11th January 2018

hardman&co

Alliance Pharma

Acquisitions to boost growth prospects

Alliance Pharma is continuing with its buy-and-build strategy, having evolved through 35 acquisitions over a period of 20 years into a profitable, cash generative, specialty pharma business. The company has a mix of international growth brands – notably Kelo-cote and MacuShield – and a bedrock of solid local low-growth brands. APH is adding new products to each of these areas with the recent acquisitions of Ametop (bedrock) and Vamousse (international growth), both for cash from the company's existing Revolving Credit Facility, and, given the good margins, these are expected to be earnings accretive by the end of the first year of ownership.

- **Strategy**: Since inauguration, APH has adopted a buy-and-build model, with 35 deals over 20 years assembling a portfolio of >90 products and establishing a strong track record. It is accelerating growth through investing in multi-market brands, with infrastructure supported by its passive products.
- **Vamousse:** Acquisition of Vamousse, for treatment of head lice, from Tyratech Inc (TYR.L) has added a third international growth brand for a total consideration of up to \$17.5m/£13.0m – \$13.0m initial; \$4.5m deferred. Annual sales of \$6.6m are mostly from the US, expanding APH's presence in this key territory.
- **Ametop:** Completed acquisition from Smith & Nephew, for \$7.8m/£5.5m, of an established gel formulation anaesthetic for numbing skin prior to venopuncture or insertion of a cannula. Sales of \$2.8m are mostly in the UK and RoI, adding to the group's bedrock of products, with some element of international expansion.
- **Financing:** The acquisitions are being financed in cash from the group's existing £35m Revolving Credit Facility. APH agreed an increase to its EBITDA covenants from 2.5x to 3.0x for the life of the facility (end 2020). Net debt/ EBITDA is likely to be 2.5x at 31 December 2017 and should revert to ca.2.0x for fiscal 2018.
- **Investment summary:** These acquisitions will offset Diclectin, which has not been approved by the regulator, and return APH to +8% CAGR in both sales and EPS over the next three years. APH is expected to continue with its progressive dividend policy. Shares are trading on a 2018E P/E of 14.1x and carry a prospective dividend yield of 2.2%, covered 3.3x.

Financial summary and valuation

Year-end Dec (£m)	2014	2015	2016	2017E	2018E	2019E
Sales	43.5	48.3	97.5	103.5	118.0	126.0
EBITDA (underlying)	13.2	13.6	26.7	29.0	33.2	36.5
Reported pre-tax profit	10.2	15.9	22.2	*28.8	27.5	31.0
Underlying EPS (p)	3.3	4.2	4.1	4.3	4.8	5.4
Reported EPS (p)	3.2	4.9	3.9	4.8	4.5	5.1
DPS (p)	1.0	1.1	1.2	1.3	1.5	1.6
Net (debt)/cash	-21.1	-71.5	-76.1	-73.9	-60.7	-45.3
Net debt/EBITDA (x)	1.6	5.3	2.8	2.5	1.8	1.2
P/E (x)	20.4	16.0	16.2	15.6	14.0	12.5
EV/sales (x)	9.0	8.1	4.0	3.8	3.3	3.1
EV/EBITDA (x)	29.8	28.8	14.7	13.5	11.8	10.7
Dividend yield (%)	1.5	1.6	1.8	2.0	2.2	2.4

*Includes £5m Sinclair settlement less associated costs

Source: Hardman & Co Life Sciences Research

Pharmaceuticals & Biotechnology

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	APH
Price (p)	67.0
12m High (p)	67.7
12m Low (p)	44.7
Shares (m)	475.0
Mkt Cap (£m)	318.2
EV (£m)	392.1
Free Float*	64%
Market	AIM

*As defined by AIM Rule 26

Description

APH acquires, markets and distributes medical and healthcare brands in the UK and Europe (direct sales) and the RoW (via a distributor network), through a buy-and-build strategy, generating relatively predictable and strong cash flows.

