

QC INVESTMENT MEMO

To: Kelvin Li
From: Danny Kim and Mike Vanderlinden
Date: July 18th, 2015
Re: Thermo Fisher Scientific Inc. (NYSE:TMO)

COMPANY PROFILE

Industry: Healthcare, Life Sciences
 Main Asset(s): Analytical, diagnostic instruments

Market Capitalization: \$54,398.5 mm
 Debt: \$14,870.2 mm
 Cash: \$873.0 mm
 Enterprise Value: \$68,395.7 mm

NTM(E) Revenue: \$16,748.39 mm
 NTM(E) EBITDA: \$4,252.00 mm
 NTM(E) FCF: \$2,641.47 mm

INVESTMENT PROFILE

Current (Proposed) Investment Size: N/A
 Position Cost Basis: N/A
 Current Share Price: \$135.75
 Life to Date Profit (Loss): \$11,196 mm since '06 merger
 Life to Date Percentage Return: 4223.25%

Base Case Valuation: \$153.00
 Downside Case Valuation: \$120.00
 Upside Case Valuation: \$180.00

COMPANY DESCRIPTION

- TMO provides analytical instruments, reagents, consumables, software and services for medical and health-related research, manufacturing and diagnostics. It was created in 2006 when Thermo Electron and Fisher Scientific merged, and is currently both the largest and most diversified company in the Life Science Tools industry
- With worldwide presence in 50 countries and 50,000 employees, the company's major sectors include Life Science Solutions, Analytical Instruments Specialty Diagnostics, and Laboratory Products and Services that serve a wide variety of pharmaceutical, biotechnology and industrial markets (exhibit 1)
- TMO's acquisition of Life Technologies in 2014 helped to make it a leading organization in life technologies, diagnostics and applied sciences, creating accelerated advantages in genetic testing, precision lab equipment and cell biology research
- Geographic distribution is concentrated in North America (51%) and Europe (27%), with a rapidly expanding manufacturing footprint in emerging markets in anticipation of rising competition from indigenous manufacturers
- Recurring revenue mix is centralized around three major sectors: consumables (61%), services (13%), and instruments, equipment & software (26%)
- Focus on a streamlined shopping strategy for laboratory consumables and equipment that has generated popularity among pharma/biotech community, major partnerships already established with companies such as Pfizer, GlaxoSmithKline and Merck

VALUATION I – Comparable Analysis

Life Sciences and Analytical Instruments Sector	Mkt Cap (MM)	EV (MM)	EV/EBITDA			P/E		Dividend Yield	Price/Book	PEG NTM	EV/Unlevered FCF
			LTM	2015E	2016E	2015E	2016E				
Waters Corporation (NYSE:WAT)	\$10,815.40	\$10,191.70	15.3x	15.21x	14.25x	22.66x	20.70x	-	5.8x	2.36x	26.98x
Agilent Technologies Inc. (NYSE:A)	\$13,441.00	\$12,903.00	10.6x	14.77x	12.92x	23.78x	20.46x	1.3%	3.2x	1.81x	12.47x
PerkinElmer Inc. (NYSE:PKI)	\$5,925.70	\$6,772.50	19.5x	14.83x	13.86x	20.24x	18.25x	0.5%	2.9x	1.84x	31.69x
Illumina Inc. (NasdaqGS:ILMN)	\$33,266.90	\$33,201.60	48.4x	41.63x	34.68x	67.05x	56.14x	-	20.5x	2.98x	80.80x
Mettler-Toledo International Inc. (NYSE:MTD)	\$9,667.50	\$10,116.10	19.3x	17.71x	16.45x	26.86x	23.88x	-	14.5x	1.97x	28.66x
Myriad Genetics Inc. (NasdaqGS:MYGN)	\$2,428.70	\$2,294.30	11.7x	12.30x	10.55x	24.04x	19.89x	-	3.7x	1.30x	19.75x
NanoString Technologies, Inc. (NasdaqGM:NSTG)	\$300.10	\$275.80	NM	NM	NM	NM	NM	-	9.4x	-	-10.84x
Veracyte, Inc. (NasdaqGM:VCTY)	\$312.80	\$292.00	NM	NM	NM	NM	NM	-	7.3x	-	-15.91x
Thermo Fisher Scientific, Inc. (NYSE:TMO)	\$54,398.50	\$68,395.70	16.9x	16.06x	14.84x	18.63x	16.77x	0.4%	2.7x	1.53x	24.21x
Mean	\$9,519.80	\$9,505.90	20.8x	19.41x	17.12x	30.77x	26.55x	0.9%	8.4x	2.04x	33.40x
Median	\$7,796.60	\$8,444.30	17.3x	15.02x	14.06x	23.91x	20.58x	0.9%	6.6x	1.91x	27.80x

