Fundies talk pros and cons of Lifehealthcare IPO

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Daren McKennay is the chief executive of Lifehealthcare which will list on Thursday with a market capitalisation of about $85 million. **Photo: Rob Homer**

Jessica Gardner

Investors buying into the initial public offering of small cap medical device distributor Lifehealthcare on Thursday see an opportunity to gain exposure to defensive earnings in the growing healthcare sector at a bargain price.

Lifehealthcare will list with a market capitalisation of about $85 million after raising over $76 million. The company generates just over half of its revenue from the distribution of implantable devices used in surgery, especially spinal and neurological procedures. About 30 per cent of revenue comes from capital equipment like operating tables and the remainder comes from the supply of non-implantable devices like disposable surgical instruments.

Chief executive Daren McKennay said a typical procedure to treat degenerative disc disease, a painful back condition where the cushioning discs between vertebrae deteriorate, might cost a hospital $10,000 to $12,000 for the use of Lifehealthcare's products. State of the art operating tables cost upwards of $200,000.

Solid track record

Montgomery Investment Management portfolio manager Russell Muldoon said Lifehealthcare was one of only three new floats, amid boom times for IPOs, which the firm would taken a position in. The other two were credit reporting agency Veda – which also lists on Thursday – and travel insurer Covermore, which released its prospectus on Monday.

Mr Muldoon expected Lifehealthcare's "very solid track record" of earnings growth to continue on the back of a growing range of products and the ability to upsell. The company had earnings before interest, tax, depreciation and amortisation of $14.1 million in 2012-13.

Lifehealthcare shares were priced at 12-times forward earnings, he said. "That's certainly very attractive when an average industrial [stock] is priced at more than 16-times forward earnings."

The company issued 38.3 million shares at $2 each, but Mr Muldoon said he valued the company at above $2.40 a share.

Positives and negatives

Perpetual fund manager Jack Collopy said the company was "pretty attractively priced", offered strong dividend yield and had a solid balance sheet. Perpetual had taken a small position out of its micro cap fund, he said.

Mr Collopy said a medical device distributor, as opposed to a developer like Resmed for example, could not offer investors hard assets or strong intellectual property, but on the flipside it also escaped potential cost blow-outs associated with research and development. "There's some positives and negatives to having healthcare exposure but without the specific products," he said.

Investors Mutual equity analyst Daniel Moore said attractive qualities of the IPO included the potential to consolidate the fragmented distribution sector, as well as a capable salesforce. Mr Moore declined to say whether or not the fund had invested in the IPO.

Risky salesforce

Montgomery's Mr Muldoon said Lifehealthcare's strong salesforce was an attraction, but also presented a risk for prospective investors. "The nature of those sales people is that they're high speciality sales people, who are very hard to replace, and upskilling might take years not months," he said.

The company was also exposed to currency risk because a significant proportion of its distributed products were sourced from overseas, Mr Muldoon said.

Lifehealthcare was established by Mr McKennay in 2006, with the backing of private equity firm Crescent Capital Partners. Crescent owns 37 per cent of the company alongside Macquarie Group, which owns 46 per cent. Both investors want to divest their full holdings.

Mr McKennay, 46, began his career in hospital administration and has been chief executive of a number of hospitals in Perth and Sydney. After the listing, new shareholders will own 89.5 per cent of the company. Mr McKennay will retain his 3.5 per cent stake.

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