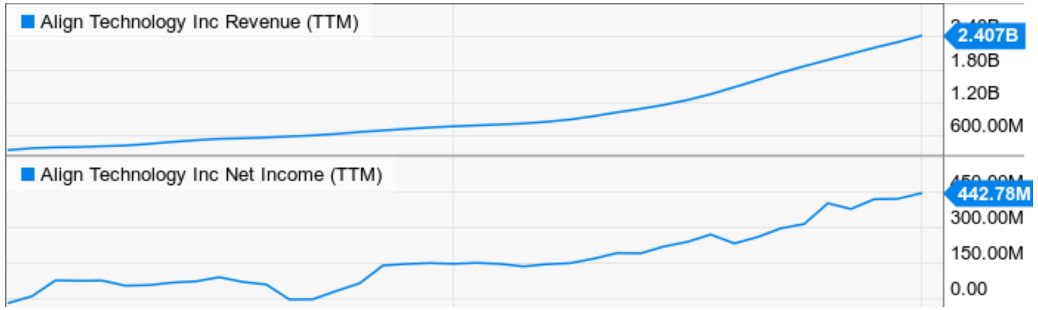
- **BARGAINING POWER OF SUPPLIERS - MODERATE**

  The main suppliers in this industry are firms that provide raw materials to be used in the production of medical devices and supplies. While companies in the industry are often large enough to bargain on price, raw material suppliers do not have a monopoly, and Healthcare Equipment and Supplies providers can often negotiate with multiple suppliers, thus reducing their dependency on a single supplier. However, firms in the industry do not simply look to bargain on price for raw materials; they also look to reduce the risk to their supply chain by decreasing their dependency on one supplier

Porter Analysis, Fern fort University

- **Main product**: The clear aligner system corrects malocclusion using nearly invisible and removable appliances that gently move the tooth to a desired final position. It is an alternative to conventional braces that are often seen as more comfortable, cheaper and better-looking. Especially their transperent appearance makes them almost invisible (hence their brand name "Invisalign"), what makes their products particularly popular among adults.

- **Target group size:** Malocclusion, or the misalignment of teeth, is one of the most prevalent clinical dental conditions, affecting billions of people, or approximately 60% to 75% of the global population. Of the 12 million annual orthodontic cases started, it is estimated that approximately 75% or 8.4 million could be treated using Invisalign clear aligners.



- **Revenue growth** has been impressive from $46M in 2001 to 2.4B in 2019 (representing a CAGR of 25%). In line with their revenue growth in the last 5 years (CAGR 25%) they target a growth rate of 20-30% for the upcoming 3-5 years. They also aim to improve their operating margin from 23% (FY2019) to 25%-30%, what means that profit growth would outpace revenue growth.

- **Growth drivers:** there are four main growth drivers for Align:
  - Taking market share from conventional treatments such as braces
  - Expanding to other developed countries (currently the US and the Netherlands make up almost 80% of their revenue)
  - Benefitting from more disposable income in emerging economies and increased demand for aesthetic treatments
  - Acquiring customers that otherwise would not have gotten treatment for their teeth misalignment, because they did not want to get braces (mainly adults)

- **Revenue by products: Clear Aligner** (known as the Invisalign system) made up 84.2% of total revenues in 2019. The **Scanner and Services** business which is known as the iTero intra-oral scanners and OrthoCAD services brought in 15.8% of total revenues in 2019.

- **Revenue by geography:** 48% of Aligns revenue is attributed to the United States, followed by 31% to the Netherlands, leaving much room for further penetration into European markets. In addition, demand for beauty care is expected to rise significantly in emerging markets as the disposable income of consumers rises.

- **Valuation:** Align trades at a PE ratio (TTM) of 9.9 and a forward PE ratio of 46.30, reflecting the revised EPS estimates for 2020 due to the Covid-19 pandemic. However, assuming that the majority of earnings from new customersare not "gone" but rather moved to next year, this forward PE ratio seems reasonable. Aligns free cash flow yield is at 3.1% what is strong for a company with such high growth rates. Although the Covid-19 pandemic is likely to impact earnings negatively, the valuation is attractive.

