



Source: Eikon Thomson Reuters

Market data

| | |
|--------------|-------|
| EPIC/TKR | APH |
| Price (p) | 53.3 |
| 12m High (p) | 56.0 |
| 12m Low (p) | 41.3 |
| Shares (m) | 474.3 |
| Mkt Cap (£m) | 252.6 |
| EV (£m) | 316.0 |
| Free Float* | 79% |
| Market | AIM |

*As defined by AIM Rule 26

Description

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

Company information

| | |
|----------|-----------------|
| CEO | John Dawson |
| CFO | Andrew Franklin |
| Chairman | Andrew Smith |

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www.alliancepharmaceuticals.com**Key shareholders**

| | |
|-------------------|-------|
| Directors | 9.2% |
| MVM Life Sciences | 11.7% |
| Fidelity | 10.1% |
| Artemis | 7.7% |
| Slater | 7.3% |
| GVQ IM | 5.0% |

Diary

| | |
|---------|---------------------|
| 13 Sept | Interims |
| Late-17 | Diclectin UK launch |

Analysts

| | | |
|---------------|---------------|--|
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Alliance Pharma

International brands driving growth

Alliance Pharma's buy-and-build strategy to evolve into a profitable, cash generative, specialty pharma business is clearly bearing fruit. Acquisition of the dermatology and woundcare products from Sinclair Pharma was transformational, doubling the size of the company and providing a more internationally-oriented business. The enlarged group is also a more attractive and credible partner for in-licensing and M&A opportunities. 2017 is building on the foundations laid in 2016 with international growth brands driving performance, which will be boosted by the upcoming regulatory approval of Diclectin.

- **Strategy:** Since inauguration, APH has adopted a buy-and-build model, with 33 deals over 19 years assembling a portfolio of >90 products and establishing a strong track record. It is accelerating growth through investing in three multi-market brands, with infrastructure supported by its passive products.
- **1H'17 sales:** In a trading update to the market, APH stated that underlying first half sales grew +2.6%, boosted at the reported level by currency (+£2.6m), to £50.3m (£46.4m). Key growth drivers, Kelo-Cote (+33% CER) and MacuShield (+65% CER), both exceeded expectations
- **Cashflow:** The strong cash generation from operations seen in 2H'16 has continued through 1H'17 (+£11.1m), which was boosted further by the £4m warranty receipt from Sinclair Pharma. Net debt at the end of the period, at -£63.4m, was about £1.2m better than forecast.
- **Risks:** APH has a diversified strategy that includes International Star brand growth potential supported by Bedrock products. However, established sales patterns are not guaranteed and can be prone to unusual distributor buying patterns. Timing of approval of Diclectin is entirely in the regulators hands.
- **Investment summary:** Although APH is forecast to have +8% CAGR in sales over the next three years, medium-term EPS growth will be held back by the investment in marketing. The progressive dividend policy is expected to remain. Shares are trading on a 2017 P/E of 12.6x and carry a dividend yield of 2.5%, covered 3.2x. Launch of Diclectin has the potential to transform medium- to long-term growth prospects (only UK launch costs included in current forecasts).

Financial summary and valuation

| Year end Dec (£m) | 2014 | 2015 | 2016 | 2017E | 2018E | 2019E |
|---------------------------|-------|-------|-------|-------|-------|-------|
| Sales | 43.5 | 48.3 | 97.5 | 103.0 | 112.0 | 121.0 |
| Underlying pre-tax profit | 10.7 | 12.8 | 23.5 | 25.2 | 28.3 | 33.3 |
| Reported pre-tax profit | 10.2 | 15.9 | 22.2 | *29.0 | 26.9 | 31.8 |
| Underlying EPS (p) | 3.3 | 4.2 | 4.1 | 4.2 | 4.7 | 5.5 |
| Reported EPS (p) | 3.2 | 4.9 | 3.9 | 5.0 | 4.4 | 5.2 |
| DPS (p) | 1.0 | 1.1 | 1.2 | 1.3 | 1.5 | 1.6 |
| Net (debt)/cash | -21.1 | -71.5 | -76.1 | -59.5 | -44.4 | -27.9 |
| Net debt/EBITDA (x) | 1.6 | 5.3 | 2.8 | 2.0 | 1.4 | 0.7 |
| P/E (x) | 16.2 | 12.7 | 12.9 | 12.6 | 11.4 | 9.7 |
| EV/sales (x) | 7.3 | 6.5 | 3.2 | 3.1 | 2.8 | 2.6 |
| EV/EBITDA (x) | 24.0 | 23.2 | 11.8 | 10.7 | 9.7 | 8.5 |
| Dividend Yield (%) | 1.9 | 2.1 | 2.3 | 2.5 | 2.7 | 3.0 |

