FORSYTH BARR

EBOS Group

NEUTRAL

FY19 Preview — Looking to the Next Chemist

We expect a continuation of recent trends when EBOS Group (EBO) reports its FY19 result on 22 August, with strong growth in Animal Care, albeit a more modest result in Healthcare. Our main focus is the transition of Chemist Warehouse (CW) volumes, set to support a step-up in earnings from FY20. Other focus areas are (1) M&A update, (2) operating cashflow, and (3) industry backdrop / outlook (particularly for Community Pharmacy). We forecast FY19 EBITDA growth of +4% to A$261m.

Key points of interest

- **Guidance:** EBO's guidance is typically opaque but any additional colour is of interest. Latest guidance is for "underlying earnings growth in FY19 with further growth into FY20".
- **CW transition:** EBO commenced its supply contract with CW on 1 July 2019. We look for any updated insight on: earnings potential, cost implication of the transition and the well signalled working capital investment in 4Q19 (inventory build +A$100m, less any supplier coverage).
- **Pharmacy backdrop:** Currently topical given the material change underway in Australia — with the CW contract changing hands and as negotiations commence for the next five year Community Pharmacy Agreement (due to roll-over 1 July 2020). We look for any update on how EBO views the landscape and areas of opportunity/risk.
- **Animal Care:** We expect another strong result, continuing recent trends, primarily driven by branded products — a favourable mix for margins. Any outlook insights and trajectory in brands will be areas of interest.
- **Cash conversion:** A key focus and strength of EBO. 1H19 disappointed and we look for a more encouraging underlying result in 2H19, although this will likely be masked by working capital investment for CW.
- **M&A update:** Following EBO's recent capital raise (and adjusting for CW) we estimate current headroom of up to A$300m.

Conference call — 11:30am NZ time on 22 August

Dial in details are 0800 667 018 for New Zealand (1800 148 258 for Australia); conference ID is **8167707**.

Figure 1. FY19 result preview

A$m	FY18	FY19E	% chg	Consensus
Revenue	6,987	6,938	-0.7%	6,997
EBITDA	250	261	4.2%	256
Underlying NPAT	137	142	3.4%	141
Underlying EPS (A cps)	90.4	92.6	2.5%	91.8
Final dividend (NZ cps)	35.5	36.5	3.6%	32.6

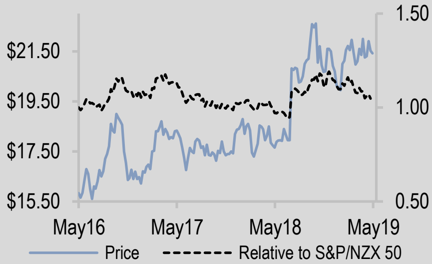
Source: Forsyth Barr analysis, Company reports

Investment View

EBO is the largest Australasian wholesaler and distributor of healthcare, medical and pharmaceutical products, while also managing a brand portfolio and Animal Care business. Valuation metrics seem fair in light of a modest underlying growth outlook, with upside reliant on M&A. NEUTRAL.

NZX Code	EBO
Share price	NZ$21.42
Target price	NZ$21.00
Risk rating	Medium
Issued shares	159.6m
Market cap	NZ$3,419m
Average daily turnover	63.3k (NZ$1,313k)

Share Price Performance



Financials: June	18A	19E	20E	21E
NPAT* (NZ$m)	149.6	146.8	189.0	198.9
EPS* (NZc)	98.5	95.9	117.9	124.1
EPS growth* (%)	7.8	-2.6	23.0	5.2
DPS (NZc)	68.5	71.0	84.0	88.5
Imputation (%)	25	25	25	25

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	14.2	13.7	11.6	11.2
EV/EBIT	16.2	15.6	13.2	12.7
PE	21.8	22.3	18.2	17.3
Price / NTA	n/a	17.8	10.6	7.3
Cash dividend yield (%)	3.2	3.3	3.9	4.1
Gross dividend yield (%)	3.5	3.6	4.3	4.5

