

EBOS Group

NEUTRAL

Sticking to the Script

In consistent EBOS Group (EBO) fashion its Annual Meeting delivered (1) a brief trading update indicating 1Q20 is on budget and (2) another small logical bolt-on acquisition. In the current environment we see EBO as fair value in light of a moderate underlying growth outlook, acknowledging upside potential from balance sheet capacity deployment although we anticipate this is likely piecemeal rather than any step-change. NEUTRAL.

Consistent messages from the ASM — trading in line, another bolt-on

EBO reiterated its qualitative guidance for FY20 and indicated 1Q20 is tracking “in line with expectations”. Our ~+18% revenue growth forecast incorporates +3% underlying, supplemented by the addition of Chemist Warehouse volumes.

EBO has a well signalled and consistent bolt-on acquisitive strategy and the ASM saw another logical small addition to its portfolio (discussed below). Given the recent \$175m capital raise in May we expect further small to mid-sized acquisitions near-term. We estimate balance sheet headroom of ~A\$300m.

Bolt-on acquisition — small first step into medical devices market

EBO announced the acquisition of LMT & National Surgical, a niche established distribution business in the Australasian A\$8bn medical device sector, from its founders (who will remain in the business). The acquisition itself doesn't move the dial in terms of EBO group earnings, albeit we view it as a strategically sensible addition as a base for entry into an adjacency. Key features:

- **Undemanding multiple:** EBO disclosed an acquisition price of A\$34m and revenue of A\$40m for LMT & National Surgical. We estimate EBITDA of ~A\$4-5m implying an EV/EBITDA of 7-8x, well below EBO (~13x) and recent (substantially larger) M&A target in the sector, Device Technologies (est. ~11x). It is anticipated to meet EBO's hurdle rate (15% return) within two years which suggests solid short-term growth expectations.
- **Well signalled area of interest in what we view as a natural adjacency:** LMT & National Surgical provides an (small) entry point into Medical Devices distribution which we expect EBO will look to leverage further through both organic means and other bolt-on acquisitions in due course. Industry growth is attractive (we estimate c. +5%) and it also adds another category to its offering when in discussions with suppliers and customers.
- **Small bolt-on private business acquisitions have been a key area of success historically.** The most notable example being BlackHawk, which has seen substantial benefits from EBO's network and capital resources.

Industry insights — Hospital trumps Pharmacy

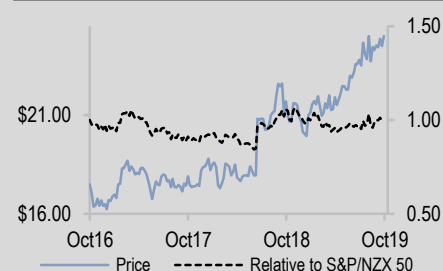
EBO's ASM commentary and recent industry anecdotes continue to reinforce the stronger growth dynamic in the Hospital channel, while Community Pharmacy remains under pressure. This reflects pricing reforms and a competitive backdrop in Pharmacy, coupled with the skew of new products and high-end drugs towards the Hospital channel. EBO's broad portfolio means it is well positioned, particularly versus its peers, although we assume lower margins in the Hospital channel relative to Pharmacy. This dynamic is already reflected in our EBO forecasts.

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\$25.00
Target price	NZ\$24.00
Risk rating	Medium
Issued shares	152.5m
Market cap	NZ\$3,813m
Average daily turnover	74.3k (NZ\$1,660k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	147.0	182.5	191.3	203.9
EPS* (NZc)	96.4	112.9	118.3	126.1
EPS growth* (%)	-2.1	17.1	4.8	6.6
DPS (NZc)	71.5	84.0	89.0	88.0
Imputation (%)	25	25	25	25

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	15.1	13.0	12.6	12.0
EV/EBIT	17.3	14.8	14.3	13.7
PE	25.9	22.2	21.1	19.8
Price / NTA	28.6	20.4	15.3	n/a
Cash dividend yield (%)	2.9	3.4	3.6	3.5
Gross dividend yield (%)	3.1	3.7	3.9	3.9

