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AFT Pharma (AFP)

Solid First Half Result

Recommendation
Hold (unchanged)
Price
$4.75
Target (12 months)
$4.80 (previously $4.70)

GICS Sector

Healthcare Equipment and Services

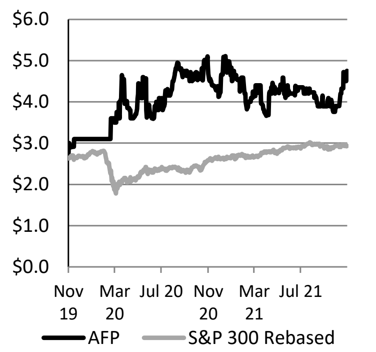
Expected Return	
Capital growth	**1.1%**
Dividend yield	**0.0%**
Total expected return	**1.1%**

Company Data & Ratios	
Enterprise value	**$528.7m**
Market cap	**$497.2m**
Issued capital	**104.7m**
Free float	**30%**
Avg. daily val. (52wk)	**$47,000**
12 month price range	**$3.64 - $5.14**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	3.76	4.23	4.88
Absolute (%)	26.33	12.29	-2.66
Rel market (%)	25.87	15.16	-18.67

Absolute Price



SOURCE: IRESS

NZ Revenues Recover Strongly (All Figures in NZ$)

AFP reported its 1H22 result earlier today with revenues increasing by 13.7% to $55.5m inclusive of $4.8m in once off milestone income. The EBIT result was 25% ahead of expectation at $5.5m and up strongly over the prior period. The company reported revenue growth in each of the key regions including Australia (4%), New Zealand (15%) and Asia (32%). Rest of World revenues inclusive of license fees and royalties increased by 74% to $7.6m (i.e. including the $4.8m milestone income).

In the US, the registration process for Maxigesic tablets and Maxigesic IV are ongoing. Maxigesic IV has a scheduled approval date from the FDA in June 2022 with a potential launch thereafter. This should be a major catalyst in FY23. The company remains in negotiation with distributors for the tablet product and is yet to file for registration. In 1H22 Maxigesic tablets were launched in 4 new countries in Europe while the Maxigesic IV formulation was launched in Germany being one of the major 5 markets in Europe. Maxigesic tablets are now sold in 46 countries around the world with 50 further countries yet to launch.

In operations, the company continues to experience production delays and logistics difficulties associated with contract manufacturers in China and India. Accordingly working capital levels remain comparatively high. These supply issues are not expected to ease any time soon.

Investment View: Maintain Hold, PT increased to $4.80

AFP maintained guidance for FY22 operating profit in the range of $18m-$23m relative to the $5.5m reported in 1H22. Revenues and earnings are strongly skewed to the second half, however, 2H22 will need to demonstrate record product sales revenues and milestone income in order to meet guidance. The key will be the milestone income of which some is expected, however, these revenues are not transparent. FY22/FY23 NPAT is reduced by 8% and 16% respectively due mainly to increases in R&D expense. Changes to FY24 earnings are not material. Price target increased to $4.80 (from $4.70) and we maintain our Hold rating.

Earnings Forecast

March Year End NZ$m	FY21	FY22e	FY23e	FY24e
Revenues	113.0	129.0	136.1	148.2
EBIT $m	10.7	16.9	16.7	22.6
NPAT (underlying) $m	7.8	14.7	14.8	20.8
NPAT (reported) $m	7.8	14.7	14.8	20.8
EPS underlying (cps)	7.5	14.1	14.2	20.1
EPS growth %	163%	88%	1%	41%
PER (x)	67	36	35	25
FCF yield (%)	-2%	1%	2%	3%
EV/EBITDA (x)	50.0	31.7	32.0	23.6
Dividend (cps)	-	-	2.8	4.0
Franking	0%	0%	0%	0%
Yield %	0%	0%	1%	1%
ROE %	21%	25%	9%	12%

