



Lab Corp Calls Bought on PAMA Over-Reaction, Potential M&A Upside

Ticker/Price: LH (\$144)

Analysis:

Lab Corp (LH) on 4/17 traded 12X daily calls as May \$145 calls were bought aggressively into weakness \$4.60 to \$5.30 for 2,300 contracts. LH has previously seen some bullish positioning in August with 900 of the \$145 calls bought on 3/4 and back on 1/31 the August \$160 puts sold to open 500X at \$21.30. LH shares are putting in an ugly weekly candle, nearly a 50% retracement of the Q4 2018 low to recent high and sit back near a key level of support near \$140 as a retest of a key 2017 breakout, VPOC, and a rising 233 week MA setting up a nice reward/risk versus \$135. The \$14.45B Company operates in two segments, Diagnostics where it is a leader along with Quest (DGX), and Covance Drug Development. LH shares now trade 12X Earnings, 9.8X EBITDA, and 15.6X FCF. On an EV/EBITDA basis it has tended to trade in a 9.5X to 12X historical range. LH saw strong topline growth the last few years but 2019 seen transitional with just 1.9% growth before re-accelerating in 2020, and similar for EPS growth. Its Covance Drug Development segment supports 50% of all clinical trials and involved in all top 50 best-selling drugs on the market. It operates in massive markets with the US Clinical Lab Testing market estimated at \$80B growing at low single digits and a \$45B Global Outsourced R&D Spend market. LH has a strong balance sheet and has favored deploying capital in M&A over the last few years. Analysts have an average target of \$170 on shares and short interest low at 2.3% of the float. LH recently partnered with Qiagen (QGEN) on a diagnostic product program. Piper defended shares in February seeing bad news priced into shares and expects for deal activity and buybacks in 2019 while UBS sees shares re-rating higher with a stronger 2H19. Jefferies upgraded to Buy on 4-2 while Wolfe Research was cautious due to 2021 impact of PAMA. The clinical laboratory industry spent 2018 fighting the reimbursement reductions mandated by PAMA but ended the year with little to show for its efforts. PAMA wiped around 7% off the fee schedule in 2018 and will take 10% more in 2019. The cumulative effect of the cuts, coupled to growing acceptance that PAMA may be here to stay, could trigger an uptick in consolidation and M&A. Hedge Fund ownership fell 7.4% in Q4 filings, Boston Partners and Healthcor Mgmt. notable sellers.

Hawk Vision:



Trading Strategy: LH looks tradable versus \$135 though it clearly has some major headwinds, valuation looks cheap and capital deployment can offer some relief.

Confidence Ranking: \$\$