*Historic and forecast numbers based on underlying profits

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Ebos Group Ltd (EBO) Priced as at 30 Apr 2019: NZ$21.42

June year end

Forsyth Barr valuation			
Valuation methodology		Weighted DCF and multiple approach	
12-month target price (NZ$)*	**21.00**	**Spot valuations (NZ$)**	
Expected share price return	-2.0%	1. DCF	20.05
Net dividend yield	3.8%	2. Multiple approach	18.40
Estimated 12-month return	1.9%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.75%	Total firm value	3,632
Equity beta	0.91	(Net debt)/cash	(321)
WACC	9.1%	Value of equity	3,311
Terminal growth	1.5%	Shares (m)	160

Profit and Loss Account (A$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Sales revenue	7,203	6,987	6,938	8,159	8,401
Normalised EBITDA	**228**	**250**	**261**	**305**	**315**
Depreciation and amortisation	(24)	(32)	(33)	(36)	(37)
Normalised EBIT	**204**	**218**	**228**	**269**	**278**
Net interest	(18)	(21)	(25)	(20)	(17)
Associate income	-	-	-	-	-
Tax	(54)	(58)	(59)	(72)	(76)
Minority interests	(0)	2	2	2	3
Normalised NPAT	**131**	**137**	**142**	**174**	**183**
Abnormals/other	(7)	-	(7)	-	-
Reported NPAT	**126**	**137**	**135**	**174**	**183**
Normalised EPS (cps)	86.3	90.4	92.6	108.7	114.2
DPS (NZ cps)	63.0	68.5	71.0	84.0	88.5

Growth Rates	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue (%)	10.1	-3.0	-0.7	17.6	3.0
EBITDA (%)	9.9	9.6	4.2	17.1	3.3
EBIT (%)	10.2	7.1	4.3	18.3	3.4
Normalised NPAT (%)	11.9	4.9	3.4	22.7	5.1
Normalised EPS (%)	11.4	4.8	2.5	17.3	5.1
DPS (%)	7.7	8.7	3.6	18.3	5.4

Cash Flow (A$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EBITDA	**228**	**250**	**261**	**305**	**315**
Working capital change	(6)	(7)	(123)	(38)	(25)
Interest & tax paid	(80)	(81)	(83)	(93)	(93)
Other	(7)	-	(7)	-	-
Operating cash flow	**136**	**162**	**48**	**174**	**198**
Capital expenditure	(36)	(58)	(25)	(25)	(25)
(Acquisitions)/divestments	(175)	(31)	(92)	-	-
Other	-	-	-	-	-
Funding available/(required)	**(74)**	**73**	**(70)**	**149**	**173**
Dividends paid	(88)	(92)	(102)	(126)	(130)
Equity raised/(returned)	-	-	140	-	-
Increase/(decrease) in net debt	**162**	**19**	**32**	**(24)**	**(44)**

Balance Sheet (A$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Working capital	278	282	405	443	468
Fixed assets	110	112	166	172	177
Intangibles	1,130	1,074	1,105	1,088	1,071
Other assets	104	164	164	164	164
Total funds employed	**1,622**	**1,632**	**1,839**	**1,867**	**1,879**
Net debt/(cash)	411	432	414	328	223
Other non current liabilities	122	127	127	127	127
Shareholder's funds	1,070	1,051	1,274	1,386	1,501
Minority interests	19	21	24	26	29
Total funding sources	**1,622**	**1,632**	**1,839**	**1,867**	**1,879**

Valuation Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EV/EBITDA (x)	15.5	14.2	13.7	11.6	11.2
EV/EBIT (x)	17.3	16.2	15.6	13.2	12.7
PE (x)	23.5	21.8	22.3	18.2	17.3
Price/NTA (x)	n/a	n/a	17.8	10.6	7.3
Free cash flow yield (%)	3.1	3.3	0.7	4.7	5.5
Net dividend yield (%)	2.9	3.2	3.3	3.9	4.1
Gross dividend yield (%)	3.2	3.5	3.6	4.3	4.5
Imputation (%)	25	25	25	25	25
Pay-out ratio (%)	69	70	74	71	71