*Historic and forecast numbers based on underlying profits

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Ebos Group Ltd (EBO)		Priced as at 15 Oct 2019: NZ\$25.00					June year end				
Forsyth Barr valuation						Valuation Ratios					
Valuation methodology						Weighted DCF and multiple approach					
12-month target price (NZ\$)*						24.00					
Expected share price return						-4.0%					
Net dividend yield						3.4%					
Estimated 12-month return						-0.6%					
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						2.00%					
Equity beta						0.91					
WACC						8.3%					
Terminal growth						1.5%					
Total firm value						3,839					
(Net debt)/cash						(389)					
Value of equity						3,450					
Shares (m)						153					
Profit and Loss Account (A\$m)						Capital Structure					
Sales revenue						2018A 2019A 2020E 2021E 2022E					
Normalised EBITDA						250 262 302 313 327					
Depreciation and amortisation						(32) (33) (38) (39) (39)					
Normalised EBIT						218 229 265 275 288					
Net interest						(21) (25) (23) (21) (18)					
Associate income						-					
Tax						(58) (59) (70) (73) (78)					
Minority interests						2 (1) - - -					
Normalised NPAT						137 145 172 180 192					
Abnormals/other						- (7) - - -					
Reported NPAT						137 138 172 180 192					
Normalised EPS (cps)						90.4 95.0 106.1 111.2 118.5					
DPS (NZ cps)						68.5 71.5 84.0 89.0 88.0					
Growth Rates						Key Ratios					
Revenue (%)						2018A 2019A 2020E 2021E 2022E					
EBITDA (%)						-3.0 -0.8 17.9 2.7 2.7					
EBIT (%)						9.6 4.6 15.5 3.7 4.4					
Normalised NPAT (%)						7.1 4.8 15.7 3.8 4.7					
Normalised EPS (%)						4.9 5.5 18.4 4.8 6.6					
DPS (%)						4.8 5.1 11.7 4.8 6.6					
DPS (%)						8.7 4.4 17.5 6.0 -1.1					
Cash Flow (A\$m)						Key assumptions					
EBITDA						2018A 2019A 2020E 2021E 2022E					
Working capital change						250 262 302 313 327					
Interest & tax paid						(0) - (90) (12) (13)					
Other						(81) (81) (93) (95) (96)					
Operating cash flow						(7) (62) - - -					
Capital expenditure						162 119 119 206 218					
(Acquisitions)/divestments						(58) (34) (25) (25) (25)					
Other						(31) (86) - - -					
Funding available/(required)						73 (2) 94 181 193					
Dividends paid						(92) (102) (128) (135) (134)					
Equity raised/(returned)						- 168 - - -					
Increase/(decrease) in net debt						19 (64) 33 (48) (62)					
Balance Sheet (A\$m)						Divisional revenue (A\$m)					
Working capital						2018A 2019A 2020E 2021E 2022E					
Fixed assets						6,609 6,548 7,766 7,970 8,184					
Intangibles						378 382 402 418 434					
Other assets						0 0 0 0 0					
Total funds employed						6,987 6,930 8,168 8,388 8,618					
Net debt/(cash)						217 227 265 275 286					
Other non current liabilities						46 48 51 53 55					
Shareholder's funds						(12) (13) (14) (14) (15)					
Minority interests						2,240 2,293 2,373 2,456 2,542					
Total funding sources						454 518 570 598 628					
						109 114 120 126 132					
						-2.0 -4.3 27.0 1.8 1.9					
						-4.6 2.4 3.5 3.5 3.5					
						-0.7 14.0 10.0 5.0 5.0					
						9.0 4.9 5.0 5.0 5.0					
						-5.4 1.0 5.2 4.1 3.7					
						-3.0 -0.8 17.9 2.7 2.7					
						3.871 3,704 4,704 4,790 4,882					
						2,240 2,293 2,373 2,456 2,542					
						454 518 570 598 628					
						109 114 120 126 132					
						-2.0 -4.3 27.0 1.8 1.9					
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						-5.4 1.0 5.2 4.1 3.7					
						-3.0 -0.8 17.9 2.7 2.7					

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

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 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.

Earnings and cashflow outlook

- **Underlying growth:** Modest without acquisitions, although the addition of Chemist Warehouse 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. Current balance sheet headroom of up to c.A\$350m provides runway for small to mid-size bolt-on acquisitions.

