NEW ZEALAND EQUITY RESEARCH | HEALTHCARE | MEDICAL DEVICE COMPANY
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F&P Healthcare
FY20 Preview — How Good is Good Enough?

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UNDERPERFORM

We already know FY20 will be a strong year for F&P Healthcare (FPH) and that momentum has continued into 1Q21; the key question is how long this lasts, with first-time FY21 guidance/outlook commentary the primary focus of its result on Monday 29 June. FPH's share price has increased ~+38% since pre COVID-19 and market cap by +NZ$4.9bn. FPH is benefitting from (1) COVID-19 related sales in 4Q20 and FY21, and (2) potential for faster adoption of high flow nasal cannula (HFNC) oxygen therapy. However, the share price reaction appears out of step with any magnitude of scenarios around the upside. There is risk earnings/growth beyond FY21 may disappoint, albeit it will likely be too early to gauge that at this result.

NZX Code	FPH
Share price	NZ$31.05
Target price	NZ$18.50
Risk rating	Medium
Issued shares	572.8m
Market cap	NZ$17,785m
Avg daily turnover	758.2k (NZ$17,909k)

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	53.8	42.2	35.8	32.7
EV/EBIT	60.6	48.3	40.4	36.8
PE	85.0	64.1	55.3	50.8
Price / NTA	n/a	n/a	n/a	n/a
Cash div yld (%)	0.7	1.0	1.2	1.3
Gross div yld (%)	1.0	1.4	1.6	1.8

FY20 — signing off a strong year

We forecast a strong FY20 result with NPAT of NZ$279m, +33%, and at the upper end of FPH's guidance range. This reflects mid-teens underlying growth, with headline growth boosted by one-off items (no litigation spend, FX and NZ's change to a R&D tax credit). COVID-19 should support a strong finish, with a spike in Hospital demand, and we expect that to have continued into 1Q21.

Two key questions we are looking to gain better insight on

- **Quantifying the spike in short-term demand:** There is no doubt COVID-19 will provide a material tailwind for FY21, however, there remains a reasonable margin of error in the extent and duration of this benefit. Hence, FY21 guidance will be of particular interest for investors. We see upside to our FY21 expectations, although this appears to already be reflected in consensus.
- **Longer-term implications for its product portfolio, particularly HFNC adoption:** We expect to see some incremental benefit for HFNC adoption rates. Usage during COVID-19 should solidify HFNCs use in the ICU, however, the largest opportunity is penetration outside of the ICU. While greater hardware availability and a positive experience using the technology is helpful, we believe changing clinical practice more broadly across the hospital will take time. The recent spike in hardware demand also likely reflects some bringing forward of future sales. However, it may be too early to get insight on longer-term implications at this result.

Investor briefing — 10am NZST on 29 June

Dial in: 09 913 3624 for NZ (+61 2 9193 3719 for Australia); conference code 609752. Webcast link on www.fphcare.com/investor.

Figure 1. FY20E result expectations (NZ$m)

	FY19	FY20E	% chg	Consensus
Sales revenue	1,070.4	1,235.4	15.4%	1,240.0
EBIT	292.6	367.2	25.5%	373.0
NPAT	**209.2**	**278.5**	**33.1%**	**277.0**
Dividend per share (cps)	23.3	31.0	33.3%	29.2

Source: Forsyth Barr analysis

Figure 2. FY21E consensus expectations (NZ$m)

	Low	Mean	High	Forsyth Barr
Sales revenue	1,341	1,439	1,522	1,445
EBIT	402	446	500	439
NPAT	**300**	**333**	**367**	**325**
Dividend per share (cps)	26	35	43	36

Source: Forsyth Barr analysis, Bloomberg

FORSYTH BARR

Fisher & Paykel Healthcare Corporation (FPH)

Priced as at 24 Jun 2020 (NZ$)	**31.05**

12-month target price (NZ$)*	**18.50**
Expected share price return	-40.4%
Net dividend yield	1.2%
Estimated 12-month return	-39.2%