SOURCE: BELL POTTER SECURITIES ESTIMATES

NZ Revenues Recover Strongly

Figure 1 - 1H22 Result Summary

NZ$m	1H21 Actual	1H22 Actual	% change	1H22 Forecast	% Diff
Revenues - product sales	48.4	50.4	4.1%	48.0	5.0%
Growth	*9.3%*	*4.1%*			
Gross profit (before royalty income)	20.3	21.6	6.4%	20.6	4.9%
Gross margin on product sales	*42%*	*43%*		*43%*	
Royalties and license income	0.4	5.1	1175.0%	4.0	27.5%
Reported gross profit	20.7	26.7	29.0%	24.6	8.5%
Total Revenues	**48.8**	**55.5**	13.7%	**52.0**	**6.7%**
Growth	***4%***	***14%***			
Operating expenses	17.9	21.2	18.4%	20.2	-4.7%
Underlying operating profit	2.8	5.5	96.4%	4.4	25.0%
NPAT - reported	1.6	4.2	162.5%	3.2	31.3%
NPAT - adjusted	1.6	4.2	162.5%	3.2	31.3%
EPS - normalised - cps	1.6	4.0	150.0%	3.0	33.3%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Product revenue growth vs pcp: NZ 15%, Australia 2% and ROW 32%. Australia and NZ continue to represent the lion's share of revenues from product sales at 89% combined.

Revenues are highly seasonal and skewed to the second half. Period on period product sales revenues declined, however, this is consistent with prior years experience.

Royalties and license income includes the one off NZ$4.8m upfront payment received from Hikma in relation to the distribution rights for Maxigesic IV in the United States. Further milestones are likely following registration (PDUFA date is June 22), however, the details of these future milestones are not public. The forecast includes some modest assumptions for future milestone income.

Operating expenses increased by 18%. The company continues to expand its marketing team in anticipation of further growth in markets outside of Australia/NZ. Expensed R&D spend also increased significantly. Total R&D spend including the capitalised development cost amounted to $5.2m with full year expenditure likely to be in the range of $11m-$12m. AFT has multiple R&D project under way and expects up to 30 new product launches in Australia and NZ over the next 18 months. These are reflected in our forecasts for product sales revenue growth of 8% and 10% for FY22 and FY23 respectively.

Net cash flow from operations was $6.8m vs -$2.7 in 1H21. Working capital was virtually unchanged at $43.4m, hence the major driver of the improved cash flow was the milestone income from Hikma. Net debt declined by $2.6m closing at $32.6m.

Figure 2 - Summary of earnings changes

	2022			2023			2024		
	New	**Old**	**% change**	**New**	**Old**	**% change**	**New**	**Old**	**% change**
Revenues	129.0	125.8	3%	136.1	130.1	5%	148.2	137.8	8%
EBIT	16.9	18.3	-8%	16.7	18.6	-10%	22.6	22.7	0%
NPAT	14.7	16.0	-8%	14.8	16.9	-13%	20.8	21.0	-1%
EPS	14.1	15.4	-8%	14.2	16.9	-16%	20.1	21.0	-4%

SOURCE: BELL POTTER SECURITIES ESTIMATES

FY22 EBIT is reduced by $1.4m (-8%) due to the inclusion of additional R&D expense.

The forecast for 2H22 implies EBIT growth of 90% vs pcp, however, the forecast is below the guidance range for full year operating profit of $18m-$23m. In order to make the bottom of the guidance range the company requires 2H22 EBIT of $12.5m relative to $6.0m in 2H21.

Management are assuming at least one additional milestone income item of approximately €1m ($1.6m) in 2H22. Other than that the guidance implies extraordinarily strong growth in product sales revenues and royalty income.

FY23/FY24 earnings are modestly reduced to account for the increased R&D expense. FY23 now includes the additional revenues from up to 30 new product launches in Australia and New Zealand. We assume gross profit on product sales (excluding milestone income and royalties) is flat at 44%.

Closing net debt was $32.6m. The company also re-affirmed its view that it would not consider a dividend until net debt is in the range of $25m-$30m. While net debt may reach this level by year end, we have taken a conservative view and delayed the commencement of dividends until FY23. The previous final dividend of 1.0cps in respect of FY22 is reduced to zero.

Price target is increased to $4.80 and we maintain our Hold recommendation.

AFT Pharma

OVERVIEW

AFT develops, licenses and distributes a range of over the counter (OTC) and prescription medicines for sale in Australia, New Zealand and an expanding international market. AFT is not a mainstream drug developer even though a portion of its revenues are earned from the sale of prescription (Rx) medicines. The vast majority of products sold are branded over the counter medicines, hence while these are regulated products, their pricing is not determined by government or private payers.

In most markets in which AFT Pharma products compete, there are multiple brands and quite often AFT products have the same active ingredients as competitors. AFP's branding and product support capability are therefore, equally as import and as the efficacy and quality of its products. In Australia its peer group is more likely to be brand managers including A2 and Blackmores rather than generic medicines.

