

EBOS Group

1H20 – Another Delivery; Some Cost Bite

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NEUTRAL 

EBOS Group (EBO) reported strong 1H20 earnings growth, albeit slightly below our expectations with margin contraction (business mix and cost inflation) outweighing stronger than anticipated revenue momentum. We have made small underlying downgrades to our earnings forecasts. Key positives in the result: (1) a step-change in Contract Logistics, (2) another strong print from Institutional Healthcare, (3) successful integration of Chemist Warehouse (CW) volumes - adding to an exemplary track record of business integration. Key negatives: (1) margin pressure across the group, (2) a material drop-off in Consumer Products, (3) higher corporate costs. 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. **NEUTRAL.**

NZX Code	EBO	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$24.15	NPAT* (NZ\$m)	147.0	174.3	187.0	202.1	EV/EBITDA	14.7	11.3	10.8	10.3
Target price	NZ\$24.00	EPS* (NZc)	96.4	107.8	115.6	125.0	EV/EBIT	16.8	14.5	13.7	12.9
Risk rating	Medium	EPS growth* (%)	-2.1	11.8	7.3	8.1	PE	25.1	22.4	20.9	19.3
Issued shares	152.5m	DPS (NZc)	71.5	78.0	83.0	87.0	Price / NTA	27.7	20.8	15.2	11.6
Market cap	NZ\$3,684m	Imputation (%)	25	25	25	25	Cash div yld (%)	3.0	3.2	3.4	3.6
Avg daily turnover	153.1k (NZ\$3,498k)	*Based on normalised profits					Gross div yld (%)	3.2	3.5	3.8	4.0

Healthcare segment – some overs and unders, modestly below expectations

EBO reported underlying Healthcare EBITDA growth (pre IFRS16) of +16%. Our analysis suggests strong 'like for like' revenue growth (we estimate c. +11%) topped up by the first time contribution of CW in Australia. However, EBITDA margin contraction of ~-30bp negatively surprised and led to a modest miss versus our expectations. Divisionally, growth was robust across the board in 1H20, with Consumer Products the only exception (continuing negative trends seen in 2H19). Key highlights were (1) Contract Logistics, encouraging after recent capacity expansion, (2) Institutional Healthcare – with growth in recent periods tracking ahead of historical levels helped by a continual pipeline of new products and specialty drugs.

We factor in similar trends for 2H20. Key near-term newsflow is the 7th Community Pharmacy Agreement which sets sector remuneration in Australia (five year term from 1 July 2020). Our forecasts factor in a stabilisation of margins, which relies on some remuneration support or efficiency gains from EBO (we view the latter as more challenging from here) to offset ongoing cost inflation.

Animal Care – growth remains robust, consistent with expectations

Underlying EBITDA (pre IFRS16) for Animal Care was up +6%, with strong revenue momentum across all key segments outpacing margin compression. The latter reflects (1) mix effect from the return to strong growth in its low margin wholesale business (Lyppard) and (2) investment in marketing for consumer brands – likely a key driver of increased market share for both Black Hawk and Vitapet in the period. We expect to see more of the same in 2H20 and the outlook for the sector remains attractive.

Balance sheet – ample capacity for bolt-on acquisitions

EBO reported a strong lift in both operating and free cashflow in 1H20, albeit off a weak prior period. Cash conversion was once again strong; pleasing given the material step-change in the business (introduction of CW volumes). Gearing is conservative, helped by the recent capital raise, with net debt to EBITDA of 1.4x offering material balance sheet headroom of up to c. A\$350m. M&A remains front and centre in EBO's strategy and we expect further small to mid size bolt-on acquisitions in the short to medium-term. This has been a key area of added value historically (particularly consumer brands) – and is an area of optionality not captured in our DCF.

