

# AFT Pharmaceuticals

## Guidance Lowered; COVID Side Effects Linger

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## RESEARCH INSIGHTS

AFT Pharmaceuticals (AFT) materially downgraded its FY21 EBIT guidance, primarily due to short-term COVID-19 related headwinds continuing for longer than envisaged, not helped by the cycling of a strong 4Q20 given stockpiling tailwinds. AFT is pursuing a multitude of growth avenues, and continues to make steady (albeit slow) progress with new agreements globally for its products, however, COVID-19 challenges means the growth path will take longer than expected. Progress on further new licensing agreements, particularly larger markets, remains a key near-term milestone and focus for us.

NZX Code	AFT	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$4.38	NPAT* (NZ\$m)	2.8	5.8	15.2	23.9	PE	n/a	78.9	30.2	19.2
Issued shares	103.6m	EPS* (NZc)	2.9	5.6	14.5	22.9	EV/EBIT	43.1	48.8	21.8	14.4
Market cap	NZ\$454m	EPS growth* (%)	n/a	92.4	n/a	57.4	EV/EBITDA	39.3	43.5	20.6	13.8
Avg daily turnover	93.3k (NZ\$423k)	DPS (NZc)	0.0	0.0	0.0	7.0	Price / NTA	n/a	n/a	n/a	21.9
		Imputation (%)	0	0	0	0	Cash div yld (%)	0.0	0.0	0.0	1.6
		*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	1.6

### Key changes

- **Earnings revisions:** EBIT downgraded -30% in FY21E, in line with guidance. Changes more moderate thereafter (-5% to -6%).

### Revised FY21 guidance

AFT materially downgraded its FY21 guidance to EBIT of NZ\$9–11m (previously NZ\$14–18m). This implies an earnings decline of -4% to -20% YoY due to gross margin pressure and weaker revenue growth than anticipated. Revenue guidance is ~NZ\$110m, up +4% YoY. Key challenges appear largely temporary, including (1) delays to licensing agreement negotiations given travel restrictions, (2) several Maxigesic launches taking longer given production and shipping disruption, (3) delayed regulatory audits of production facilities impacting the launch of new products in Australia, (4) material gross margin headwinds from FX, freight costs & product mix.

### Where to from here?

There is a high margin of error in near-term earnings forecasts, not helped by the volatile backdrop, low external visibility and operating leverage. Nonetheless, the majority of challenges currently being faced appear temporary and should mean the growth path (particularly new agreements/product launches) takes longer than expected, rather than changing the opportunity. We are assuming a more 'normal' backdrop from FY22E and expect to see further progress with new International agreements in the near-term, which help to expand the addressable market. With the range of justifiable long-term outcomes wide, we expect AFT's share price to be driven by news flow in the near-term.

**Figure 1. Implied 2H21E using revised guidance**

	1H20	2H20	1H21	2H21E Low	2H21E High
Revenue	46.9	58.7	48.8	61.2	61.2
% growth	22%	26%	4%	4%	4%
EBIT	2.3	9.1	2.4	6.6	8.6
% growth	873%	42%	6%	-28%	-6%
EBIT margin	4.9%	15.5%	5.0%	10.8%	14.0%

Source: Forsyth Barr analysis, Company reports

**Figure 2. Spot DCF highly sensitive to NOPAT growth**

		0.5%	1.0%	1.5%	2.0%	2.5%
	1.5%	3.53	3.70	3.90	4.14	4.43
Growth	2.5%	3.73	3.91	4.13	4.38	4.69
FY23E	3.5%	3.93	4.13	4.36	4.63	4.96
to FY30E	4.5%	4.15	4.36	4.60	4.90	5.24
	5.5%	4.37	4.60	4.86	5.17	5.55

Source: Forsyth Barr analysis

## AFT Pharmaceuticals (AFT)

Priced as at 05 Apr 2021 (NZ\$)

4.38

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Our earnings and cashflow forecasts, together with key valuation and ratios provided on this page should assist investors in determining the relative valuation merits of the company.

