Weekday Trader

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ICU Medical: A Stock That Can Deliver

By BOB O'BRIEN

The maker of intravenous-drug systems benefits from strong cash flows and products "that aren't going to go away."

INVESTORS LATELY HAVE REALLY been sticking it to ICU Medical. Which is a shame -- as the maker of one of the leading "ouchless" intravenous systems, the company can't even be accused of sticking its patients.

Since ICU (ticker: ICUI) posted its first-quarter earnings April 19 -- earnings that proved enormously disappointing relative to estimates -- the stock has declined nearly 10%, stripping some $42 million out of its market capitalization, and dropping it back to about $430 million in market cap. Trading at about $32 a share, it's about 10% below where it was 12 months ago.

But bulls on the stock say they're willing to overlook the medical device maker's penchant for the occasional earnings disappointment, and think investors should focus on the company's more-attractive characteristics.

"This is a company that has many of the things that we look for in an investment," says Mark Travis, president of Intrepid Capital Funds. "Their products may be occasionally over-looked, but they're nevertheless heavily utilized, and aren't going to go away, regardless of the reimbursement environment.

"It's got a debt-free balance sheet, strong cash-flow generation, and management with a sizable stake in the business," Travis adds.

And it's got another feature that bulls on the stock find appealing: it's cheap, trading at just over 7 times enterprise value to EBITDA, versus about 9.5 times for the average stock in its sector.

"It's very inexpensive," Jeffrey Cohen, analyst at C.K. Cooper & Co., says. "Especially relative to its peers."

ICU Medical manufactures and sells a variety of vascular therapy products. Its main product line, called the CLAVE, is basically a needleless intravenous system for the delivery of liquid medicines. It also makes custom I.V. sets for makers of oncology treatments. ICU added a third product line last year, with its acquisition of critical care products, such as cardiac angiography kits, from Hospira (HSP).

The company's needleless I.V. products address two of the biggest risks in vascular therapies. The CLAVE prevents any airborne contaminants from infecting the patient. And, since it's needleless, it prevents health-care workers from suffering "needlestick" -- where hospital staffers accidentally prick themselves with used needles, a serious issue when treating patients with diseases such as hepatitis or HIV.

The way the company has been selling its products has been changing. That may be one of the reasons why there was such a gap between analysts' forecasts for ICU's first quarter, and the company's performance.

About 56% of ICU's revenues come from sales to medical product manufacturers, who incorporate ICU products as components in their own devices and drug therapies. That's down from about 69% of its sales two years ago. Cooper's Cohen says it could dwindle further, to as low as 45% over the next 12 months.

The principle reason those sales to manufacturers declined owes to the acquisition of Hospira's critical care product line. But those sales aren't lost. They're essentially transferred to ICU's direct-sales efforts. As part of the acquisition, ICU also took on some of Hospira's sales staff, and boosted its own hiring on reps, adding to costs. It also made additional investments in its international manufacturing operations.

As it turned out, because of higher costs, EPS came in a full 11 cents light in the quarter, at 30 cents a share, a big miss. But did the company stumble, or were the expectations too high?

"Given the changes in the business model, it feels like the Street didn't get the message," Matt Dolan, an analyst at Roth Capital Partners, says.

Meanwhile, the company's sales through domestic distributors have been growing, as a percentage of overall revenues. The distributor sales can be unpredictable -- during last year's financing crisis, when hospitals slowed spending, distributors met orders out of their own inventories -- adding to the difficulty in quarterly models.

''The story can be inconsistent quarter over quarter,'' Dolan says. "But, for the year, they hit their numbers." In fact, the company -- expected to earn $1.78 a share for 2010 -- backed its guidance for the year when it reported its quarter last month.

There are other attractive features about ICU. The company's cash-flow generation allows it to return cash to shareholders via share repurchases. By the end of the first quarter, the company spent $50 million of its authorized $55 million buyback authorization. There's also more than $6 a share in cash on the books.

The stock's worth a lot more than the market recognizes. ''The reason to look at this is the value,'' Cohen says. If the stock trades with its peers, there's as much as 30% upside from here, he says.

The catalysts for higher valuation could include an expansion of its international operations, which currently account for about 20% of sales, as well as the completion of the integration of the assets it bought from Hospira.

"I think ICU can show definitively how it gets its stock price into the low $40s," Travis says.