

F&P Healthcare

UNDERPERFORM

Temporary Lift in the Pulse

F&P Healthcare (FPH) upgraded its FY20 guidance ~+2%, reflecting (1) stronger than expected 1Q20 in Hospital and (2) FX tailwinds. Both drivers appear temporary boosts rather than a sustained acceleration in growth. Guidance implies underlying core business growth of +1–6%, lacklustre versus history and in light of elevated valuation metrics. A re-acceleration is reliant on success with new Homecare masks, which is far from a forgone conclusion in a competitive market. Retain UNDERPERFORM.

What's changed?

- **Earnings:** Minor upgrades. NPAT revised +2% for FY20/21E.
- **Target Price:** Lifted to NZ\$15.00, primarily due to a WACC change in light of a lower risk free assumption. Peer multiples are also higher, given the recent re-rate of ResMed.
- **Rating:** UNDERPERFORM.

FY20 guidance lift — stronger 1Q and FX benefit

FPH upgraded its FY20 NPAT by ~+2% at its Annual Shareholders' Meeting to NZ\$245–255m (prior NZ\$240–250m provided in May). The mid-point is slightly ahead of consensus and broadly consistent with our prior forecast. FPH also guided to higher revenue at NZ\$1.17bn (prior NZ\$1.15bn). Key drivers are:

- **Stronger 1Q volumes than expected for its Hospital business:** This has been consistent across all product groups and management attributes this to the US flu season being stronger for longer (although data is far from perfect to assess drivers). We understand this strength hasn't continued into 2Q which has been consistent with the typical growth run-rate and FPH forecasts.
- **FX:** FY20 NPAT will benefit from a net tailwind of c. NZ\$10–11m. Guidance uses a NZDUSD of 0.64 (prior 0.65) and FPH's hedging book shows a further step-up with FY20 now 90% hedged against key currencies.

Two speed growth path continues

FY19 saw a meaningful divergence in growth across its two divisions, which we expect to accelerate in FY20.

- **Hospital:** Growth remains strong and the standout segment within FPH. Returns are highly attractive and there remains material growth runway to support a sustained double-digit growth trajectory as adoption continues to build for Optiflow in particular.
- **Homecare:** Pressure is evident following a hiatus in new product releases while its competitors have advanced considerably. Changing the negative trajectory is reliant on success with new mask(s) in what is a highly competitive current market landscape. This remains an area of downside risk, with our forecasts assuming a return to strong growth from FY21E.

Investment View

FPH is a high quality company with an attractive outlook supported by a long runway of organic growth opportunities, particularly in the Hospital segment where clinical evidence continues to build. However, valuation metrics are elevated, even when adjusting for growth, relative to global peers, which leaves little room for error. UNDERPERFORM.

NZX Code	FPH
Share price	NZ\$16.07
Target price	NZ\$15.00
Risk rating	Medium
Issued shares	572.8m
Market cap	NZ\$9,205m
Average daily turnover	600.5k (NZ\$8,736k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ\$m)	209.2	253.1	292.3	336.6
EPS* (NZc)	36.5	44.0	50.6	57.9
EPS growth* (%)	9.5	20.5	14.9	14.6
DPS (NZc)	23.3	27.9	32.6	37.4
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	27.8	23.7	20.3	17.8
EV/EBIT	31.3	27.5	23.1	20.0
PE	44.0	36.5	31.8	27.7
Price / NTA	n/a	n/a	n/a	n/a
Cash dividend yield (%)	1.4	1.7	2.0	2.3
Gross dividend yield (%)	2.0	2.4	2.8	3.2

*Historic and forecast numbers based on underlying profits

Chelsea Leadbetter, CFA

chelsea.leadbetter@forsythbarr.co.nz

+64 4 495 5262

Key tables and charts

We make minor upgrades to our near-term forecasts due to lower NZDUSD assumptions and slightly higher near-term Hospital growth rates. Our long-term expectations are unchanged.