FY2019 Annual Report, Y-Charts, Yahoo Finance

- **Profitability:** With a gross margin of 63%, a net margin of 18% and a free cash flow margin of 25%, Align is a very profitable business. ROE is at 11%, althoug the unusally high amount of equity has to be taken into consideration. The high margins are a sign that Align has a competitive advantage ("moat") that shields its business from competition

Strong Balance Sheet: With an equity ratio of 53%, the company has negligible amount of debt on its balance sheet. With $790M Align has a large amount of cash on its balance sheet, resulting in net debt (Total debt - cash & equivalents) of only $321M (0,51x EBITDA) at the end of Q1. In Q1, there was a one time tax benefit, following a transaction of intellectual property (see figure).

- **Capital allocation:** As reflected in the balance sheet, Align generates far more cash than the company can sensibly invest in R&D and advertising. As a result, they will be able to either acquire competitors, pay a dividend or buy back their shares. Additionally, they have $100.0 million remaining available for repurchase of the common stock under their May 2018 Repurchase Program.

- **Covid-19 impact:** Due to closures of doctor's office, there is an expectation of a significant impact of the pandemic on FY2020 results. The company adopted to the new situation by launching two virtual solutions that help doctors connect with existing Invisalign patients to ensure continuity of care. Consequently, they were able to continue the treatment of their existing customers only suffered from less sales of Scanners to doctors and depressed customer acquisition. However, once the situation has relaxed and there is a more predictable outlook for the upcoming quarters, doctors will likely invest in new scanners and patients will start their treatment as planned.
    - Since Align has a very strong balance sheet, there is no reason to think the Covid-19 pandemic will pose an existential threat to the company
    - Although Covid-19 will have an adverse impact on financial results of FY2020, all mid- and long-term growth drivers remain intact
    - The majority of sales of new Aligners and Scanners are only postponed and will take place once the situation has relaxed and consumers return to their doctor's offices
    - High amount of cash gives Align the ability to exploit inorganic growth opportunities if competitors struggle during the economic downturn

Breakdown	3/30/2020	12/30/2019
Total Assets	3,964,840	2,500,702
Current Assets	1,576,525	1,633,419
Cash, Cash Equivalents & S...	790,696	868,627
Receivables	616,046	620,976
Inventory	120,977	112,051
Prepaid Assets	48,806	31,765
Total non-current assets	2,388,315	867,283
Total Liabilities Net Minority Int...	1,111,851	1,154,533
Total Equity Gross Minority Inte...	2,852,989	1,346,169
Total Capitalization	2,852,989	1,346,169
Common Stock Equity	2,852,989	1,346,169
Capital Lease Obligations	73,970	59,200
Net Tangible Assets	2,779,238	1,270,477
Working Capital	665,839	662,449
Invested Capital	2,852,989	1,346,169
Tangible Book Value	2,779,238	1,270,477
Total Debt	73,970	59,200

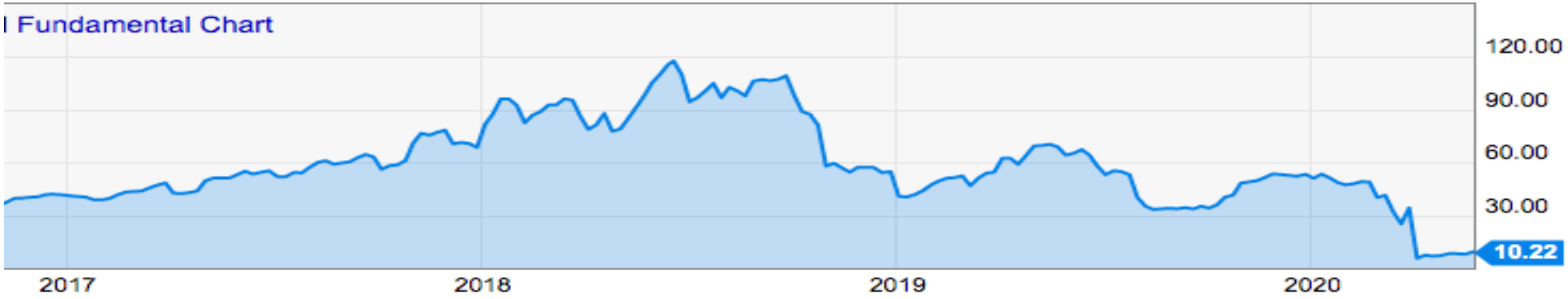
FY2020/Q1 Align Financial Results Presentation, Yahoo Finance

