

Health Care Analyst Report

Bryce Young, Nick Armato, John Wunderlick



Date: November 19, 2020

Fonar P/B: 1.17

Company Ticker: FONR

Sector P/B: 2.39

Sector: Health Care

Market Price: \$20.30

Industry: Medical Devices

Forecasted Price: \$35.93

Recommendation: HOLD

Company Summary:

Fonar has been on a steady upwards progression ever since it had introduced the world's first commercial MRI machine. This special machine utilized Fonar's patented iron-core technology which is the basis for all MRI machines today. In 1997 Fonar created a new practice management subsidiary which brought them substantial synergy and growth potential in the market. This new subsidiary allowed Fonar to create a unique and exclusive machine that gave doctors the ability to contort patients into different positions so they could have a more accurate diagnosis when using their products. COVID-19 has stunted the growth of Fonar over the past several months because of the industries push to fight the virus instead of invest in new heavy duty machinery. Even though the industry has swayed away from heavy machinery Fonar has made a huge rebound over the past several months.

Industry Outlook:

The Healthcare industry is a very interesting industry right now. Because of the nature of the pandemic there is a push towards companies that specialize in drug manufacturing and PPE to combat the virus, and a pushing away from expensive hardware companies that a hospital/ clinic would do business with during a normal year. The reason for this odd dynamic is quite simple. The Healthcare industry in allocating a large amount of their funds to combat the Corona Virus which streamlines a lot of resources to companies that are actively battling the virus. Companies that are not currently fighting the virus head-on are forced to wait until the virus recedes.

Earnings Forecast:

Income Statement Per Year Starting 06/30	A 2017-2018	A 2018-2019	A2019-2020	E2020-2021	E2021-2022	E2022-2023	E2023-2024	E2024-E2025	E2025-2026	E2026-E2027	E2027-2028
Revenue	81.5	87.2	85.7	92.6	100.1	108.2	116.9	126.4	136.6	147.7	159.6
+ Sales & Services Revenue	60.2	63.0	63.2	67.6	73.1	79.0	85.4	92.3	99.7	107.8	116.5
+ Other Revenue	21.3	24.2	22.5	25.0	27.0	29.2	31.6	34.1	36.9	39.9	43.1
- Cost of Revenue	42.0	44.0	43.3	54.4	58.9	63.6	68.8	74.3	80.3	86.8	93.8
Gross Profit	39.6	43.2	42.4	38.2	41.3	44.6	48.2	52.1	56.3	60.9	65.8
- Operating Expenses	19.9	21.1	28.7	23.2	23.2	23.2	23.2	23.2	23.2	23.2	23.2
+ Selling, General & Admin	18.1	19.3	26.7	21.4	21.4	21.4	21.4	21.4	21.4	21.4	21.4
+ Research & Development	1.8	1.8	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Operating Income (Loss)	19.7	22.1	13.7	14.9	18.0	21.4	25.0	28.9	33.1	37.7	42.6
- Non-Operating (Income) Loss	-0.1	-0.4	-0.5	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
+ Interest Expense, Net	-0.1	-0.4	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
+ Interest Expense	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
- Interest Income	0.3	0.5	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
+ Other Investment (Inc) Loss	-0.3	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
+ Foreign Exch (Gain) Loss	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+ Other Non-Op (Income) Loss	0.3	0.5	-0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Pretax Income (Loss), GAAP	19.8	22.5	14.1	15.3	18.3	21.7	25.3	29.2	33.4	38.0	42.9
- Income Tax Expense (Benefit)	-5.7	2.0	2.4	3.2	3.9	4.6	5.3	6.1	7.0	8.0	9.0
Income (Loss) from Cont Ops	25.5	20.5	11.7	12.1	14.5	17.1	20.0	23.1	26.4	30.0	33.9
Income (Loss) Incl. MI	25.5	20.5	11.7	12.1	14.5	17.1	20.0	23.1	26.4	30.0	33.9
- Minority Interest	4.2	5.2	3.5	4.3	4.3	3.5	4.3	4.3	4.3	4.3	4.3
Net Income, GAAP	21.2	15.3	8.2	7.8	10.2	13.7	15.7	18.8	22.1	25.7	29.6
Shares Outstanding	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
EPS	3.03	2.19	1.18	1.11	1.45	1.95	2.24	2.68	3.16	3.67	4.22

Our earnings forecast for Fonar is driven by two unique drivers, Revenue Growth Rate and Gross Margin. Both of these drivers were calculated by taking the historical averages of each increase or decrease over the last 15 years. The driver for Revenue Growth Rate equaled 8.1% and the driver for Gross Margin equaled 59%. After getting both of these drivers we were able to estimate the remaining pieces with historical averages over the last two years. As you can see we expect Fonar to bounce back quickly from the Pandemic and be on track to steadily increase their Net Income for years to come.

Valuation:

Valuation								
	FY 2020 E	FY 2021 E	FY 2022 E	FY 2023 E	FY 2024 E	FY 2025 E	FY 2026 E	FY 2027 E
Net Income	\$1.94	\$10.17	\$13.67	\$15.68	\$18.76	\$22.09	\$25.68	\$29.57
+ D&A	1.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
- Capex	-2.00	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00
- Change in NWC	5.87	-4.34	-4.69	-5.07	-5.48	-5.93	-6.41	-6.92
+ Change in Debt Balance	0.00	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCFE	\$6.81	\$1.82	\$4.97	\$6.61	\$9.28	\$12.16	\$15.28	\$18.65
PV of FCFE	6.65	1.62	4.04	4.89	6.26	7.48	8.56	9.52
Terminal Value	300.25							
Sum of Discounted FCFE	49.02							
Discounted Terminal Value	202.50							
Equity Value	251.52							
Shares Outstanding	7.0							
Target Share Price	35.93							
Current Share Price	19.95							
Recommendation	HOLD							

The long-term growth rate that we used for the valuation was 3.5%, and the discount rate that we calculated for our sector was 9.71%. Capital Expenditures and debt were both calculated by taking historical averages over the last several years. After calculating equity value and dividing that by the number of shares outstanding we found that the target share price is \$35.93 in the year 2027.

Sensitivity Analysis:

Sensitivity Analysis		Short-term Growth Rate			
	\$	6%	8%	10%	15%
	35.93				
	9.00%	40.79	40.79	40.79	40.79
Discount Rate	9.71%	35.93	35.93	35.93	35.93
	10.00%	34.25	34.25	34.25	34.25

After inputting various different calculations for the Discount Rate and Short-Term Growth Rate we found that Fonar is not a sensitive holding.

Conclusion:

In Conclusion we believe that Fonar is a great company to hold onto during the midst of the Coronavirus. Despite performing poorly over the last couple months, we expect Fonar to rebound quickly and start producing a consistent line of revenue.