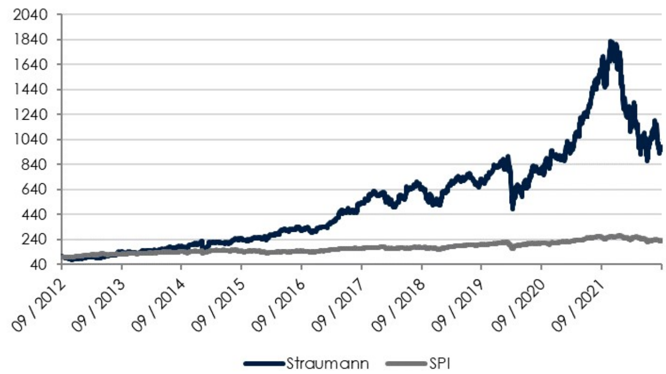
September 2022

Straumann

Market profile

Country	Switzerland
Sector	Health Care Equipment
Market cap (CHF m)	12'621
52-week high / low (CHF)	587 / 896.20
Price per share (CHF)	795

Evolution of stock price with respect to benchmark (rebased)
Source: IAM



Key metrics (CHF)

	2021	2022e	2023e
EPS	2.48	3.0	3.53
PE	78.0x	37.3x	31.8x
EV/EBITDA	37.7x	20.2x	17.6x
Dividend yield	0.3%	0.6%	0.8%

Executive summary

Straumann is a global leader in esthetic dentistry. The company has a 29% market share in the implant dentistry market worldwide. Straumann manufactures and distributes implant solutions in all market segments (from value to premium).

The company is relatively old (founded in 1954), but only starting focusing exclusively on dental implants in 1990 with 25 employees. Management's strategy is to be focused on clients needs and is extremely nimble in acquiring external technologies that it lacks.

The group is able to rapidly deploy the acquired technologies through their global distribution reach. Currently the group employs over 9'000 people worldwide and its products, solutions and services are available in more than 100 countries.

Straumann has been able to grow its top-line at an impressive 8.4% compound annual growth over the last 15 years. Nevertheless, dental implants are not immune to economic slowdowns, as we have witnessed in 2020 with the global COVID-19 pandemic.

In order to diversify its offering, Straumann has entered the clear aligner market in 2017. This market is foreseen to grow even faster than implants, as more adults are taking measures to correct their dentition, without the need for braces.

Despite all these acquisitions, Straumann's balance sheet is still in a net cash position, and free cash flow has always been positive in the last 15 years. This is testament to the company's great management team, and the high margins it was able to achieve (and maintain).

Nevertheless, the stock price is richly valued (as most growth stocks), and it still trades above its decade average forward P/E ratio of 26x. If interest rates keep moving upwards, valuations for growth stocks could come under further pressure.