Source – Capital IQ

- On an EV/EBITDA, P/E, EV/FCF, PEG and P/B basis, TMO trades at a discount to the mean
- Illumina is the next largest company by market capitalization in the sector and TMO's closest competitor in DNA sequencing and genomics, it trades at a significant premium on all multiples
- LTM EV/EBITDA for Illumina is ~246% TMO's multiple, while the forecasted PEG ratio yields a 195% discount for TMO
- TMO is also one of three companies in the sector that yields dividends, a payout ratio of ~15% means that the company could easily raise the dividends in years to come

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VALUATION II - TMO 2016 EV/EBITDA Sensitivity Analysis

		2016E EBITDA at Various Revenue Levels			
		\$16,833	\$17,550	\$18,281	\$19,026
Margin	23.5%	\$3,956	\$4,124	\$4,296	\$4,471
	25.5%	\$4,292	\$4,475	\$4,662	\$4,852
	27.5%	\$4,629	\$4,826	\$5,027	\$5,232
	29.5%	\$4,966	\$5,177	\$5,393	\$5,613
		Stock Prices at EV/EBITDA of 15			
		\$123	\$129	\$136	\$142
	23.5%	\$123	\$129	\$136	\$142
	25.5%	\$136	\$142	\$150	\$157
	27.5%	\$148	\$156	\$163	\$171
	29.5%	\$161	\$169	\$177	\$186

Source – KeyBanc, Thomson One

- Our target price of \$153.00 is based on TMO trading at 18.8x a 2016 EPS of \$8.14/share, which represents a P/E that is slightly higher than its current value, moving towards the mean of other comparable life sciences companies and its own historical 5 year average
- 4% organic growth in 2016, continuous development of synergies with Life Technologies, margin expansion and management's efficient execution on their capital deployment plans are expected to yield the equity upside of ~13%

INVESTMENT THESIS

- TMO is a high quality earnings grower and industry leader that is trading at a discount. Key observations are as follows: 1) TMO's distribution infrastructure, scale and e-commerce platform has garnered the attention of pharma/biotech firms looking for simplicity and pricing flexibility, while strengthening the partnerships that currently exist. 2) A strong and diversified portfolio of products uniquely positions TMO among its peers to take advantage of both small and large cap partnerships, as well as benefit from the convergence of life science tools and diagnostics. 3) Management's focus on organic growth is supplemented by a solid M&A strategy while revenue/cost synergies are continuously developed with its latest acquisition: Life Technologies. 4) TMO's disciplined approach to margin expansion and capital deployment will remain a key earnings driver.

KEY INVESTMENT RISKS

- RISK I Synergy shortcomings associated with an M&A focused strategy**
 Less than expected synergies with Life Technologies and newly acquired bolt-on acquisitions such as Alfa Aeser may cause issues in revenue generating capabilities. Conflicts during the integration and consolidation of Life Technologies processes with TMO subsidiaries may affect the long-term outlook on cost saving and revenue synergies.
Mitigating Factor to Risk I: TMO has a proven track record of delivering revenue synergies and integrating new businesses into its global operations smoothly.
- RISK II End-market dependence and exposure to macroeconomic factors affecting the pharma/biotech sector**
 Significant exposure to industrial end-markets increases vulnerability to prolonged secular downturns. A macro slowdown in emerging markets caused by fiscal concerns or currency headwinds will also deter plans for geographic expansion.
Mitigating Factor to Risk II: Core partnerships exist with highly globalized pharmaceutical and biotech companies, leads to highly diversified geographic coverage when considering the demand that will exist among each company's respective needs.
- RISK III CAD versus USD FOREX risk**
 A Canadian dollar that has plunged to post-recession lows will adversely affect returns when exchange rates are applied in American investments. A weak commodities story, a high number of short positions in the Canadian dollar, and sliding oil prices may continue to pose a major risk.
Mitigating Factor to Risk III: Rising full-time employment and consumer spending, a cheaper Canadian dollar attracting foreign business into the country's oil exporters are among the mitigating factors that may reduce this risk.

KEY INVESTMENT STRENGTHS AND CATALYSTS

- STRENGTH I Strong online presence in the Life Sciences and Analytical Instruments Sector**
 Management's execution of an e-commerce strategy has created profitable partnerships. 2014 e-commerce sales were \$2.5 bn, relative to \$17 bn in total revenues with growth expected as TMO consolidates its websites with Life Technologies' to launch a single, company-wide global channel by year-end. This also creates comprehensive real-time data for market analysts that will be available to improve offerings, marginalize smaller competitors and rationalize production.
- STRENGTH II A robust product portfolio and industry dominating distribution network**
 TMO's diversified portfolio of offerings has made it the one-stop shop for many pharmaceutical and biotechnology companies. This is due to its success in consolidating the brands under its name including Phadia, Dionex and Fisher Scientific. With newly added Life Technologies product rollouts including the clinically well-received QuantStudio 3/5, and the Ion PGM System (both genetic research tools), TMO's suite of products have enabled it to cross-sell higher value proposition instruments. Couple this with the largest sales force among comparable companies, well-established distribution infrastructure, and unmatched scale; TMO is positioned to lead the life technologies industry.