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	18.51
2.Compco	16.57
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	10,776
(Net debt)/cash	0
Less: Capitalised operating leases	0
Value of equity	10,776

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	57.4	53.8	42.2	35.8	32.7
EV/EBIT (x)	65.8	60.6	48.3	40.4	36.8
PE (x)	93.1	85.0	64.1	55.3	50.8
Price/NTA (x)	>100x	>100x	>100x	>100x	>100x
Free cash flow yield (%)	0.9	0.7	0.7	1.4	1.6
Net dividend yield (%)	0.7	0.7	1.0	1.2	1.3
Gross dividend yield (%)	1.0	1.0	1.4	1.6	1.8

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

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 marketposition (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 standout 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

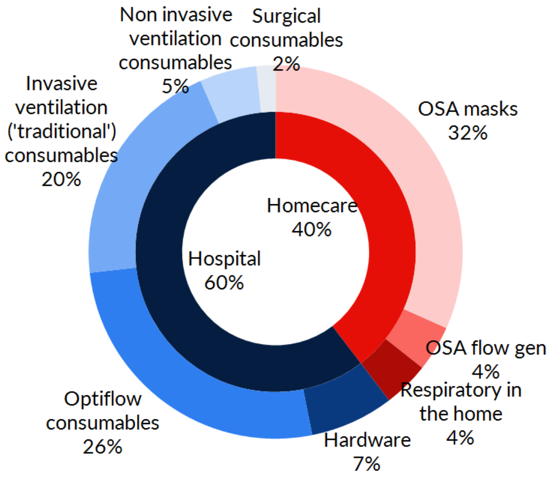
Financial structure

- **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

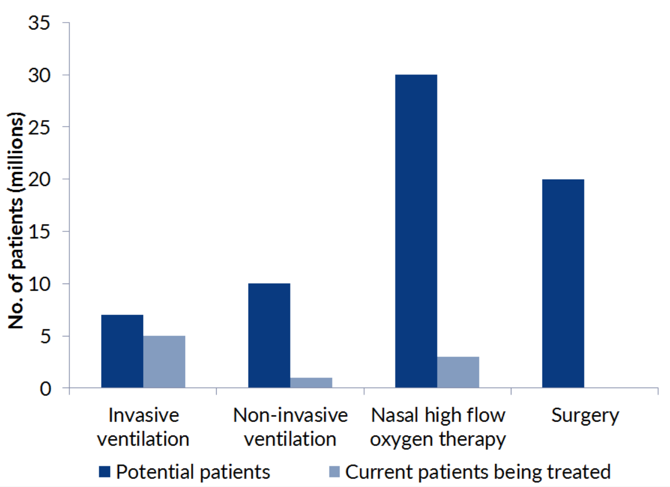
- **Change in technology or medical treatments:** May result in some products becoming obsolete or cause it to incur costs to implement new technologies. There is some risk mitigation given FPH's diversified offering.
- **Litigation or a need to defend its intellectual property:** This can be an expensive exercise.

Figure 3. Revenue breakdown by segment (est.)



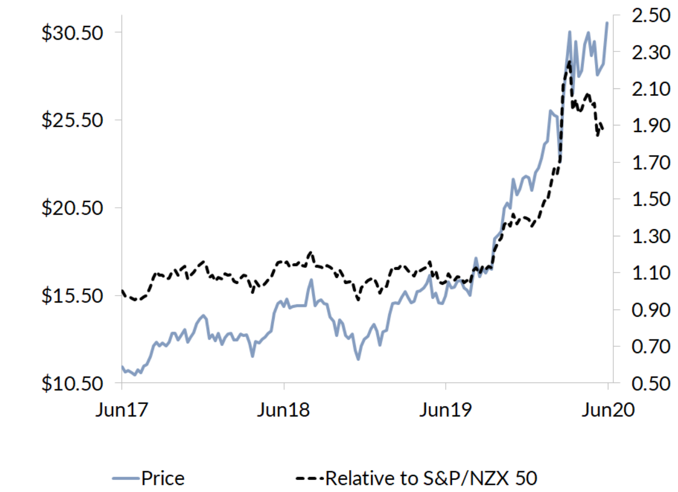
Source: Forsyth Barr analysis, Company reports