Capital Structure	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Interest cover EBIT (x)	11.3	10.4	9.3	13.1	16.4
Interest cover EBITDA (x)	12.7	12.0	10.6	14.9	18.6
Net debt/ND+E (%)	27.7	29.1	24.5	19.1	12.9
Net debt/EBITDA (x)	1.8	1.7	1.6	1.1	0.7

Key Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Return on assets (%)	6.7	7.4	7.1	8.0	8.2
Return on equity (%)	12.2	13.1	11.1	12.6	12.2
Return on funds employed (%)	11.0	10.7	10.5	11.4	11.6
EBITDA margin (%)	3.2	3.6	3.8	3.7	3.8
EBIT margin (%)	2.8	3.1	3.3	3.3	3.3
Capex to sales (%)	0.5	0.8	0.4	0.3	0.3
Capex to depreciation (%)	275	358	147	128	125

Key assumptions	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Divisional revenue (A$m)					
Healthcare	6,803	6,609	6,545	7,745	7,964
Animal Care	400	378	393	414	436
Other	0	0	0	0	0
Total revenue	**7,203**	**6,987**	**6,938**	**8,159**	**8,401**
Divisional EBITDA (A$m)					
Healthcare	197	217	223	264	272
Animal Care	42	46	50	54	57
Corporate / Other	(11)	(12)	(13)	(13)	(14)
Total EBITDA	**228**	**250**	**261**	**305**	**315**
EBITDA margins (%)					
Healthcare	2.9	3.3	3.4	3.4	3.4
Animal Care	10.6	12.1	12.8	13.0	13.1
Total EBITDA margin	**3.2**	**3.6**	**3.8**	**3.7**	**3.8**
Key Healthcare segment revenue (A$m)					
Community Pharmacy	3,950	3,871	3,677	4,766	4,871
Institutional Healthcare	2,347	2,251	2,268	2,347	2,429
Contract Logistics	458	443	481	505	530
Consumer Products	100	109	119	127	134
Revenue growth (%)					
Community Pharmacy	9.8	-2.0	-5.0	29.6	2.2
Institutional Healthcare	14.0	-4.1	0.8	3.5	3.5
Contract Logistics	0.4	-3.1	8.5	5.0	5.0
Consumer Products	25.1	9.0	9.5	7.0	5.0
Animal Care	4.7	-5.4	3.9	5.3	5.5
Group revenue growth	**10.1**	**-3.0**	**-0.7**	**17.6**	**3.0**

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

FY19 preview tables

Figure 2. FY19E result preview in more detail

A$m	FY18	FY19E	% chg
Total revenue	6,986.8	6,937.5	-0.7%
Operating expenses	(6,736.7)	(6,676.9)	-0.9%
Total EBITDA	**250.1**	**260.6**	**4.2%**
Depreciation	16.2	17.0	4.9%
Amortisation	15.7	16.0	1.9%
EBIT	**218.2**	**227.6**	**4.3%**
Net Interest	(20.9)	(24.5)	17.2%
Net profit before tax	**197.3**	**203.1**	**2.9%**
Tax	(58.0)	(58.9)	1.6%
Net profit after tax	**139.3**	**144.2**	**3.5%**
Minorities	(2.0)	(2.3)	15.0%
Abnormals	0.0	(6.7)	n/a
Reported profit	**137.3**	**135.3**	**-1.5%**
Underlying profit	**137.3**	**141.9**	**3.4%**
Underlying EPS (A cps)	90.4	92.6	2.5%
Dividend (NZ cps)	68.5	71.0	3.6%

