

# 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

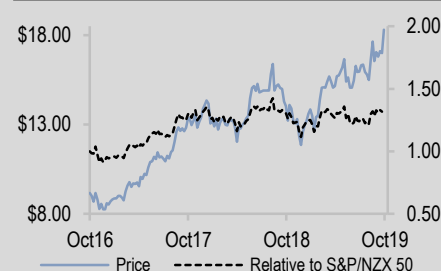
Valuation metrics are elevated versus history, Australasian growth peers and global healthcare compcos — even after adjusting for its attractive growth profile. Our medium-term growth trajectory is unchanged following FPH's update (at +10-15%), and already captures a strong rebound in OSA mask growth 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

### Chelsea Leadbetter, CFA

chelsea.leadbetter@forsythbarr.co.nz

+64 4 495 5262

**Fisher & Paykel Healthcare Corporation (FPH)** Priced as at 14 Oct 2019: NZ\$18.32

March year end

Forsyth Barr valuation					Valuation Ratios						
Valuation methodology					Blended DCF/Compco						
12-month target price (NZ\$)*					Spot valuations (NZ\$)						
Expected share price return	-12.7%	1. DCF	15.73		EV/EBITDA (x)	33.8	31.7	26.3	22.6	19.8	
Net dividend yield	1.7%	2. Compco	14.35		EV/EBIT (x)	38.8	35.7	30.4	25.7	22.2	
Estimated 12-month return	-10.9%	3. n/a	n/a		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	
Key WACC assumptions					DCF valuation summary (NZ\$m)						
Risk free rate	2.00%	Total firm value	9,085		Capital Structure						
Equity beta	0.77	(Net debt)/cash	0		Interest cover EBIT (x)	>100x	n/a	>100x	>100x	>100x	
WACC	7.5%	Value of equity	9,086		Interest cover EBITDA (x)	>100x	n/a	>100x	>100x	>100x	
Terminal growth	2.0%	Shares (m)	573		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	
Profit and Loss Account (NZ\$m)					Key Ratios						
Sales revenue	981	1,070	1,195	1,351	1,530	Return on assets (%)	26.3	24.2	25.0	28.3	30.4
Normalised EBITDA	309	329	397	463	528	Return on equity (%)	25.0	22.9	25.6	26.2	26.8
Depreciation and amortisation	(45)	(42)	(53)	(55)	(57)	Return on funds employed (%)	28.0	26.8	27.4	29.9	32.5
Normalised EBIT	270	293	344	407	471	EBITDA margin (%)	31.5	30.8	33.3	34.3	34.5
Net interest	(2)	1	(2)	(2)	(3)	EBIT margin (%)	27.5	27.3	28.8	30.2	30.8
Associate income	-	-	-	-	-	Capex to sales (%)	8.5	11.7	12.6	4.9	7.1
Tax	(78)	(82)	(91)	(106)	(122)	Capex to depreciation (%)	238	366	332	141	223
Minority interests	-	-	-	-	-	Operating Performance					
Normalised NPAT	190	209	262	300	346	Sales revenue (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Abnormals/other	-	-	-	-	-	Hospital	572	642	757	873	1,004
Reported NPAT	190	209	262	300	346	Growth (%)	14.3	12.3	17.9	15.3	15.0
Normalised EPS (cps)	33.4	36.5	45.5	51.9	59.4	Homecare	398	421	432	473	521
DPS (cps)	21.3	23.3	29.0	34.0	39.0	Growth (%)	4.4	5.9	2.5	9.4	10.2
						Core products - total					
						Distributed products	11	7	5	5	5
						Total sales					
						Hospital	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					
						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
Balance Sheet (NZ\$m)					Total funding sources						
Working capital	159	159	182	205	233	2018A	2019A	2020E	2021E	2022E	
Fixed assets	476	601	706	726	785	780	931	1,090	1,134	1,221	
Intangibles	50	62	62	62	62	Net debt/(cash)	(50)	(54)	(35)	(118)	(173)
Other assets	95	109	141	141	141	Other non current liabilities	69	72	104	104	104
Total funds employed	780	931	1,090	1,134	1,221	Shareholder's funds	761	913	1,022	1,148	1,290
Net debt/(cash)	(50)	(54)	(35)	(118)	(173)	Minority interests	-	-	-	-	-
Other non current liabilities	69	72	104	104	104	Total funding sources	780	931	1,090	1,134	1,221
Shareholder's funds	761	913	1,022	1,148	1,290						
Minority interests	-	-	-	-	-						

\* 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	FY20E			FY21E			FY22E		
	Actual	Old	New	% chg	Old	New	% chg	Old	New	% 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%
<b>Normalised Profit</b>	<b>209.2</b>	<b>253.1</b>	<b>262.0</b>	<b>3.5%</b>	<b>292.3</b>	<b>300.2</b>	<b>2.7%</b>	<b>336.6</b>	<b>345.5</b>	<b>2.6%</b>
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.

