

# EBOS Group

## Temporary Pulse Spike

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**NEUTRAL** 

EBOS Group (EBO) provided a market update confirming strong 3Q20 trading, helped by a spike in demand in its categories as a result of COVID-19, albeit this appears to be short-lived. Outlook comments from EBO point to some caution given an uncertain consumer demand outlook. The company retained prior qualitative FY20 guidance for a "significant increase in earnings" which still leaves plenty of scope for interpretation. FY20 is tracking well to be a strong year, albeit we see some risk of a lower underlying growth outlook in FY21. EBO is a well-run business but trading broadly in line with our view of fundamental value, while multiples are not cheap in light of a modest underlying growth outlook. Retain NEUTRAL.

NZX Code	EBO	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$24.18	NPAT* (NZ\$m)	147.0	176.8	187.9	202.1	EV/EBITDA	14.7	11.2	10.8	10.3
Target price	NZ\$24.50	EPS* (NZc)	96.4	109.3	116.2	125.0	EV/EBIT	16.8	14.3	13.7	12.9
Risk rating	Medium	EPS growth* (%)	-2.1	13.4	6.3	7.5	PE	25.1	22.1	20.8	19.3
Issued shares	152.5m	DPS (NZc)	71.5	78.0	83.0	87.0	Price / NTA	27.7	20.5	15.0	11.5
Market cap	NZ\$3,688m	Imputation (%)	25	25	25	25	Cash div yld (%)	3.0	3.2	3.4	3.6
Avg daily turnover	162.8k (NZ\$3,734k)	*Based on normalised profits					Gross div yld (%)	3.2	3.5	3.8	3.9

### Strong 3Q, helped by what appears to be a temporary demand spike; small upgrade to FY20E estimates, no change thereafter

EBO provided an update confirming strong 3Q20 trading, with comments its Healthcare segment saw "unprecedented demand in response to COVID-19 development", while Animal Care also remained strong. This aligns with recent competitor commentary (both API and Sigma reported revenue growth of c. +50% for pharmacy for February/early-mid March) and anecdotes on temporary stockpiling. Retail spending data from Australia (refer Figure 1) shows a clear spike for circa four weeks in 1Q20, however, this has subsequently weakened in recent weeks. We make a minor earnings upgrade for FY20E (EBITDA +2%), but no change to forecasts thereafter. This reflects assumptions around a short spike in revenue, partially offset by additional costs (temporary labour and heightened distancing/safety measures), and then reversion to 'typical' spending patterns, albeit with some assumed weakness.

### Balance sheet – ample headroom for M&A, although COVID-19 uncertainty may influence potential vendors near-term

EBO's gearing is conservative, helped by the recent capital raise, and the company has material headroom (we estimate ~A\$350m) to continue to look for M&A opportunities, and has also increased its bank facilities on refinancing. M&A remains front and centre in EBO's strategy and has been a key area of added value historically (particularly consumer brands); hence, is an area of optionality not captured in our DCF. It is difficult to judge the impact of COVID-19 – it may produce target options and/or a reset in valuation expectations, however, in the short-term there is risk it slows decision making from vendors while uncertainty is rife.

### Regulatory backdrop – recent events likely a timely reminder of the importance of the supply chain players

EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. The key near-term newsflow is the 7th Community Pharmacy Agreement which sets sector remuneration in Australia (five year term from 1 July 2020) although there is potential the timing is temporarily delayed. 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. We expect the COVID-19 pandemic, combined with Australia's recent bush fires, to provide a timely reminder of the importance of a well functioning supply chain which can't hurt at this time.

**Ebos Group Ltd (EBO)**

 Priced as at 21 Apr 2020 (NZ\$) **24.18**

<b>12-month target price (NZ\$)*</b>	<b>24.50</b>
Expected share price return	1.3%
Net dividend yield	3.4%
Estimated 12-month return	4.7%

<b>Spot valuations (NZ\$)</b>		
1. DCF		22.62
2. Multiple approach		22.20
3. n/a		n/a

<b>Key WACC assumptions</b>	
Risk free rate	2.00%
Equity beta	0.94
WACC	8.1%
Terminal growth	1.5%

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	4,124
(Net debt)/cash	(389)
Less: Capitalised operating leases	(285)
Value of equity	3,450