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	85.1	105.6	110.6	135.3	161.9	EV/EBITDA (x)	69.5	39.3	43.5	20.6	13.8
<b>Normalised EBITDA</b>	<b>7.0</b>	<b>12.5</b>	<b>11.4</b>	<b>23.9</b>	<b>35.6</b>	EV/EBIT (x)	72.8	43.1	48.8	21.8	14.4
Depreciation and amortisation	(0.3)	(1.1)	(1.2)	(1.3)	(1.4)	PE (x)	n/a	>100x	78.9	30.2	19.2
<b>Normalised EBIT</b>	<b>6.6</b>	<b>11.4</b>	<b>10.1</b>	<b>22.6</b>	<b>34.2</b>	Price/NTA (x)	n/a	n/a	>100x	57.9	21.9
Net interest	(8.4)	(8.3)	(3.3)	(2.6)	(1.5)	Free cash flow yield (%)	-1.3	0.5	-2.0	2.0	3.8
Associate income	(0.5)	(0.1)	0	0	0	Net dividend yield (%)	0.0	0.0	0.0	0.0	1.6
Tax	(0.2)	(0.2)	(1.0)	(4.8)	(8.8)	Gross dividend yield (%)	0.0	0.0	0.0	0.0	1.6
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>(2.4)</b>	<b>2.8</b>	<b>5.8</b>	<b>15.2</b>	<b>23.9</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	0	9.8	0	0	0	Interest cover EBIT (x)	0.8	1.4	3.0	8.7	23.5
<b>Reported NPAT</b>	<b>(2.4)</b>	<b>12.6</b>	<b>5.8</b>	<b>15.2</b>	<b>23.9</b>	Interest cover EBITDA (x)	0.8	1.5	3.4	9.2	24.4
Normalised EPS (cps)	(2.5)	2.9	5.6	14.5	22.9	Net debt/ND+E (%)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	0	0	0	0	7.0	Net debt/EBITDA (x)	5.0	3.0	3.1	1.1	0.4
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	4.9	24.0	4.8	22.3	19.7	Return on assets (%)	10.4	13.1	9.8	20.2	28.1
EBITDA (%)	n/a	79.7	-9.2	>100	49.1	Return on equity (%)	-47.7	16.3	16.6	30.5	34.1
EBIT (%)	n/a	71.8	-11.3	>100	51.6	Return on funds employed (%)	22.7	21.7	13.1	22.7	30.8
Normalised NPAT (%)	n/a	n/a	>100	>100	57.4	EBITDA margin (%)	8.2	11.8	10.3	17.6	22.0
Normalised EPS (%)	n/a	n/a	92.4	>100	57.4	EBIT margin (%)	7.8	10.8	9.1	16.7	21.1
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	4.1	6.2	7.3	6.0	5.0
						Capex to depreciation (%)	3,013	806	1,088	1,189	1,297
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	0	0	0	0	0
<b>EBITDA</b>	<b>7.0</b>	<b>12.5</b>	<b>11.4</b>	<b>23.9</b>	<b>35.6</b>	Pay-out ratio (%)	0	0	0	0	31
Working capital change	(4.7)	1.0	(8.1)	0.6	0.1						
Interest & tax paid	(3.7)	(6.1)	(4.4)	(7.4)	(10.3)	<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Other	(1.1)	1.6	0	0	0	Revenue breakdown					
<b>Operating cash flow</b>	<b>(2.5)</b>	<b>9.0</b>	<b>(1.1)</b>	<b>17.1</b>	<b>25.3</b>	Australia	50.3	61.4	66.6	80.6	89.9
Capital expenditure	(3.5)	(6.6)	(8.1)	(8.1)	(8.1)	New Zealand	26.8	30.1	30.6	32.1	33.1
(Acquisitions)/divestments	(1.4)	0	0	0	0	SE Asia	2.1	4.9	4.2	4.6	5.1
Other	0	(0.5)	(0.3)	(0.3)	(0.3)	Rest of World	5.9	9.1	9.2	17.9	33.8
<b>Funding available/(required)</b>	<b>(7.4)</b>	<b>1.9</b>	<b>(9.6)</b>	<b>8.7</b>	<b>16.9</b>	<b>Total revenue</b>	<b>85.1</b>	<b>105.6</b>	<b>110.6</b>	<b>135.3</b>	<b>161.9</b>
Dividends paid	(0.1)	(0.6)	0	0	(3.7)	incl license income of	1.2	3.8	1.8	2.0	2.0
Equity raised/(returned)	0	0	11.6	0	0						
<b>(Increase)/decrease in net debt</b>	<b>(7.5)</b>	<b>1.3</b>	<b>2.0</b>	<b>8.7</b>	<b>13.2</b>	Gross profit	40.7	48.3	47.5	61.3	74.2
						Gross margin (%)	47.8	45.7	43.0	45.3	45.8
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Other income	2.2	0.5	0.1	0.1	0.1
Working capital	29.2	30.4	38.5	37.9	37.9						
Fixed assets	0.4	0.3	0.3	0.3	0.3	<b>Expenses breakdown</b>					
Intangibles	8.2	27.0	34.5	41.9	49.2	Selling & distribution	(26.5)	(26.2)	(25.4)	(26.2)	(27.0)
Right of use asset	0	3.7	3.3	3.0	2.7	General & admin costs	(7.2)	(9.1)	(8.7)	(9.2)	(9.6)
Other assets	3.7	1.2	1.2	1.2	1.2	R&D expenses	(2.6)	(2.0)	(3.5)	(3.5)	(3.5)
<b>Total funds employed</b>	<b>41.6</b>	<b>62.6</b>	<b>77.9</b>	<b>84.3</b>	<b>91.3</b>	Total SG&A	(36.3)	(37.3)	(37.6)	(38.9)	(40.1)
Net debt/(cash)	34.8	37.1	35.1	26.4	13.2						
Lease liability	0	4.0	3.9	3.9	3.8	<b>Underlying EBIT</b>	<b>6.6</b>	<b>11.5</b>	<b>10.1</b>	<b>22.6</b>	<b>34.2</b>
Other liabilities	1.7	4.3	4.3	4.3	4.3	EBIT excl all license income	5.4	7.6	8.8	20.6	32.2
Shareholder's funds	5.1	17.3	34.6	49.8	70.0						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>41.6</b>	<b>62.6</b>	<b>77.9</b>	<b>84.3</b>	<b>91.3</b>						