Company information

CEO	John Dawson
COO	Peter Butterfield
CFO	Andrew Franklin
Chairman	Andrew Smith

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Key shareholders

Directors	12.5%
MVM Life Sciences	11.7%
Artemis	10.1%
Fidelity	9.4%
Slater Invests.	7.3%
River & Merc	5.0%

Diary

Jan-18	Trading statement
Mar-18	Finals
May-18	AGM

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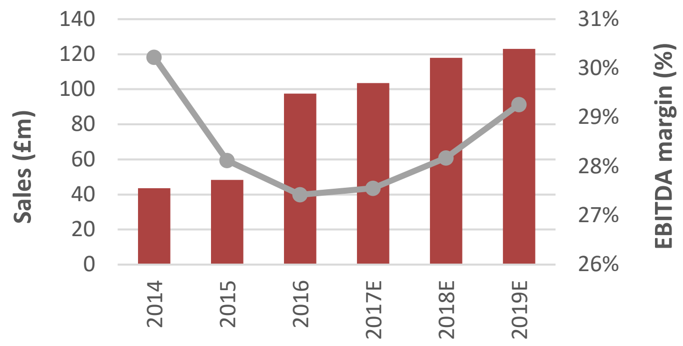
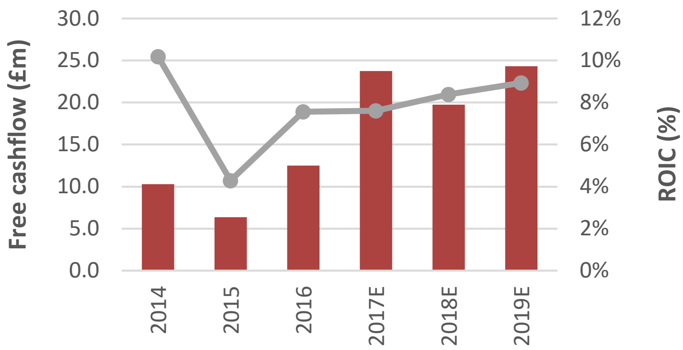
Sales & EBITDA margin



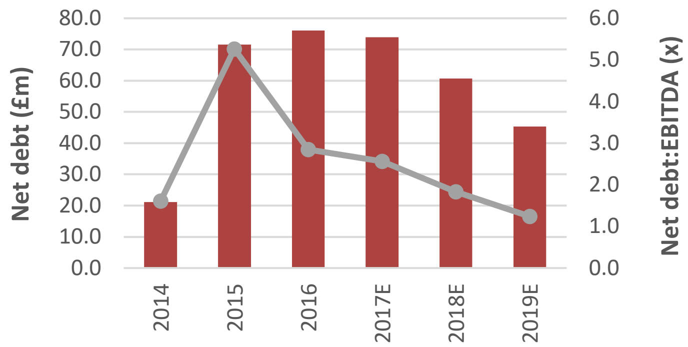
- Underlying sales growth of +3.0% is forecast for fiscal 2017, boosted at reported level by forex
- The two international brands (Kelo-cote and MacuShield) are driving sales growth and Vamousse should add to this in the future
- EBITDA margin is before share-based payments
- Gross margins are rising modestly as the contribution from the international stars increases each year

Free cashflow & ROIC



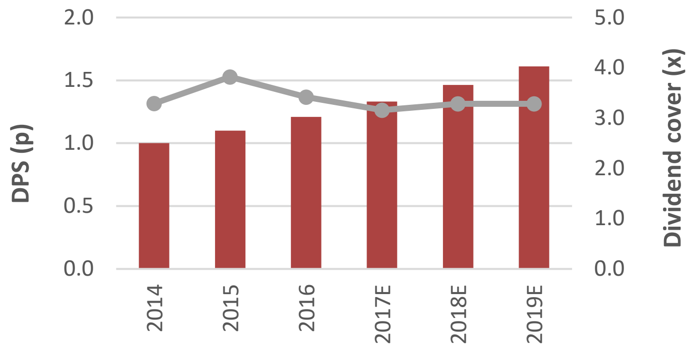
- 2016 investment and integration were offset by big jumps in gross profits generating free cash increases
- Driven by ex-Sinclair products acquired at the end of fiscal 2015
- Operating cashflow conversion is typically ca.90% of EBIT
- Dips in ROIC are caused by acquisitions made towards the end of the financial year (e.g. 2015)