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STRENGTH III

Acquisitions are supplemented by a strong organic growth strategy.

The organic growth outlook at the May 20th analyst conference was 4%, up 100 bps from 3% previously, which relies on improving end markets, new product introductions and the continued development of revenue synergies with Life Technologies. Robust end-market demand as pipelines among pharma/biotech firms stabilize and positive industry trends persist will drive growth in TMO's specialty diagnostics business and analytical instruments, while the mature catalog business may act as cash cows to fund investments in growth segments.

STRENGTH IV

Margin expansion and capital deployment plans

TMO has also announced at their analyst conference their forecasts for margin expansion of 60-90 bps y/y that will accelerate its earnings growth. Highlighted factors that bring about this growth include practical process improvements, companywide sourcing programs, and an optimized global footprint that targets \$330 million in gross savings. ~\$8.3 bn in capital deployment as a base case is also expected, targeting leverage of 2x gross debt to EBITDA. TMO estimates ~\$15 bn in capacity for M&As or share repurchases in an upside case, implying flexibility for larger deals if a strategic fit is identified.

CATALYST I

TMO is prepared for a large deal on the horizon

TMO's recent ~\$14 bn bid for Pall Corporation in early 2015 has also increased analyst expectations for a much larger deal that could significantly diversify its revenue streams. As synergies with Life Technologies deliver on analyst expectations, another \$10 bn + deal is possible and may bring another wave of diversification and synergies.

CATALYST II

Buybacks are another possibility in the absence of an acquisition

Although growth through acquisition is the top priority for TMO executives, the management team also believes that the stock is undervalued and highlighted the company's \$3.5 bn of buyback authorization. If a large deal does not occur, bolt-on acquisitions and buybacks will likely be the result.

CATALYST III

Successful share gains in the small and medium biotech sector

Previously dominated by competitor Waters Corporation, TMO is mobilizing its commercial teams to focus on SMEs in the biotech sector to improve market share. Scaling the business is a huge priority within this market, and TMO's diversified and broad selection of products derived from its acquisitions is a key factor that will drive growth among these customers.

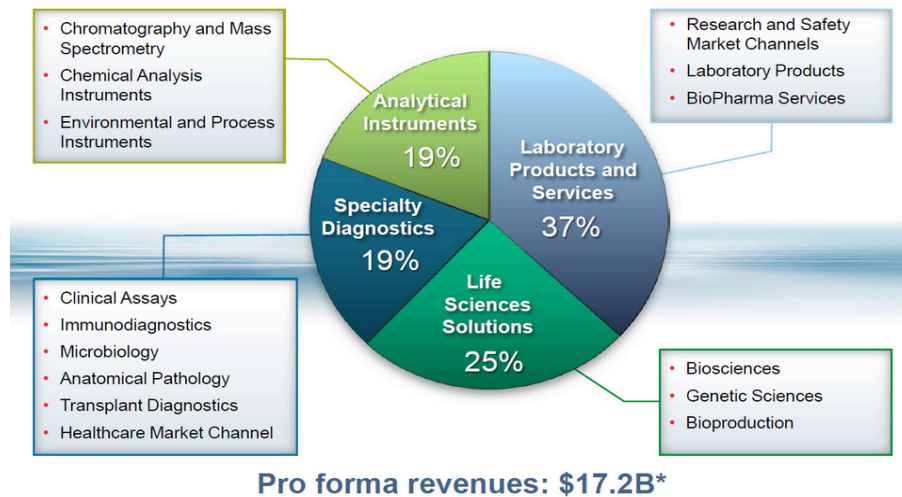
INDUSTRY DETAILS

- Life sciences technologies are directly tied to the R&D demand of major pharmaceutical/biotech companies, research and academic institutions, governments, and clinical markets
- Rising incidences of chronic disease brought upon by an aging population of baby boomers offers opportunities for exponential growth in R&D demand among major players in the healthcare and biotech industries as pharmaceuticals and medical services become more prominent consumer staples
- United Health forecasts genetic testing and genomics to grow from a current market of \$10 bn to \$20 bn by the year 2020, a major growth market that TMO has acquired access to due to its acquisition of Life Technologies
- Increases in life expectancy are expected to rise from 72.6 in 2012 to 73.7 in 2017, bringing in a new age of accessibility issues and amplifying the sustainability of the industry as demand for novel and more efficient pharmaceuticals sharply rise
- Continued development of biotechnology infrastructure in emerging markets is creating opportunities for international penetration, while healthcare spending in the US currently covers approximately 16% of the nation's GDP, projected to increase to approximately 25% by 2040 if historical trends persist