AFT Pharma was established in 1997 as a privately owned family business of Dr Hartley Atkinson (CEO) and Marree Atkinson (Executive Director). It had several funding rounds during its early years before the IPO in 2015.

Following the recent financing round the Atkinson Trust remains the largest shareholders with 70%.

AFT has a primary listing on the NZX (AFT.NZ) and a secondary listing on the ASX (AFP.ASX).

BUSINESS MODEL

The key points are:

- Core business is the development of in house brands for over the counter medicines;
- Certain products are in-licensed from other developers for the Australia and New Zealand market only;
- The company relies on a series of contract manufacturers in India, China and Australia for its production. It does not have any in house production capability;
- The company is now significantly advanced in the international expansion of its leading brand Maxigesic.

The reliance on outsourced manufacturing in our view is a strength. Many global pharma companies have divested or closed manufacturing capacity over recent years as a result of a large influx of cheap generic medicines that have flooded global markets. AFT is a beneficiary of this trend and it is in a far better position under this model than rather than trying to compete on cost with its own plant.

Key Risks:

Regulatory risk – any change in scheduling of the medicines distributed by the company could result in a material impact to revenues.

Liquidity risk – the free float is 30%. Conversely management are the majority shareholders and share directly in the wealth creation from key decisions.

Intellectual Property – the patents on Maxigesic tablets expire between 2025 – 2028 in key jurisdictions. Following expiry we expect generics of the 500/150mg formulation to emerge. The company is currently working to bring new formulation of Maxigesic to market.

AFT Pharma
as at 18 November 2021

Recommendation	Hold
Price	$4.75
Target (12 months)	$4.80

Table 1 - Financial summary

NZ$m	FY20	FY21	FY22e	FY23e	FY24e
Year Ending 31 March					
Revenue from product sales	**101.4**	**110.7**	**121.6**	**134.1**	**143.2**
Growth	***21.2%***	***9.2%***	***9.8%***	***10.3%***	***6.7%***
COGS	-57.3	-64.4	-68.8	-75.1	-80.2
Gross profit	44.1	46.3	52.8	59.0	63.0
GP Margin	43%	42%	43%	44%	44%
Royalty and license income	4.2	2.3	7.4	2.0	5.0
Total Revenues	105.6	113.0	129.0	136.1	148.2
Selling costs	-26.2	-27.4	-28.0	-28.6	-29.1
Administration costs	-9.1	-7.8	-9.0	-9.5	-9.9
R&D	-2.0	-3.3	-6.0	-6.0	-6.0
D&A	-0.3	0.0	-0.8	-0.8	-0.8
Other expenses	10.5	0.6	0.5	0.5	0.5
EBIT - reported	21.2	10.7	16.9	16.7	22.6
Add back D&A	0.3	0.0	0.8	0.8	0.8
EBITDA	21.5	10.7	17.7	17.5	23.4
Interest expense	-8.3	-2.8	-2.2	-2.0	-1.8
Other items	-0.1	-0.1	0.0	0.0	0.0
Pre tax profit	12.8	7.9	14.7	14.8	20.8
Tax expense	-0.2	-0.1	0.0	0.0	0.0
NPAT- reported	**12.6**	**7.8**	**14.7**	**14.8**	**20.8**
Add back					
Non recurring items net of tax	(9.8)	-	-	-	-
Adjusted NPAT	2.8	7.8	14.7	14.8	20.8

Cashflow (NZ$m)	FY20	FY21	FY22e	FY23e	FY24e
EBITDA	22.3	11.8	17.7	17.5	23.4
Working capital adjustment	-7.4	-10.8	-4.2	-1.1	-0.7
Gross cashflow	**14.9**	**1.0**	**13.5**	**16.4**	**22.7**
Net interest	-6.4	-3.5	-2.2	-2.0	-1.8
Income tax paid	-0.2	-0.2	0.0	0.0	0.0
Operating cash flow	8.3	-2.7	11.3	14.4	20.9
Maintenance capex	-0.1	-0.1	-0.1	-0.1	-0.1
Capitalised R&D	-6.5	-6.1	-6.0	-6.0	-6.0
Free cash flow	1.7	-8.9	5.2	8.3	14.8
Proceeds from issuance	0.0	0.0	0.0	0.0	0.0
Movement in borrowings	-2.6	-5.5	-0.4	-5.0	0.0
Dividend paid on preference shares	-0.6	-0.2	0.0	0.0	0.0
Dvidends paid (common stock)	0.0	0.0	0.0	-1.0	-3.0
Change in cash held	-1.5	-14.6	4.8	2.3	11.9
Cash at beginning of period	6.9	6.1	3.2	8.0	10.3
FX adjustment	0.0	0.0	0.0	0.0	0.0
Cash at year end	**6.1**	**3.2**	**8.0**	**10.3**	**22.2**