Net debt



- Net debt at 31st December 2017 is forecast at ca.£74m due to large cash outflow for the acquisitions
- Financial covenants have been increased for the life of the Credit Facility from 2.5x to 3.0x to cover for acquisition spikes, and should fall back to around 2.0x in fiscal 2018
- Minimum interest cover (EBITDA/interest cost) of 4.0x. This is expected to be 8.8x in 2017
- Cash compensation from Sinclair Pharma has been used to pay down debt

Dividends



- Progressive dividend policy since dividend commenced in 2009
- Interim dividend of 0.44p, +10%; forecast to rise to 1.33p for the full year (also +10%)
- Dividend cover of ca.3.2x in 2017 and ca.3.3x in 2018 based on current forecasts
- There is scope to increase the dividend

Source: Company data; Hardman & Co Life Sciences Research

Beneficial effect of acquisitions

Acquisition of Vamousse®

- ► Cash consideration of \$13.0m/£9.6m, plus deferred payments up to \$4.5m/£3.3m based on achieving certain sales growth targets.
- ► Sales in the year to 31st December 2016 were \$6.6m/£4.9m and are thought to have been broadly flat in 2017.
- ► Effective consideration is 2.0x EV/sales, rising to 2.7x on the basis that the full deferred element is paid.

On 4th December 2017, APH announced the proposed acquisition of Vamousse from AIM-listed company, TyraTech Inc (TYR.L), for an initial cash consideration of \$13.0m/£9.6m, payable from the company's existing cash/banking facility resources, rising to \$17.5m/£13.0m – up to \$2.0m payable in 2019; and up to \$2.5m payable in 2020, both on achievement of certain sales growth targets. Following TyraTech shareholder approval, the acquisition was completed on 28th December 2017.

Vamousse was launched in the US and UK in 2014 for the treatment of head lice. Its USP is that it is a fast-acting, pesticide-free product, containing a specific mixture including isopropyl alcohol and isopropyl myristate in a mousse formulation, which kills 100% of lice and eggs within 15 minutes of being applied.

Vamousse vs dimeticone

Source: Vamousse website; Hardman & Co Life Sciences Research

In the year to 31st December 2016, sales were \$6.6m/£4.9m, derived mostly (83%) from the US, with the remainder from the UK. Rising US sales offset a decline in the UK due to reduced investment. Forecast sales growth in 2018 is driven by the increased investment by APH.

APH's strategy is two-fold: first, the product will become its third international growth brand, with the company looking to expand its use through its distribution network; secondly, Vamousse adds significantly to APH's footprint in the US, the largest consumer healthcare market in the world. This acquisition allows APH to set up its own US affiliate, Alliance Pharma Inc, based in North Carolina.

APH has entered also into a transition services agreement with TyraTech to transfer the existing Vamousse business to APH in 2018. On closing, APH acquired inventories of ca.\$0.8m.

Acquisition of Ametop®

- Cash consideration of \$7.5m/£5.6m.
- MAT sales in year to 31st October 2017 were \$2.8m/£2.2m.
- Effective consideration is EV/sales of 2.7x.
- Accretive to earnings in the first 12 months.

On 1st December 2017, APH announced that it had completed the acquisition of Ametop from Smith & Nephew (S&N) for a cash consideration of \$7.5m/£5.6m, payable from the company's existing cash/banking facility resources.

Ametop is a topical anaesthetic gel that is used to numb the skin prior to venopuncture or insertion of a cannula. Its active ingredient is tetracaine (4% w/w). S&N has been selling the product for over 10 years, therefore it is well established in the market and will join APH's 'bedrock' group of products. The main competition comes from EMLA cream (5% w/w), which is a mixture of lidocaine (50%) + prilocaine (50%), LMX4 (4% w/w, 100% lidocaine), and Denela cream (5% w/w), which is a 50:50 mixture of lidocaine and prilocaine.

In the year to 31st October 2017, sales were \$2.8m/£2.2m. Around 75% of sales are made in APH's largest territory, the UK and Eire, with the remainder from New Zealand and Canada. In addition to the cash consideration of \$7.5m/£5.6m, APH will acquire inventories of ca.\$0.4m/£0.3m. S&N will continue to manufacture Ametop for APH for a period of up to ca.three years. Moreover, in territories outside the UK and Eire, there will be a transition period, with S&N continuing to sell the product until APH has put in place its own distribution arrangements.