Straumann

Daniel Pfund, Senior Financial Analyst **September 2022**

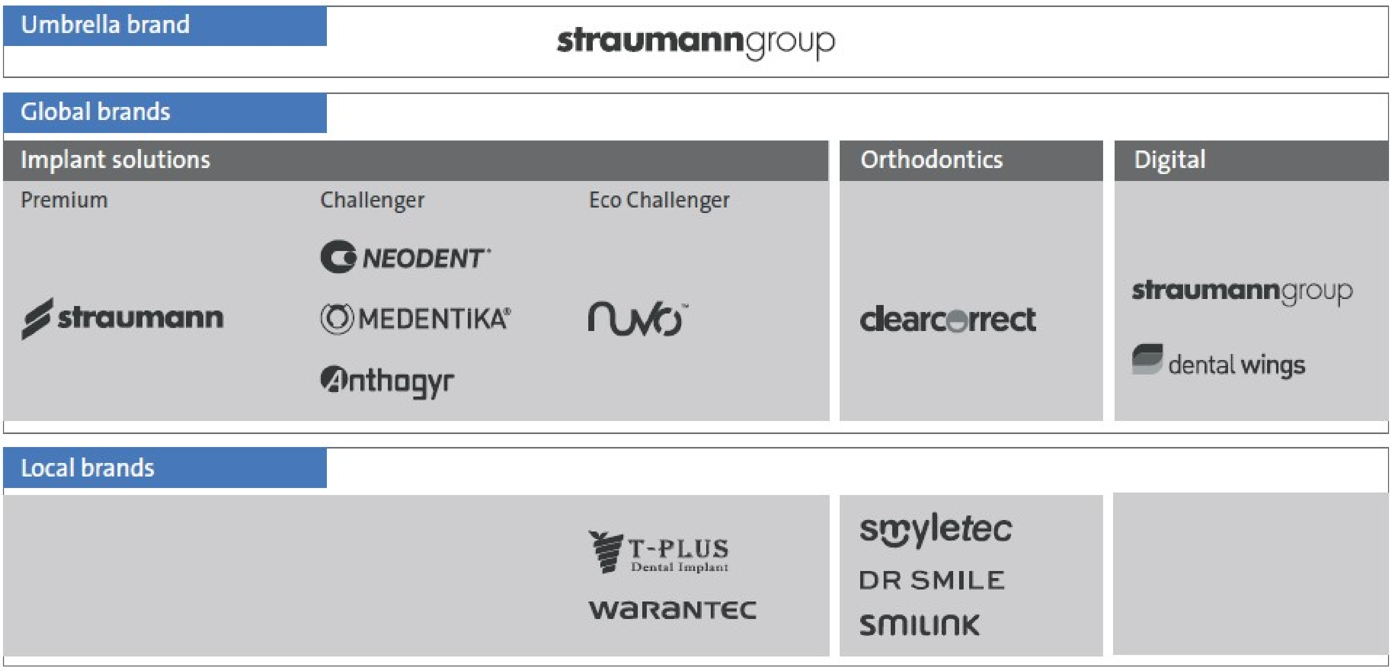
Company description

Headquartered in Basel, the Straumann group is a global leader in tooth replacement and orthodontic solutions. It unites global and international brands that stand for excellence, innovation and quality in replacement, corrective and digital dentistry, including Straumann, Neodent, Medentika, ClearCorrect, Dental Wings, and other fully or partly owned companies and partners.

The group currently employs over 9'000 people worldwide and its products, solutions and services are available in more than 100 countries through a broad network of distribution subsidiaries and partners.

Its principal production sites are in Switzerland, the US, Brazil, and Germany.

Fig. 1: Straumann brands
Source: Company data, IAM research



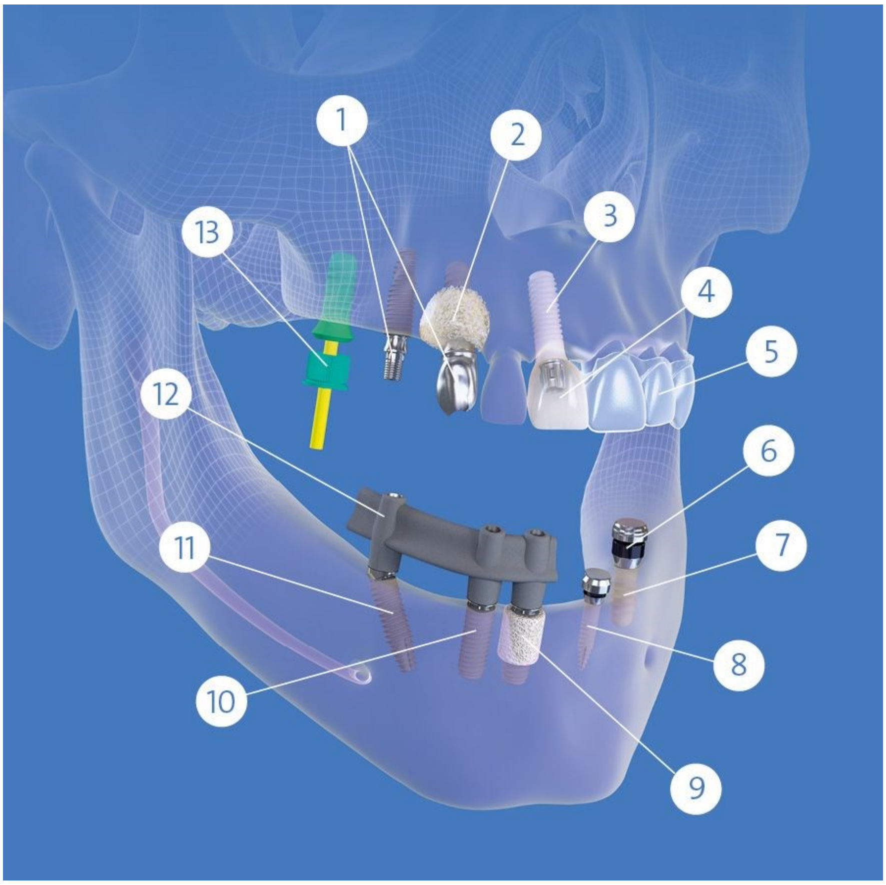
In collaboration with leading clinics, institutes and universities, the group researches, develops, manufactures and supplies dental implants, instruments, computer aided design (CADCAM) prosthetics, biomaterial, digital equipment, and clear aligners for use in tooth replacement, restoration, orthodontic or to prevent tooth loss.

