

# F&P Healthcare

UNDERPERFORM

## 1H20 Result — Healthy Pulse

F&P Healthcare (FPH) delivered a 1H20 result in line with expectations and retained recently upgraded FY20 guidance. Headline growth is flattered by a number of one-offs, with underlying growth ~+12% in 1H20. Momentum remains strong across the key Hospital segment, while Homecare was not as weak as anticipated in 1H20. FPH is a high quality business which continues to deliver on a well-articulated growth story; however, we struggle to justify current valuations levels which are elevated versus any benchmark (even when growth adjusted). **UNDERPERFORM.**

### What's changed?

- **Earnings:** Minor changes of +1% over our forecast horizon.

### Key take-outs

- **1H20 result — in line, with some mix differences:** The result itself was broadly consistent with expectations, underpinned by a (predictably) strong result in Hospital. FPH's Homecare segment declined less than expected, outweighing higher cost growth than forecast.
  - Hospital — another consistent, strong performance: With growth modestly above historical averages (constant currency, CC, revenue +17%, with 'new' applications +23%), helped by a strong US flu season and stellar period for devices (unlikely to be maintained, with growth typically lumpy). Optiflow remains the standout as adoption continues to build — with material runway still ahead.
  - Homecare — a better mask result than anticipated: FPH saw market share losses in 1H20 for the key masks category (CC revenue down -1% vs industry growth ~+8%) given a hiatus of new products; however, early sales from its recent mask launch helped deliver a better outcome vs. expectations. 2H20 will benefit from first-time early sales into the key US market, while we assume FY21 will see a return to industry growth. The latter relies on a favourable industry response in what is currently a competitive landscape of well-regarded masks.
  - Gross margins benefitted from product mix, although stronger cost growth than we forecast constrained the upside.
- **No change to FY20 revenue and NPAT guidance:** Not surprising, given it was recently updated in October 2019. We forecast NPAT of NZ\$265m, at the top end of FPH's guidance band (NZ\$255–265m), implying growth of +27% on the prior year, or +12.7% when adjusted for one-off benefits.
- **Lift in FY20 capex guidance** to NZ\$170m (prior ~NZ\$150m) to support business growth.
- **No new products:** A key driver of growth, particularly in Homecare where product life cycles are shorter. FPH has just ended a longer than usual period without new Homecare masks, with the recent launch of Vitera in the full face category. We expect a further new mask in FY20.
- **Interim dividend:** Up +23% to 12cps, slightly below our expectations.

### 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\$21.10
Target price	NZ\$16.50
Risk rating	Medium
Issued shares	572.8m
Market cap	NZ\$12,086m
Average daily turnover	617.7k (NZ\$9,709k)

### Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ\$m)	209.2	265.5	304.0	350.1
EPS* (NZc)	36.5	46.2	52.6	60.2
EPS growth* (%)	9.5	26.4	13.9	14.6
DPS (NZc)	23.3	29.5	34.0	39.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	36.5	30.0	25.8	22.6
EV/EBIT	41.1	34.6	29.4	25.4
PE	n/a	45.7	40.1	35.0
Price / NTA	n/a	n/a	n/a	n/a
Cash dividend yield (%)	1.1	1.4	1.6	1.8
Gross dividend yield (%)	1.5	1.9	2.2	2.6

\*Historic and forecast numbers based on underlying profits

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**Fisher & Paykel Healthcare Corporation (FPH)** Priced as at 27 Nov 2019: NZ\$21.10