Balance Sheet (NZ$m)	FY20	FY21	FY22e	FY23e	FY24e
Cash	6.1	3.2	8.0	10.3	22.2
Receivables	22.6	31.0	33.8	37.3	39.8
Other current assets	3.8	-	4.0	4.2	4.2
Inventory	22.7	33.7	31.0	30.0	30.0
Property, Plant and Equipment	0.3	0.3	0.4	0.5	0.6
Intangibles	27.0	32.7	37.9	43.1	48.3
Right of use assets	3.7	3.5	2.8	2.1	1.4
Other non current assets	0.7	0.7	0.8	0.8	0.8
Total assets	86.9	105.1	118.7	128.3	147.2
Trade payables	18.3	21.3	21.5	22.8	23.6
Other liabilities	4.2	5.0	5.3	5.6	5.9
Debt	43.3	38.4	38.0	33.0	33.0
Lease liabilities	4.0	3.8	2.5	1.8	1.8
Total Liabilities	69.8	68.5	67.3	63.2	64.3
Net Assets	17.1	36.6	51.4	65.1	83.0
Share capital	63.7	77.2	77.2	77.2	77.2
Other equity	1.7	-	-	-	-
Retained earnings	(49.3)	(41.3)	(26.6)	(12.9)	5.0
Reserves	0.9	0.7	0.8	0.8	0.8
Shareholders Equity	17.1	36.6	51.4	65.1	83.0

Valuation Ratios	FY20	FY21	FY22e	FY23e	FY24e
Reported EPS (cps)	12.9	7.5	14.1	14.2	20.1
Normalised EPS (cps)	2.9	7.5	14.1	14.2	20.1
EPS growth (%)	na	163%	88%	1%	41%
Free cash flow per share	1.7	-8.6	5.0	8.0	14.3
Growth	na	-596%	-158%	60%	78%
PE(x)	**175.6**	**66.8**	**35.5**	**35.3**	**25.0**
EV/EBIT (x)	25.3	50.0	31.7	32.0	23.6
P/NTA (x) -	49	134	39	24	15
Book Value Per Share (cps)	17.5	35.3	49.6	62.8	80.0
Price/Book (x)	29	14	1,014	800	628
DPS (cps)	-	-	-	2.8	4.0
Payout ratio %	0%	0%	0%	20%	20%
Dividend Yield %	0.0%	0.0%	0.0%	0.6%	0.8%
Franking %	0%	0%	0%	0%	0%
FCF yield %	0%	-2%	1%	2%	3%
Net debt/Equity	218%	96%	58%	35%	13%
Net debt/Assets	43%	33%	25%	18%	7%
Gearing	69%	49%	37%	26%	12%
Net debt/EBITDA (x)	1.7	3.0	1.7	1.3	0.5
Interest cover (x)	2.6	3.8	7.7	8.6	12.5

	FY20	FY21	FY22e	FY23e	FY24e
Revenues Analysis					
Sale of goods					
Australia	61.5	68.3	75.0	82.0	88.6
New Zealand	30.1	30.5	35.1	36.8	38.7
Asia	4.9	4.4	4.5	6.3	6.9
ROW	4.9	7.5	7.0	9.0	9.0
Total Sales of good	**101.4**	**110.7**	**121.6**	**134.1**	**143.2**
Royalties	0.4	0.2	0.6	1.0	2.0
License fees - milestones	3.8	2.1	2.0	0.5	3.0
License fees - one offs	-	-	4.8	0.5	-
Total Revenues	**105.6**	**113.0**	**129.0**	**136.1**	**148.2**

Interim Results	1H21	2H21	1H22	2H22e
Revenues	48.8	64.2	55.5	73.5
EBIT	2.8	6.0	5.5	11.4
NPAT	1.6	4.3	4.2	10.3

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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