Figure 1. Earnings revisions (NZ\$m)

NZ\$m	FY19A	FY20E			FY21E			FY22E		
	Actual	Old	New	% chg	Old	New	% chg	Old	New	% chg
Total revenue	1,070.4	1,159.7	1,169.2	0.8%	1,321.3	1,332.6	0.9%	1,497.8	1,510.0	0.8%
EBITDA	329.3	384.0	386.5	0.7%	446.1	452.5	1.4%	509.0	516.4	1.4%
Normalised Profit	209.2	249.1	253.1	1.6%	287.9	292.3	1.6%	331.6	336.6	1.5%
Normalised EPS (cps)	36.5	43.3	44.0	1.6%	49.8	50.6	1.6%	57.0	57.9	1.5%
Dividend per share (cps)	23.3	27.5	27.9	1.5%	32.1	32.6	1.6%	36.8	37.4	1.6%
NZDUSD	0.68	0.65	0.64	-1.7%	0.66	0.65	-1.1%	0.66	0.65	-1.1%

Source: Forsyth Barr analysis

Target price NZ\$15

We have increased our target price to NZ\$15.00 (prior NZ\$13.50). This reflects a +12% increase in our DCF primarily due to lowering our risk free rate assumption from 2.75% to 2.0% across our research coverage. Our WACC assumption is now 7.6% (prior 8.3%).

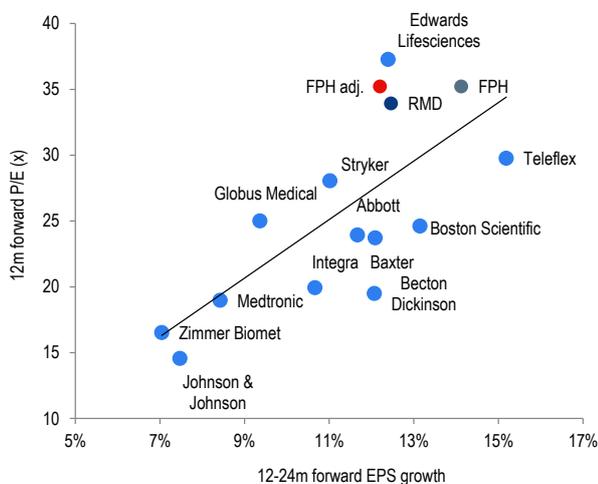
Our valuation also benefits from higher peer multiples, predominantly underpinned by the recent re-rate in ResMed (following recent result strength, showing evident market share gains in the key mask segment — likely at the expense of FPH).

UNDERPERFORM retained

FPH offers a well-articulated, attractive long-term growth story. However, at current valuation metrics we see the risk/reward as negatively skewed.

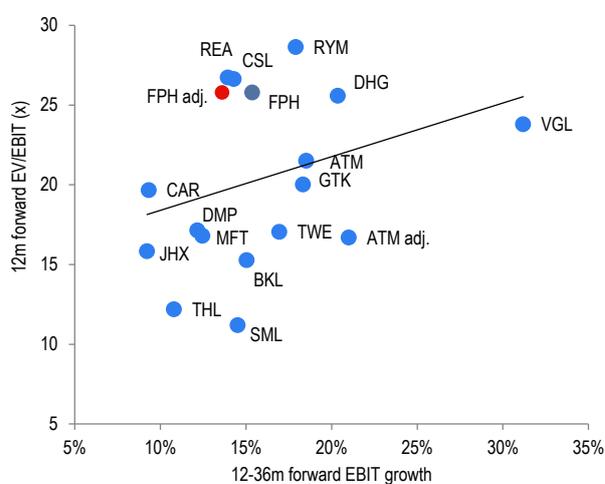
Valuation metrics are elevated versus history, Australasian growth peers and global healthcare compcos. Adjusting for temporary boosts to growth in FY20, our 3 year CAGR lowers to +12% which amplifies this further. We don't question the sustainability of strong Hospital growth, however, the material opportunity in this segment is well-known, in our view. We see the key area of risk (downside) to market expectations being Homecare, where forecasts include a return to strong growth. While we have no reason to doubt a step-forward in technology in its new mask, a highly competitive market backdrop (rife with new products across the key players) likely constrains the upside.