Figure 4. Global market penetration in Hospital/RAC segment



Source: Forsyth Barr analysis, Company reports

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

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

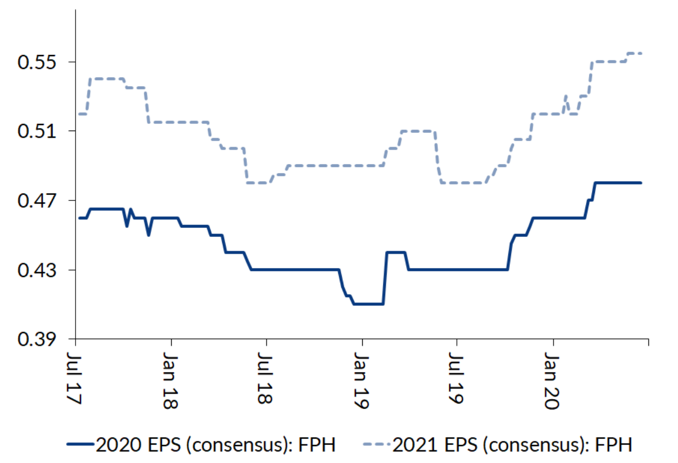
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. 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$31.05**	**NZ$17,785**	**>50x**	**>50x**	**42.2x**	**35.7x**	**48.3x**	**40.4x**	**1.2%**
RESMED INC	RMD US	US$182.60	US$26,416	47.5x	40.7x	31.1x	28.0x	37.2x	32.2x	0.9%
TELEFLEX INC	TFX US	US$371.57	US$17,243	37.1x	34.5x	28.9x	27.1x	41.7x	29.1x	0.4%
BOSTON SCIENTIFIC CORP	BSX US	US$36.38	US$51,990	17.6x	34.1x	24.5x	24.2x	38.9x	29.9x	0.0%
BECTON DICKINSON AND CO	BDX US	US$238.36	US$69,055	41.2x	21.0x	20.0x	16.8x	35.8x	19.9x	1.5%
			Compco Average:	**35.8x**	**32.6x**	**26.1x**	**24.0x**	**38.4x**	**27.8x**	**0.7%**
EV = Current Market Cap + Actual Net Debt			**FPH Relative:**	**n/a**	**n/a**	**61%**	**49%**	**26%**	**45%**	**65%**

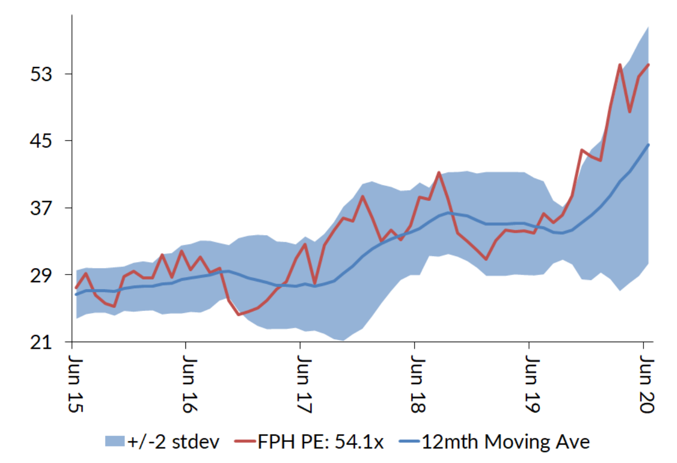
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FPH) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

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