

F&P Healthcare

Tailwinds Still Flowing

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UNDERPERFORM

F&P Healthcare (FPH) provided a trading update confirming an exceptional start to FY21, underpinned by continued momentum in its Hospital division, with its products used as a front-line therapy for COVID-19 patients. FPH is a high quality growth company and a material beneficiary of COVID-19. Earnings momentum is strong, although it becomes more challenging as consensus better reflects this, it begins to cycle larger numbers and when Hospital equipment sales fade from elevated levels. We see better value growth stocks in both the NZ market and globally.

NZX Code	FPH	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$36.50	NPAT* (NZ\$m)	287.3	408.7	399.2	451.8	EV/EBITDA	47.5	33.7	34.1	30.5
Target price	NZ\$32.50	EPS* (NZc)	50.0	71.0	69.1	77.8	EV/EBIT	55.1	37.8	38.9	34.4
Risk rating	Medium	EPS growth* (%)	37.0	41.9	-2.7	12.7	PE	72.9	51.4	52.9	46.9
Issued shares	574.2m	DPS (NZc)	27.5	39.0	41.4	46.7	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$20,958m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.8	1.1	1.1	1.3
Avg daily turnover	808.9k (NZ\$20,960k)	*Based on normalised profits					Gross div yld (%)	1.0	1.5	1.6	1.8

Exceptional 4m21; FY21 on track to be a bumper year, with FPH's revised assumption set (once again) conservative

FPH has (unsurprisingly) seen a very strong start to FY21. We understand monthly growth rates remain volatile which means FPH will not provide 1H20 guidance, as is typical at its Annual Meeting, albeit it did provide an updated 'guide' for FY21 (revenue ~NZ\$1.61bn; NPAT NZ\$365–385m) based on a revised set of COVID-19 assumptions which we view as conservative. We increase our FY21 forecasts (which were already top of the revised range) to above FPH's 'guide', reflecting stronger revenue growth.

- **Hospital – stellar trading:** Revenue is up +91% YoY for the first four months of FY21 (Hardware +390%; Consumables +48%). This is also ahead of indications in June, with a strong July. We understand this reflects a rebuilding of stocks by hospitals, elevated COVID-19 hospitalisations in some countries / US states and a shift in COVID-19 clinical practice in ICU towards high flow nasal cannula oxygen therapy, away from invasive ventilation (both therapies where FPH is the market leader).
- **Homecare holding up:** Despite some areas of weakness / pressure Homecare revenue is +up 5% for the first four months of FY21, this is consistent with our FY21 expectations.

Where to thereafter?

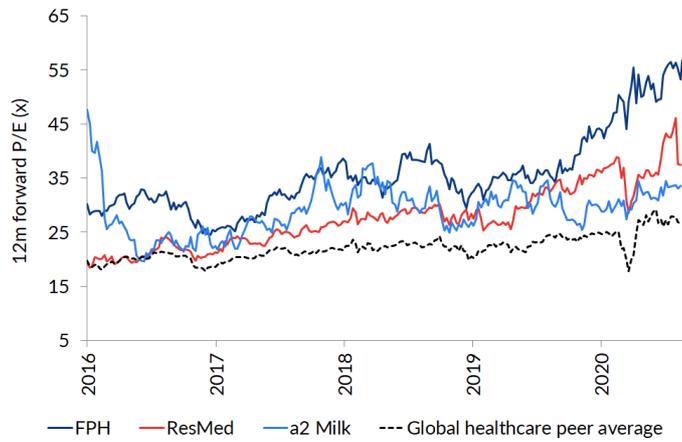
The path beyond FY21 remains an area of debate, with a number of unanswerable questions on behaviour and adoption rates, particularly when we return to a more 'normal' backdrop without the unprecedented level of government funding support. Whenever the demand for Hospital equipment and elevated COVID-19 hospitalisations diminishes, we expect growth to be difficult, with potential for disappointment if consumables revenue cannot replace the spike in hardware in particular. COVID-19 may prove to be an enduring catalyst to higher adoption rates (as assumed in our DCF), however, the extent of the uplift remains up for debate.

