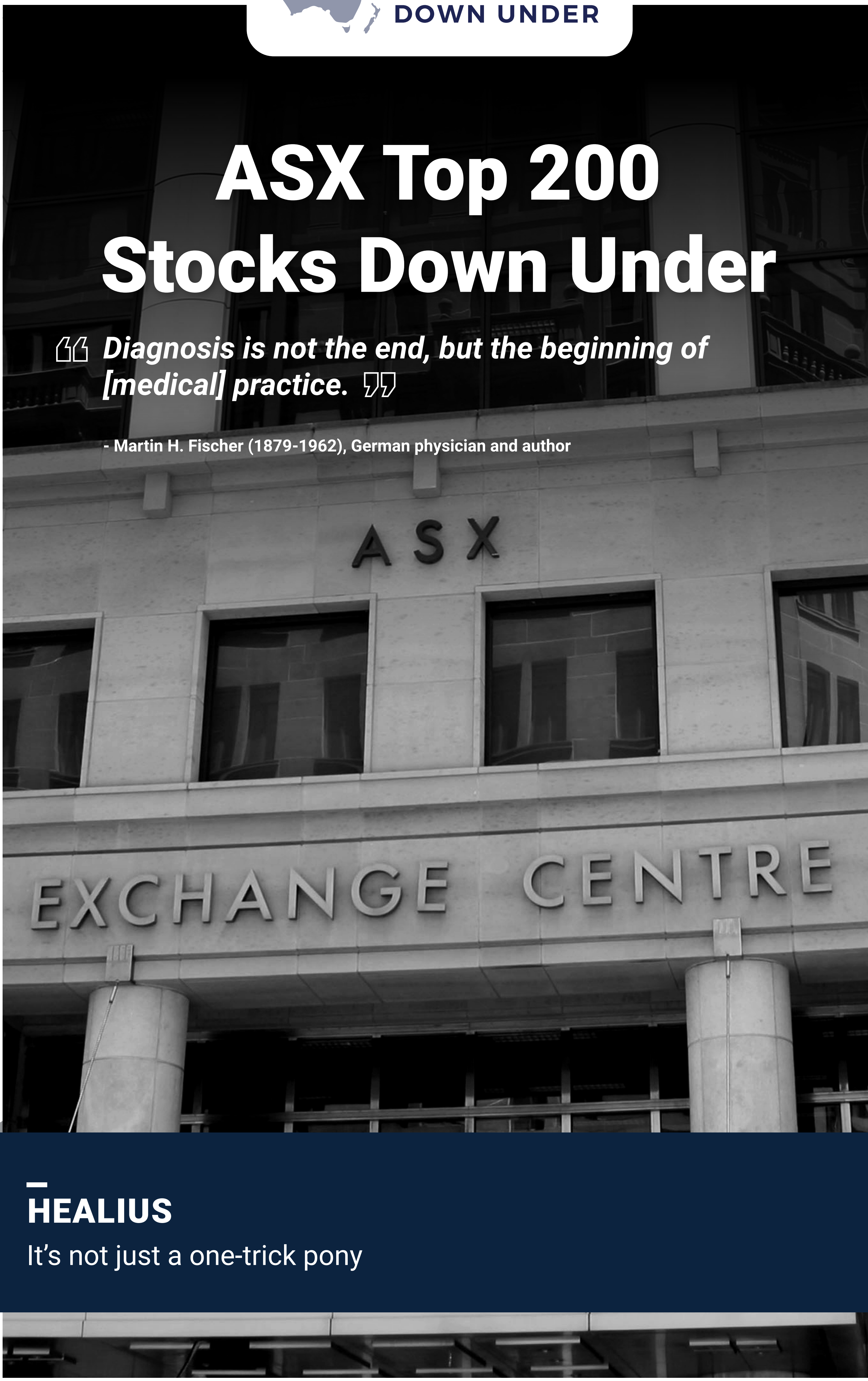
STOCKS DOWN UNDER

9 MAY 2022



ASX Top 200 Stocks Down Under

> ***Diagnosis is not the end, but the beginning of [medical] practice.***
>
> **- Martin H. Fischer (1879-1962), German physician and author**

HEALIUS

It’s not just a one-trick pony

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Stocks Down Under rating: ★★★★

ASX: HLS
Market cap: A$2.5BN

52-week range: A$3.89 / A$5.54
Share price: A$4.30

We can't blame investors for being sceptical about Healius and its peers. Yes, we know the boom period of COVID-19 tests isn't coming back. But pathology stocks like Healius aren't just one trick ponies. Pathology is an important branch of medicine, involving medical tests to help diagnose a patient's disease – in Australia it accounts for 70% of all healthcare decisions and is a $5bn market. Even if you beg to differ, we note that pathology is just one of Healius' divisions. While it is far from the cheapest stock on the ASX, we think it is more fairly valued than its peers especially because it's landing back to normality won't be as rough compared to its peers.

