NEW ZEALAND EQUITY RESEARCH | HEALTHCARE | MEDICAL DEVICE COMPANY
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F&P Healthcare
COVID-19 and Currency Boost

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UNDERPERFORM

F&P Healthcare's (FPH) FY20 upgrade cycle continues, with a further ~5% uplift to NPAT guidance as it benefits from (1) a lower NZ dollar and (2) a spike in demand for Hospital hardware. We expect further tailwinds for FY21 as a result of a strong lift in demand for its Hospital products due to the COVID-19 pandemic, albeit assume this is predominantly a one-off uplift. There is no doubt the company is well positioned, with products in high demand (and vital for critical patients) and a strong balance sheet. However, FPH was already one of the most expensive global medical device companies (growth-adjusted and absolute) leading into COVID-19 and has outperformed to date in 2020. While it is difficult to foresee a catalyst for a de-rating, particularly given near-term earnings momentum, we see better value for risk elsewhere.

NZX Code	FPH
Share price	NZ$24.90
Target price	NZ$18.50
Risk rating	Medium
Issued shares	572.8m
Market cap	NZ$14,262m
Avg daily turnover	624.9k (NZ$12,043k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	209.2	278.5	324.7	355.5
EPS* (NZc)	36.5	48.4	56.2	61.2
EPS growth* (%)	9.5	32.6	16.0	8.9
DPS (NZc)	23.3	31.0	36.0	39.5
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	43.2	33.9	28.7	26.2
EV/EBIT	48.6	38.7	32.4	29.5
PE	n/a	n/a	44.3	40.7
Price / NTA	n/a	n/a	n/a	n/a
Cash div yld (%)	0.9	1.2	1.4	1.6
Gross div yld (%)	1.3	1.7	2.0	2.2

FY20 upgrade cycle continues

FPH upgraded FY20 guidance by ~+2% to revenue (to NZ$1.24bn) and ~+5% to NPAT (revised range NZ$275–280m) driven by (1) strong demand for its Hospital products globally, particularly hardware, (2) FX tailwinds, helped by more exposure to spot rates than planned (despite high levels of hedging) given the sharp lift in China sales, (3) Homecare new masks continuing to sell well. We understand the mix of the upgrade is 40/40/20 between those three drivers, respectively.

Where to beyond FY20?

Forecasting the pace or extent of the global spread of COVID-19 is fraught with difficulty. The current data available suggests that of those cases requiring hospitalisation ~25% are 'critical', which is of most relevance to FPH. Within this cohort an estimated ~94% receive either invasive ventilation (IV) or high flow nasal cannula (HFNC) oxygen therapy within the ICU. Given FPH's strong market positioning in both of these (est. global market share ~75%) it is a key beneficiary of any continued lift in this patient cohort.

There is no doubt COVID-19 will provide a material tailwind for FY21. At this stage we have lifted our EBITDA forecast +6%, acknowledging a high margin of error. Our medium-term changes are small — we expect to see some incremental benefit from hardware deployment, although don't expect to see a step-change in adoption rates.

Supply chain and capacity — well positioned currently with ~30% additional capacity

At this stage FPH is not constrained in terms of raw material access, getting products to market and producing product. The company typically ensures ~2yrs of capacity at any point in time across its manufacturing facilities, which leaves ~30% additional capacity currently. This suggests a maximum possible uplift to patient set-ups of c.+30% or c.3m across HFNC oxygen therapy and IV. Our prior forecasts already assumed a lift in HFNC/IV set-ups of ~1m, leaving incremental capacity of ~2m for COVID-19 patients. FPH has a number of options to scale up capacity further, however, in practice this will take time (we expect many months). Another key area of capacity constraint is ICU beds in hospitals globally.

