FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | HEALTHCARE | WHOLESALE & DISTRIBUTION
18 FEBRUARY 2020

EBOS Group
1H20 Preview — Chemist Warehouse Injection

CHELSEA LEADBETTER CFA
chelsea.leadbetter@forsythbarr.co.nz
+64 4 495 5262

NEUTRAL

We expect a strong headline 1H20 result from EBOS Group (EBO) on 20 February, with modest underlying earnings growth topped up by the first-time contribution of its new contract with Chemist Warehouse (CW) in Australia. Key focus areas are (1) any greater clarity on FY20 guidance; (2) M&A update, (3) cash conversion, particularly given the recent step-change in volumes the company is handling, and (4) industry backdrop commentary (particularly for Community Pharmacy).

NZX Code	EBO
Share price	NZ$23.62
Target price	NZ$24.00
Risk rating	Medium
Issued shares	152.5m
Market cap	NZ$3,603m
Avg daily turnover	150.1k (NZ$3,426k)

Financials: Jun/	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	89.0
Imputation (%)	25	25	25	25

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	14.4	12.3	11.9	11.4
EV/EBIT	16.4	14.1	13.6	13.0
PE	24.5	20.9	20.0	18.7
Price / NTA	27.1	19.3	14.5	11.1
Cash div yld (%)	3.0	3.6	3.8	3.8
Gross div yld (%)	3.3	3.9	4.1	4.1

Key points of interest

- **Any greater clarity on FY20 guidance:** Guidance is for "a significant increase in earnings in FY20" — not surprising given the first-time contribution from its contract with CW. Our current forecast is for FY20 EBITDA of A$302m, up +15% on the prior year.
- **First contribution from wholesale contract with CW in Australia:** EBO commenced its supply contract with CW on 1 July 2019. We look for any insight into earnings contribution, growth outlook and contract margin / returns.
- **Update on pharmacy backdrop and outlook:** Topical given material change underway in Australia — with negotiations underway for the next Community Pharmacy regulatory agreement (due to roll-over 1 July 2020), the recent change in suppliers for CW, and a move back into the wholesale channel (away from direct distribution) for some manufacturers.
- **Divisional detail — expecting growth across the board:** We expect consistent trends to the FY19 result — with strength in Hospital volumes, branded product and Contract Logistics outweighing pressure in Community Pharmacy (ex CW) and cost inflation in NZ.
- **Cash conversion:** We look for confirmation EBO can maintain strong cash conversion following the recent step-change in volumes.
- **M&A update:** EBO has a well signalled and consistent bolt-on acquisitive strategy. Given the recent $175m capital raise in May 2019 we expect further small to mid-sized acquisitions near-term. We estimate current balance sheet headroom of ~A$300m.

Conference call — 11:30am NZ time on 20 February

Dial in details are 0800 667 018 for New Zealand (1800 148 258 for Australia); conference ID is 1880317.

Figure 1. 1H20 result expectations (A$m)

A$m	1H19	1H20E	% chg
Revenue	3,496.5	4,115.2	17.7%
EBITDA	131.4	152.5	16.1%
Underlying NPAT	72.7	86.8	19.4%
Reported NPAT	67.0	86.8	29.5%
Underlying EPS (A cps)	47.8	57.0	19.4%
Dividend (NZ cps)	34.5	40.5	17.3%

Source: Forsyth Barr analysis, Company reports

Figure 2. EBITDA breakdown (A$m)

A$m	1H19	1H20E	% chg
Healthcare	112.7	133.2	18.2%
Animal Care	24.3	25.8	6.0%
Corporate costs	(5.6)	(6.5)	15.6%
Total EBITDA	131.4	152.5	16.1%
Like-for-like EBITDA growth (i.e. excluding new CW contract)			3.4%

Source: Forsyth Barr analysis, Company reports

FORSYTH BARR

Ebos Group Ltd (EBO)

Priced as at 17 Feb 2020 (NZ$)	**23.62**

12-month target price (NZ$)*	**24.00**
Expected share price return	1.6%
Net dividend yield	3.7%
Estimated 12-month return	5.3%