Figure 2. FPH versus global healthcare compcos



Source: Forsyth Barr analysis, Bloomberg Adj. for underlying core business growth

Figure 3. FPH versus Australasian growth peers



Source: Forsyth Barr analysis, Bloomberg Adj. for underlying core business growth

Investment summary

F&P Healthcare (FPH) has developed specialised expertise in heated humidification that forms the basis of its strong market position in the hospital and growing presence in homecare. It has progressively widened its addressable market through 'new' applications which is a key driver of an attractive, long-term, double-digit profit growth outlook. Valuation metrics are elevated, even when adjusting for growth, relative to global peers, leaving little room for error. **UNDERPERFORM.**

Business quality

- **Track record:** FPH has created value through continued product innovation and progressively widening its addressable market with 'new' applications of its technology to serve more patient groups and provide more products per patient.
- **Strong market position:** FPH's business model is supported by a high portion of recurring revenue (>85%) and strong global market position (including c. 70% share in the invasive ventilation market; c. 15% in sleep apnea and growing presence in areas where FPH is working to change clinical practice).
- **Attractive industry backdrop:** FPH operates in markets with high barriers to entry and where adoption curves are long. Structural trends are also supportive (ageing population, global focus on lowering healthcare costs and improving diagnosis rates).

Earnings and cash flow outlook

- **Slower near-term revenue growth:** Near-term growth is increasingly reliant on the Hospital segment, with Homecare under pressure following a period of new product hiatus. Changing this trajectory is reliant on new products being successful.
- **Long-term growth thesis attractive:** FPH has a long runway of organic growth opportunities, particularly in the Hospital segment where clinical evidence continues to build for 'new' applications.

Financial structure

- **Balance sheet:** FPH's target gearing range of -5% to +5% ensures flexibility for events like product recalls or hedging opportunities. We expect it to remain in a net cash position near-term.

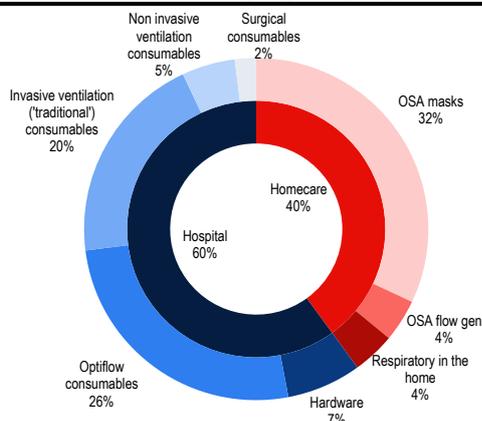
Risks factors

- **Change in technology or medical treatments:** May result in some products becoming obsolete or cause it to incur costs to implement new technologies. There is some risk mitigation given FPH's diversified offering.

Company description

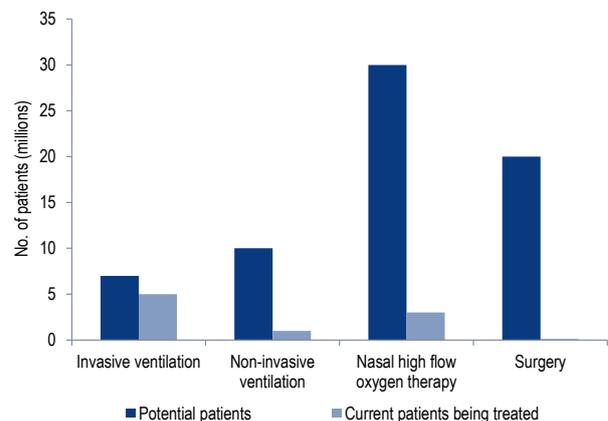
FPH designs, manufactures and markets heated humidifiers for use in respiratory care and humidified airflow generators for obstructive sleep apnea (OSA), along with associated single and multi-use accessories. FPH has a strong global market share in respiratory care following over 30 years in the market. The company leveraged its expertise in humidification products into the OSA market. It has a market share of 10%-15% and is the third player behind ResMed and Phillips Respironics. FPH has a range of over 2,700 products and accessories and sells its products globally.

