FORSYTH BARR

F&P Healthcare

UNDERPERFORM

Defying Gravity

F&P Healthcare (FPH) upgraded its FY20 guidance ~+4%, primarily due to factors we view as temporary boosts rather than a sustained acceleration in growth. Our medium-term growth outlook is unchanged. We are surprised at the share price reaction (~+8%) which is out-of-step with the quantum of the headline upgrade and amplified further if adjusted for short-term timing/FX benefits. FPH offers a well-articulated attractive long-term growth story; however, valuation metrics (even growth adjusted) are elevated versus any benchmark. UNDERPERFORM.

What's changed?

- **Earnings:** FY20E NPAT revised +3.5%, broadly consistent with FPH's guidance lift. FY21/22E upgraded c. +2-3% due to lower FX assumptions.
- **Target Price:** NZ$16.00 — higher peer multiples & modest lift in earnings.
- **Rating:** UNDERPERFORM retained.

Guidance lift drivers (in order): mask timing, tax credit, FX and volumes

FPH has lifted its FY20 guidance c. +4% to NPAT of NZ$255–265m (prior NZ$245–255m) on revenue of ~NZ$1.19bn (prior ~NZ$1.17bn). Key drivers in order of magnitude are:

- **Earlier US regulatory sign-off for its new OSA mask, Vitera:** This is the key driver of the upgrade (est. 50%). Vitera has just received FDA sign-off, allowing sale in the key US market for almost six months in FY20, around three months earlier than expected. The FDA website shows an application ('received') date of 19 March 2019, suggesting the process started ahead of commercial release and launch in May. Hence, the approval timeline is consistent with prior products, but start point was earlier than we thought.
- **Lift in expected level of R&D spend eligible for tax credit:** An estimated 80% of FPH's spend (prior 75%) is expected to be eligible for NZ's 15% tax credit. We estimate this provides ~+NZ$2m of FPH's NPAT guidance upgrade. FY20 earnings will see an estimated gross benefit of NZ$13m (NZ$10m net) from NZ's change to a tax credit regime for R&D spend.
- **FX:** The fall in the NZDUSD continues to benefit FPH earnings. Revised guidance uses a rate of 0.63 (prior 0.64) which we estimate increases FY20 revenue by ~+NZ$10m and NPAT ~+NZ$1m.
- **Volume growth:** Continues to track slightly ahead of expectations, driving c. +0.5% of the upgrade (~+NZ$1m).

Short-term kicker; medium-term growth outlook unchanged

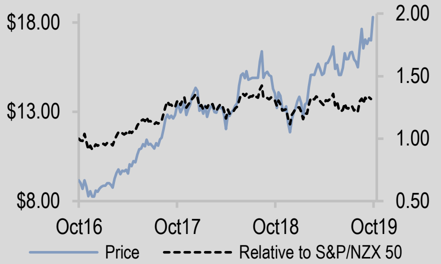
Valuation metrics are elevated versus history, Australasian growth peers and global healthcare compcos — even after adjusting for its attractive growth profile. Our medium-term growth trajectory is unchanged following FPH's update (at +10-15%), and already captures a strong rebound in OSA mask growth and sustained strength in its Hospital segment. We continue to view OSA masks as an area of medium-term downside risk given a highly competitive market backdrop (rife with new products) and the latest round of competitive bidding (to be implemented Jan 2021).

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$18.32
Target price	NZ$16.00
Risk rating	Medium
Issued shares	572.8m
Market cap	NZ$10,493m
Average daily turnover	597.3k (NZ$8,851k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ$m)	209.2	262.0	300.2	345.5
EPS* (NZc)	36.5	45.5	51.9	59.4
EPS growth* (%)	9.5	24.7	14.0	14.5
DPS (NZc)	23.3	29.0	34.0	39.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	31.7	26.3	22.6	19.8
EV/EBIT	35.7	30.4	25.7	22.2
PE	n/a	40.2	35.3	30.8
Price / NTA	n/a	n/a	n/a	n/a
Cash dividend yield (%)	1.3	1.6	1.9	2.1
Gross dividend yield (%)	1.8	2.2	2.6	3.0