Spot valuations (NZ$)	
1. DCF	22.96
2. Multiple approach	21.02
3. n/a	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.94
WACC	8.1%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	4,036
(Net debt)/cash	(389)
Less: Capitalised operating leases	0
Value of equity	3,647

Profit and Loss Account (A$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	6,987	6,930	8,168	8,388	8,618
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	0	0	0	0	0
Tax	(58)	(59)	(70)	(73)	(78)
Minority interests	2	(1)	0	0	0
Normalised NPAT	**137**	**145**	**172**	**180**	**192**
Abnormals/other	0	(7)	0	0	0
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	89.0

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	14.8	14.4	12.3	11.9	11.4
EV/EBIT (x)	17.0	16.4	14.1	13.6	13.0
PE (x)	24.0	24.5	20.9	20.0	18.7
Price/NTA (x)	n/a	27.1	19.3	14.5	11.1
Free cash flow yield (%)	3.1	2.5	2.8	5.4	5.7
Net dividend yield (%)	2.9	3.0	3.6	3.8	3.8
Gross dividend yield (%)	3.2	3.3	3.9	4.1	4.1

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	10.5	9.0	11.5	12.8	16.1
Interest cover EBITDA (x)	12.0	10.3	13.2	14.6	18.3
Net debt/ND+E (%)	28.3	22.7	23.7	21.0	17.6
Net debt/EBITDA (x)	1.7	1.4	1.3	1.1	0.9

Growth Rates	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (%)	-3.0	-0.8	17.9	2.7	2.7
EBITDA (%)	9.6	4.6	15.5	3.7	4.4
EBIT (%)	7.1	4.8	15.7	3.8	4.7
Normalised NPAT (%)	4.9	5.5	18.4	4.8	6.6
Normalised EPS (%)	4.8	5.1	11.7	4.8	6.6
Ordinary DPS (%)	8.7	4.4	17.5	6.0	0.0

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	7.4	7.1	7.8	8.0	8.3
Return on equity (%)	13.1	11.7	13.3	13.5	13.8
Return on funds employed (%)	10.7	10.9	11.8	12.0	12.5
EBITDA margin (%)	3.6	3.8	3.7	3.7	3.8
EBIT margin (%)	3.1	3.3	3.2	3.3	3.3
Capex to sales (%)	0.8	0.5	0.3	0.3	0.3
Capex to depreciation (%)	358	208	122	119	118
Imputation (%)	25	25	25	25	25
Pay-out ratio (%)	70	74	74	75	71

Cash Flow (A$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**250.1**	**261.6**	**302.1**	**313.2**	**327.1**
Working capital change	(20.9)	(25.3)	(23.0)	(21.4)	(17.8)
Interest & tax paid	(60.0)	(55.3)	(160.1)	(85.4)	(91.2)
Other	(7.1)	(62.5)	0	0	0
Operating cash flow	**162.1**	**118.5**	**119.0**	**206.4**	**218.1**
Capital expenditure	(58.0)	(34.2)	(25.0)	(25.0)	(25.0)
(Acquisitions)/divestments	(30.8)	(85.9)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**73.3**	**(1.5)**	**94.0**	**181.4**	**193.1**
Dividends paid	(92.0)	(102.5)	(127.6)	(135.3)	(135.3)
Equity raised/(returned)	0	168.2	0	0	0
(Increase)/decrease in net debt	**(18.7)**	**64.2**	**(33.6)**	**46.2**	**57.8**

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Divisional revenue (A$m)					
Healthcare	6,609	6,548	7,766	7,970	8,184
Animal Care	378	382	402	418	434
Total revenue	**6,987**	**6,930**	**8,168**	**8,388**	**8,618**
Divisional EBITDA (A$m)					
Healthcare	217	227	265	275	286
Animal Care	46	48	51	53	55
Corporate / Other	(12)	(13)	(14)	(14)	(15)
Total EBITDA	**250.1**	**261.6**	**302.1**	**313.2**	**327.1**
Key Healthcare segment revenue (A$m)					
Community Pharmacy	3,871	3,704	4,704	4,790	4,882
% growth	-2.0	-4.3	27.0	1.8	1.9
Institutional Healthcare	2,240	2,293	2,373	2,456	2,542
% growth	-4.6	2.4	3.5	3.5	3.5
Contract Logistics	454	518	570	598	628
% growth	-0.7	14.0	10.0	5.0	5.0
Consumer Products	109	114	120	126	132
% growth	9.0	4.9	5.0	5.0	5.0