APH should benefit from a month's contribution to sales in fiscal 2017. Given that margins are thought to be at the upper end of APH's EBITDA margin range, the deal is expected to be accretive to earnings in the first year of ownership.

Changes to forecasts

- **Currencies:** Our forecasts have been updated to reflect the actual exchange rates for 2017 – GBP:USD 1.289 (vs 1.354) and GBP:EUR 1.141 (vs 1.223). This has added an extra ca.£0.5m to our sales forecast and -£0.3m to overseas costs.
- **Acquisitions:** Sales forecasts have been boosted in 2018 and 2019 by the two product acquisitions. This has benefited the gross margins and dropped through to EBITDA. However, the operational improvement is partially offset by the increased financing costs, but overall they are earnings-enhancing.

Changes to forecasts*

	------ 2017E ------		------ 2018E ------		------ 2019E ------	
	Old	**New**	**Old**	**New**	**Old**	**New**
Sales	102.9	103.5	111.0	118.0	117.7	126.0
EBITDA	29.1	29.0	31.8	33.2	34.7	36.5
Underlying PBT	25.5	25.5	28.2	28.9	31.4	32.5
Underlying EPS	4.3	4.3	4.7	4.8	5.2	5.4
Net cash/(debt)	-57.5	-73.9	-43.0	-60.7	-26.6	-45.3

**Compared to our last published forecasts on 17th October 2017*
Source: Hardman & Co Life Sciences Research

Financial forecasts

Profit & Loss

- **SG&A:** Much of the marketing spend originally earmarked for Diclectin will be re-allocated to Vamousse.
- **Tax:** The tax rate is reverting to normalised levels of around 22% in the absence of any further reduction in the UK corporation tax rate. Deferred tax associated with the reduced intangible tax relief on Kelo-stretch will affect 2017 only.

Profit & Loss account

Year-end Dec (£m)	2014	2015	2016	2017E	2018E	2019E
GBP:EUR	-	1.284	1.223	1.141	1.141	1.141
GBP:USD	-	1.432	1.354	1.289	1.289	1.289
Sales	**43.5**	**48.3**	**97.5**	**103.5**	**118.0**	**126.0**
Cost of goods	-18.5	-19.6	-42.6	-44.3	-49.5	-52.9
Gross profit	25.0	28.7	54.8	59.2	68.5	73.1
Admin & marketing	-12.5	-15.6	-28.8	-31.2	-37.0	-38.5
Underlying EBITDA	**13.2**	**13.6**	**26.7**	**29.0**	**33.2**	**36.5**
EBITDA margin	30.2%	28.1%	27.4%	28.1%	28.1%	29.0%
Depreciation	-0.3	-0.3	-0.3	-0.5	-1.2	-1.5
Amortisation	-0.5	-0.2	-0.1	-0.3	-0.2	-0.2
Other income	0.0	0.0	0.0	0.0	0.0	0.0
Share of JV profits/(loss)	0.3	0.2	0.3	0.3	0.3	0.3
Underlying EBIT	**12.4**	**13.1**	**26.3**	**28.3**	**31.8**	**34.9**
Share-based costs	-0.6	-0.6	-0.7	-1.5	-1.5	-1.5
Exceptional items	-0.6	4.5	0.0	4.8	0.0	0.0
Statutory EBIT	11.2	17.0	25.6	31.6	30.3	33.4
Net interest	-1.0	-1.1	-2.8	-2.8	-2.9	-2.4
Other financials	0.0	0.1	-0.6	0.0	0.1	0.0
U/lying pre-tax profit	**10.7**	**12.8**	**23.5**	**25.5**	**28.9**	**32.5**
Extraordinary items	0.0	0.0	0.0	0.0	0.0	0.0
Reported pre-tax	**10.2**	**15.9**	**22.2**	**28.8**	**27.5**	**31.0**
Underlying tax	-2.0	-1.4	-4.1	-5.2	-6.2	-7.0
Exceptional tax	0.3	-1.1	0.0	-0.9	0.0	0.0
Tax payable/credit	-1.8	-2.5	-4.1	-6.1	-6.2	-7.0
Tax rate	17.4%	15.6%	18.6%	21.0%	22.4%	22.5%
Underlying net income	**8.7**	**11.5**	**19.4**	**20.3**	**22.7**	**25.5**
Statutory net income	8.4	13.5	18.1	22.7	21.3	24.0
Ordinary 1p shares:						
Period-end (m)	264.1	468.2	472.6	475.0	475.0	475.0
Weighted average (m)	264.1	272.7	469.4	472.6	475.0	475.0
Fully diluted (m)	265.6	299.2	505.0	508.1	510.5	510.5
U/lying basic EPS (p)	**3.29**	**4.20**	**4.14**	**4.29**	**4.79**	**5.37**
Statutory basic EPS (p)	3.17	4.93	3.85	4.81	4.49	5.06
U/lying fully-dil. EPS (p)	**3.27**	**3.83**	**3.85**	**3.99**	**4.45**	**5.00**
Stat. fully-dil. EPS (p)	3.16	4.50	3.58	4.47	4.18	4.71
DPS (p)	**1.00**	**1.10**	**1.21**	**1.33**	**1.46**	**1.61**