*Historic and forecast numbers based on underlying profits

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Fisher & Paykel Healthcare Corporation (FPH) Priced as at 14 Oct 2019: NZ$18.32 — March year end

Forsyth Barr valuation			
Valuation methodology			Blended DCF/Compco
12-month target price (NZ$)*	**16.00**	**Spot valuations (NZ$)**	
Expected share price return	-12.7%	1. DCF	15.73
Net dividend yield	1.7%	2.Compco	14.35
Estimated 12-month return	-10.9%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.00%	Total firm value	9,085
Equity beta	0.77	(Net debt)/cash	0
WACC	7.5%	Value of equity	9,086
Terminal growth	2.0%	Shares (m)	573

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	981	1,070	1,195	1,351	1,530
Normalised EBITDA	**309**	**329**	**397**	**463**	**528**
Depreciation and amortisation	(45)	(42)	(53)	(55)	(57)
Normalised EBIT	**270**	**293**	**344**	**407**	**471**
Net interest	(2)	1	(2)	(2)	(3)
Associate income	-	-	-	-	-
Tax	(78)	(82)	(91)	(106)	(122)
Minority interests	-	-	-	-	-
Normalised NPAT	**190**	**209**	**262**	**300**	**346**
Abnormals/other	-	-	-	-	-
Reported NPAT	**190**	**209**	**262**	**300**	**346**
Normalised EPS (cps)	33.4	36.5	45.5	51.9	59.4
DPS (cps)	21.3	23.3	29.0	34.0	39.0

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	9.7	9.1	11.6	13.1	13.3
EBITDA (%)	12.8	6.4	20.6	16.5	14.1
EBIT (%)	12.4	8.5	17.6	18.4	15.6
Normalised NPAT (%)	12.4	10.0	25.2	14.6	15.1
Normalised EPS (%)	11.7	9.5	24.7	14.0	14.5
DPS (%)	9.0	9.4	24.7	17.2	14.7

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**309**	**329**	**397**	**463**	**528**
Working capital change	9	7	(23)	(24)	(27)
Interest & tax paid	(71)	(83)	(93)	(107)	(125)
Other	-	-	-	-	-
Operating cash flow	**248**	**253**	**281**	**332**	**375**
Capital expenditure	(83)	(126)	(150)	(66)	(108)
(Acquisitions)/divestments	-	-	-	-	-
Other	(100)	-	-	-	-
Funding available/(required)	**65**	**128**	**131**	**265**	**267**
Dividends paid	(103)	(115)	(150)	(182)	(212)
Equity raised/(returned)	2	2	-	-	-
Increase/(decrease) in net debt	**36**	**(15)**	**19**	**(83)**	**(55)**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	159	159	182	205	233
Fixed assets	476	601	706	726	785
Intangibles	50	62	62	62	62
Other assets	95	109	141	141	141
Total funds employed	**780**	**931**	**1,090**	**1,134**	**1,221**
Net debt/(cash)	(50)	(54)	(35)	(118)	(173)
Other non current liabilities	69	72	104	104	104
Shareholder's funds	761	913	1,022	1,148	1,290
Minority interests	-	-	-	-	-
Total funding sources	**780**	**931**	**1,090**	**1,134**	**1,221**

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	33.8	31.7	26.3	22.6	19.8
EV/EBIT (x)	38.8	35.7	30.4	25.7	22.2
PE (x)	54.9	50.2	40.2	35.3	30.8
Price/NTA (x)	>100x	>100x	>100x	>100x	>100x
Free cash flow yield (%)	1.6	1.2	1.3	2.5	2.5
Net dividend yield (%)	1.2	1.3	1.6	1.9	2.1
Gross dividend yield (%)	1.6	1.8	2.2	2.6	3.0
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	64	64	64	65	66

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	>100x	n/a	>100x	>100x	>100x
Interest cover EBITDA (x)	>100x	n/a	>100x	>100x	>100x
Net debt/ND+E (%)	-7.0	-6.3	-3.6	-11.5	-15.5
Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	26.3	24.2	25.0	28.3	30.4
Return on equity (%)	25.0	22.9	25.6	26.2	26.8
Return on funds employed (%)	28.0	26.8	27.4	29.9	32.5
EBITDA margin (%)	31.5	30.8	33.3	34.3	34.5
EBIT margin (%)	27.5	27.3	28.8	30.2	30.8
Capex to sales (%)	8.5	11.7	12.6	4.9	7.1
Capex to depreciation (%)	238	366	332	141	223