As a total solution provider for esthetic dentistry, the company takes a holistic approach, offering training, support and a wide range of services to dental practitioners, clinics and laboratories all over the world.

History of the company

Straumann can retrace its history to Dr. Ing Reinhard Straumann, who created a research institute in 1954. The company specialized in alloys used in timing instruments and in materials testing. A breakthrough in the use of non-corroding alloys for treating bone fractures prompted Dr. Fritz Straumann (son of the founder) to enter the fields of orthopedics and dental implantology, which began the second phase of the company's history.

Fig.2: Straumann products
Source: Company data, IAM research



1 Prosthetics
2 Regenerative Biomaterials
3 Ceramic Implants
4 Crowns
5 Clear Aligners
6 Retention systems
7 Soft Tissue Implants
8 Mini Implants
9 Biomaterial Bonering
10 Bone Level Implants
11 Bone Level Tapered Implants
12 CADCAM Screw-retained Bridges and Bars
13 CADCAM Planning Components

Between 1970 and 1990, Straumann became a leading manufacturer of osteosynthesis implants. A management buy-out of the osteosynthesis division in 1990 led to the creation of Stratec (subsequently Synthes) as a separate company.

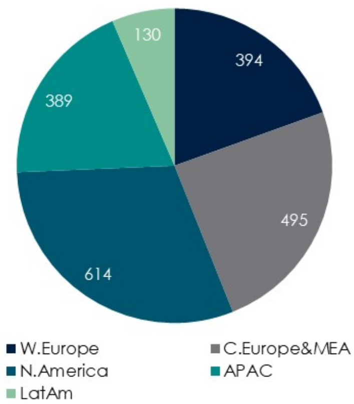
1990 thus marked the beginning of the Straumann Group as it is known today. Thomas Straumann, grandson of the founder, headed the remaining part of the firm, which employed just 25 people focused exclusively on dental implants.

In 1998, Straumann Holding AG became a publicly traded company on the Swiss exchange. Through the acquisition of Kuros Therapeutics (2002) and Biora (2003), Straumann entered the promising field of oral tissue regeneration. In 2004, Straumann moved its headquarters from Waldenburg to Basel.

Geographic exposure

Since acquiring several companies in the value segments, Straumann has been able to diversify its geographic exposure towards faster growing (emerging) markets. While developed markets still contribute to a large proportion of revenues, emerging markets will soon become the biggest part of the group's total revenues.

Fig.3: Straumann revenues by geography (CHF mn)
Source: Company data, IAM research



Industry Overview & Competitive positioning

The dental supply and equipment market is an attractive subsector of the medical device sector and ranges from instruments, adhesives and filling materials to imaging hardware and practice equipment. It also includes specialty segments like implant dentistry, endodontics, biomaterials, CADCAM equipment, prosthetics, and orthodontics. The total dentistry market was valued at CHF 36 billion in 2021 and is growing rapidly, driven by the aging and growing population, increasing prosperity, awareness of oral health, and innovation.

The Straumann group's main market is implant dentistry, which is estimated to be worth approximately CHF 5billion globally. However, Straumann also operates in other segments like custom-made prosthetics, so it targets a CHF 10 billion market. Implant dentistry bounced back strongly in 2021 by growing 25-30% throughout the year as dental practices re-opened and COVID-19 vaccination progressed.

