

# Thermo Fisher: scalable solutions to real-world problems

Take Note, March 2019  
Hermes Global Equities

Hermes Global Equity assess each stock’s value, growth and quality characteristics, along with market sentiment towards a company, to find those with the most attractive long-term fundamentals in the investment universe. In turn, this creates a diversified portfolio that aims to maximise risk adjusted returns. Here we examine how current holding Thermo Fisher has helped us achieve long-term capital appreciation.



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### Key points:

- Using a diversified, systematic, bottom-up approach, we identified Thermo Fisher as a company that has a combination of attractive long-term fundamentals
- Given the diverse nature of its business, Thermo Fisher is exposed to lower levels of risk than other healthcare providers, notably pharmaceutical companies
- Through our engagements, we are encouraging the company to extend its programmes and policies to better demonstrate key risks, such as business ethics

### Serving science

From discovering new treatments for chronic diseases to understanding climate change, innovation in science is essential for economic development and addressing some of the world’s greatest societal challenges.

Current holding Thermo Fisher is doing just that: by accelerating life sciences research, solving complex analytical challenges, improving patient diagnostics, delivering medicines to market and increasing laboratory productivity, the company is helping its customers find answers to the most pressing issues of our time. Thermo Fisher’s products are used across pharmaceutical, biotechnology, academic, government, environmental and industrial research, as well as the clinical laboratory.

For example, in 2017 Thermo Fisher formed a partnership with Mars Inc. to tackle aflatoxins – naturally occurring poisons that contaminate an estimated 25% of food crops and 4.5bn people worldwide<sup>1</sup>. Aflatoxins originate in certain species of fungi that grow on feed and food, such as groundnuts, peanuts, spices and corn. They are near-impossible to destroy and are considered a Class 1 carcinogen by the International Agency for Research on Cancer. Together with Mars, Thermo Fisher aims to identify a protein to reduce the impact of the aflatoxin in food. Such a development would have a positive societal impact, particularly in developing countries, where the amount of aflatoxins in food products is not well regulated.

### A combination of attractive fundamentals

Thermo Fisher’s commitment to innovation and its ability to meet rising healthcare needs globally is compelling, but it boasts a combination of attractive long-term fundamentals too.

Thermo Fisher enjoys strong and stable growth as well as good and improving margins. In 2017, emerging markets accounted for 24% of its full-year revenues. What’s more, it is attractively valued (see Figure 2) and has strong governance structures.

Figure 1. Gaining ground: shares in Thermo Fisher have risen steadily since 2012

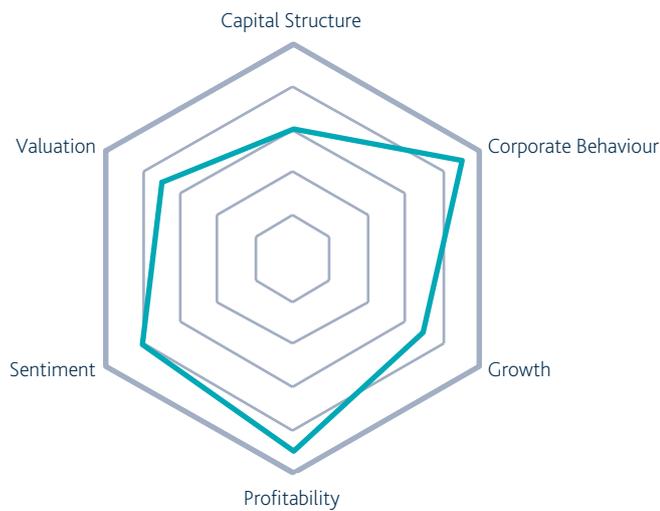


Source: Bloomberg as at February 2019.

The diversified nature of the company’s product portfolio means that it enjoys a competitive advantage from scale. Indeed, no single product or end-market materially impact its performance. In addition, the company targets an organic revenue growth rate of 4-6% and an earnings per share of about 12-15% per annum, reflecting its cost-cutting culture and process improvements.

<sup>1</sup> "Corporate Social Responsibility Report," published by Thermo Fisher Scientific in 2017.

Figure 2. The Alpha Model views Thermo Fisher as attractive



Source: Factset and Hermes as at December 2018.

Encouragingly, the company also generates a significant portion of its revenue through activities that have a positive social and environmental impact, such as access to healthcare or sustainable solutions that help customers reduce its environmental footprint. It offers 45 'greener' products, which strive to provide customers with alternatives that are less hazardous, more energy efficient and reduce waste.

Thermo Fisher is also contributing to the UN Sustainable Development Goals. Its diagnostic tools are helping achieve the SDGs by diagnosing some of the world's most infectious diseases. In addition, the company produces environmental tools and IT systems, such as soil analysers that help produce healthier and safer crops, water analysers that help deliver safe drinking water, and air quality measurement tools that help track pollutants and assist industrial manufacturing monitor compliance.

It is for these reasons that our proprietary Alpha Model views Thermo Fisher as a very attractive long-term investment in a diversified portfolio (see Figure 2) – and why we decided to take a long-term position in the company (more than five years ago). The company ranks ahead of its peers in the six factors – valuation, corporate behaviour, growth, profitability, capital structure and sentiment – used to generate our Alpha Score. It is broadly neutral to some of the underlying factors within corporate behaviour. Understandably, sentiment towards Thermo Fisher is strong.