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

## Earnings revisions

We materially downgrade our FY21E earnings expectations with more moderate changes thereafter, summarised in Figure 3.

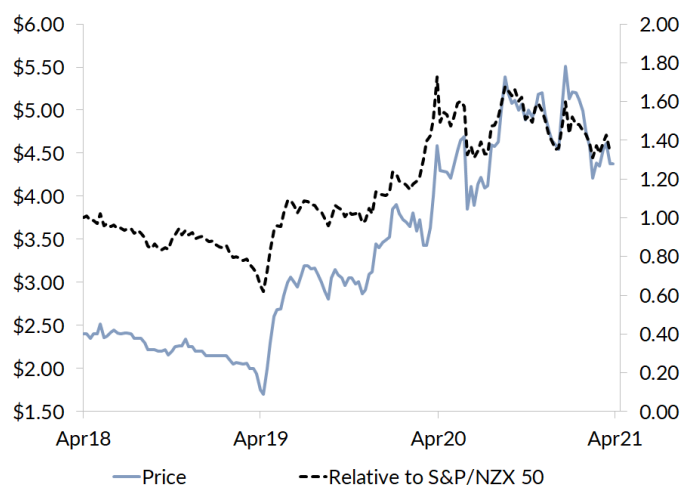
Key changes include:

- Lower growth assumptions in Australia and International. We assume this is largely temporary, with a recovery in FY22E in Australia and steady recovery over FY22/23E for International.
- Small adjustments to FX.
- Lower license income in FY21E as new agreements have taken longer than anticipated. Given minimal associated cost, license income largely flows straight through to bottom-line profit.
- Gross margin pressure in FY21E reflecting; (1) unfavourable FX movements, (2) freight cost escalation (including using more air freight), and (3) a small change in product mix.