Name	Revenue (USD million)	Sales growth (YoY)	Gross margin	Net margin	ROE	P/E	Forward P/E	PEG	Price to Sales	Market Cap (USD million)
Align (ALGN)	2,406,796	22%	72%	18%	11%	9.90	46.30	2.71	7.81	18,59
SmileDirectClub(SDC)	750,428	56%	73%	-17%	-188%	N/A	N/A	N/A	3.58	2,927
Dentsply Sirona (XRAY)	4,029,200	1%	53%	7%	2%	113.41	23.04	16.89	2.37	9,245
Henry Schein (HSIC)	10,054,406	-24%	30%	7%	19%	11.86	20.41	3.07	0.84	8,096

Comment: The only direct competitor in this table is SDC. XRAY and HSIC are suppliers of dental medical products, which I included as a reference for companies operating in a very similar field.

- Besides Align the market for clear aligners is very fragmented and made up of small privately held companies.
- Most competitors sell their teeth aligners online and customise them using tooth prints impression kits which the patient does by himself and sends back. In comparison to the way Align operates, namely by using cutting edge technology and the professional experience of trained doctors to guarantee optimal outcomes, these companies are unable to match the quality of Invisalign and the usage of their teeth aligners can lead to unsatisfying result or even serious medical issues.
- These low cost suppliers are generally cheaper and have to compete with each other on prices because this segment has a low barrier of entry and is easy to replicate. However, Align does not have to compete on price, they compete on the quality of their product which is grounded in their years long experience, their partnerships with orthodontists, their patents, cutting edge technology in scanning and designing and a huge stock of data to evaluate their success and improve quality even more. This is very hard to replicate, which is why Align will be able to sustain current pricing levels and hence its high margins.
- Aligns main competitor SmileDirectClub has significant problems with customer satisfaction and many ongoing law suites because of unsatisfying results of their treatment. Align can avoid similar situations because they have an exceptional quality standard, thus saving high legal costs and reputation damage competitors are faced with.
- Align has a significantly lower risk from regulation than its competitors. That is because they provide a product that already keeps up with highest standards of similar medical devices (e.g. braces). A ban of teeth aligners like Invisalign seems very unlikely, although stricter regulation in selected countries on the medical standards is a realistic scenario. While stricter regulation on teeth aligners may pose an existential threat to competitors they can't keep up to the high quality standards of medical products, Align would likely even benefit from regulation because they would be able to and would face less competition.