March year end

<b>Forsyth Barr valuation</b>					<b>Valuation Ratios</b>						
Valuation methodology					Blended DCF/Compco						
<b>12-month target price (NZ\$)*</b>					<b>Spot valuations (NZ\$)</b>						
Expected share price return	-21.8%	1. DCF	16.49		EV/EBITDA (x)	39.0	36.5	30.0	25.8	22.6	
Net dividend yield	1.5%	2. Compco	14.75		EV/EBIT (x)	44.7	41.1	34.6	29.4	25.4	
Estimated 12-month return	-20.3%	3. n/a	n/a		PE (x)	63.2	57.8	45.7	40.1	35.0	
					Price/NTA (x)	>100x	>100x	>100x	>100x	>100x	
					Free cash flow yield (%)	1.4	1.1	0.9	2.3	2.2	
					Net dividend yield (%)	1.0	1.1	1.4	1.6	1.8	
					Gross dividend yield (%)	1.4	1.5	1.9	2.2	2.6	
					Imputation (%)	100	100	100	100	100	
					Pay-out ratio (%)	64	64	64	65	65	
<b>Key WACC assumptions</b>					<b>DCF valuation summary (NZ\$m)</b>						
Risk free rate	2.00%	Total firm value	9,525		<b>Capital Structure</b>						
Equity beta	0.77	(Net debt)/cash	0		Interest cover EBIT (x)	>100x	n/a	>100x	>100x	>100x	
WACC	7.3%	Value of equity	9,525		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	-1.1	-9.6	-14.1	
					Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a	
<b>Profit and Loss Account (NZ\$m)</b>					<b>Key Ratios</b>						
Sales revenue	981	1,070	1,202	1,359	1,539	Return on assets (%)	26.3	24.2	24.8	28.1	30.2
<b>Normalised EBITDA</b>	<b>309</b>	<b>329</b>	<b>402</b>	<b>468</b>	<b>534</b>	Return on equity (%)	25.0	22.9	25.9	26.4	26.9
Depreciation and amortisation	(45)	(42)	(53)	(57)	(58)	Return on funds employed (%)	28.0	26.8	27.5	29.5	32.2
<b>Normalised EBIT</b>	<b>270</b>	<b>293</b>	<b>349</b>	<b>411</b>	<b>476</b>	EBITDA margin (%)	31.5	30.8	33.4	34.4	34.7
Net interest	(2)	1	(2)	(1)	(3)	EBIT margin (%)	27.5	27.3	29.0	30.2	30.9
Associate income	-	-	-	-	-	Capex to sales (%)	8.5	11.7	14.5	4.7	7.1
Tax	(78)	(82)	(92)	(106)	(123)	Capex to depreciation (%)	238	366	385	130	221
Minority interests	-	-	-	-	-	<b>Operating Performance</b>					
<b>Normalised NPAT</b>	<b>190</b>	<b>209</b>	<b>266</b>	<b>304</b>	<b>350</b>	<b>Sales revenue (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Abnormals/other	-	-	-	-	-	Hospital	572	642	757	873	1,004
<b>Reported NPAT</b>	<b>190</b>	<b>209</b>	<b>266</b>	<b>304</b>	<b>350</b>	Growth (%)	14.3	12.3	17.9	15.3	15.0
Normalised EPS (cps)	33.4	36.5	46.2	52.6	60.2	Homecare	398	421	440	481	530
DPS (cps)	21.3	23.3	29.5	34.0	39.0	Growth (%)	4.4	5.9	4.3	9.4	10.2
						<b>Core products - total</b>	<b>970</b>	<b>1,064</b>	<b>1,197</b>	<b>1,354</b>	<b>1,535</b>
						Distributed products	11	7	5	5	5
						<b>Total sales</b>	<b>981</b>	<b>1,070</b>	<b>1,202</b>	<b>1,359</b>	<b>1,539</b>
<b>Growth Rates</b>					<b>Cost breakdown and margins</b>						
Revenue (%)	9.7	9.1	12.3	13.1	13.2	Gross profit (NZ\$m)	650	716	801	911	1,033
EBITDA (%)	12.8	6.4	22.0	16.5	14.1	Gross margin (%)	66.3	66.9	66.6	67.0	67.1
EBIT (%)	12.4	8.5	19.2	17.9	15.7	R & D costs (NZ\$m)	(95)	(100)	(114)	(125)	(139)
Normalised NPAT (%)	12.4	10.0	26.9	14.5	15.2	as % of revenue	9.7	9.4	9.5	9.2	9.0
Normalised EPS (%)	11.7	9.5	26.4	13.9	14.6	SG&A costs (NZ\$m)	(246)	(286)	(285)	(318)	(360)
DPS (%)	9.0	9.4	26.9	15.3	14.7	as % of revenue	25.1	26.7	23.7	23.4	23.4
						<b>Key line items to call out</b>					
						R&D tax credit (incl. as offset to tax)	n/a	n/a	14	15	17
						Litigation costs within SG&A	(16)	(23)	(1)	-	-
<b>Cash Flow (NZ\$m)</b>					<b>Currency rates</b>						
EBITDA	309	329	402	468	534	<b>Spot rates</b>					
Working capital change	9	7	(25)	(24)	(28)	NZDUSD	0.71	0.68	0.63	0.63	0.63
Interest & tax paid	(71)	(83)	(93)	(107)	(126)	NZDEUR	0.61	0.59	0.58	0.58	0.58
Other	-	-	-	-	-	<b>Effective rates</b>					
<b>Operating cash flow</b>	<b>248</b>	<b>253</b>	<b>283</b>	<b>337</b>	<b>381</b>	NZDUSD	0.68	0.68			
Capital expenditure	(83)	(126)	(174)	(63)	(110)	NZDEUR	0.60	0.60			
(Acquisitions)/divestments	-	-	-	-	-	<b>FX hedging</b>					
Other	(100)	-	-	-	-	2020E	2021E	2022E			
<b>Funding available/(required)</b>	<b>65</b>	<b>128</b>	<b>109</b>	<b>273</b>	<b>271</b>	USD cover of expected exposure (%)	90	80	40		
Dividends paid	(103)	(115)	(152)	(184)	(212)	USD average rate of cover	0.67	0.66	0.66		
Equity raised/(returned)	2	2	-	-	-	EUR cover of expected exposure (%)	90	70	50		
<b>Increase/(decrease) in net debt</b>	<b>36</b>	<b>(15)</b>	<b>43</b>	<b>(90)</b>	<b>(59)</b>	EUR average rate of cover	0.58	0.55	0.53		
<b>Balance Sheet (NZ\$m)</b>					<b>FX hedging</b>						
Working capital	159	159	184	209	236	2020E	2021E	2022E			
Fixed assets	476	601	730	745	805	USD cover of expected exposure (%)	90	80	40		
Intangibles	50	62	62	62	62	USD average rate of cover	0.67	0.66	0.66		
Other assets	95	109	141	141	141	EUR cover of expected exposure (%)	90	70	50		
<b>Total funds employed</b>	<b>780</b>	<b>931</b>	<b>1,117</b>	<b>1,156</b>	<b>1,244</b>	EUR average rate of cover	0.58	0.55	0.53		
Net debt/(cash)	(50)	(54)	(11)	(101)	(160)						
Other non current liabilities	69	72	104	104	104						
Shareholder's funds	761	913	1,025	1,153	1,300						
Minority interests	-	-	-	-	-						
<b>Total funding sources</b>	<b>780</b>	<b>931</b>	<b>1,117</b>	<b>1,156</b>	<b>1,244</b>						