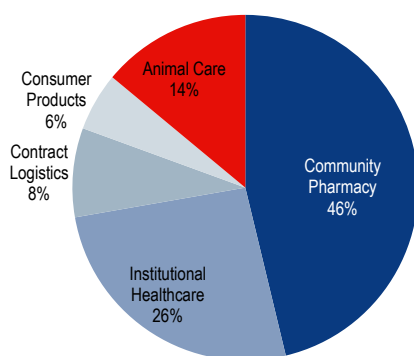
Risk factors

- **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

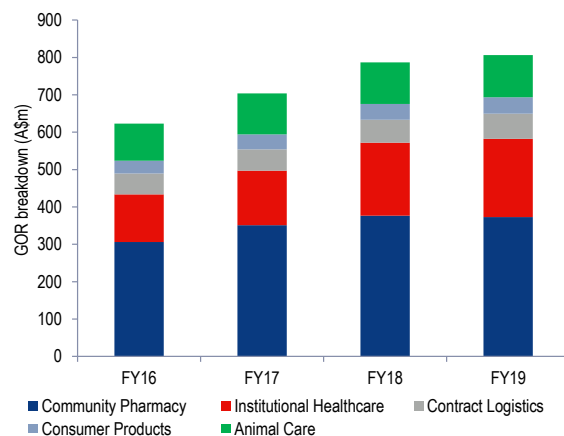
EBO is involved in the healthcare products supply industry in both New Zealand and Australia. Following a large number of acquisitions, EBO has evolved into an Australasian integrated healthcare supply chain business. It is the largest diversified wholesaler, marketer, and distributor of healthcare, 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 — FY19



Source: Company reports, Forsyth Barr analysis

Figure 2. Gross operating revenue through time



Source: Company reports, Forsyth Barr analysis

Figure 3. Substantial Shareholders

Shareholder	Latest Holding
The Zuellig Group	40.0%
FMR	10.1%

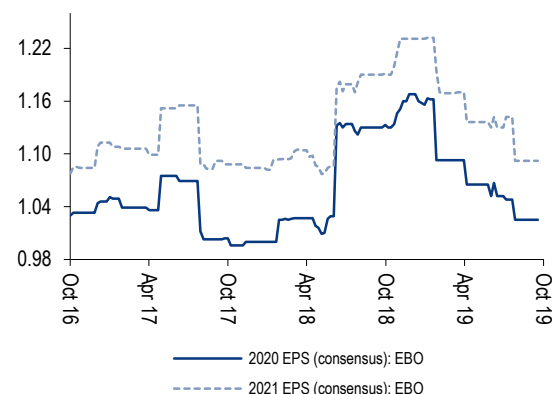
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 4. International Compco's

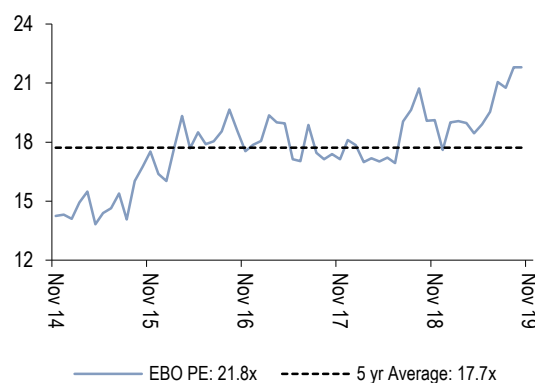
Company <i>(metrics re-weighted to reflect EBO's balance date - June)</i>	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
				2020E	2021E	2020E	2021E	2020E	2021E		
EBOS Group	EBO NZ	NZ\$25.00	NZ\$3,813	22.2x	21.1x	13.1x	12.6x	14.9x	14.4x	3.6%	
Australian Pharmaceutical Industries	API AT	A\$1.42	A\$699	12.7x	11.7x	7.7x	7.3x	10.0x	9.2x	6.3%	
Sigma Healthcare	SIG AT	A\$0.58	A\$614	28.3x	23.7x	14.0x	12.3x	19.9x	17.1x	3.9%	
McKesson Corp	MCK US	US\$134.37	US\$24,846	9.2x	8.5x	7.9x	7.8x	9.3x	8.7x	1.3%	
AmerisourceBergen Corp	ABC US	US\$81.93	US\$17,067	11.0x	10.1x	7.6x	7.3x	8.7x	8.4x	2.1%	
Henry Schein Inc	HSIC US	US\$61.64	US\$9,146	17.2x	15.9x	11.6x	11.2x	14.3x	13.7x	n/a	
Patterson Cos Inc	PDCO US	US\$17.07	US\$1,631	12.3x	11.8x	9.3x	8.9x	11.5x	11.2x	6.6%	
Sinopharm Group Co	1099 HK	CN¥25.85	CN¥76,817	11.4x	10.0x	5.9x	5.3x	6.4x	5.7x	3.0%	
				Compco Average:	14.6x	13.1x	9.1x	8.6x	11.4x	10.6x	3.9%
				EBO Relative:	+52%	+61%	+43%	+47%	+31%	+36%	-8%

EV = Current Market Cap + Actual Net Debt

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

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