Divisional Breakdown	FY18	FY19E	% chg
External revenue			
Healthcare	6,609	6,545	-1.0%
Animal Care	378	393	3.9%
Total revenue	**6,987**	**6,938**	**-0.7%**
EBITDA			
Healthcare	217	223	3.0%
Animal Care	46	50	10.1%
Corporate costs	(12)	(13)	5.0%
Total EBITDA	**250**	**261**	**4.2%**
EBITDA margin			
Healthcare	3.3%	3.4%	13bp
Animal Care	12.1%	12.8%	72bp

Source: Forsyth Barr analysis, Company reports

Investment summary

EBOS Group (EBO) is the largest diversified Australasian marketer, wholesaler and distributor of healthcare, medical and pharmaceutical products, and a leading Australasian animal care products distributor. Its core competency is specialised healthcare logistics. EBO is best-in-class with higher margins, superior working capital management and a more diversified earnings profile than its listed peers. We see EBO as fairly valued and our rating is NEUTRAL. The key area of optionality is M&A which has been an area of value accretion over history.

Business quality

- **Industry leader:** A well-run business in a challenging industry. EBO is a best in class operator and is the market leader across many complementary segments. Its portfolio approach and diversified model is superior to its listed peers.
- **Capital discipline:** Adept working capital management and a strong ROIC focus to any investment of capital (organic / acquisitions) is a strength.
- **Limited divisional financial disclosure:** This makes underlying organic growth trends more difficult to interpret. We note disclosure has improved.

Earnings and cashflow outlook

- **Underlying growth:** Modest without acquisitions, although the addition of Chemist Warehouse (CW) from FY20 will likely improve the growth trajectory.
- **M&A:** Has been a key feature through history and not captured in a DCF. EBO is disciplined on hurdle rates, with a longstanding target ROCE in excess of 15%.

Financial structure

- **Gearing:** EBO targets a long term net debt to EBITDA range of 1.7–2.3x. Adjusting for CW, we estimate balance sheet headroom of up to c.A$300m which provides runway for small to mid-size bolt-on acquisitions.

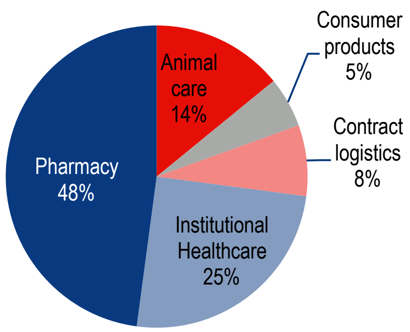
Risk factors

- **Regulatory change:** EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. Any change can impact EBO given its role in the supply chain.
- **Suppliers opting for a direct distribution model:** This could result in a loss of scale for wholesalers, undermining the economics of the channel. Direct distribution is a risk to wholesalers, albeit history suggests the economics are not compelling for broader adoption by manufacturers.

Company description

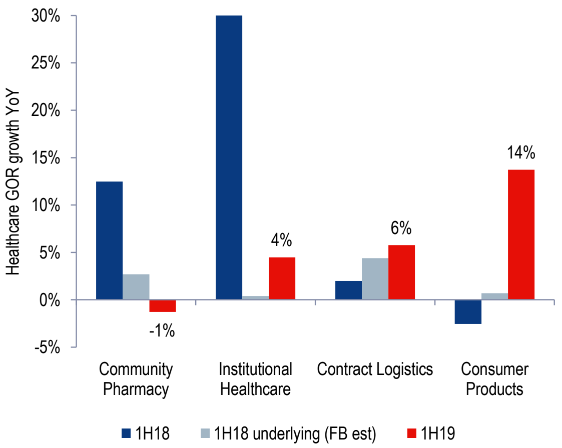
EBO is involved in the healthcare products supply industry in both New Zealand and Australia. Following a large number of acquisitions, EBO has evolved into an Australasian integrated healthcare supply chain business. It is the largest diversified wholesaler, marketer, and distributor of healthcare, medical and pharmaceutical products in Australasia. EBO is also a leading Australasian animal care products distributor. Two key acquisitions in its history are Masterpet (2011), a leading Australasian distributor of premium pet foods and accessories and Symbion (2013), an Australian pharmaceutical wholesaler and distributor.