Ebos Group Ltd (EBO)

Priced as at 20 Feb 2020 (NZ\$) **24.15**

12-month target price (NZ\$)*	24.00
Expected share price return	-0.6%
Net dividend yield	3.4%
Estimated 12-month return	2.7%

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

Spot valuations (NZ\$)	
1. DCF	22.61
2. Multiple approach	21.02
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	4,123
(Net debt)/cash	(389)
Less: Capitalised operating leases	(285)
Value of equity	3,449

Profit and Loss Account (A\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	6,987	6,930	8,679	8,954	9,238
Normalised EBITDA	250	262	333	349	365
Depreciation and amortisation	(32)	(33)	(73)	(73)	(73)
Normalised EBIT	218	229	260	276	292
Net interest	(21)	(25)	(28)	(26)	(23)
Associate income	0	0	0	0	0
Tax	(58)	(59)	(69)	(74)	(79)
Minority interests	2	(1)	0	0	0
Normalised NPAT	137	145	164	176	190
Abnormals/other	0	(7)	0	0	0
Reported NPAT	137	138	164	176	190
Normalised EPS (cps)	90.4	95.0	101.3	108.7	117.5
DPS (NZ cps)	68.5	71.5	78.0	83.0	87.0

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	15.1	14.7	11.3	10.8	10.3
EV/EBIT (x)	17.3	16.8	14.5	13.7	12.9
PE (x)	24.5	25.1	22.4	20.9	19.3
Price/NTA (x)	n/a	27.7	20.8	15.2	11.6
Free cash flow yield (%)	3.1	2.4	4.1	6.1	6.5
Net dividend yield (%)	2.8	3.0	3.2	3.4	3.6
Gross dividend yield (%)	3.1	3.2	3.5	3.8	4.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	10.5	9.0	9.3	10.5	12.9
Interest cover EBITDA (x)	12.0	10.3	11.9	13.3	16.2
Net debt/ND+E (%)	28.3	22.7	21.7	17.4	12.5
Net debt/EBITDA (x)	1.7	1.4	1.1	0.8	0.5

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	-3.0	-0.8	25.2	3.2	3.2
EBITDA (%)	9.6	4.6	27.3	4.8	4.7
EBIT (%)	7.1	4.8	13.9	5.9	6.0
Normalised NPAT (%)	4.9	5.5	13.1	7.3	8.1
Normalised EPS (%)	4.8	5.1	6.6	7.3	8.1
Ordinary DPS (%)	8.7	4.4	9.1	6.4	4.8

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	7.4	7.1	7.1	7.4	7.7
Return on equity (%)	13.1	11.7	12.8	13.3	13.8
Return on funds employed (%)	10.7	10.9	11.9	12.5	13.4
EBITDA margin (%)	3.6	3.8	3.8	3.9	4.0
EBIT margin (%)	3.1	3.3	3.0	3.1	3.2
Capex to sales (%)	0.8	0.5	0.3	0.3	0.3
Capex to depreciation (%)	358	208	45	45	45
Imputation (%)	25	25	25	25	25
Pay-out ratio (%)	70	74	72	72	70

Cash Flow (A\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	250.1	261.6	333.1	349.0	365.3
Working capital change	(20.9)	(25.3)	(27.9)	(26.2)	(22.6)
Interest & tax paid	(60.0)	(55.3)	(139.7)	(87.3)	(93.7)
Other	(7.1)	(62.5)	0	0	0
Operating cash flow	162.1	118.5	165.5	235.4	249.1
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)	140.5	210.4	224.1
Dividends paid	(92.0)	(102.5)	(120.5)	(129.0)	(133.0)
Equity raised/(returned)	0	168.2	0	0	0
(Increase)/decrease in net debt	(18.7)	64.2	12.7	73.4	82.4

Operating Performance	2018A	2019A	2020E	2021E	2022E
Divisional revenue (A\$m)					
Healthcare	6,609	6,548	8,272	8,530	8,798
Animal Care	378	382	408	424	440
Total revenue	6,987	6,930	8,679	8,954	9,238
Divisional EBITDA (A\$m)					
Healthcare	217	227	291	305	320
Animal Care	46	48	57	59	61
Corporate / Other	(12)	(13)	(15)	(15)	(15)
Total EBITDA	250.1	261.6	333.1	349.0	365.3

Balance Sheet (A\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	281.8	333.0	404.1	417.9	432.0
Fixed assets	112.2	174.5	179.5	183.4	187.1
Intangibles	1,074.4	1,117.2	1,100.2	1,082.7	1,064.6
Right of use asset	0	0	230.8	224.9	219.1
Other assets	163.7	122.6	122.6	122.6	122.6
Total funds employed	1,632.1	1,747.3	2,037.2	2,031.4	2,025.4
Net debt/(cash)	432.4	365.7	353.0	279.6	197.3
Lease liability	0	0	267.9	288.8	308.2
Other liabilities	126.8	142.3	142.3	142.3	142.3
Shareholder's funds	1,051.5	1,242.3	1,277.0	1,323.8	1,380.8
Minority interests	21.4	(3.1)	(3.1)	(3.1)	(3.1)
Total funding sources	1,632.1	1,747.3	2,037.2	2,031.4	2,025.4