Growth, high returns and lower interest rates a powerful combination

FPH's share price and valuation metrics have seen a remarkable step-change through 2020 (price +67%; market cap +NZ\$8.6bn; PE +34%). The combination of high returns, a lift in growth and lower interest rates has been a powerful source of multiple expansion (easy to see in hindsight, particularly in light of what we know now about COVID-19). We lift our target price to NZ\$32.50 following revisions to our team cost of capital inputs which materially lifts our DCF, with FPH one of the most favourably impacted across our coverage. Despite this lift, we are still below current trading levels; retain UNDERPERFORM.

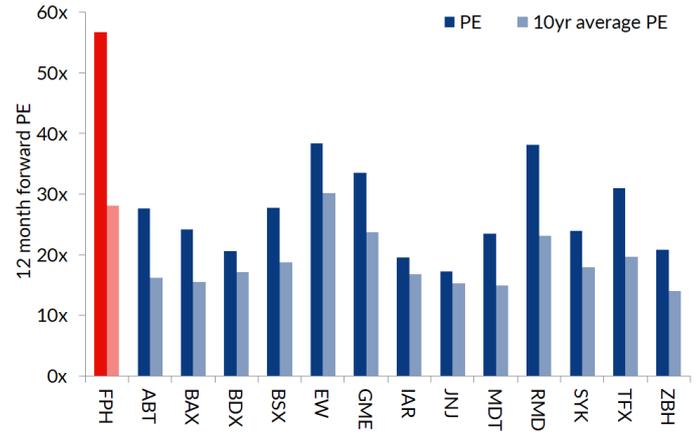
Charts of interest

Figure 1. FPH 12 month forward PE versus peers



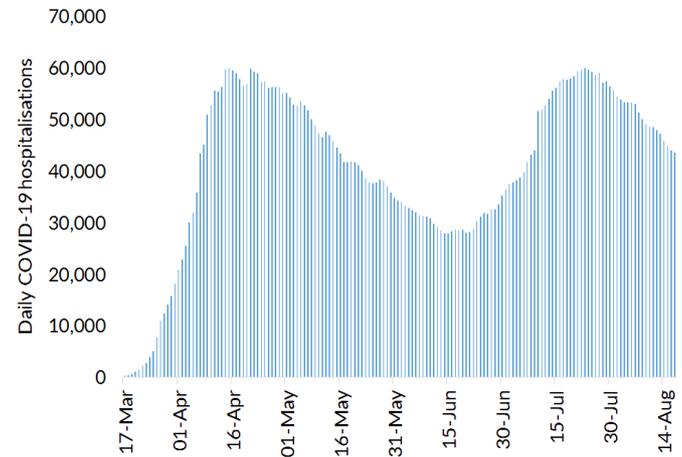
Source: Forsyth Barr analysis, Bloomberg

Figure 2. Global healthcare peers – PE vs 10yr average



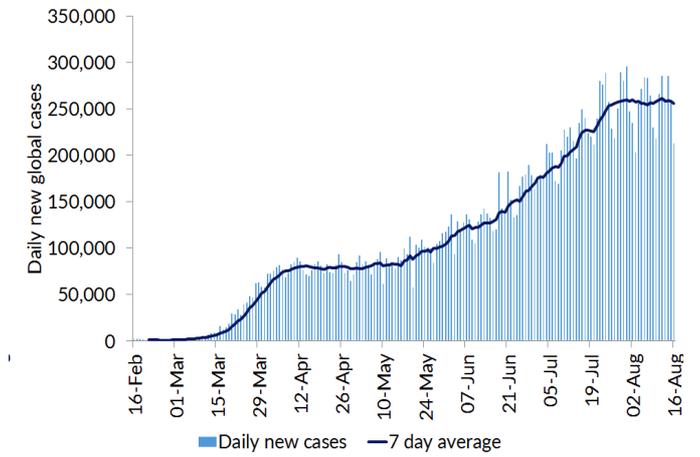
Source: Forsyth Barr analysis, Bloomberg

