

Yovich & Co. Market Update

6th June 2022

As at 3rd June	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11065.15	7413.13	3130.24	7585.46	33212.96	12131.13	0.9129	0.6530	2.00%
Week Close	11417.34	7472.44	3195.46	7532.95	32899.70	12012.73	0.9028	0.6486	2.00%
Change	3.18%	0.80%	2.08%	-0.69%	-0.94%	-0.98%	-1.11%	-0.67%	0.00%

The local sharemarket had a strong week, recovering some of the losses made last month, with the index rising 3.18%. Meanwhile the US market lost some ground after making strong gains in the previous week, with the Dow down 0.94% and the NASDAQ down 0.98%.

Employment growth in the US saw interest rates move higher, having a negative effect on the US sharemarket, but driving the USD higher. The USD DXY (US dollar index) was stronger over the week, moving higher against the NZD, with the NZD/USD rate falling 0.67% to below the 0.65 mark.

The US 10-year Treasury yield increased by 16bps to close the week at 2.91%. NZ long-term interest rates moved up also, with the 5-year swap rate up 22bps to 3.94%.

In housing, CoreLogic has highlighted weakness in auction clearance rates, with more than 20% of auctions being cancelled or withdrawn in the past week, compared with a 5-year average of 12.5%.

The biggest movers of the week ending 3 rd June 2022			
Up		Down	
A2 Milk	11.94%	EROAD	-9.92%
Meridian Energy	8.26%	Ryman Healthcare	-7.07%
Mainfreight	8.00%	Heartland Bank	-2.35%

Market Highlight – Fisher & Paykel Healthcare’s Rise and Fall

In the 12 months to 31st May 2022, the NZX 50 gross index has made a return of -8.2%. Fisher & Paykel Healthcare’s return for the 12-month period was -27.7%, and if we exclude dividends paid by the company during that period, the capital return has been -29.5%. The chart below shows the movement of the share price over the last 5 years, with the red line marking the onset of Covid-19.



As the chart shows, the onset of the Covid-19 pandemic initially represented an opportunity for FPH, reflected in a boom in the share price. This was followed by a period of volatility for over a year, as investors reacted to news related to the pandemic’s impact on the health sector globally. And finally, the period from the start of 2022 has seen the share price follow a downward course, with a decline of 36.8%.

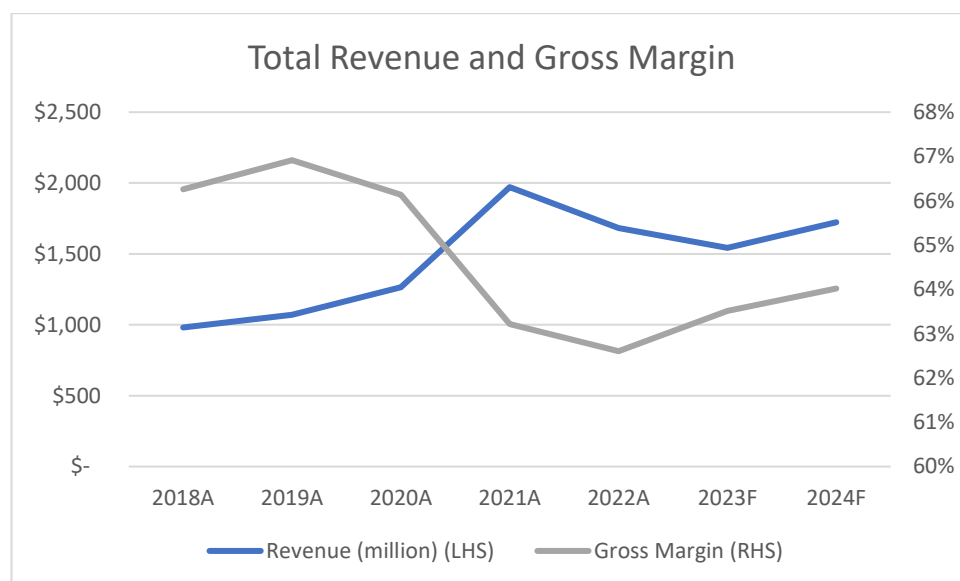
What Does Fisher & Paykel Healthcare Do?