Fisher & Paykel Healthcare Corporation (FPH)

Priced as at 17 Mar 2020 (NZ$)	**24.90**

12-month target price (NZ$)*	**18.50**
Expected share price return	-25.7%
Net dividend yield	1.4%
Estimated 12-month return	-24.3%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.77
WACC	7.0%
Terminal growth	2.0%

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	980.8	1,070.4	1,235.4	1,444.7	1,566.7
Normalised EBITDA	**309.4**	**329.3**	**420.2**	**496.2**	**544.0**
Depreciation and amortisation	(44.6)	(41.7)	(53.0)	(56.9)	(61.2)
Normalised EBIT	**269.8**	**292.6**	**367.2**	**439.4**	**482.8**
Net interest	(2.1)	0.8	(1.7)	(0.8)	(1.9)
Associate income	0	0	0	0	0
Tax	(77.6)	(82.0)	(97.0)	(113.9)	(125.4)
Minority interests	0	0	0	0	0
Normalised NPAT	**190.2**	**209.2**	**278.5**	**324.7**	**355.5**
Abnormals/other	0	0	0	0	0
Reported NPAT	**190.2**	**209.2**	**278.5**	**324.7**	**355.5**
Normalised EPS (cps)	33.4	36.5	48.4	56.2	61.2
DPS (cps)	21.3	23.3	31.0	36.0	39.5

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	9.7	9.1	15.4	16.9	8.4
EBITDA (%)	12.8	6.4	27.6	18.1	9.6
EBIT (%)	12.4	8.5	25.5	19.7	9.9
Normalised NPAT (%)	12.4	10.0	33.1	16.6	9.5
Normalised EPS (%)	11.7	9.5	32.6	16.0	8.9
Ordinary DPS (%)	9.0	9.4	33.3	16.1	9.7

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**309.4**	**329.3**	**420.2**	**496.2**	**544.0**
Working capital change	9.3	6.7	(30.5)	(32.1)	(18.7)
Interest & tax paid	(70.9)	(82.7)	(98.7)	(114.7)	(127.3)
Other	0	0	0	0	0
Operating cash flow	**247.8**	**253.3**	**290.9**	**349.5**	**398.0**
Capital expenditure	(83.2)	(125.7)	(174.3)	(108.4)	(113.2)
(Acquisitions)/divestments	0	0	0	0	0
Other	(100.0)	0	0	0	0
Funding available/(required)	**64.6**	**127.6**	**116.7**	**241.0**	**284.8**
Dividends paid	(102.5)	(114.6)	(156.0)	(193.7)	(219.4)
Equity raised/(returned)	1.8	2.1	0	0	0
(Increase)/decrease in net debt	**(36.1)**	**15.1**	**(39.4)**	**47.3**	**65.4**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	158.6	159.0	189.5	221.7	240.4
Fixed assets	476.4	601.4	730.4	790.2	850.7
Intangibles	50.4	61.5	61.5	61.5	61.5
Right of use asset	0	0	0	0	0
Other assets	94.6	109.1	141.1	141.1	141.1
Total funds employed	**780.0**	**931.0**	**1,122.6**	**1,214.4**	**1,293.7**
Net debt/(cash)	(49.9)	(54.4)	(15.0)	(62.4)	(127.8)
Lease liability	0	0	0	0	0
Other liabilities	68.5	72.2	104.2	104.2	104.2
Shareholder's funds	761.4	913.2	1,033.4	1,172.6	1,317.2
Minority interests	0	0	0	0	0
Total funding sources	**780.0**	**931.0**	**1,122.6**	**1,214.4**	**1,293.7**

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

Spot valuations (NZ$)	
1. DCF	18.17
2.Compco	
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	10,579
(Net debt)/cash	0
Less: Capitalised operating leases	0
Value of equity	10,579

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	46.0	43.2	33.9	28.7	26.2
EV/EBIT (x)	52.8	48.6	38.7	32.4	29.5
PE (x)	74.6	68.2	51.4	44.3	40.7
Price/NTA (x)	>100x	>100x	>100x	>100x	>100x
Free cash flow yield (%)	1.2	0.9	0.8	1.7	2.0
Net dividend yield (%)	0.9	0.9	1.2	1.4	1.6
Gross dividend yield (%)	1.2	1.3	1.7	2.0	2.2