### Recap: What is the Alpha Model?

The Alpha Model is our "automated analyst" which assesses the attractiveness of every investable company in our universe on a daily basis. The metrics used to select stocks are justified by both economic reasoning and statistical effectiveness, and have a long-term focus that leads to low portfolio turnover. They are grouped into six categories: valuation, corporate behaviour (including governance), growth, profitability, capital structure and sentiment. The model identifies which stocks have the most attractive combinations of these characteristics and the output is subsequently used to create an optimised portfolio that aims to maximise risk-adjusted returns. The Alpha Model also uses proprietary data from Hermes EOS to incorporate an assessment of corporate governance in every valuation (see *The Alpha Model: laying the path to consistent returns*). Together, these insights help us action compelling opportunities and pick long-term winners, like Thermo Fisher, which prove beneficial to a diversified portfolio that aims to maximise risk-adjusted returns.

During the investment process, we also evaluate other companies that influence our holdings, such as their competitors, suppliers, customers and partners. In particular, we examine any negative incidents or events, such as lawsuits, spills or child labour, that the ecosystem of companies may have been involved in. This ensures that we, as a team, have a complete picture of the company and the environment in which it operates.

It also confirms alternative relevant peers. Indeed, by conducting this analysis, we identified that product governance is a common source of risk for companies operating in this industry. However, Thermo Fisher has robust product quality programmes in place. In addition, we were also able to confirm the attractiveness of the industry in which Thermo Fisher operates, with some of its peers ranking well according to our Alpha Model (see Figure 3).

**Figure 3.** The full picture: our company report identifies other companies that influence our holdings

### Competitors

Sector	Industry	Country	Market Cap	Products that Overlap	Direction	Max Controversy	Controversy Type	Alpha Decile	Holding
Health Care	Life Sciences Tools & Sciences	United States	20,603.22	29 of 51	Reverse	2	Product Governance	3	0
Health Care	Life Sciences Tools & Sciences	United States	15,327.12	15 of 17	Reverse	0	Product Governance	6	0
Health Care	Health Care Equipment & Supplies	France	10,594.56	21 of 33	Reverse	1	Product Governance	5	0
Health Care	Health Care Equipment & Supplies	Germany	6,531.88	23 of 35	Reverse	0	Product Governance	4	0
Health Care	Life Sciences Tools & Sciences	United States	5,564.03	12 of 20	Reverse	0	Product Governance	4	0

### Suppliers

Sector	Industry	Country	Market Cap	Products that Overlap	Direction	Max Controversy	Controversy Type	Alpha Decile	Holding
Real Estate	Equity Real Estate Investment Trusts (REITs)	Canada	313.17	0 of 4	Reverse	0	n/a	n/a	0
Industrials	Air Freight & Logistics	Germany	58,432.98	1 of 5	Direct	2	Carbon – Own Operations	9	0
Industrials	Air Freight & Logistics	United States	66,247.20	1 of 6	Direct	3	Carbon – Own Operations	2	1
Health Care	Life Sciences Tools & Sciences	United States	855.07	5 of 13	Reverse	0	n/a	3	0
Health Care	Health Care Equipment & Supplies	United States	631.76	8 of 9	Reverse	0	n/a	n/a	0

### Customers

Sector	Industry	Country	Market Cap	Products that Overlap	Direction	Max Controversy	Controversy Type	Alpha Decile	Holding
n/a	n/a	United States	812.06	9 of 14	Reverse	0	n/a	n/a	0
Health Care	Health Care Equipment & Supplies	France	10,594.56	21 of 33	Reverse	1	Product Governance	5	0
Health Care	Biotechnology	United States	79,240.55	0 of 26	Direct	2	Product Governance	6	0
n/a	n/a	United States	n/a	n/a	Direct	0	n/a	n/a	0

### Partners

Sector	Industry	Country	Market Cap	Partnership Type	Products that Overlap	Direction	Max Controversy	Controversy Type	Alpha Decile	Holding
Health Care	Health Care Equipment & Supplies	France	10,594.56	In-licensing	21 of 133	Reverse	1	Product Governance	5	0
Health Care	Biotechnology	United States	79,240.55	Out-licensing	0 of 26	Direct	2	Product Governance	6	0
Industrials	Air Freight & Logistics	United States	66,247.20	Distribution	1 of 6	Direct	3	Carbon – Own Operations	2	1
n/a	n/a	United States	n/a	Distribution	n/a	Direct	0	n/a	n/a	0
n/a	n/a	United States	n/a	Research Collaboration	n/a	Direct	0	n/a	n/a	0

Source: Hermes as at December 2018.

### Engaging on ESG risks

Interestingly, Thermo Fisher is not highlighted as a clear leader by ESG data providers. That's because many data providers apply the same level of scrutiny to healthcare providers as they do to pharmaceutical companies – a highly regulated industry. However, the diverse nature of the business means it is exposed to lower levels of risk. That said, it does have some weaknesses – or at least areas of risk that could be better addressed – particularly around disclosure.

We are engaging with the company. Thus far, we are encouraged by the strength of its governance. The company has an independent chair, which serves to highlight its positive corporate mind-set. In addition, Thermo Fisher has developed policies and systems to address some environmental and social issues.

Through our ongoing engagements, we are encouraging the company to extend its programmes and policies to better demonstrate key risks, such as business ethics.

### Sustained growth

As we have highlighted, Thermo Fisher is an attractive long-term investment – and we believe it will continue to deliver robust growth, in-line with management's conservative forecasts of future growth (which we think also leave room for further upside).

That said, both the company and the industry in which it operates face headwinds from foreign-exchange rate moves and raw materials cost inflation. Nevertheless, we believe Thermo Fisher's innovative technologies, services and its vast operating footprint position it as a global leader in the healthcare provision – and a long-term winner in our portfolio too.

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