STOCKS DOWN UNDER

19 SEP 2022

ASX Top 200 Stocks Down Under

> *Poor quality is remembered long after low prices are forgotten.*
>
> **- Charles Rolls (1877-1910), co-founder of Rolls Royce**

FISHER & PAYKEL

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Stocks Down Under rating: ★★★★

ASX: FPH
Market cap: A$11.7BN

52-week range: A$16.87 / A$33.01
Share price: A$17.47

Today we take a look at one of the most famous New Zealand exports to the ASX, Fisher & Paykel Healthcare (ASX: FPH). Similar to Xero, it has made hefty returns since its ASX debut, which was back in 2001. But it has dropped over 40% in the past year, which we foresaw when we last covered this company in July last year. Is the worst of the rout over now? We think better times are ahead of the company, but they aren't here just yet.

Share price chart

Source: Tradingview

Another Kiwi export

We think investors would know Fisher & Paykel for manufacturing home appliances, such as washing machines, dishwashers and ovens. Indeed, appliances were the company's focus when it was founded in 1934, but it has been in healthcare since the 1960s. When the company was listed just over two decades ago, these two divisions were split into separate companies. The healthcare division makes equipment, such as respirators and humidifiers, used to treat obstructive sleep apnea (OSA) and other respiratory conditions in adults and adolescents.

Similar to most New Zealand companies that have made names for themselves globally, Fisher & Paykel now makes the bulk of its sales outside Aotearoa (New Zealand) – 75% of sales come from North America and Europe. It has manufacturing facilities in Tijuana, Mexico as well as a facility in New Zealand for assembly and testing. Overseas manufacturing has bitten many companies during the pandemic with supply chain disruptions. For Fisher & Paykel, however, it has been positive, meaning it is able to export its products directly to the US.

A rollercoaster ride for shareholders, but one going down

The pandemic was a positive time for the company. It was able to operate, being deemed an essential service, and demand for its products went up exponentially, especially in the US and Europe. Across FY21 and FY22, it supplied NZ$880m of hospital hardware, equivalent of approximately 10 years' hardware sales prior to

COVID-19, because its products played a key role on the COVID front line. In the 12 months to 31 March 2021 (FY21), it grew its post-tax profit by 82% to NZ$524m and its operating revenue by 61% in constant currencies to NZ$2bn, despite increased freight costs and high airfreight utilization.

The company's financials went backwards in FY22, but were still up compared to pre-COVID levels. Operating revenue was $1.7bn, down 14% in one year, but 33% above FY20. Its profit was $376.9m, down 28% from FY21, but up 31% from FY22. Total dividend was 39.5c per share, up 4% from the year before, but represented a yield of only 2.2% at the current share price.

Consensus estimates for FY23 suggest more pain for shareholders, with NZ$1.4bn in revenue - down 16% from FY22. EBITDA is expected to fall too, by 38% from NZ$601.6m to NZ$373.7m and EPS is roughly half at just 32c. If you assume a 60% dividend payout ratio (as was the case in FY22) that would be 19.2c a share and yield of just 1.1%.

Regular readers would know we like using consensus estimates for revenue and EBITDA and these can be wrong. But there's nothing more reliable than actual figures from the company and they paint a similar picture. Fisher and Paykel provided a trading update for 1HY23 and expects revenue of ~NZ$670m and a profit of $85-$95m. Revenues would be 17% higher than pre-COVID levels (i.e. 1HY20), but down 25% from 12 months earlier in 1HY22. The Omicron wave has proven to be less deadly than previous waves of COVID-19 meaning less demand for the company's hardware. It is also juggling inflated freight costs, absenteeism in its manufacturing and elevated stock levels.

Nevertheless, even without providing formal guidance, the company estimates that revenues for the second half (the six-month period from 1 October 2022 to 31 March 2023) will be higher based on new product launches and higher COVID hospitalisations in the Northern Hemisphere winter. Current freight costs would not impact gross margins further, but any further increases would increase expenses. It is already anticipating constant currency operating expense growth of approximately 10% for the year.

Can things turn around?

We've covered plenty of companies in many sectors that had a boom in the early stages of the pandemic, only to see growth moderate and investors turn on the company in droves. We foresaw this happening when we last covered Fisher & Paykel, giving it two stars on 17 May 2021 thinking its share price and multiples were too high. The current share price is a better entry point than 16 months ago, but we don't think now is the right time. Its multiples are still high, at 29.6x EV/EBITDA and 56.2x P/E for FY23, especially considering its revenue and EBITDA are all but certain to go backwards. Even if the second half of the year is better than the first, both periods will be reflected in the statutory FY23 result.

Is there hope on the horizon? Looking to consensus estimates for later years, there could well be. These suggest a return to growth in FY24 with NZ$1.6bn in revenue and $491.9m in EBITDA, representing growth of 14% and 32% from FY23, but still behind FY22. FY24's multiples look more reasonable at 22.5x EV/EBITDA and 38.1x P/E. In FY25, revenue is expected to surpass FY22 levels, at $1.8bn, but EBITDA is still predicted to be slightly behind at $595.7m.

We think Fisher & Paykel is one for investors' watchlists, but we rather would wait until after its FY23 results and for the projected growth in FY24. The full year figures will inevitably be lower but will likely come with some indications about if or when the company is returning to growth. The share price appears to have bottomed out, but it is not in an uptrend – we think would take hitting $20 to make such a conclusion. Ultimately, two months from now, we think investors will look to FY24 and evaluate what is working well. Looking now they we think they can't see it but will soon. For investors with that amount patience this one is four stars.

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