Figure 4. Revenue breakdown by segment (est.)



Source: Company reports, Forsyth Barr analysis

Figure 5. Global market penetration in RAC / Hospital segment



Source: Company reports, Forsyth Barr analysis

Figure 6. Substantial Shareholders

Shareholder	Latest Holding
The Vanguard Group	5.3%
The Capital Group Companies	5.1%
BlackRock Investment Management	5.0%

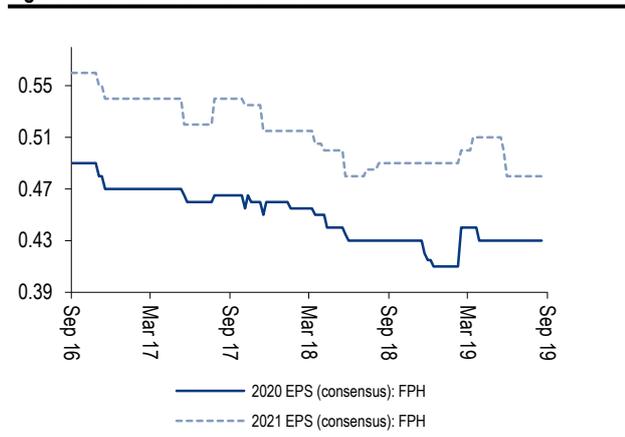
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International Compco's

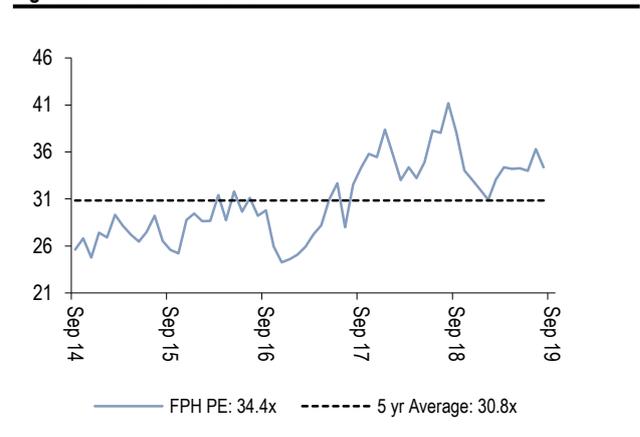
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
				2020E	2021E	2020E	2021E	2020E	2021E	
<i>(metrics re-weighted to reflect FPH's balance date - March)</i>										
F&P Healthcare	FPH NZ	NZ\$16.07	NZ\$9,205	36.5x	31.8x	23.7x	20.2x	27.4x	23.0x	2.0%
ResMed Inc	RMD US	US\$135.98	US\$19,534	38.0x	31.8x	24.0x	21.2x	29.6x	25.8x	1.2%
Teleflex Inc	TFX US	US\$359.99	US\$16,643	31.6x	27.5x	22.3x	19.8x	30.6x	25.2x	0.4%
Boston Scientific Corp	BSX US	US\$42.22	US\$58,811	26.1x	22.9x	20.3x	18.1x	23.7x	20.7x	n/a
Becton Dickinson and Co	BDX US	US\$250.32	US\$67,575	20.4x	18.3x	15.3x	13.3x	18.9x	17.0x	1.5%
Compco Average:				29.0x	25.1x	20.5x	18.1x	25.7x	22.2x	1.0%
FPH Relative:				+26%	+27%	+16%	+12%	+7%	+4%	+97%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FPH) companies fiscal year end

Figure 8. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 9. 12 Month Forward PE


Source: Forsyth Barr analysis

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge. **Disclosure:** Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Forsyth Barr confirms no inducement has been accepted from the researched entity, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. **Analyst Disclosure Statement:** In preparing this publication the analyst(s) may or may not have a threshold interest in the financial products referred to in this publication. For these purposes a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the entity being researched. **Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction. **Terms of use:** Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.