Balance Sheet (A$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	281.8	333.0	423.0	435.0	447.8
Fixed assets	112.2	174.5	179.0	183.0	186.7
Intangibles	1,074.4	1,117.2	1,100.2	1,082.7	1,064.6
Right of use asset	0	0	0	0	0
Other assets	163.7	122.6	122.6	122.6	122.6
Total funds employed	**1,632.1**	**1,747.3**	**1,824.8**	**1,823.2**	**1,821.7**
Net debt/(cash)	432.4	365.7	399.3	353.2	295.4
Lease liability	0	0	0	0	0
Other liabilities	126.8	142.3	142.3	142.3	142.3
Shareholder's funds	1,051.5	1,242.3	1,286.2	1,330.8	1,387.2
Minority interests	21.4	(3.1)	(3.1)	(3.1)	(3.1)
Total funding sources	**1,632.1**	**1,747.3**	**1,824.8**	**1,823.2**	**1,821.7**

* 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 valuation. EBO is disciplined on hurdle rates, with a longstanding target return on capital employed in excess of 15%.

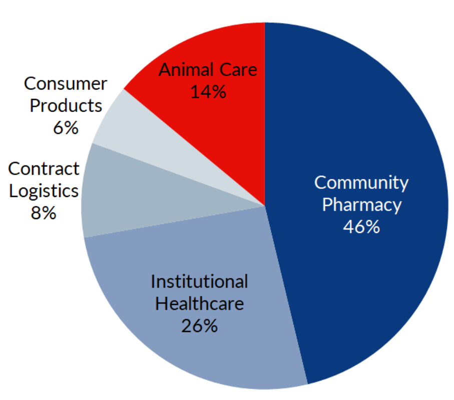
Financial structure

- **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$300m provides runway for small to mid-size bolt-on acquisitions.

Risk factors

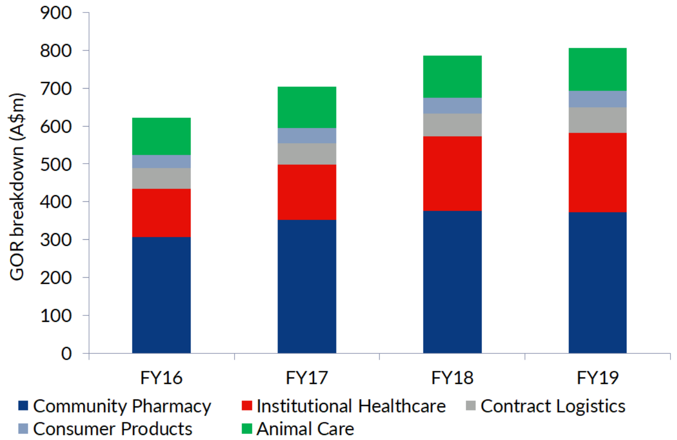
- **Regulatory change:** EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. Any change can impact EBO given its role in the supply chain.
- **Suppliers opting for a direct distribution model:** This could result in a loss of scale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

Figure 3. Gross operating revenue breakdown — FY19



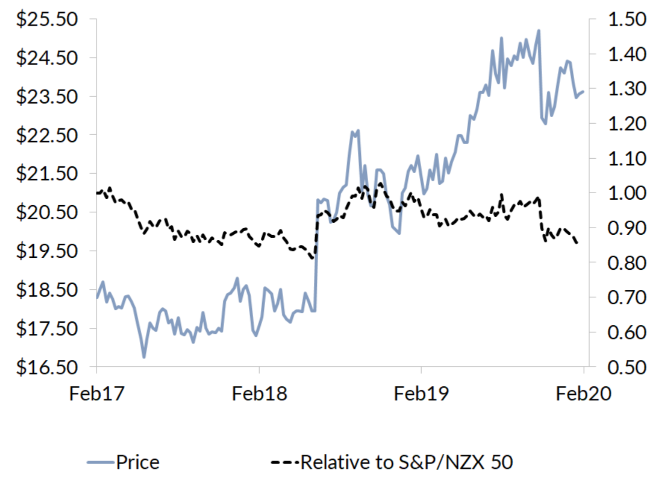
Source: Company reports, Forsyth Barr analysis