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

## 1H20 result — key features

FPH reported 1H20 NPAT of NZ\$121m, up +24% on the prior year and in line with our forecasts, and FY20 guidance was retained. We derive underlying constant currency (CC) profit growth of +11.7% (Figure 2), with headline growth boosted by a number of one-off factors including: no litigation spend, FX and NZ's move to R&D tax credits.

Figure 1. 1H20 result breakdown (NZ\$m)

	1H19	1H20	% chg	Forsyth Barr
Sales revenue	511.3	570.9	11.7%	562.3
<b>Gross profit</b>	<b>341.6</b>	<b>382.9</b>	<b>12.1%</b>	<b>375.1</b>
R&D costs	(45.7)	(54.0)	18.2%	(50.6)
SG&A	(156.9)	(162.9)	3.8%	(163.6)
<b>EBIT</b>	<b>139.0</b>	<b>166.0</b>	<b>19.4%</b>	<b>161.0</b>
<b>NPAT</b>	<b>97.4</b>	<b>121.2</b>	<b>24.4%</b>	<b>121.2</b>
Underlying EPS (cps)	17.0	21.1	24.0%	21.1
DPS (cps)	9.75	12.00	23.1%	12.30

Source: Forsyth Barr analysis, Company reports

Figure 2. Deriving 'underlying' constant currency growth

NZ\$m	1H19	1H20
NPAT as reported	97.4	121.2
R&D tax credit net benefit	0.0	4.8
Litigation (post tax)	(5.5)	0.0
Total FX benefit (post tax)	4.1	6.0
NPAT - adjusted	98.9	110.5
<b>Like for like CC NPAT growth</b>		<b>+11.7%</b>

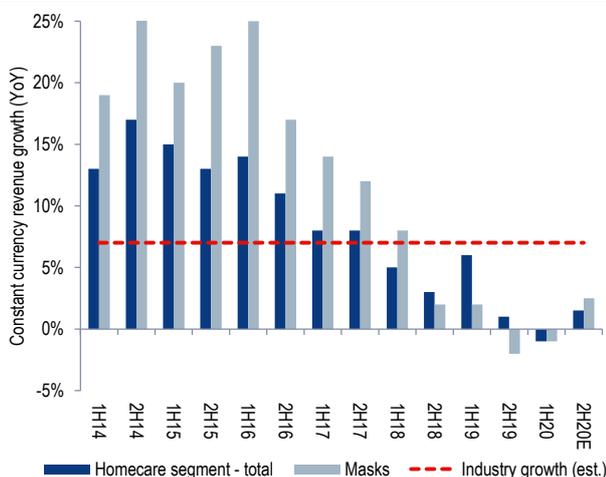
Source: Forsyth Barr analysis, Company reports

## Divisional insights

Hospital continues to impress, while the Homecare result wasn't as weak as anticipated.