Share price chart

Source: Tradingview

We last covered Healius in November 2020 and it is up 17% since then – impressive when you consider the ASX 200 is barely 10% higher over that time frame. However, Healius is off its all-time high of $5.37 (reached in December 2021) as COVID testing shifted from professionally administered tests to self-administered tests. Clearly the market realised Healius was a big player in the pathology market, evident in its 160% rise from April 2020 to December 2021.

But what it is yet to realise, or perhaps has forgotten, is that pathology is not just a COVID industry, it facilitates diagnostics for various diseases and ailments, respiratory and otherwise. Healius operates 95 medical laboratories over 2,000 patient collection centres, employing 200 specialist pathologists and over 6,000 scientists, technicians, collectors and team members and it provides one in every three pathology services in Australia every year. Arguably one reason for the company's lack of recognition is that it has several brands. But many would be familiar with the names, including QML, Laverty, Dorevitch and Western Diagnostic Pathology.

In FY19, it generated revenues of $1.8bn, EBIT of $167.3m and an NPAT of $93.2m. In FY20, its revenue fell to $1.6bn and NPAT fell to $55.4m, but EBIT grew to $102.7m - in a result affected by the sale of the Healius Primary Care business and impairment of goodwill. In FY21, it made $1.9bn in revenue, $266.5m in EBIT and an $148.4m NPAT representing gains of 6%, 59% and 58% compared to FY19. In 1HY22, a period impacted by the Delta outbreaks in NSW and Victoria, it made revenue of $1.3bn, EBIT of $376.1m and a $245.6m NPAT – the latter two figures being up 229% and 189%. The company admitted its role in the public health response, by conducting PCR testing, was the main driver of growth.

What else does it have up its sleeve besides COVID testing?

Healius has three other divisions – two of which are radiography and day hospitals. Both are also significant in their markets – Healius conducts 3.3m radiography examinations per year (through Lumus Imaging) and over 50,000 annual procedures in its 11 day hospitals. The third is bioanalytical laboratory Agilex Biolabs, which the company bought in December last year, in a transaction valuing Agilex at $301.3m. The company also operated a handful of IVF clinics, but it has recently divested them.

Although Healius has not given specific guidance – something we can understand in light of the unpredictability of the pandemic – it is confident that these procedures and other pathology services could make up for the shortfall. During the pandemic, many non-essential medical procedures were cancelled (either forced or voluntarily by patients fearful of COVID). But with restrictions easing, especially those on elective surgery, the company is hopeful that such patients will come back. With virtually no influenza present in Australia for two years, medical experts are warning it could return and pathology companies such as Healius help in detecting influenza.

We are also confident that Agilex can contribute to the business as clinical trials resume. Prior to COVID-19, the Australian clinical research market grew substantially – by 17% CAGR from FY15 to FY20. Australia has speed and cost advantages relative to other markets, such as the US, but similar high-quality medical research. We finally note that, even amidst the Delta outbreak in 1HY22, the company's non-COVID revenue grew 3% - which is a positive sign for the company's potential with fewer restrictions.

FY23 won't be as solid, but Healius will be better off than its peers

Looking ahead to the FY22 results, Healius anticipates revenue of $2.5bn and EBITDA of $844.0m. In FY23, analysts forecast a drop to $2.0bn and $559.4m EBITDA – inevitably off the back of the reduction in COVID testing. But it would be 9% higher than FY21's EBITDA figure of $513.8m. Furthermore, Healius is trading at just 6.9x EV/EBITDA and a 15.6x P/E for FY23. Turning to its competitors, Australian Clinical Labs (ASX: ACL) is trading at 6.2x EV/EBITDA and 18.3x P/E while Sonic Healthcare (ASX: SHL) is trading substantially higher, at 10.4x EV/EBITDA and 20.4x P/E.

However, consensus estimates for Sonic and ACL tip reduced EBITDA from FY22 to FY23 - from $2.8bn to $1.9bn for Sonic and from $395.3m to $205.3m for ACL. And compared to FY21, ACL's EBITDA is down 11% and Sonic is down by 26% - with FY21 figures being $230.7m and $2.6bn for ACL and Sonic respectively.

ACL is purely a pathology stock and although Sonic does offer radiology services, we think the difference can be explained by Healius' acquisition of Agilex along with a higher contribution from Healius' day hospitals. We are bullish on the pathology sector generally, but we think between ACL, Sonic and Healius, the latter company is the best pick of the three. This is because it's "landing" to normality won't be as hard as its peers because of the performance of its non-COVID businesses. Four stars from us.

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