Figure 4. Gross operating revenue through time



Source: Company reports, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Sybos Holdings	28.1%
FMR	10.1%

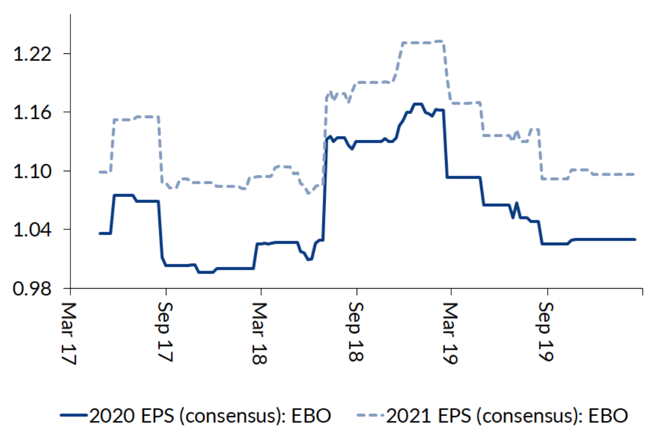
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect EBO's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
EBOS Group	**EBO NZ**	**NZ$23.62**	**NZ$3,603**	**20.9x**	**20.0x**	**12.4x**	**12.0x**	**14.2x**	**13.7x**	**3.8%**
Australian Pharmaceutical Industries	API AT	A$1.28	A$628	13.4x	13.3x	7.0x	7.0x	9.8x	9.8x	5.9%
Sigma Healthcare	SIG AT	A$0.60	A$630	36.6x	22.7x	14.9x	11.8x	24.4x	17.7x	4.6%
McKesson Corp	MCK US	US$168.03	US$29,730	11.2x	10.4x	9.6x	9.3x	11.1x	10.7x	1.1%
AmerisourceBergen Corp	ABC US	US$94.36	US$19,428	15.0x	11.7x	9.6x	8.2x	12.0x	9.4x	1.8%
Henry Schein Inc	HSIC US	US$72.13	US$10,584	20.2x	18.8x	12.9x	12.5x	16.1x	15.5x	n/a
Patterson Cos Inc	PDCO US	US$23.01	US$2,203	16.1x	15.3x	11.5x	11.1x	14.3x	13.9x	4.6%
Sinopharm Group Co	1099 HK	CN¥25.80	CN¥80,513	11.2x	9.9x	6.1x	5.4x	6.6x	5.9x	3.0%
			Compco Average:	**17.7x**	**14.6x**	**10.2x**	**9.3x**	**13.5x**	**11.8x**	**3.5%**
EV = Current Market Cap + Actual Net Debt			**EBO Relative:**	**18%**	**37%**	**22%**	**28%**	**5%**	**15%**	**7%**

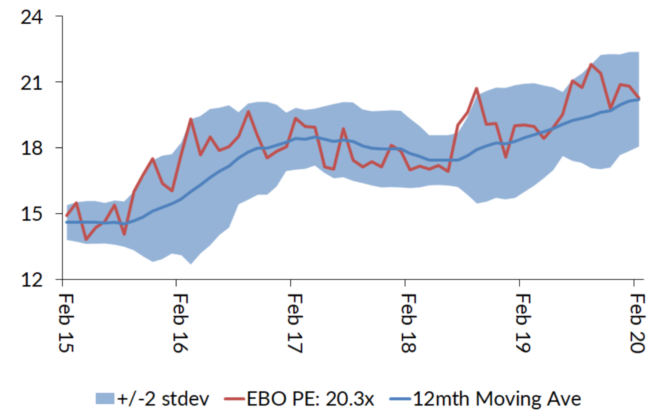
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (EBO) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

FORSYTH BARR

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than $50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 14 Feb 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
31.4%	**51.0%**	**17.6%**

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the following issuers that are the subject of this publication: ARV MET PEB

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.