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	-1.5	-5.6	-10.7
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	25.9	28.7	29.7
Return on equity (%)	25.0	22.9	26.9	27.7	27.0
Return on funds employed (%)	28.0	26.8	28.8	30.6	31.1
EBITDA margin (%)	31.5	30.8	34.0	34.3	34.7
EBIT margin (%)	27.5	27.3	29.7	30.4	30.8
Capex to sales (%)	8.5	11.7	14.1	7.5	7.2
Capex to depreciation (%)	238	366	385	223	215
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	64	64	64	64	65

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue (NZ$m)					
Hospital	572	642	778	946	1,020
Growth (%)	14	12	21	22	8
Homecare	398	421	452	494	542
Growth (%)	4	6	7	9	10
Core products - total	**970**	**1,064**	**1,230**	**1,440**	**1,562**
Distributed products	11	7	5	5	5
Total sales	**981**	**1,070**	**1,235**	**1,445**	**1,567**
Cost breakdown and margins					
Gross profit (NZ$m)	650	716	827	964	1,048
Gross margin (%)	66	67	67	67	67
R & D costs (NZ$m)	(95)	(100)	(114)	(129)	(137)
SG&A costs (NZ$m)	(246)	(286)	(293)	(339)	(367)
Key line items to call out					
R&D tax credit (incl. as offset to tax)	n/a	n/a	14	16	16
Litigation costs within SG&A	(16)	(23)	(1)	0	0
Currency					
NZDUSD spot rate	0.71	0.68	0.61	0.62	0.63
NZDEUR spot rate	0.61	0.59	0.58	0.58	0.58
USD hedging - % cover			90	80	40
USD hedging - average rate			0.67	0.66	0.66

COVID-19 in more detail

We don't profess to be able to forecast the pace or extent of the global spread of COVID-19. However, there is no doubt FPH is a beneficiary of the pandemic given its products are important in the treatment of those critically ill. This has continued the FY20 earnings upgrade cycle and should provide a material tailwind for FY21.

What does WHO and published studies tell us?

The World Health Organisation (WHO) papers indicate most people (~81%) with COVID-19 develop mild or uncomplicated illness, ~14% develop severe illness requiring hospitalisation and ~5% require admission to the ICU.

WHO recommendations are:

- Mild: Do not require hospital intervention, but isolation is necessary to contain virus transmission.
- Severe: Recommended management is supplemental oxygen therapy and monitoring. Flow rate guidance suggest standard oxygen should suffice in most instances, without co-infections.
- Critical: Typically admitted to ICU. Guidelines suggest high flow nasal cannula (HFNC) oyxgen therapy or non-invasive ventilation should only be used in COVID-19 patients with hypoxemic respiratory failure. Invasive ventilation (IV) is viewed as the main supportive treatment for critical COVID-19 patients.

Two observational studies from China show a range of HFNC use in the ICU of 11–63% and invasive ventilation of 47–56%. The average length of stay in the ICU was 14 days.

What matters to FPH?

Of those COVID-19 cases requiring hospitalisation it has been estimated ~25% fit the 'critical' category, which is of most relevance to FPH. In this segment an estimated 94% receive either HFNC or IV within the ICU. FPH is a key beneficiary from growing patient numbers given we estimate its global market share is c. 75% in these segments.

Earnings revisions and valuation

We upgrade our near-term earnings profile, with FY21 particularly material, to take into account a volume lift from COVID-19 in its Hospital segment and a lower NZ dollar. Greater hardware deployment into ICUs globally strengthens FPH's market position. It also may be beneficial to FPH's HFNC oxygen therapy product use within the ICU. We expect to see some incremental benefit over the medium to longer-term, although we believe a step-change in adoption rates is unlikely (inertia will remain a challenge to changing clinical practice post COVID-19). We have made only small upgrades to medium-term forecasts accordingly.

We lift our 12m target price to NZ$18.50 (prior NZ$16.50). This reflects earnings upgrades which benefit both our DCF and peer multiple valuations and higher peer multiples. There is a small offset in our DCF from bringing forward capex for capacity expansion.