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue (NZ$m)					
Hospital	572	642	757	873	1,004
Growth (%)	14.3	12.3	17.9	15.3	15.0
Homecare	398	421	432	473	521
Growth (%)	4.4	5.9	2.5	9.4	10.2
Core products - total	**970**	**1,064**	**1,189**	**1,346**	**1,525**
Distributed products	11	7	5	5	5
Total sales	**981**	**1,070**	**1,195**	**1,351**	**1,530**
Cost breakdown and margins					
Gross profit (NZ$m)	650	716	796	905	1,026
Gross margin (%)	66.3	66.9	66.6	67.0	67.1
R & D costs (NZ$m)	(95)	(100)	(107)	(117)	(130)
as % of revenue	9.7	9.4	9.0	8.7	8.5
SG&A costs (NZ$m)	(246)	(286)	(291)	(325)	(369)
as % of revenue	25.1	26.7	24.4	24.1	24.1
Key line items to call out					
R&D tax credit (incl. as offset to tax)	n/a	n/a	13	14	16
Litigation costs within SG&A	(16)	(23)	(1)	-	-
Currency rates					
Spot rates					
NZDUSD	0.71	0.68	0.63	0.63	0.63
NZDEUR	0.61	0.59	0.58	0.58	0.58
Effective rates					
NZDUSD	0.68	0.68			
NZDEUR	0.60	0.60			

FX hedging	**2020E**	**2021E**	**2022E**
USD cover of expected exposure (%)	90	80	40
USD average rate of cover	0.67	0.66	0.66
EUR cover of expected exposure (%)	90	70	50
EUR average rate of cover	0.58	0.55	0.53

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Figure 1. Earnings revisions (NZ$m)

NZ$m	FY19A Actual	FY20E Old	FY20E New	FY20E % chg	FY21E Old	FY21E New	FY21E % chg	FY22E Old	FY22E New	FY22E % chg
Total revenue	1,070.4	1,169.2	1,194.5	2.2%	1,332.6	1,351.0	1.4%	1,510.0	1,530.2	1.3%
EBITDA	329.3	386.5	397.2	2.8%	452.5	462.7	2.2%	516.4	527.8	2.2%
Normalised Profit	**209.2**	**253.1**	**262.0**	**3.5%**	**292.3**	**300.2**	**2.7%**	**336.6**	**345.5**	**2.6%**
Normalised EPS (cps)	36.5	44.0	45.5	3.5%	50.6	51.9	2.7%	57.9	59.4	2.6%
Dividend per share (cps)	23.3	27.9	29.0	3.9%	32.6	34.0	4.3%	37.4	39.0	4.3%
NZDUSD	0.68	0.64	0.63	-1.8%	0.65	0.63	-2.3%	0.65	0.63	-2.3%

Source: Forsyth Barr analysis

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.

