

St Jude Medical

Early Thoughts on the Shortfall - ALERT

St. Jude pre-announced 3Q results this morning, with revenues of \$1,159M (+7%, 10%cc) coming in at the low end of management's guidance range (\$1,157-\$1,222M) and \$28M below Street consensus despite a lower-than-expected Fx headwind. On the bottom line, EPS are now expected to be in the \$0.57-\$0.58 range, below the \$0.61-\$0.63 guidance range.

- **Shortfall comes across the board, with the exception of Neuro.** Third-quarter softness at St. Jude was evident in all segments with the exception of Neuro, which at \$84 million were \$3M better than expected. The company is attributing the softness to hospital destocking for certain medical devices as well as delayed purchasing behavior with the current healthcare reform backdrop. St. Jude did have two extra selling days in its 3Q, but this was already factored into guidance and Street forecasts.
- **It is clear from our conversation with St. Jude that the shortfall this quarter was back-end loaded.** In other words, that the quarter through the first two months of the year had been on track. The questions therefore are (1) Did hospitals reduce their inventories? And if so, why would we just be seeing it four quarters into the economic turndown? Or (2) Did St. Jude just have too much inventory in the field? St. Jude's own inventories on hand had climbed 9.5 days since year-end, and at 185 days was 17 days above the 2Q average of the prior 7 years.
- **It's too early to make a call on read-through to other device makers.** We have calls in to various contacts within the industry, and will circle back once we get a better read. The early feedback from Medtronic is that they're not seeing any changes in their business. The challenge, though, is that Medtronic is mid-quarter, whereas the rest of the industry just went through its quarter-end. Worth noting, St. Jude isn't blaming the layoff of 200 low productivity sales reps intra-quarter as a reason for the shortfall or at least a cause of disruption.
- **With the shares off 12% today, despite the limited visibility, we would be buyers on the pullback.** While we've now seen two shaky quarters in a row, organic growth still came in at 8% despite the miss, which is at the high end of the MedTech group average. On the bottom line, we see 10% as a worst-case scenario for earnings growth in 2010 (we currently model 15% growth), placing St. Jude at the top end of its peer group in terms of both top- and bottom-line growth.

Overweight

STJ, STJ US

Price: \$38.24

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Medical Supplies & Devices

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- **More on the quarter.** Preliminary 3Q ICD sales of \$389M were up 2% as reported and 5%cc, coming in \$9M below our forecast, again despite a lighter Fx headwind. We won't know the full ICD market picture until Boston reports on Oct 20th and then Medtronic in November, but our current forecast calls for market growth of 5%cc, which is unchanged in light of St. Jude's pre-announcement. Pacemaker sales of \$301M in the 3Q were \$7M below our forecast, up 4%cc, while total CRM sales of \$690M (+5%cc) were \$16M below our forecast and at the low end of St. Jude's \$700-\$730M guidance range. Afib sales of \$155M were \$6M below our forecast and came in at the midpoint of the company's guidance range, up 18%cc. Finally, Vascular sales of \$230M (+14%cc) were \$5M below our forecast and at the bottom end of the guidance range.

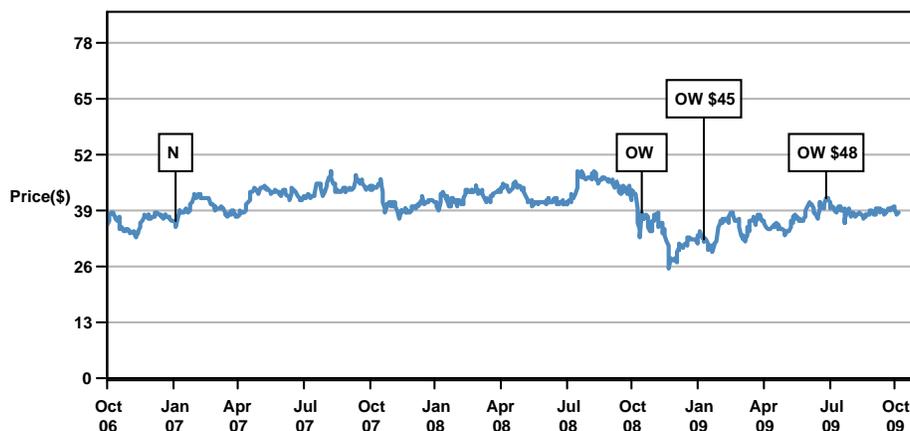
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St Jude Medical (STJ) Price Chart



Date	Rating	Share Price (\$)	Price Target (\$)
03-Jan-07	N	36.56	--
13-Oct-08	OW	38.27	--
07-Jan-09	OW	32.24	45.00
26-Jun-09	OW	41.77	48.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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