*Includes £5.0m warranty settlement from Sinclair;

Source: Hardman & Co Life Sciences Research

Trading update

Key features

- ▶ **Sales:** Underlying sales growth was +3%, boosted +£2.6m by currency at the reported level, to £50.3m (£46.1m). This was extremely close to forecasts, being +£0.1m at the underlying level, and -£0.1m due to currency
- ▶ **Key drivers:** Sales growth was led by the international star brands that receive approximately 50% of the group's investment in marketing support, with Kelo-Cote +33% (CER) to £6.2m (£4.1m) and MacuShield +65% to £3.4m (£2.0m), both exceeding expectations
- ▶ **Other products:** Although there is limited information available at this stage, implicit in the numbers is that the remaining brands, mostly the bedrock/passive portfolio, have slightly underperformed expectations, and may be due to distributor buying patterns
- ▶ **Profitability:** Forecasts are assuming a modest improvement in the underlying EBIT margin during 1H'17, offset by pre-launch investment in Diclectin (see below). Although weakness of sterling has provided a substantial benefit to the top line, APH is hedged naturally against movements in key currencies with a significant proportion of its costs being overseas
- ▶ **Cashflow:** Free cashflow has been particularly strong at +£11.1m, generating a similar amount to the level seen in 2H'16. This was boosted further by receipt of the first tranche of £4m (out of a total of £5.0m) received from Sinclair Pharma (SPH.L) in settlement of a warranty claim
- ▶ **Net debt:** Cashflow from operations has been used to pay down debt, such that APH ended the period with net debt of £63.4m, which was £1.2m better than forecast. Period end movement in currencies was balanced, a strengthened EUR offset by a weaker USD (compared to 31st December)

| Actual vs expectations | | | | | |
|------------------------|--------------|--------------|------------|----------------|-------------|
| Interims to June (£m) | 1H'16 actual | 1H'17 actual | CER % | 1H'17 forecast | Delta |
| Kelo-Cote | 4.1 | 6.2 | +32% | 5.8 | +0.4 |
| MacuShield | 2.0 | 3.4 | +67% | 2.8 | +0.7 |
| Other products | 40.2 | 40.7 | -3% | 41.8 | -1.1 |
| Group sales | 46.4 | 50.3 | +3% | 50.4 | -0.1 |
| Underlying EBIT | 13.5 | | | 13.9 | |
| EBIT margin (%) | 29.0% | | | 27.6% | |
| Free cashflow* | 2.1 | 11.1 | | 10.0 | +1.1 |
| Net cash/(debt) | -79.0 | -63.3 | | -64.5 | +1.2 |

Numbers may not add up exactly due to rounding

*Hardman definition

Source: Hardman & Co Life Sciences Research

- ▶ **FY forecasts:** Although there may be scope to increase forecasts due to the very strong performance from the leading international brands, no changes are being made at this stage. Forecasts will be reviewed when all the detail is available from the first half – announcement scheduled for 13th September 2017
- ▶ **Diclectin:** Management has done all it can regarding the UK approval of Diclectin (prevention of nausea and vomiting in pregnancy), answering all the questions raised by the regulator. The current expectation remains that this drug will receive regulatory approval during the current quarter, allowing a launch during 4Q'17