Figure 3. US COVID-19 hospitalisations



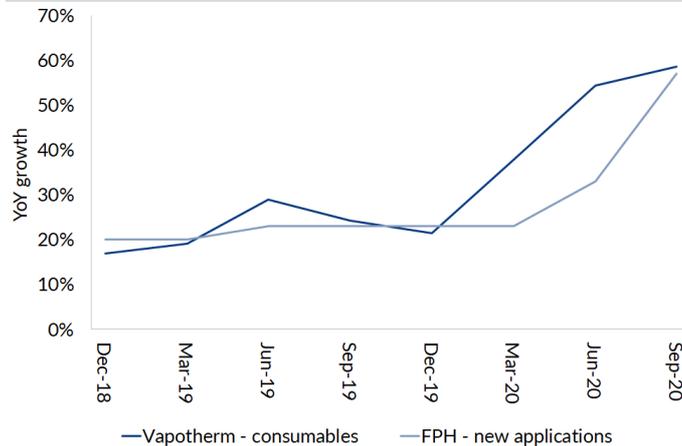
Source: Forsyth Barr analysis, COVID tracking

Figure 4. Daily global COVID-19 cases



Source: Forsyth Barr analysis, Worldometer

Figure 5. Nasal high flow consumable growth – FPH vs Vapotherm (VAPO)



Source: Forsyth Barr analysis, Company releases

Figure 6. Forsyth Barr forecasts vs FPH 'guide'

FY21	FPH 'guide'		Forsyth Barr	
	29-Jun	18-Aug	Old	New
Revenue (NZ\$bn)	1.48	1.61	1.62	1.71
NPAT (NZ\$m)	325-340	365-385	378.6	408.7
COVID-19 assumptions	Q1 peak in hospitalisations	Hospitalisations steadily return to normal by end of CY20		

Source: Forsyth Barr analysis, FPH guidance

Earnings and valuation

While our forecasts were already at the top end of management's FY21 'guide', we have upgraded FY21 expectations assuming COVID-19 related tailwinds continue for an extra quarter.

We lower our WACC from 6.7% to 5.2% in light of changes to our cost of capital assumptions highlighted in our recent report, "*The Cost of Capital Conundrum: When TINA Came to Our Shores*" published 7 August 2020. FPH is one of the companies most positively impacted by the changes, however, the step-up in our DCF valuation (+49%) simply sees some 'catch up' to the share price which suggests investors may already be assuming a cost of capital closer to our new assumption (likely helped by FPH being partly priced by international investors with a lower cost of capital for NZ stocks).

Figure 7. Earnings revisions (NZ\$m)

NZ\$m	FY20A				FY21E				FY22E				FY23E			
	Actual	Old	New	% chg	Old	New	% chg	Old	New	% chg	Old	New	% chg	Old	New	% chg
Total revenue	1,263.7	1,615.5	1,705.3	5.4%	1,645.2	1,673.1	1.7%	1,847.1	1,868.4	1.2%						
Normalised Profit	287.3	378.6	408.7	7.9%	388.7	399.2	2.7%	441.6	451.8	2.3%						
Normalised EPS (cps)	50.0	65.8	71.0	7.9%	67.2	69.1	2.7%	76.1	77.8	2.3%						
Dividend per share (cps)	27.5	36.0	39.0	8.3%	40.3	41.4	2.7%	45.6	46.7	2.4%						
Hospital revenue	801.3	1,124.9	1,214.7	8.0%	1,105.3	1,133.2	2.5%	1,262.1	1,283.4	1.7%						
Homecare revenue	457.3	485.6	485.6	0.0%	535.1	535.1	0.0%	580.5	580.5	0.0%						

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. The company is also benefiting from COVID-19 related demand, with some of its products recommended as a front-line therapy. However, FPH is one of the most expensive global medical device companies (growth-adjusted and absolute). While it is difficult to foresee a catalyst for a derating, particularly given near-term earnings momentum, we see better value for risk elsewhere. 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 supportive (ageing population, global focus on lowering healthcare costs and improving diagnosis rates).