Figure 1. Earnings revisions (NZ$m)

	FY19A		FY20E			FY21E			FY22E	
NZ$m	**Actual**	**Old**	**New**	**% chg**	**Old**	**New**	**% chg**	**Old**	**New**	**% chg**
Total revenue	1,070.4	1,202.2	1,235.4	2.8%	1,359.3	1,444.7	6.3%	1,539.4	1,566.7	1.8%
EBITDA	329.3	401.7	420.2	4.6%	468.0	496.2	6.0%	533.9	544.0	1.9%
Normalised Profit	**209.2**	**265.5**	**278.5**	**4.9%**	**304.0**	**324.7**	**6.8%**	**350.1**	**355.6**	**1.6%**
Normalised EPS (cps)	36.5	46.2	48.4	4.9%	52.6	56.2	6.8%	60.2	61.2	1.6%
Dividend per share (cps)	23.3	29.5	31.0	5.1%	34.0	36.0	5.9%	39.0	39.5	1.3%
NZDUSD	0.68	0.63	0.61	-3.2%	0.63	0.62	-1.9%	0.63	0.63	-0.6%

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. 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. 75% 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 cashflow outlook

- **Near-term two speed growth path:** Hospital continues to deliver strong results, while Homecare is more moderate 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.

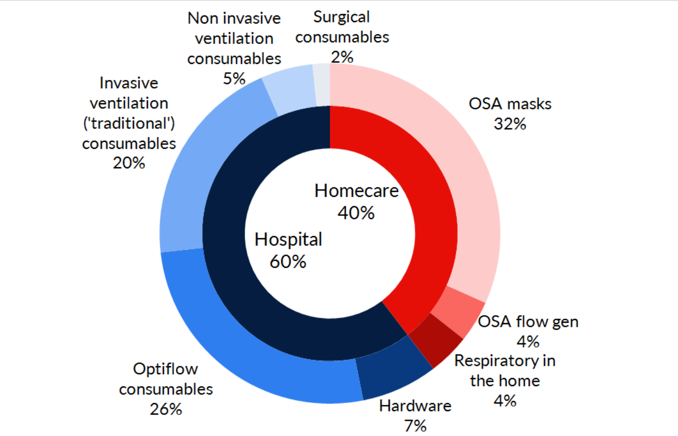
Financial structure

- **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.

Risk factors

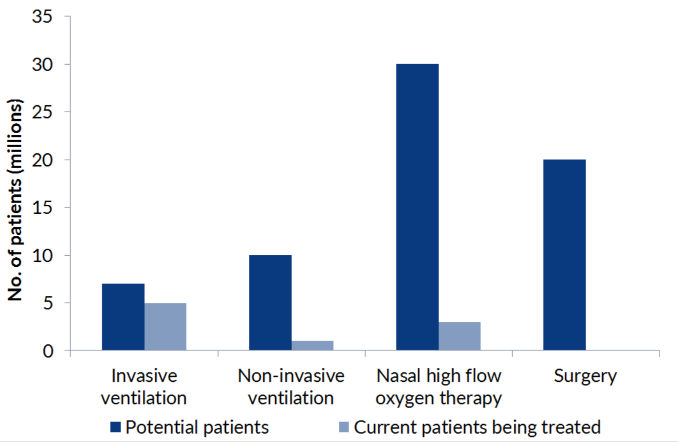
- **Change in technology or medical treatments:** May result in some products becoming obsolete or cause it to incur costs to implement new technologies. There is some risk mitigation given FPH's diversified offering.

Figure 2. Revenue breakdown by segment (est.)