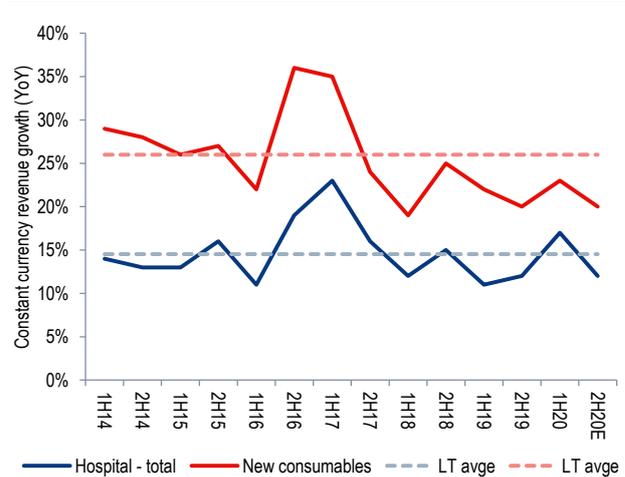
- Hospital:** Total CC revenue growth of +17%, with 'new' applications +23%. The total run-rate is modestly ahead of history, helped by (1) extended US flu season (~-1%) and (2) a standout result for devices (~+18% in CC) where growth is inherently lumpy. Optiflow remains the key standout as momentum/adoption continues to build. Outlook commentary suggests some moderation in growth in 2H20.
- Homecare:** CC revenue was down -1%, with the key mask segment -1% — both of which were ahead of our expectations as early sales of its new mask (full face, Vitera) in Australasia, Canada and Europe helped offset weakness in legacy masks. We expect a stronger 2H helped by early sales of Vitera in the key US market.

Figure 3. Homecare revenue – constant currency growth



Source: Forsyth Barr analysis, Company reports

Figure 4. Hospital revenue – constant currency growth



Source: Forsyth Barr analysis, Company reports

## Earnings, target price and rating

### Earnings and target price

We have made minor upgrades to our forecasts of +1%. Higher revenue expectations for Homecare masks also benefits our gross margin forecast and outweighs a modest lift in SG&A and R&D cost expectations.

We forecast NPAT of NZ\$265m in FY20, at the upper end of FPH's guidance band (NZ\$255–265m). This reflects growth of +27% on the prior year or underlying constant currency growth of +12.7% (adjusted for one-off related benefits including FX, litigation and NZ's move to a tax credit system).

Our target price lifts slightly to NZ\$16.50 (prior NZ\$16.00).

Figure 5. 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	1,194.5	1,202.2	0.6%	1,351.0	1,359.3	0.6%	1,530.2	1,539.4	0.6%
<b>Normalised Profit</b>	<b>209.2</b>	<b>262.0</b>	<b>265.5</b>	<b>1.4%</b>	<b>300.2</b>	<b>304.0</b>	<b>1.3%</b>	<b>345.5</b>	<b>350.1</b>	<b>1.3%</b>
Normalised EPS (cps)	36.5	45.5	46.2	1.4%	51.9	52.6	1.3%	59.4	60.2	1.3%
Dividend per share (cps)	23.3	29.0	29.5	1.7%	34.0	34.0	0.0%	39.0	39.0	0.0%

Source: Forsyth Barr analysis

### UNDERPERFORM retained

FPH offers a well-articulated, attractive long-term growth story. We like both the business and the runway ahead, however, struggle to justify current valuation metrics (even when taking its strong growth profile into consideration) and hence view 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 ~+14% 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 also view this segment as a fairly consistent long-dated growth runway with growth broadly range bound (with any step-change unlikely or temporary) given the long adoption cycles in hospitals. 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.

## 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. However, valuation metrics are elevated versus history and global peers, even when adjusting for this growth profile. **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

- **Near-term two speed growth path:** Hospital continues to deliver strong results, while Homecare is under pressure following a period of new product hiatus. Changing the latter 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 within this range near-term.