Figure 1. Gross operating revenue breakdown — FY18



Source: Company reports, Forsyth Barr analysis

Figure 2. Healthcare segmental growth



Source: Company reports, Forsyth Barr analysis

Figure 3. Substantial Shareholders

Shareholder	Latest Holding
The Zuellig Group	40.0%
FMR	9.1%

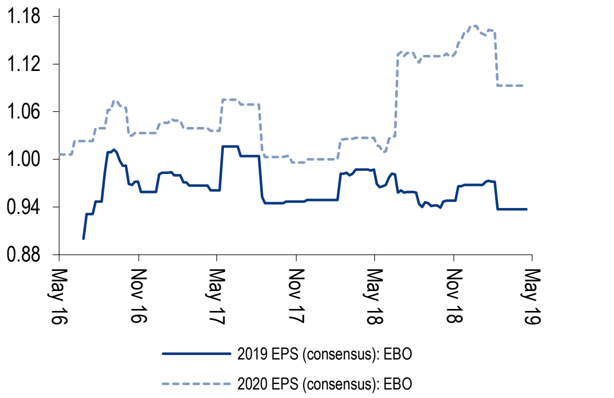
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 4. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect EBO's balance date - June)			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
EBOS Group	**EBO NZ**	**NZ$21.42**	**NZ$3,419**	**22.3x**	**18.2x**	**13.7x**	**11.7x**	**15.7x**	**13.3x**	**3.9%**
Australian Pharmaceutical Industries	API AT	A$1.45	A$714	13.7x	12.9x	8.2x	7.8x	11.0x	10.1x	5.7%
Sigma Healthcare	SIG AT	A$0.53	A$556	17.6x	21.4x	11.8x	13.0x	15.2x	17.3x	4.0%
McKesson Corp	MCK US	US$118.64	US$22,752	8.7x	8.2x	7.5x	7.3x	8.6x	8.4x	1.4%
AmerisourceBergen Corp	ABC US	US$74.51	US$15,734	10.7x	10.4x	8.0x	7.4x	9.8x	8.5x	2.2%
Henry Schein Inc	HSIC US	US$63.38	US$9,488	18.3x	17.8x	12.4x	12.7x	15.2x	15.1x	n/a
Patterson Cos Inc	PDCO US	US$21.72	US$2,068	15.0x	14.0x	10.8x	10.0x	13.1x	12.0x	5.2%
Sinopharm Group Co	1099 HK	CN¥30.50	CN¥90,636	14.6x	13.0x	5.6x	5.1x	6.1x	5.6x	2.3%
			Compco Average:	**14.1x**	**14.0x**	**9.2x**	**9.0x**	**11.3x**	**11.0x**	**3.5%**
EV = Current Market Cap + Actual Net Debt			**EBO Relative:**	**+59%**	**+30%**	**+49%**	**+30%**	**+40%**	**+21%**	**+13%**

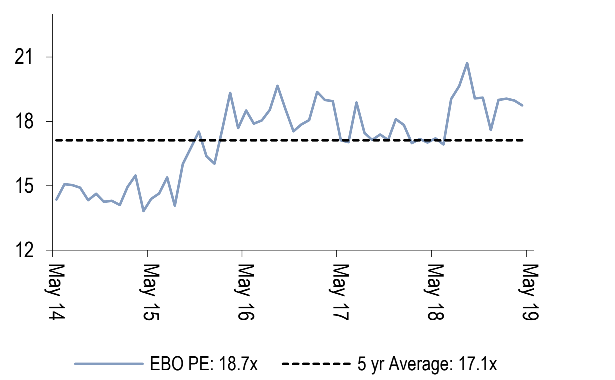
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (EBO) companies fiscal year end

Figure 5. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 6. 12 Month Forward PE



Source: Forsyth Barr analysis