Having outperformed for several years, Straumann now leads the implant market with a share of 29%. Three quarters of the market are controlled by the leading five companies, while the rest is divided among several hundred manufacturers, most of whom operate on a regional basis and compete in the non-premium segment. The latter has been growing faster than premium, due to the increase in manufacturers, the lack of reimbursement schemes, and stronger growth in emerging markets where procedure prices and disposable income are lower. The non-premium brands collectively account for approximately half of the worldwide implant market.

Having focused exclusively on premium implants, Straumann entered the non-premium segment in 2012 and, by acquiring various brands, now offers a broad range of solutions in both the upper and lower value price segments. Since then, the group has gained a leading position in the non-premium segment, although its market share is still only in the mid-single percentage range and therefore offers an attractive growth potential in the coming years.

Dental implants can be distinguished by their shape. Tapered implants offer high primary stability and are the preferred choice of many clinicians in extraction-socket indications and immediacy protocols or when patients have a soft bone morphology. More than 80% of dental implants sold in 2021 had a tapered design. Parallel-walled implants, on the other hand, are valued for their periodontal performance (soft tissue attachment properties) and have been documented for more than 30 years. The Straumann brand dominates the latter category, while their Straumann BLT, BLX and TLX brands focus on tapered implants. Even Straumann's value brands such as Anthogyr, Neodent or Medentika offer tapered implants.

Independent researchers expect implant dentistry to continue outpacing the overall dental market. In the world's largest dental market, the US, more than 120 million people are missing at least one tooth, yet just one and a half million are treated each year (corresponding to 2.7 million implants).

Fig.4: Straumann market share
Source: Company data, IAM research

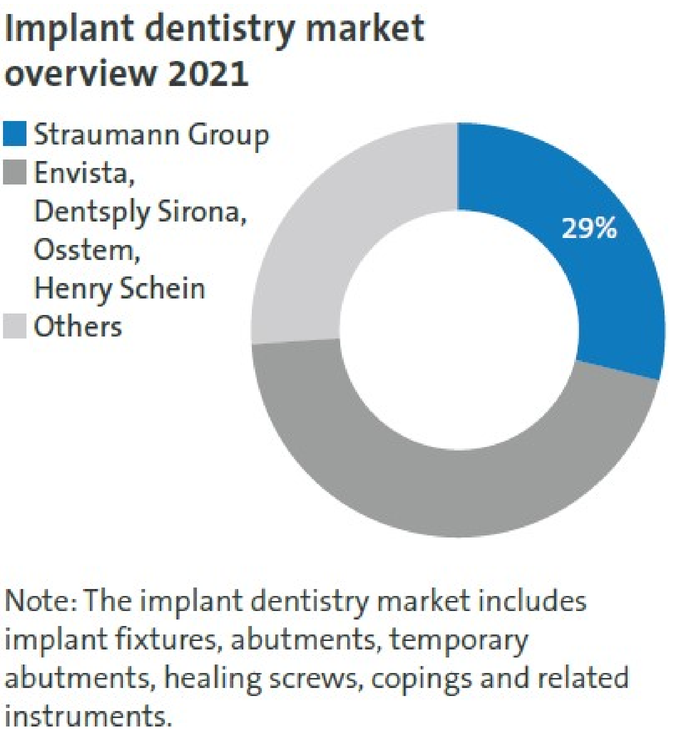
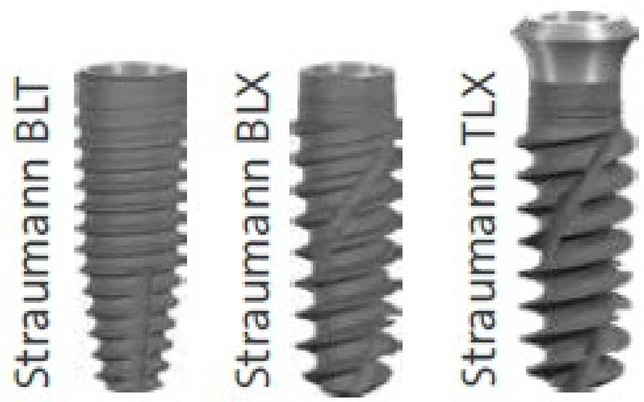


Fig.5: Straumann's different tapered implants
Source: Company data, IAM research



This is low in absolute terms and in comparison with other countries. Our analysis shows that only one in four medically eligible US residents who seek treatment for tooth loss actually receive implants. In Germany, the penetration level is approximately 30%, while in Switzerland, it is close to 40%. The tooth replacement market therefore offers considerable potential and its principal growth drivers are:

- Demographics – in an ageing population, more elderly people need tooth replacement
- Affordability – the middle class is growing in developing countries
- Treatment provision – rising number of trained dentists who are confident placing implants
- Awareness – patients are better informed about the negative effects of poor oral health
- Esthetics – the trend in people choosing cosmetic treatments and dental implants is growing and consumer expectations are rising.