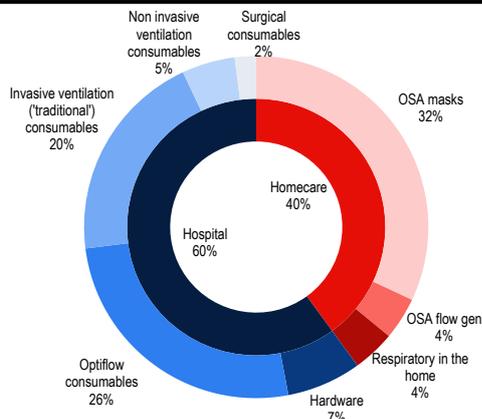
### Risks factors

- **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

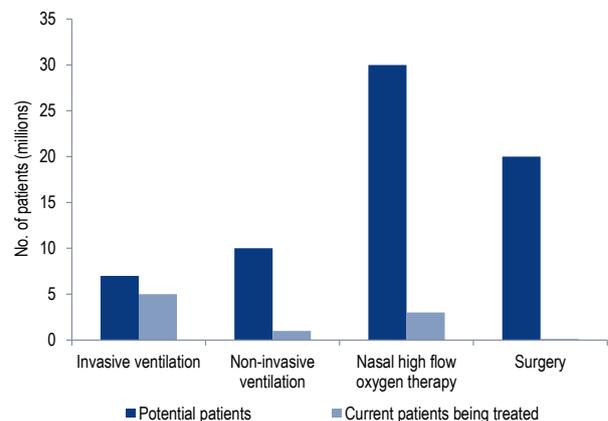
FPH designs, manufactures and markets heated humidifiers for use in respiratory care and humidified airflow generators for obstructive sleep apnea (OSA), along with associated single and multi-use accessories. FPH has a strong global market share in respiratory care following over 30 years in the market. 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 6. Revenue breakdown by segment (est.)



Source: Company reports, Forsyth Barr analysis

Figure 7. Global market penetration in RAC / Hospital segment



Source: Company reports, Forsyth Barr analysis

**Figure 8. 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

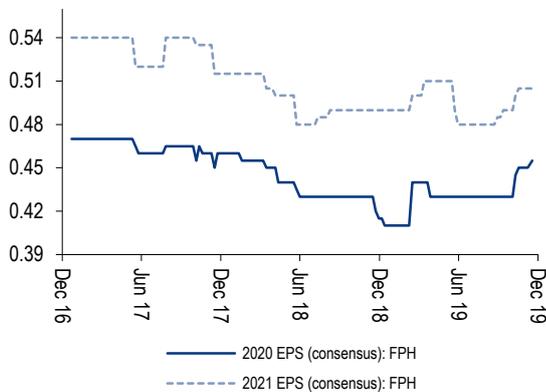
**Figure 9. International Compco's**

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\$21.10</b>	<b>NZ\$12,086</b>	<b>45.7x</b>	<b>40.1x</b>	<b>30.0x</b>	<b>25.7x</b>	<b>34.5x</b>	<b>29.3x</b>	<b>1.6%</b>
ResMed Inc	RMD US	US\$149.05	US\$21,431	41.0x	33.9x	26.0x	22.9x	31.0x	26.5x	1.1%
Teleflex Inc	TFX US	US\$349.85	US\$16,197	30.6x	26.5x	21.6x	19.3x	27.0x	24.1x	0.4%
Boston Scientific Corp	BSX US	US\$42.68	US\$59,488	26.3x	23.1x	20.9x	18.5x	24.1x	21.1x	n/a
Becton Dickinson and Co	BDX US	US\$255.16	US\$68,881	42.4x	19.3x	18.5x	14.5x	34.1x	17.6x	1.5%
<b>Compco Average:</b>				<b>35.1x</b>	<b>25.7x</b>	<b>21.7x</b>	<b>18.8x</b>	<b>29.1x</b>	<b>22.3x</b>	<b>1.0%</b>
<b>FPH Relative:</b>				<b>+30%</b>	<b>+56%</b>	<b>+38%</b>	<b>+37%</b>	<b>+19%</b>	<b>+31%</b>	<b>+63%</b>

EV = Current Market Cap + Actual Net Debt

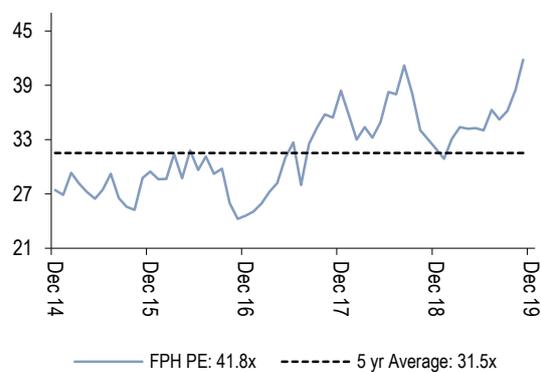
Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FPH) companies fiscal year end

**Figure 10. Consensus EPS Momentum**



Source: Forsyth Barr analysis, Bloomberg

**Figure 11. 12 Month Forward PE**



Source: Forsyth Barr analysis

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