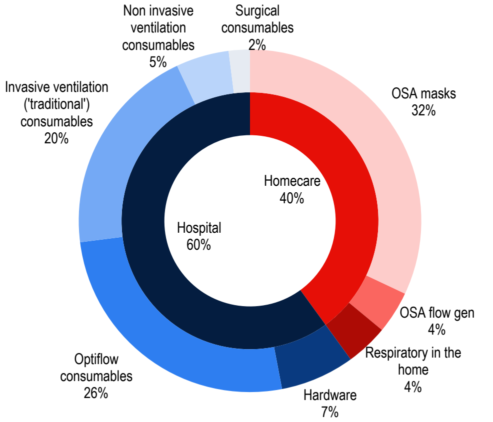
Risks factors

- **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

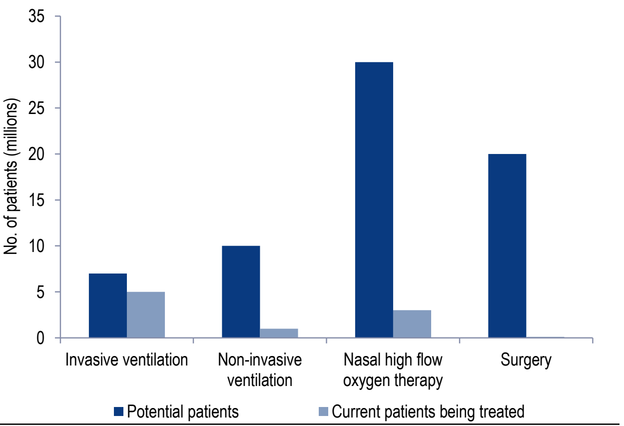
FPH designs, manufactures and markets heated humidifiers for use in respiratory care and humidified airflow generators for obstructive sleep apnea (OSA), along with associated single and multi-use accessories. FPH has a strong global market share in respiratory care following over 30 years in the market. 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 2. Revenue breakdown by segment (est.)



Source: Company reports, Forsyth Barr analysis

Figure 3. Global market penetration in RAC / Hospital segment



Source: Company reports, Forsyth Barr analysis

Figure 4. Substantial Shareholders

Shareholder	Latest Holding
The Capital Group Companies	6.4%
The Vanguard Group	5.3%
BlackRock Investment Management	5.0%

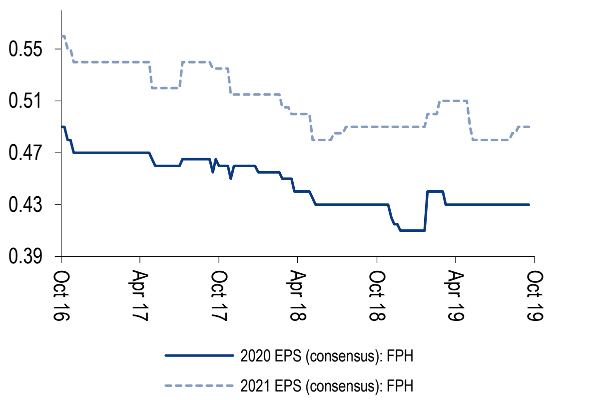
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect FPH's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
F&P Healthcare	**FPH NZ**	**NZ$18.32**	**NZ$10,493**	**40.2x**	**35.3x**	**26.3x**	**22.6x**	**30.3x**	**25.6x**	**1.9%**
ResMed Inc	RMD US	US$129.56	US$18,627	36.4x	30.5x	23.0x	20.3x	28.4x	24.7x	1.3%
Teleflex Inc	TFX US	US$323.95	US$14,984	28.4x	24.5x	19.1x	16.7x	25.2x	22.3x	0.4%
Boston Scientific Corp	BSX US	US$38.22	US$53,337	23.7x	20.7x	18.4x	16.3x	21.7x	19.0x	n/a
Becton Dickinson and Co	BDX US	US$251.38	US$67,893	20.5x	18.4x	15.4x	13.4x	18.9x	17.1x	1.5%
			Compco Average:	**27.2x**	**23.5x**	**19.0x**	**16.7x**	**23.6x**	**20.8x**	**1.1%**
EV = Current Market Cap + Actual Net Debt			**FPH Relative:**	**+48%**	**+50%**	**+39%**	**+35%**	**+29%**	**+23%**	**+75%**

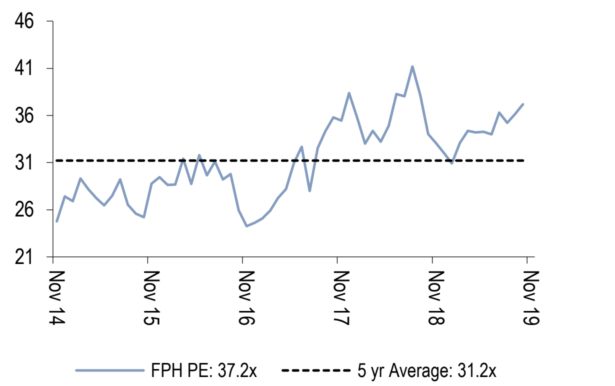
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FPH) companies fiscal year end

Figure 6. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 7. 12 Month Forward PE



Source: Forsyth Barr analysis