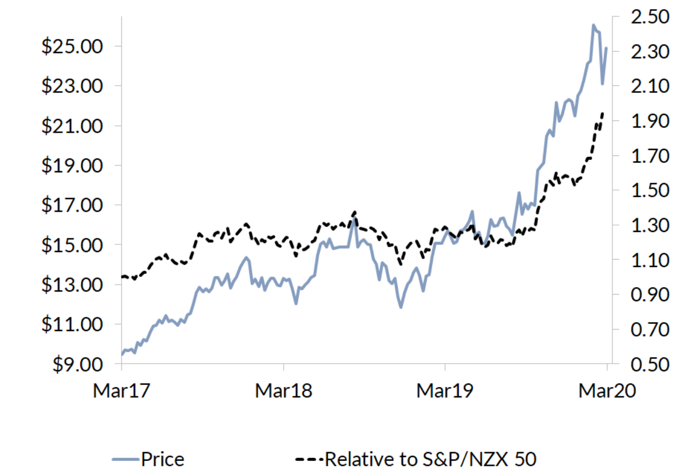
Source: Forsyth Barr analysis, company reports

Figure 3. Global market penetration in RAC / Hospital segment



Source: Forsyth Barr analysis, company reports

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

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

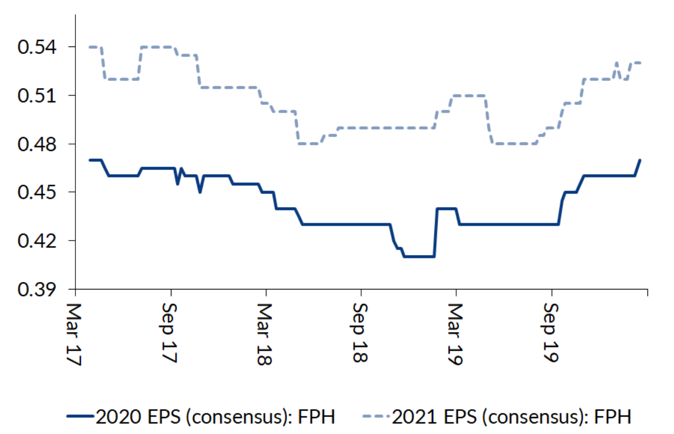
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash 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$24.90**	**NZ$14,262**	**>50x**	**44.3x**	**33.8x**	**28.6x**	**38.7x**	**32.3x**	**1.4%**
RESMED INC	RMD US	US$140.32	US$20,293	36.9x	30.4x	24.5x	21.4x	29.5x	25.0x	1.2%
TELEFLEX INC	TFX US	US$273.25	US$12,677	25.9x	20.8x	20.4x	16.6x	30.3x	n/a	n/a
BOSTON SCIENTIFIC CORP	BSX US	US$28.03	US$39,170	10.2x	15.4x	17.7x	13.7x	28.2x	15.1x	0.0%
BECTON DICKINSON AND CO	BDX US	US$223.53	US$60,835	37.2x	17.7x	17.1x	13.7x	31.6x	16.8x	1.7%
			Compco Average:	**27.6x**	**21.1x**	**19.9x**	**16.4x**	**29.9x**	**18.9x**	**1.0%**
EV = Current Market Cap + Actual Net Debt			**FPH Relative:**	**n/a**	**110%**	**70%**	**75%**	**29%**	**71%**	**49%**

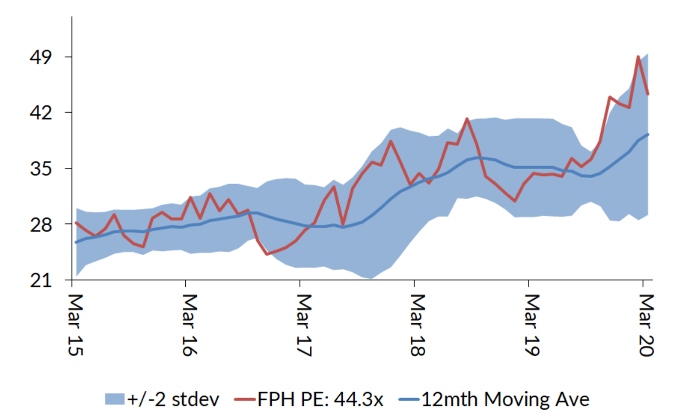
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FPH) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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