Key Healthcare segment revenue (A\$m)	2018A	2019A	2020E	2021E	2022E
Community Pharmacy	3,871	3,704	4,956	5,086	5,221
% growth	-2.0	-4.3	33.8	2.6	2.6
Institutional Healthcare	2,240	2,293	2,476	2,563	2,652
% growth	-4.6	2.4	8.0	3.5	3.5
Contract Logistics	454	518	725	761	800
% growth	-0.7	14.0	40.0	5.0	5.0
Consumer Products	109	114	114	120	126
% growth	9.0	4.9	0.0	5.0	5.0

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

1H20 Result Takeaways

EBO reported 1H20 underlying profit of A\$84m, up +16%, although modestly below our expectations (-3%) and consensus. Despite a revenue beat, cost inflation and negative mix effects weighed on margins. FY20 qualitative guidance commentary was reiterated for “significant growth in earnings” – this is expected given the first-time contribution from CW, with no further clarity provided.

Figure 1. 1H20 result snapshot (pre IFRS16)

A\$m	1H19	1H20	% chg	Forsyth Barr
Revenue	3,496.5	4,376.1	25.2%	4,115.4
EBITDA	131.4	149.0	13.4%	152.5
Underlying NPAT	72.7	84.2	15.8%	86.8
Underlying EPS (A cps)	47.8	52.2	9.3%	53.7
Dividend (NZ cps)	34.5	37.5	8.7%	40.5

Source: Forsyth Barr analysis, Company reports

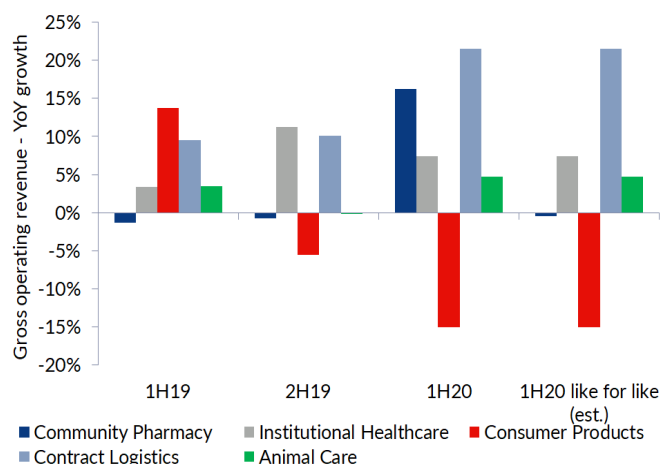
Figure 2. 1H20 other line items (pre IFRS16)

A\$m	1H19	1H20	% chg	Forsyth Barr
Healthcare	112.7	131.1	16.4%	133.2
Animal Care	24.3	25.7	5.7%	25.8
Corporate costs	(5.6)	(7.8)	38.7%	(6.5)
Total EBITDA	131.4	149.0	13.4%	152.5
Net debt to EBITDA	2.2x	1.4x	-0.8x	