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Appendix

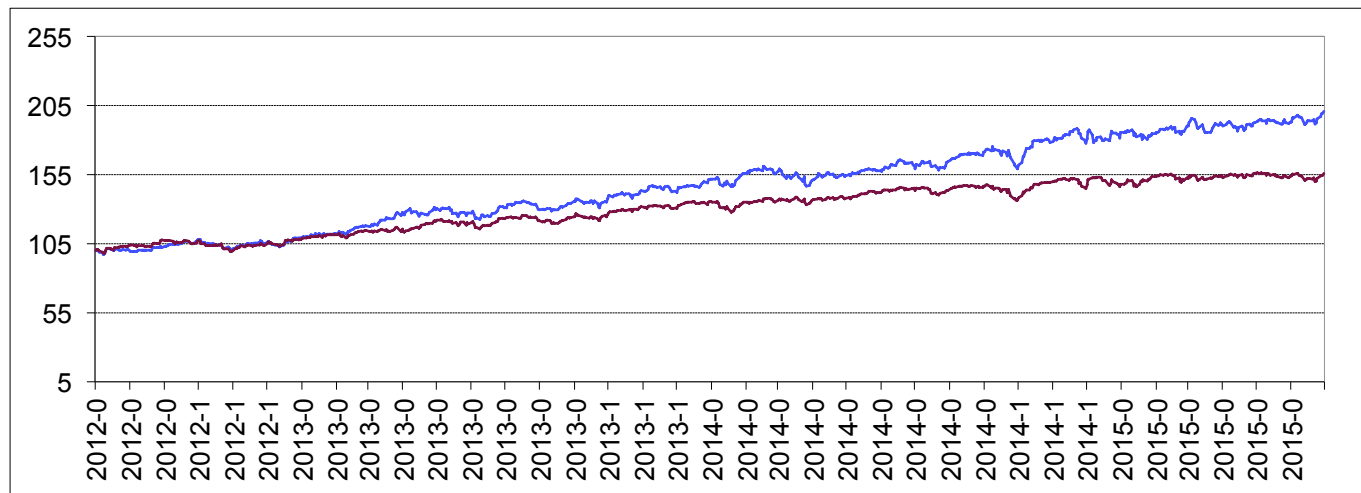
Exhibit I – TMO Snapshot of Product Portfolio



* Estimates based on unaudited LTM combined revenues of Thermo Fisher Scientific and Life Technologies through Q4 2014.
 1 Percentages calculated are based on estimates for intercompany eliminations and other accounting policy adjustments.

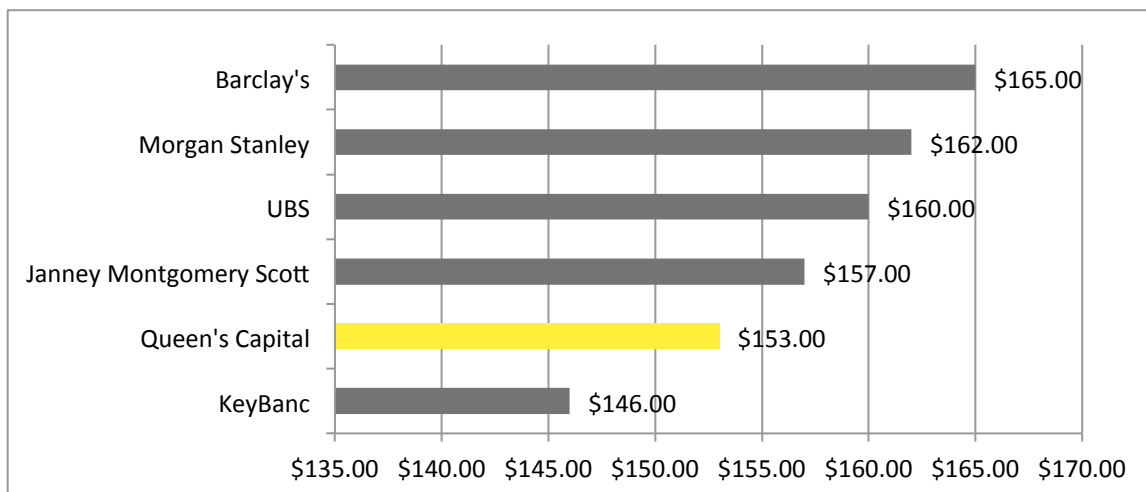


Exhibit II – Outperformance of the S&P 500 – Pharmaceuticals, Biotech, Life Sciences Industry Group vs. S&P 500



Source – Capital IQ

Exhibit III – Target Price vs. Consensus



Source – Thomson One

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