*Note: *Warranty receipt: a £5m accrual in 2017 due to Kelo-stretch, with £4.0m cash received in 2017 and £1m to be received in cash by 30th June 2018, less modest associated costs*

Source: Hardman & Co Life Sciences Research

Balance sheet

- **Net debt** – At 31st December 2017, APH is forecast to have net debt of ca.£74m, having invested ca.£17.0m on acquisitions and inventories during the last month.
- **Loans –** Underlying cash generation will reduce debt by £20m in 2017, boosted by the £4m warranty cash settlement, but offset by acquisitions & related costs.
- **ROIC** – Modest improvement over 2016 despite the recent acquisitions; expected to rise faster as acquired products gain traction and loans are paid off.

Balance sheet

@31st December (£m)	2014	2015	2016	2017E	2018E	2019E
Shareholders' funds	70.8	162.4	179.3	195.7	210.0	226.4
Cumulated goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Total equity	74.4	188.5	205.3	221.7	236.1	252.5
Share capital	2.6	4.7	4.7	4.7	4.7	4.7
Reserves	68.1	157.8	174.5	190.9	205.3	221.7
Provisions/liabilities	0.4	1.5	1.7	1.7	1.7	1.7
Deferred tax	6.1	37.0	29.7	29.7	29.7	29.7
Long-term loans	19.2	59.0	57.6	55.3	46.2	38.5
Short-term debt	3.3	15.8	25.8	25.8	21.8	14.1
less: Cash	1.4	3.2	7.2	7.2	7.2	7.2
Invested capital	**98.4**	**272.5**	**286.8**	**301.0**	**302.2**	**303.2**
Fixed assets	0.4	1.0	1.8	3.4	3.7	3.3
Intangible assets	85.3	233.9	238.5	238.5	238.5	238.5
JV assets	2.7	2.9	2.9	2.9	2.9	2.9
Goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Inventories	5.9	12.9	15.4	17.2	19.6	20.9
Trade debtors	*6.6*	*8.8*	*20.5*	*21.8*	*24.8*	*26.5*
Other debtors	*1.7*	*2.8*	*6.2*	*6.6*	*7.5*	*8.0*
Tax liability/credit	*-1.0*	*-2.1*	*-2.5*	*-2.0*	*-2.1*	*-2.2*
Trade creditors	*-1.7*	*-1.2*	*-5.7*	*-5.9*	*-6.6*	*-7.0*
Other creditors	*-5.2*	*-12.7*	*-16.3*	*-7.5*	*-12.2*	*-13.8*
Debtors less creditors	0.4	-4.3	2.2	13.0	11.5	11.6
Invested capital	**98.4**	**272.5**	**286.8**	**301.0**	**302.2**	**303.2**