Source: Forsyth Barr analysis, Company reports

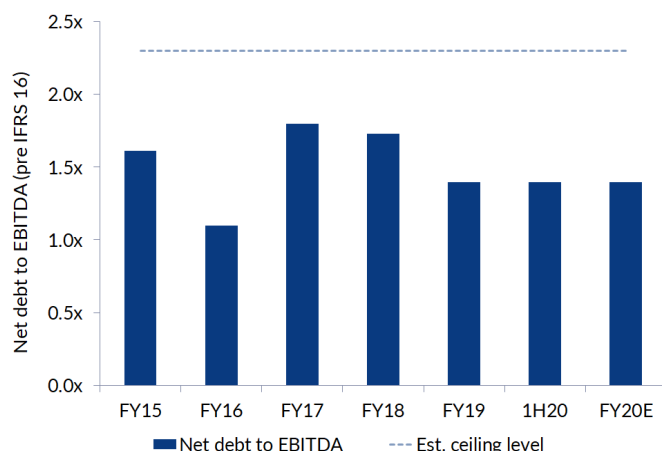
Key charts

Figure 3. Divisional result detail



Source: Forsyth Barr analysis, Company reports

Figure 4. Net debt to EBITDA - material headroom for M&A



Source: Forsyth Barr analysis, Company reports

Earnings revisions

We have made modest earnings downgrades of c. -2-3% across our forecast horizon, with upgraded revenue growth forecasts (particularly in Contract Logistics and Institutional Healthcare) outweighed by lower gross margin assumptions across most segments. Gross operating revenue changes provide the best proxy for our underlying revisions, given EBITDA/NPAT changes incorporate IFRS16 for the first-time which materially lifts EBITDA but lowers NPAT. Our FY20E EBITDA forecast pre IFRS16 is now A\$295m (down -2%). We have also taken a more conservative view on the dividend payout ratio near-term following EBO's 1H20 result. While we see ample capacity on the balance sheet, it is apparent the priority remains M&A near-term.

Our target price is unchanged at NZ\$24.00, with time value of money outweighing small earnings downgrades across our medium-term forecast horizon.

Figure 5. Earnings revisions

A\$m	FY19A Actual	FY20E Old	FY20E New	% Chg	FY21E Old	FY21E New	% Chg	FY22E Old	FY22E New	% Chg
Revenue	6,930	8,168	8,679	6.3%	8,388	8,954	6.8%	8,618	9,238	7.2%
Gross operating revenue	806	923	896	-3.0%	949	924	-2.6%	976	954	-2.2%
EBITDA	261.6	302.1	333.1	10.3%	313.2	349.0	11.4%	327.1	365.3	11.7%
Underlying NPAT	144.4	171.5	163.8	-4.4%	179.8	175.8	-2.2%	191.7	190.0	-0.9%
Underlying EPS (cps)	94.7	106.0	101.3	-4.4%	111.2	108.7	-2.2%	118.5	117.5	-0.9%
Dividend (NZ cps)	71.5	84.0	78.0	-7.1%	89.0	83.0	-6.7%	89.0	87.0	-2.2%

Source: Forsyth Barr analysis

Result in more detail

Figure 6. Result breakdown (A\$m) - earnings pre IFRS16

A\$m	1H19	1H20	% chg	Comment
Total revenue	3,496.5	4,376.1	25.2%	Significant growth due to CW injection but strong performance seen from Contract Logistics, Animal Care and TerryWhite Chemmart
Gross operating revenue	404.8	449.4	11.0%	A measure of gross profit (less any inventory write downs)
SG&A	(273.4)	(300.4)	9.9%	
Total EBITDA	131.4	149.0	13.4%	EBITDA margin pressure reflects (1) negative business mix effect (2) cost inflation, particularly labour, leases and insurance
Depreciation & Amort.	(15.2)	(17.7)	16.1%	Uplift due to new Australian facilities and Auckland expansion
EBIT	116.1	131.3	13.1%	
Net Interest	(12.4)	(11.5)	-6.9%	Slight reduction in interest bearing liabilities
Tax	(30.9)	(35.6)	15.3%	Effective tax rate ~30%, broadly consistent with last year
Minorities	0.2	0.0	n/a	
Abnormals	(5.7)	(1.0)	n/a	Abnormal items comprise M&A costs, warehouse transition and restructuring costs
Reported NPAT	67.0	83.2	25.6%	
Underlying NPAT	72.7	84.2	15.8%	Cost inflation and mix pressure offsetting strong revenue growth
Underlying EPS (cps)	47.8	51.9	8.8%	Resulting from increase in underlying NPAT and changes in shares on issue after the recent capital raise
Dividend (NZ cps)	34.5	37.5	8.7%	Below expectations, leaving ~\$350m balance sheet headroom for future acquisitions
Divisional breakdown				
External revenue				
Healthcare	3,304.2	4,165.5	26.1%	Revenue growth excl CW c.11% by our estimates
Animal Care	192.3	210.6	9.5%	Continued strong growth in consumer brands, Black Hawk (9.7%) and Vitapet (14.7%)
Total revenue	3,496.5	4,376.1	25.2%	
GOR Breakdown				
Community Pharmacy	190.6	221.4	16.2%	First-time contribution from CW, albeit the change in product mix as a result sees a lower gross margin
Institutional	101.8	109.4	7.5%	A marked pick up, reflecting increased sales in specialty products
Healthcare				
Contract Logistics	32.3	39.3	21.7%	Impressive uplift suggesting a number of contract wins following recent capacity expansion
Consumer Products	23.2	19.7	-15.1%	Decline arising from supply chain transition and lower daigou channel sales
Animal Care	56.9	59.6	4.7%	Key brands Black Hawk, Vitapet and Lyppard performing strongly
Total GOR	404.8	449.4	11.0%	
EBITDA				
Healthcare	112.7	131.1	16.4%	Strong uplift but margin contraction evident in both Australia and New Zealand reflecting cost inflation and negative business mix effect
Animal Care	24.3	25.7	5.7%	Robust growth for the period, consistent with our forecasts
Corporate costs	(5.6)	(7.8)	38.7%	Higher than expected, predominantly reflecting a material step-up in breadth of executive LTI scheme
Total EBITDA	131.4	149.0	13.4%	
Balance Sheet & Cashflow				
Operating cash flow	40.3	74.2	84.4%	46% uplift excluding the first-time impact of IFRS 16
Investing cash flow	(109.4)	(43.9)	-59.8%	Modest capex and lower M&A this period
Working Capital	329.9	378.0	14.6%	Trade receivables greater than that of trade payables
Capex	16.9	13.7	-18.9%	No significant acquisitions with capex spent on Consumer Products facility and small projects
Net debt	552.0	392.0	-29.0%	ND/EBITDA of 1.41x, assisted by capital raise and earnings uplift
Shareholders' Equity	1,051.4	1,281.9	21.9%	Increase based off \$150m May 2019 capital raise
Cash conversion cycle (days)	18	16	-11.1%	Driven by working capital management discipline and CW injection