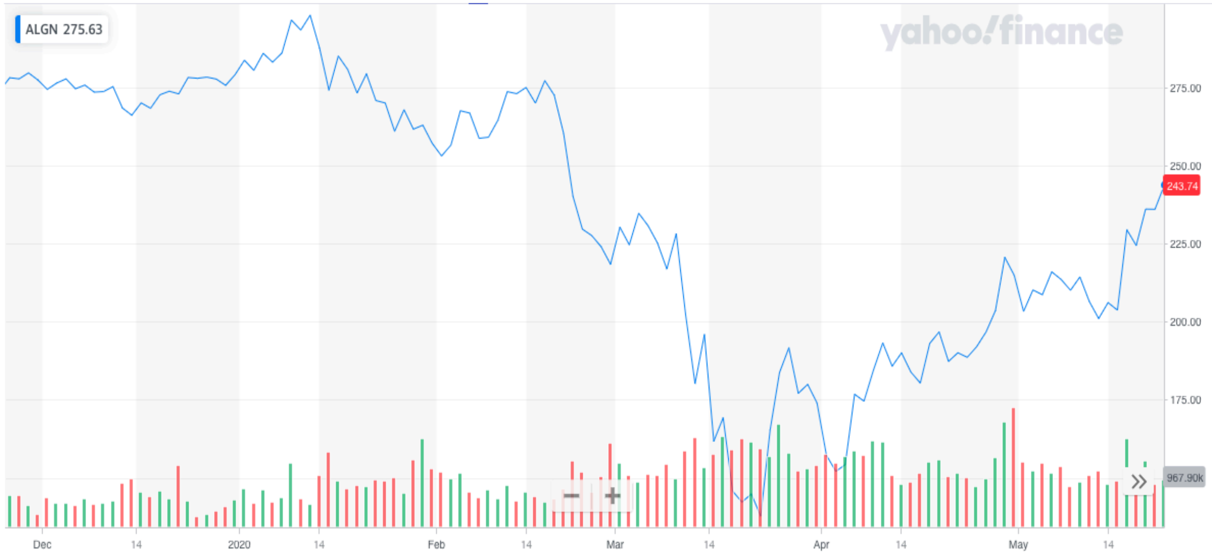
Yahoo Finance, Zacks, Fool.com



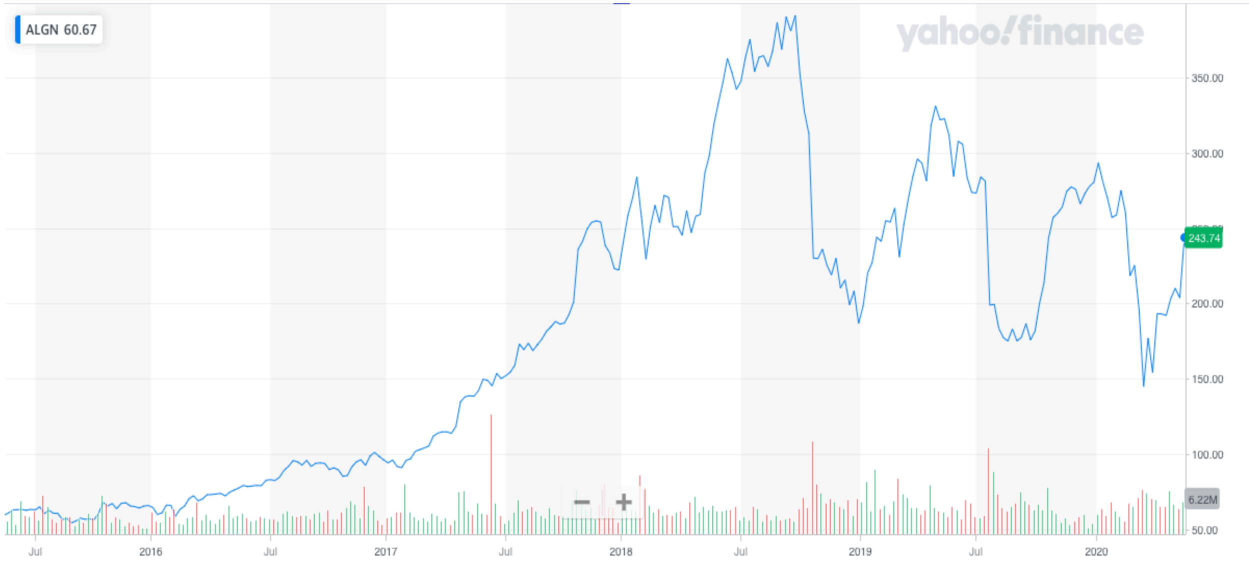
PE ratio since 2017

With a PE Ratio of approximately 10, ALGN is on its lowest valuation since the IPO, although long-term growth drivers remain intact

After sharp declines in March due to the Covid-19 epidemic, the stock price has already recovered and rose 69% from its low



Stock performance
last 6 months



Stock performance
last 5 years

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