Earnings and cashflow outlook

- **COVID-19:** FPH is benefitting, and will continue to benefit, from demand for its products as a result of COVID-19. In particular, nasal high flow oxygen therapy has been recommended as a front-line therapy by a growing number of public health authorities globally. Predicting the course and duration of new cases remains challenging, influenced by countries' corrective measures.
- **Attractive long-term growth runway; albeit with two speed growth path:** FPH has a long runway of organic growth opportunities, particularly in the Hospital segment where clinical evidence continues to build for 'new' applications. Penetration for the latter remains low relative to a large addressable market. While Hospital continues to deliver standout results, we expect a more modest outlook for Homecare, not helped by a highly competitive environment.

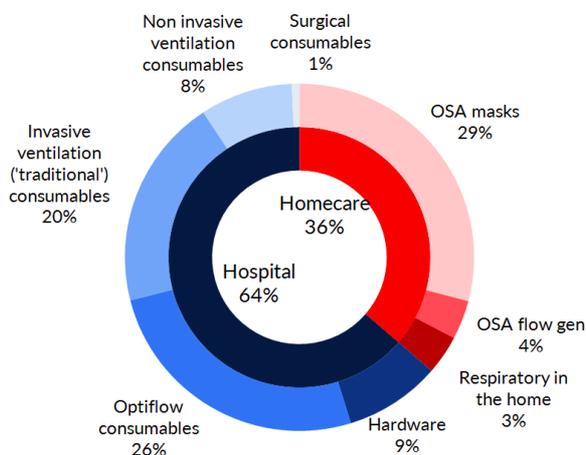
Financial structure

- **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

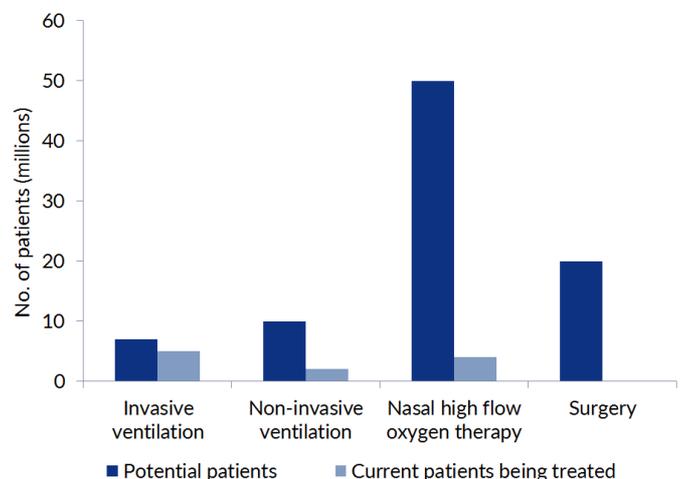
- **Change in technology or medical treatments:** May result in some products becoming obsolete or cause it to incur costs to implement new technologies. There is some risk mitigation given FPH's diversified offering.
- **Litigation or a need to defend its intellectual property:** This can be an expensive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

Figure 8. Revenue breakdown by segment (est.)