Forecasts

| Financial summary | | | | | | |
|-------------------------------|--------------|---------------|---------------|--------------|--------------|--------------|
| Year end Dec (£m) | 2014 | 2015 | 2016 | 2017E | 2018E | 2019E |
| GBP:EUR | 1.241 | 1.378 | 1.223 | 1.223 | 1.223 | 1.223 |
| GBP:USD | 1.648 | 1.529 | 1.354 | 1.354 | 1.354 | 1.354 |
| Profit & Loss | | | | | | |
| Sales | 43.54 | 48.34 | 97.49 | 103.0 | 112.0 | 121.0 |
| Cost of goods | -18.49 | -19.61 | -42.64 | -44.7 | -48.3 | -51.6 |
| Gross profit | 25.04 | 28.73 | 54.85 | 58.3 | 63.7 | 69.4 |
| SG&A | -12.51 | -15.63 | -28.84 | -29.5 | -32.7 | -34.1 |
| Underlying EBITDA | 13.16 | 13.60 | 26.74 | 29.6 | 32.6 | 37.2 |
| Depreciation | -0.31 | -0.31 | -0.34 | -0.4 | -1.1 | -1.4 |
| Underlying EBIT | 12.36 | 13.09 | 26.31 | 29.0 | 31.3 | 35.6 |
| EBIT margin | 28.4% | 27.1% | 27.0% | 28.2% | 27.9% | 29.4% |
| Net interest | -1.04 | -1.08 | -2.76 | -3.8 | -3.0 | -2.3 |
| U/lying pre-tax profit | 10.73 | 12.83 | 23.55 | 25.2 | 28.3 | 33.3 |
| Tax payable/credit | -1.77 | -2.49 | -4.13 | -5.3 | -6.1 | -7.2 |
| Underlying net income | 8.69 | 11.45 | 19.42 | 19.9 | 22.2 | 26.1 |
| Weighted av. Shares (m) | 264.1 | 272.7 | 469.4 | 472.6 | 474.3 | 474.3 |
| Underlying EPS (p) | 3.29 | 4.20 | 4.14 | 4.2 | 4.7 | 5.5 |
| Fully diluted EPS (p) | 3.27 | 3.83 | 3.85 | 3.9 | 4.4 | 5.1 |
| Balance sheet | | | | | | |
| Share capital | 2.64 | 4.68 | 4.73 | 4.7 | 4.7 | 4.7 |
| Reserves | 68.14 | 157.76 | 174.54 | 191.9 | 205.8 | 222.8 |
| Deferred tax | 6.12 | 37.00 | 29.73 | 29.7 | 29.7 | 29.7 |
| Debt + loans | 22.54 | 74.78 | 83.34 | 66.7 | 51.6 | 35.1 |
| less: Cash | 1.43 | 3.23 | 7.22 | 7.2 | 7.2 | 7.2 |
| Invested capital | 98.36 | 272.48 | 286.81 | 287.6 | 286.4 | 286.8 |
| Net cash/(debt) | -21.11 | -71.55 | -76.12 | -59.5 | -44.4 | -27.9 |
| EBITDA cover | 1.60 | 5.26 | 2.85 | 2.0 | 1.4 | 0.7 |
| Cashflow | | | | | | |
| Underlying EBIT | 12.36 | 13.09 | 26.31 | 29.0 | 31.3 | 35.6 |
| Depreciation | 0.31 | 0.24 | 0.34 | 0.4 | 1.1 | 1.4 |
| Change in working capital | -1.78 | -7.99 | -6.48 | 0.0 | -1.9 | -2.9 |
| Exceptionals/provisions | 0.00 | 4.49 | 0.00 | 4.0 | 1.0 | 0.0 |
| Net interest | -0.87 | -1.02 | -3.04 | -3.8 | -3.0 | -2.3 |
| Tax paid/received | -2.03 | -1.86 | -3.03 | -3.9 | -5.5 | -7.3 |
| Capital expenditure | -0.11 | -0.65 | -1.13 | -2.0 | -1.5 | -1.0 |
| Free cashflow | 10.29 | 6.35 | 12.49 | 23.7 | 21.4 | 23.5 |
| Acquisitions | -3.32 | -133.85 | -6.03 | -1.4 | 0.0 | 0.0 |
| Dividends | -2.40 | -2.64 | -5.15 | -5.7 | -6.3 | -6.9 |
| Change in net debt | 4.11 | -50.44 | -4.57 | 16.6 | 15.1 | 16.5 |
| Hardman CF/share (p) | 3.89 | 2.33 | 2.66 | 5.0 | 4.5 | 4.9 |

Summary only – numbers may not add up exactly
Source: Hardman & Co Life Sciences Research

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