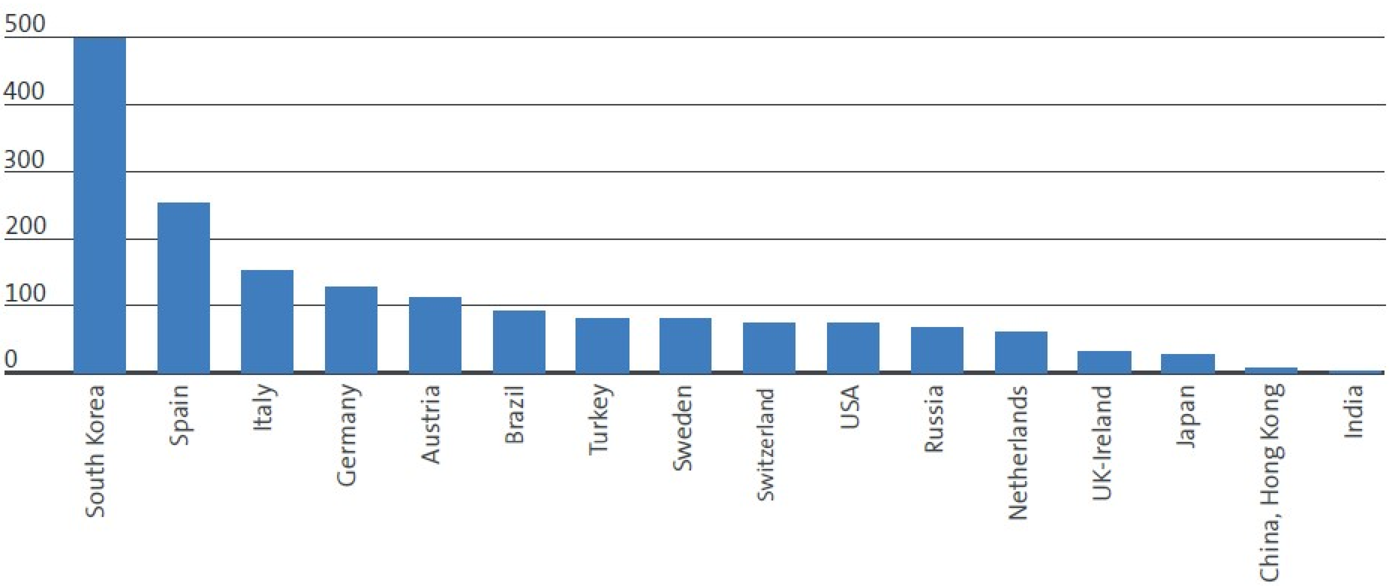
With very few exceptions, tooth replacement is an out-of-pocket expense. In South Korea, reimbursement was gradually introduced for senior citizens in 2014. This, together with the fact that more than 70% of the dentists in the country place implants, explains the high penetration rate. By contrast, large economies like China and India remain heavily underpenetrated due to a lack of qualified dental professionals.

As the chart below shows, the number of patients treated per 10'000 adult population in the US is only half that of Italy and only a third that of Spain, the largest European market. This illustrates the considerable growth potential there. Penetration in other highly populated countries like the UK, India, China and Japan is also clearly below average, offering strong upside potential in the coming years.

The population in the US aged 65 and older is projected to more than double from 46 million today to over 95 million by 2060 corresponding to 15% and 24% of the population respectively. According to the American College of Prosthodontists (ACP), about 23 million people in the US are completely edentulous (lacking teeth) and another 12 million are edentulous in one arch. Ninety percent of edentulous people in the US use simple, gingiva supported dentures. Most are unable to afford implant solutions. To serve this market, Straumann launched a cost-effective mini-implant line already in 2018. This type of implant is easy to place and has been gaining popularity. It is estimated that more than a million were placed last year.