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 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%.

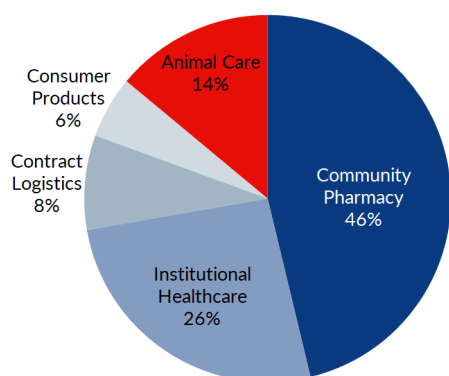
Financial structure

- **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

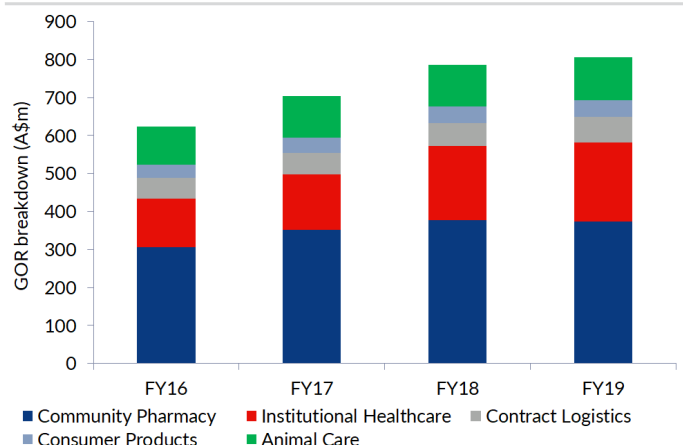
- **Regulatory change:** EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. Any change can impact EBO given its role in the supply chain.
- **Suppliers opting for a direct distribution model:** This could result in a loss of scale 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.