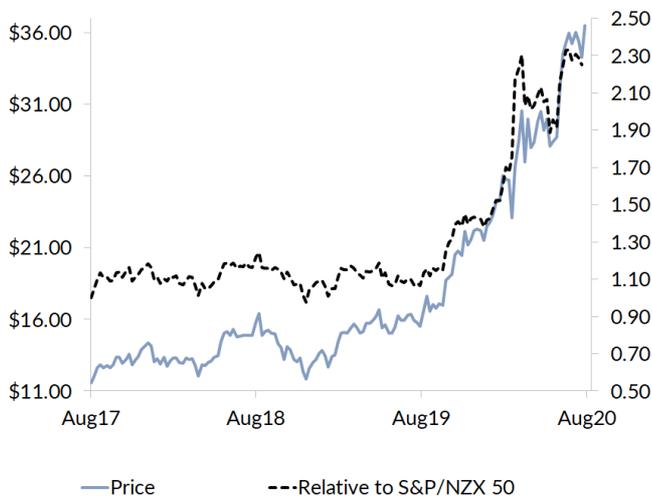


Source: Forsyth Barr analysis, Company reports

Figure 9. Global market penetration in Hospital/RAC segment



Source: Forsyth Barr analysis, Company reports

Figure 10. Price performance


Source: Forsyth Barr analysis

Figure 11. Substantial shareholders

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

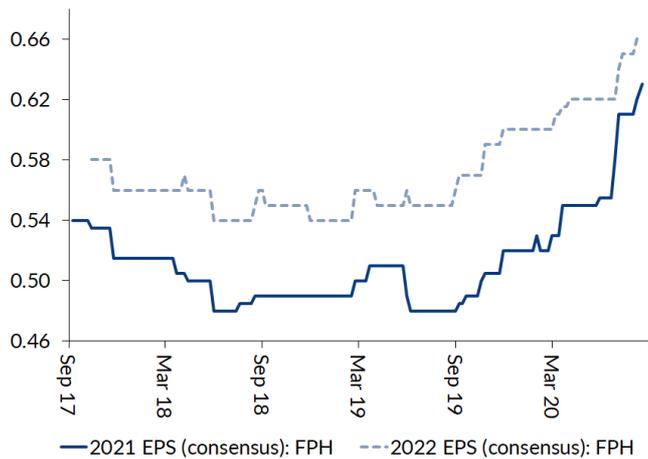
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 12. International valuation comparisons

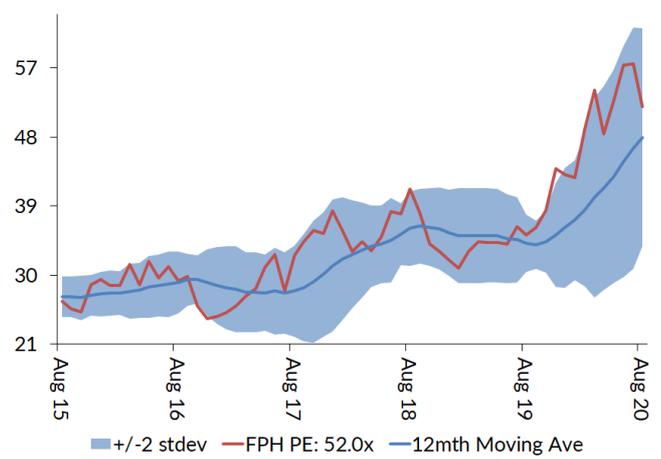
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				2021E	2022E	2021E	2022E	2021E	2022E	
F&P Healthcare	FPH NZ	NZ\$36.50	NZ\$20,958	>50x	>50x	33.7x	34.2x	37.9x	38.9x	1.1%
RESMED INC	RMD US	US\$183.20	US\$26,546	39.6x	36.1x	27.5x	25.7x	32.6x	30.0x	0.9%
TELEFLEX INC	TFX US	US\$374.73	US\$17,431	35.0x	27.1x	27.3x	20.9x	29.8x	23.1x	0.4%
BOSTON SCIENTIFIC CORP	BSX US	US\$39.35	US\$56,297	35.7x	22.8x	25.6x	18.5x	32.0x	22.3x	0.0%
BECTON DICKINSON AND CO	BDX US	US\$260.04	US\$75,377	23.0x	19.6x	17.1x	14.8x	22.7x	19.6x	1.6%
Compcpo Average:				33.3x	26.4x	24.4x	20.0x	29.3x	23.8x	0.7%
FPH Relative:				n/a	n/a	38%	71%	29%	64%	57%

EV = Current Market Cap + Actual Net Debt

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

Figure 13. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 14. One year forward PE (x)


Source: Forsyth Barr analysis

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