Source: Hardman & Co Life Sciences Research

Key metrics

Year end Dec (£m)	2014	2015	2016	2017E	2018E	2019E
Net cash/(debt)	-21.1	-71.5	-76.1	-73.9	-60.7	-45.3
Net debt/EBITDA (x)	1.6	5.3	2.8	2.5	1.8	1.2
Net debt/equity (%)	-28%	-38%	-37%	-33%	-26%	-18%
NAV/share (p)	27	35	38	41	44	48
Stock days	48	71	53	57	57	59
Debtor days	66	58	77	75	72	74
Creditor days	33	57	48	48	48	48
Interest cover (x)	11.4	10.8	9.2	9.7	10.7	14.5
Dividend cover (x)	3.3	3.8	3.4	3.2	3.3	3.3
Cap-ex/depreciation (x)	0.4	2.7	3.4	4.4	1.3	0.7
NOPAT	10	12	22	23	25	27
After-tax ROIC	10.2%	4.3%	7.6%	7.5%	8.3%	9.0%
Cap-ex/sales (%)	0.3%	1.3%	1.2%	1.9%	1.3%	0.8%

Source: Hardman & Co Life Sciences Research

Cashflow

- **Free cashflow:** About £24m of free cashflow is expected for fiscal 2017 (including the £4m warranty receipt), offset by acquisition costs of ca.£17m.
- **Leverage:** APH has increased its banking covenants from 2.5x to 3.0x for the life of the credit agreement to allow for the short-term impact of making acquisitions.
- Investment in business system infrastructure has been included in capital expenditure, with an associated increase in subsequent depreciation.

Cashflow

Year-end Dec (£m)	2014	2015	2016	2017E	2018E	2019E
Underlying EBIT	12.4	13.1	26.3	28.3	31.8	34.9
Depreciation	0.3	0.2	0.3	0.5	1.2	1.5
Amortisation	1.1	0.2	0.1	0.3	0.2	0.2
Inventories	*-0.4*	*-7.0*	*-2.4*	*-1.8*	*-2.4*	*-1.3*
Receivables	*2.8*	*2.3*	*-14.1*	*2.3*	*-3.1*	*-1.7*
Payables	*-1.8*	*-3.3*	*10.1*	*-0.2*	*0.7*	*0.4*
Change in working capital	-1.8	-8.0	-6.5	0.2	-4.8	-2.6
Exceptionals/provisions	0.0	4.5	0.0	4.0	1.0	0.0
Other	1.4	-0.1	-0.3	0.0	0.0	0.0
Cashflow from ops.	**13.4**	**9.9**	**20.0**	**33.2**	**29.4**	**34.0**
Net interest	-0.9	-1.0	-3.0	-2.8	-2.9	-2.4
Tax paid/received	-2.0	-1.9	-3.0	-4.6	-5.2	-6.5
Operational cashflow	**10.5**	**7.0**	**13.9**	**25.8**	**21.2**	**25.1**
Capital expenditure	-0.1	-0.6	-1.1	-2.0	-1.5	-1.0
Capitalised R&D	-0.1	0.0	-0.3	-0.3	-0.3	-0.3
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Free cashflow	**10.3**	**6.4**	**12.5**	**23.6**	**19.5**	**23.9**
Acquisitions	-3.3	-133.9	-6.0	-17.1	0.0	-1.5
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	-2.4	-2.6	-5.2	-5.7	-6.3	-7.0
Other investments	-0.5	0.0	-1.0	0.0	0.0	0.0
CF after investments	**4.1**	**-130.1**	**0.3**	**0.7**	**13.2**	**15.4**
Share repurchases	0.0	0.0	0.0	0.0	0.0	0.0
Capital increases	0.0	79.8	1.3	0.5	0.0	0.0
Currency effect	0.0	-0.1	-6.2	1.0	0.0	0.0
Change in net debt	**4.1**	**-50.4**	**-4.6**	**2.2**	**13.2**	**15.4**
Opening net cash/(debt)	-25.2	-21.1	-71.6	-76.1	-73.9	-60.7
Closing net cash/(debt)	**-21.1**	**-71.6**	**-76.1**	**-73.9**	**-60.7**	**-45.3**
Hardman CF/share (p)	3.9	2.3	2.7	5.0	4.1	5.0

Source: Hardman & Co Life Sciences Research

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