FPH manufactures respiratory/ventilation machines and the associated accessories that include masks and filters. 72% of the FY2022 operating revenue came from the Hospital product group, that includes ventilation machines, and the remaining 28% of operating revenue came from the Homecare product group, that includes devices used to treat sleep apnea. A large percentage of total revenue comes from ongoing sales of the accessories to the machines, such as mask and filters, which are single-use in nature, providing normally predictable revenues. The sale of consumables (accessories to the hardware) made up 73% of FY2022 sales in the Hospital product group, and 84% of the Homecare product group. FPH sells its products globally; in FY2022, 42% of revenue came from North America, 32% from Europe, and 18% from Asia Pacific. With the majority of sales in foreign currency, the company is exposed to movements in the NZ dollar.

Beneficiary of the Covid-19 Pandemic

FPH was a beneficiary of the pandemic, with their products being in extremely high demand in hospitals globally. After historic revenue growth of c. 9%-10% leading up to the pandemic, revenue suddenly grew by 56% in FY2021, and net profit increased by 82%. Gross margin decreased however from 66% down to 63%, reflecting increased freight costs and higher usage of airfreight.

The chart below shows the company’s revenue and gross margin since 2018, plus forecasts. This highlights the extraordinary increase in sales in FY2022, and the associated decrease in gross margin as a result of the higher freight costs.



As markets are forward-looking, investors pushed the share price of FPH up during FY2021. The share price reached a lofty \$36.55, representing a PE ratio of 40.1x FY2021 earnings. At such a high ratio, investors buying at the peak were relying on a growth rate even in excess of what was delivered.

The Fall

FPH delivered a solid result in FY2022, broadly in line with analysts’ expectations. Revenue declined by 15% to a more normalised level, and still 33% above FY2020. Gross margin continued to decline given higher freight costs. Since earnings announcement, the share price has hit a low of \$19.48, which equates to a PE ratio of 29.8x FY2022 earnings. This has been impacted not only by the reduced earnings, but also a reduction in the PE ratio given the macroeconomic environment whereby increased interest rates have dampened PE ratios across the board.

Forecast

While FPH did not provide guidance on FY2023 revenue and earnings, market expectations are for revenue to fall again with a full 12 month period of non-extraordinary sales, before moving back to growth in FY2024. While the forecast revenue represents a decline, the longer-term view shows an increase on historical revenue. The decline is understandable, and perhaps inevitable, after the spike in demand created by a once-in-a-lifetime pandemic (touch wood).

FPH remains a strong long-term growth prospect, however the 12-month forward PE ratio at the current price of \$20.79 is 40.0x, meaning there may still be some downside to the share price in the near time. Looking forward to FY2024 however, the expected return to growth provides for a PE ratio of 30.1x. Overall, despite the still high PE ratio, we believe the future earnings over the long-term will justify the price, given the high-quality nature of the company’s products.

Investment News

Pacific Edge (PEB.NZ) – Kaiser Permanente Incorporates Cxbladder Tests

Cancer diagnostics company Pacific Edge has announced that Kaiser Permanente, the largest integrated health provider in the US, has given the green light to incorporate Cxbladder tests within its Electronic Medical Records (EMR) system. The company sees this as an important commercial milestone. The share price jumped 16.9% on the day of the announcement.

Current Share Price: \$0.79, **Consensus Target Price:** \$0.98

Sky TV (SKT.NZ) Addresses Media Speculation

Sky TV has addressed recent speculation in the Australian Financial Review and other media sources, in relation to Sky's possible acquisition of MediaWorks Holdings Limited. Sky advised that: it is currently in exclusive negotiations with MediaWorks shareholders regarding a potential acquisition of MediaWorks' radio and out of home advertising business; the likelihood of a transaction proceeding is highly uncertain; and the current proposal would not require Sky to raise equity.

Current Share Price: \$2.64, **Consensus Target Price:** \$3.04