The Straumann group is also active in the global market for oral biomaterials, which include bone augmentation materials, membranes, fleeces, sponges and soft-tissue regenerative products. As biomaterials are used in a large proportion of dental implant procedures, market growth is linked to that of implant and bone ridge preservation treatments (although biomaterials are used less with mini and short implants).

Fig.6: Implant penetration: patients treated annually (per 10'000 adult population)
Source: Company data, IAM research



In 2021, the worldwide market for oral biomaterials was estimated to be worth more than CHF 800 million. Over the past five years, the group has significantly expanded its biomaterials franchise through partnerships (botiss, Genoss, and Nibec) and today is a top-5 global player in this market.

Another high growth market is the clear aligner market. Approximately two in five children in North America have crooked teeth and 10% have severe malocclusion. Tooth displacement is far more common among teenagers than in younger children because of the greater number of erupted teeth. More than 60% have severe tooth displacement and approx. 17% have either lingual or buccal crossbite. Of the three million orthodontic cases actually treated in North America in 2018, the majority received conventional wires and brackets, while approximately one third received modern clear-aligner solutions. Conservative estimates state that 50–60% of all patients with misaligned teeth could theoretically be treated with clear-aligner solutions. Outside North America, penetration rates are considerably lower. Internationally, fewer than 10% of dentists offer clear aligners. The global market for clear aligners is estimated to be worth approximately CHF 5 billion and is growing in excess of 20%, representing one of the most attractive areas in dentistry. Clear aligners' market dynamics are spurred by their significant advantages over conventional wires and brackets mainly related to esthetics, patient compliance, cleaning, teeth stains and convenience. The growing awareness of these advantages among dentists and patients and the broader availability (through general dentists and direct to consumer offerings) of the solutions will lead to higher penetration rates in the future. Straumann estimates that only about 20% of orthodontic cases worldwide were treated in 2021 with clear aligners.

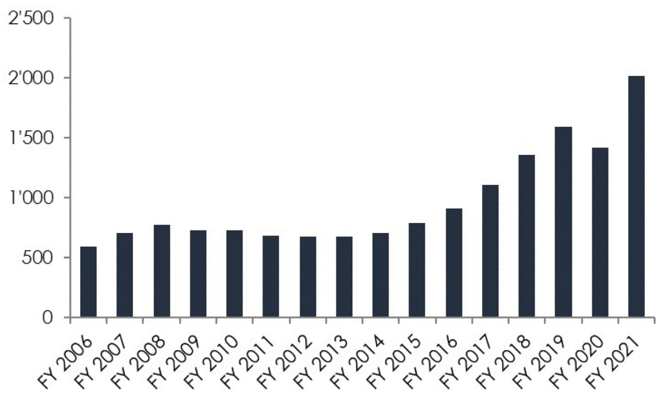
Straumann entered this attractive field in 2017 by acquiring ClearCorrect and investing in Geniova. In 2018, they also invested in, and partnered with Dental Monitoring, a pioneer of remote monitoring systems using mobile phone technology to support clear aligner treatment and add convenience for dentists and patients. The system relies on artificial intelligence technology, which we believe will significantly change dentistry in the future. Beyond accelerating orthodontic treatment outcomes, automated algorithms could enhance diagnoses and prevention, both in general and implant dentistry. In 2022, Straumann acquired a German company called PlusDental, specializing in orthodontics in Europe. Initially a US player, the Group's orthodontic presence has grown from 13 markets in 2017 to 46 markets in 2021 and established a global manufacturing footprint for clear aligners.

Financial analysis

Growth

The following figure depicts Straumann's top-line growth in millions of CHF.

Fig.7: Revenues
Source: Company data, IAM research



As we can see, the top-line has grown at an impressive 8.4% compound annual rate in the last 15 years. But what is even more remarkable is the growth of the last 5 years: 17.1% per annum compounded.