**Figure 3. Earnings revisions (NZ\$m)**

	FY20A Actual	Old	FY21E New	chg	Old	FY22E New	chg	Old	FY23E New	chg
Revenue	105.6	116.0	110.6	-4.6%	139.2	135.3	-2.8%	168.6	161.9	-4.0%
<b>EBIT</b>	<b>11.4</b>	<b>14.4</b>	<b>10.1</b>	<b>-29.7%</b>	<b>23.9</b>	<b>22.6</b>	<b>-5.4%</b>	<b>36.3</b>	<b>34.2</b>	<b>-5.9%</b>
Underlying NPAT	2.8	9.6	5.8	-39.8%	16.6	15.2	-8.4%	26.0	23.9	-8.1%
Underlying EPS (cps)	2.9	9.2	5.6	-39.8%	15.9	14.5	-8.4%	24.9	22.9	-8.1%
DPS (cps)	0.0	0.0	0.0	n/a	0.0	0.0	n/a	7.0	7.0	0.0%

Source: Forsyth Barr analysis

**Figure 4. Price performance**


Source: Forsyth Barr analysis

**Figure 5. Substantial shareholders**

Shareholder	Latest Holding
Atkinson Family Trust	69.8%

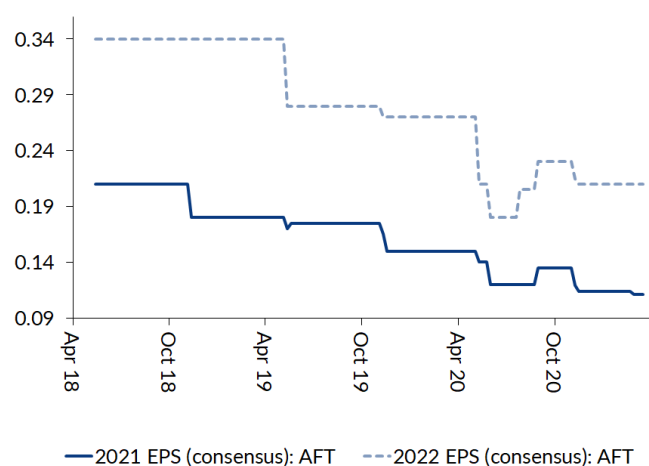
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 6. International valuation comparisons**

Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash Yld
(metrics re-weighted to reflect AFT's balance date - March)							
AFT Pharmaceuticals	AFT NZ	NZ\$4.38	NZ\$454	>75x	30.2x	43.2x	0.0%
PROBIOTEC	PBP AT	A\$2.15	A\$169	20.9x	9.8x	10.9x	4.2%
GLAXOSMITHKLINE PLC	GSK LN	£12.88	£64,800	11.5x	12.4x	8.5x	5.9%
SANOFI	SAN FP	€84.25	€106,068	9.8x	13.3x	7.2x	4.0%
PFIZER INC	PFE US	US\$36.37	US\$202,878	18.5x	11.3x	15.5x	4.3%
JOHNSON & JOHNSON	JNJ US	US\$165.14	US\$434,765	26.5x	17.0x	15.7x	2.6%
BAYER AG-REG	BAYN GR	€53.98	€53,031	<0x	9.2x	<0x	3.7%
ROCHE HOLDING AG-GENUSSCHEIN	RHHVF US	CHF336.55	CHF282,017	n/a	17.1x	12.2x	2.8%
MERCK & CO. INC.	MRK US	US\$77.48	US\$196,049	23.8x	11.6x	16.5x	3.4%
Compc Average:				18.5x	12.7x	12.3x	3.9%
AFT Relative:				n/a	137%	250%	-100%

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (AFT) companies fiscal year end

**Figure 7. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

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