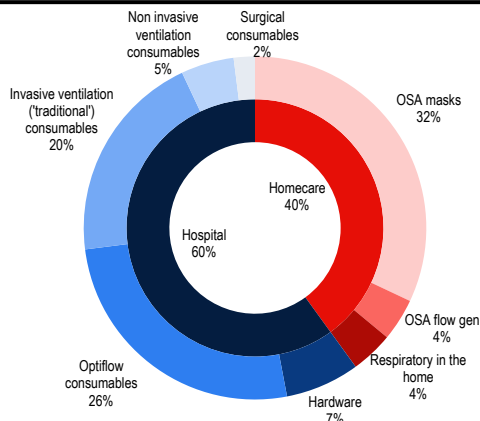
### Risks factors

- **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

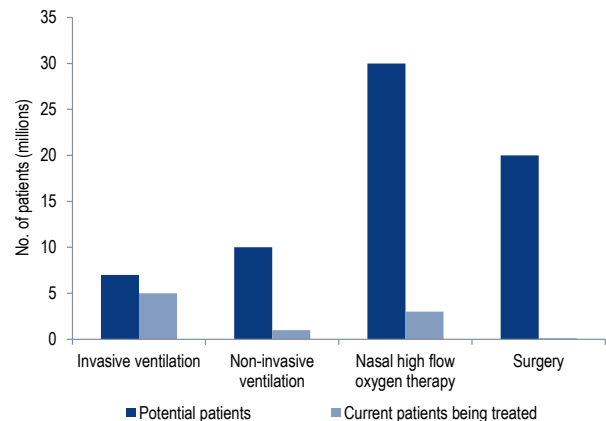
FPH designs, manufactures and markets heated humidifiers for use in respiratory care and humidified airflow generators for obstructive sleep apnea (OSA), along with associated single and multi-use accessories. FPH has a strong global market share in respiratory care following over 30 years in the market.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

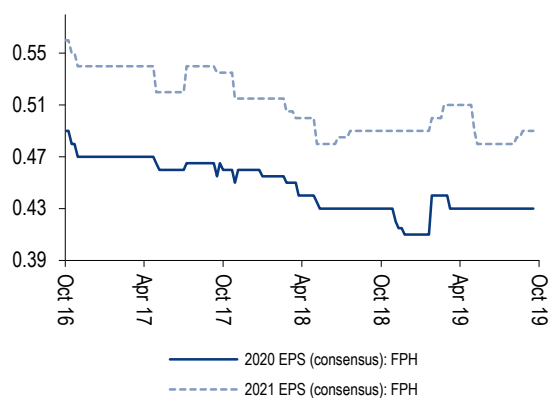
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 5. International Compcos**

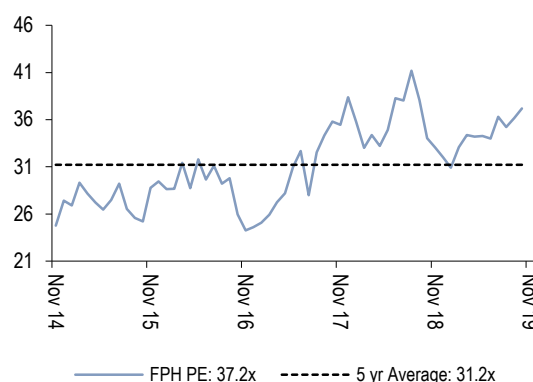
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect FPH's balance date - March)</i>										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
<b>F&amp;P Healthcare</b>	<b>FPH NZ</b>	<b>NZ\$18.32</b>	<b>NZ\$10,493</b>	<b>40.2x</b>	<b>35.3x</b>	<b>26.3x</b>	<b>22.6x</b>	<b>30.3x</b>	<b>25.6x</b>	<b>1.9%</b>
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%
<b>Compcos Average:</b>				<b>27.2x</b>	<b>23.5x</b>	<b>19.0x</b>	<b>16.7x</b>	<b>23.6x</b>	<b>20.8x</b>	<b>1.1%</b>
<b>FPH Relative:</b>				<b>+48%</b>	<b>+50%</b>	<b>+39%</b>	<b>+35%</b>	<b>+29%</b>	<b>+23%</b>	<b>+75%</b>

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compcos 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

**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.