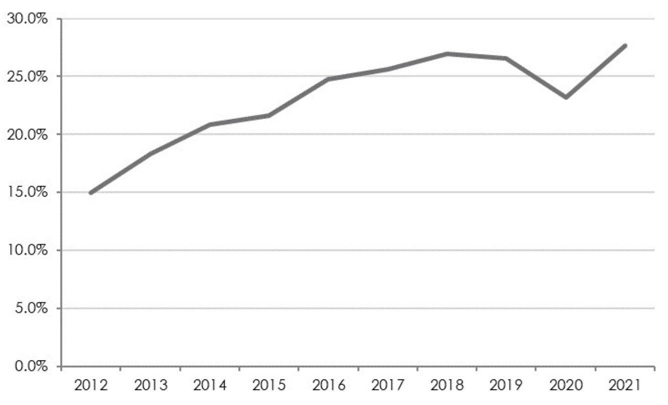
This acceleration of revenue growth is due to two factors:

1. Entering the lower value segment, which has opened another 50% of the market in implants
2. Entering adjacent markets has allowed Straumann to diversify its revenues and sell in a much larger addressable market

Indeed, the implant industry is worth 5 bn CHF, while the overall dentistry market is worth at least 30 bn CHF.

Margins

Fig.8: EBIT margin
Source: Company data, IAM research



Operating margins (adjusted EBIT) are shown in the previous graph.

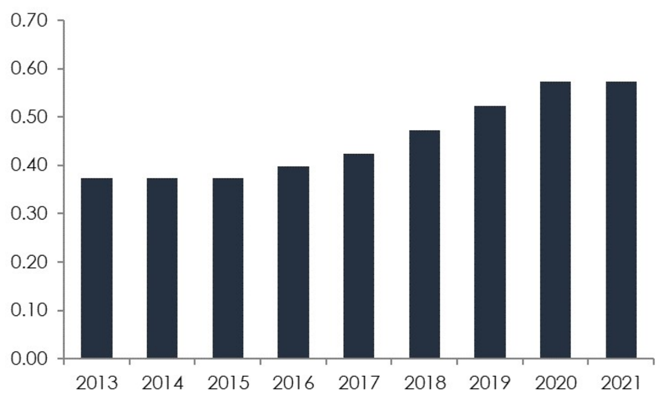
As we can see, the company has always achieved respectable margins. Apart in 2012/2013, the operating margin has remained above 20%.

Over the last 3 years, the company has been able to improve their margin to over 27%. We think this is likely to remain at a high level as Straumann continues to gain market share, especially with their high end fully tapered implant, which is much more accretive than other products. Straumann itself targets an EBIT margin in the range 25-30% over the long term.

Dividend

The following figure shows Straumann's dividend history (CHF/share).

Fig.9: Dividend per share
Source: Company data, IAM research



Paying a progressive dividend is not Straumann's priority. Obviously, they need to keep money for acquisitions and growth developments. Not shown in the graph, but 2011/2012 were not good years financially, and the company didn't hesitate to cut the dividend. The payout ratio is currently around 25%.

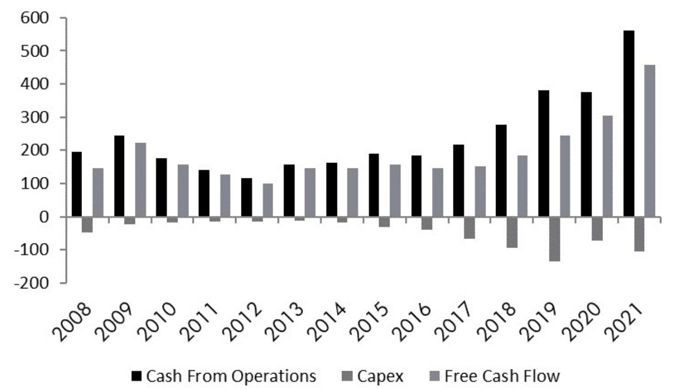
Free Cash Flow

Figure 10 shows Straumann's operating cash flows, capex and free cash flow over time.

As we can see, free cash flow has always been positive. The company is very cash generative, as it doesn't need to invest a lot of money into capital expenditures (capex).

We do note that some development expenditures are not recognized on the P&L, but are capitalized as an intangible asset, which are then amortized on a straight-line basis over the period of its expected benefit.