Figure 7. Gross operating revenue breakdown - FY19

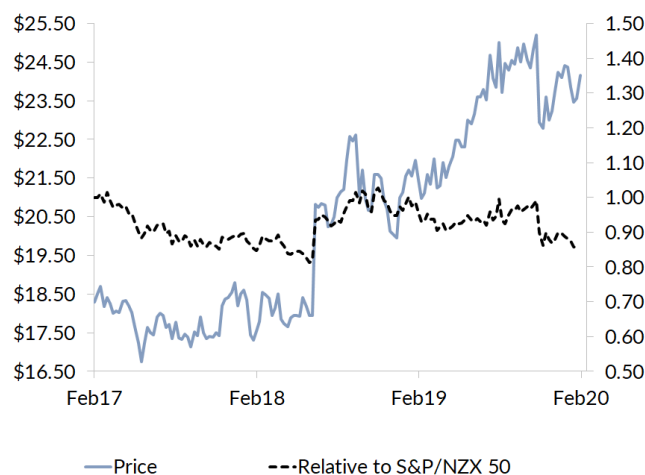


Source: Forsyth Barr analysis, Company reports

Figure 8. Gross operating revenue through time



Source: Forsyth Barr analysis, Company reports

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
Sybos Holdings	28.1%
FMR	10.1%

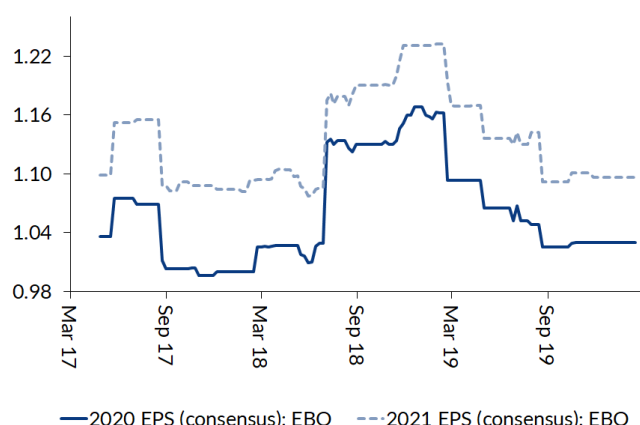
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 11. International valuation comparisons

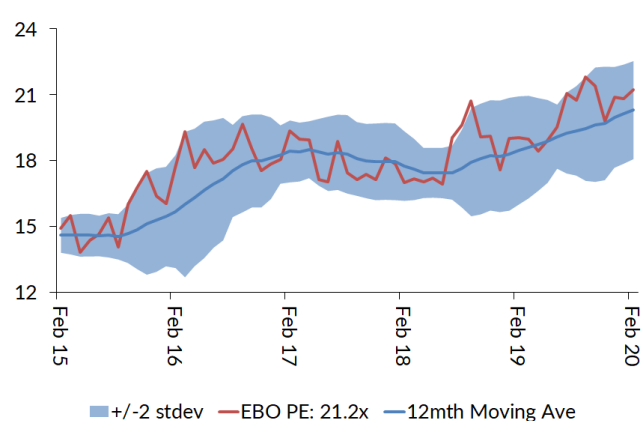
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect EBO's balance date - June)											
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E	
EBOS Group	EBO NZ	NZ\$24.15	NZ\$3,684	22.4x	20.9x	11.5x	11.0x	14.7x	13.9x	3.4%	
Australian Pharmaceutical Industries	API AT	A\$1.29	A\$633	13.6x	13.4x	7.1x	7.1x	9.9x	9.9x	5.8%	
Sigma Healthcare	SIG AT	A\$0.59	A\$620	36.0x	22.4x	14.7x	11.6x	24.1x	17.5x	4.7%	
McKesson Corp	MCK US	US\$167.40	US\$29,634	11.2x	10.4x	9.5x	9.3x	11.0x	10.7x	1.1%	
AmerisourceBergen Corp	ABC US	US\$94.42	US\$19,457	15.0x	11.7x	9.6x	8.2x	12.0x	9.4x	1.8%	
Henry Schein Inc	HSIC US	US\$73.87	US\$10,840	20.7x	19.3x	13.2x	12.7x	16.4x	15.8x	n/a	
Patterson Cos Inc	PDCO US	US\$23.29	US\$2,232	16.3x	15.5x	11.6x	11.2x	14.5x	14.1x	4.6%	
Sinopharm Group Co	1099 HK	CN¥26.55	CN¥82,853	11.5x	10.1x	6.2x	5.5x	6.7x	6.0x	2.9%	
Compco Average:				17.8x	14.7x	10.3x	9.4x	13.5x	11.9x	3.5%	
EV = Current Market Cap + Actual Net Debt				EBO Relative:	26%	42%	12%	17%	9%	17%	-2%

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 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
29.4%	52.9%	17.6%

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