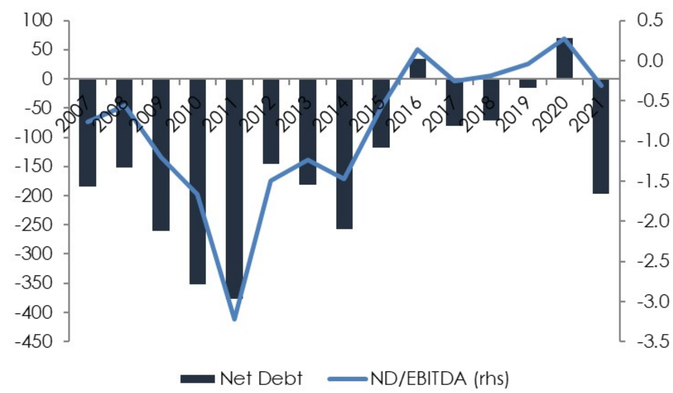
Fig.10: Operating cash flow, capex and free cash flow
Source: Company data, IAM research



Balance Sheet

The following chart shows Straumann's net debt (ND) as well as a common indebtness ratio (ND/EBITDA).

Fig.11: Net debt and Net debt/EBITDA
Source: Company data, IAM research



We can see that Straumann's management has always been very conservative. Only in 2016 and 2020 did the company show a net debt position; all the other years, the company has held more cash than debt. In fact, the group only has 685 million in long term debt. It could be argued that more debt could definitively be taken on, especially with the currently low interest rate environment. However, we need to keep in mind that implants are a relatively discrete purchase, and can be postponed in recessionary times, so we like that the company is financially strong. In turbulent times, Straumann will likely be able to continue making acquisitions at relatively depressed prices.

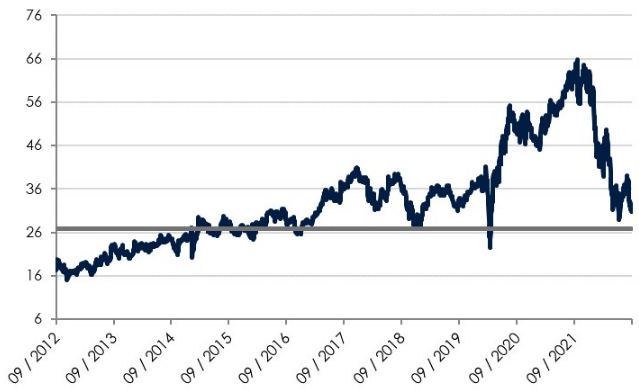
Investment case

We like Straumann because of its clear focus on the dental industry. The goup's management has very defined objectives and is diversifying from purely dental implants into adjacent businesses. Coming from a position of strength, the company is able to understand end market demands, as well as addressing their weaknesses by acquiring companies that complement their portfolio. All the while, the company is able to keep a strong balance sheet because of the management's financial expertise.

Valuation

The following chart depicts Straumann's next 12 months forward P/E multiple over the last decade.

Fig. 12: 12M forward P/E over last decade
Source: IAM research



As we can see, the Price/Earnings multiple of the company has really taken off until end of 2021, due to an acceleration in revenues. Straumann's stock also amplifies market movements with a beta of 1.5, so it profited well in a bull market.

We feel that a ratio of two times the growth rate is appropriate (PEG of 2). At current levels, the share price seems still a little expensive, and it trades above its decade average P/E ratio of 26.

Long term, the company targets revenues of CHF 5 billion by 2030, implying an average organic growth rate of 10% per annum.

Straumann is clearly a growth company, and as this kind of investment has become rare and in demand, the valuation has increased accordingly. The main risk is that the company only reports earnings in line with current consensus, which will clearly be a disappointment to investors (as we witnessed with H1 2022 results). The company must deliver results above consensus and increase guidance if it wants to maintain a premium multiple over the market.

To Straumann's defense, the stock got pummeled along with all other growth peers once interest rates started to rise. Indeed, rising interest rates mathematically mean a lower current valuation, as we discount further years' cashflows with a bigger interest rate.

Risks

The biggest risk we see for Straumann is a poor macro environment. Obviously, a recession will take its toll on the company, and with such a high valuation, would severely negatively impact the share price.

Other risks include litigation risks, but we think the company has a fair hold on these. The company has a culture of managing risks tightly. They cultivate an environment of trust, and employees are encouraged to report any fraudulent activity through the company's code of conduct.

Finally, we note that there is a relative financial risk concerning the swiss franc appreciation. Indeed, the company has 14% of its costs in CHF, while only 2% of its sales are done in CHF. Should the Swiss franc continue its appreciation, margins could come under pressure.