<b>Profit and Loss Account (A\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Sales revenue	6,987	6,930	8,902	8,965	9,246
<b>Normalised EBITDA</b>	<b>250</b>	<b>262</b>	<b>338</b>	<b>350</b>	<b>366</b>
Depreciation and amortisation	(32)	(33)	(73)	(73)	(73)
<b>Normalised EBIT</b>	<b>218</b>	<b>229</b>	<b>266</b>	<b>277</b>	<b>292</b>
Net interest	(21)	(25)	(30)	(26)	(23)
Associate income	0	0	0	0	0
Tax	(58)	(59)	(70)	(74)	(79)
Minority interests	2	(1)	0	0	0
<b>Normalised NPAT</b>	<b>137</b>	<b>145</b>	<b>166</b>	<b>177</b>	<b>190</b>
Abnormals/other	0	(7)	0	0	0
<b>Reported NPAT</b>	<b>137</b>	<b>138</b>	<b>166</b>	<b>177</b>	<b>190</b>
Normalised EPS (cps)	90.4	95.0	102.8	109.3	117.5
DPS (NZ cps)	68.5	71.5	78.0	83.0	87.0

<b>Valuation Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
EV/EBITDA (x)	15.1	14.7	11.2	10.8	10.3
EV/EBIT (x)	17.4	16.8	14.3	13.7	12.9
PE (x)	24.6	25.1	22.1	20.8	19.3
Price/NTA (x)	n/a	27.7	20.5	15.0	11.5
Free cash flow yield (%)	3.1	2.4	3.8	6.4	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	3.9

<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Interest cover EBIT (x)	10.5	9.0	8.9	10.5	12.8
Interest cover EBITDA (x)	12.0	10.3	11.3	13.3	16.0
Net debt/ND+E (%)	28.3	22.7	22.0	17.3	12.3
Net debt/EBITDA (x)	1.7	1.4	1.1	0.8	0.5

<b>Growth Rates</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Revenue (%)	-3.0	-0.8	28.4	0.7	3.1
EBITDA (%)	9.6	4.6	29.4	3.5	4.4
EBIT (%)	7.1	4.8	16.2	4.2	5.6
Normalised NPAT (%)	4.9	5.5	14.7	6.3	7.5
Normalised EPS (%)	4.8	5.1	8.2	6.3	7.5
Ordinary DPS (%)	8.7	4.4	9.1	6.4	4.8

<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Return on assets (%)	7.4	7.1	7.1	7.4	7.7
Return on equity (%)	13.1	11.7	13.0	13.3	13.7
Return on funds employed (%)	10.7	10.9	12.1	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	71	71	70

<b>Cash Flow (A\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>EBITDA</b>	<b>250.1</b>	<b>261.6</b>	<b>338.4</b>	<b>350.3</b>	<b>365.7</b>
Working capital change	(20.9)	(25.3)	(29.9)	(26.4)	(22.9)
Interest & tax paid	(60.0)	(55.3)	(150.5)	(78.6)	(93.4)
Other	(7.1)	(62.5)	0	0	0
<b>Operating cash flow</b>	<b>162.1</b>	<b>118.5</b>	<b>158.1</b>	<b>245.4</b>	<b>249.4</b>
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
<b>Funding available/(required)</b>	<b>73.3</b>	<b>(1.5)</b>	<b>133.1</b>	<b>220.4</b>	<b>224.4</b>
Dividends paid	(92.0)	(102.5)	(120.5)	(129.0)	(133.0)
Equity raised/(returned)	0	168.2	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(18.7)</b>	<b>64.2</b>	<b>5.3</b>	<b>83.4</b>	<b>82.7</b>

<b>Operating Performance</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>Divisional revenue (A\$m)</b>					
Healthcare	6,609	6,548	8,489	8,541	8,806
Animal Care	378	382	413	424	440
<b>Total revenue</b>	<b>6,987</b>	<b>6,930</b>	<b>8,902</b>	<b>8,965</b>	<b>9,246</b>
<b>Divisional EBITDA (A\$m)</b>					
Healthcare	217	227	295	307	320
Animal Care	46	48	58	59	61
Corporate / Other	(12)	(13)	(15)	(15)	(15)
<b>Total EBITDA</b>	<b>250.1</b>	<b>261.6</b>	<b>338.4</b>	<b>350.3</b>	<b>365.7</b>

<b>Balance Sheet (A\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Working capital	281.8	333.0	413.9	418.5	432.4
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
<b>Total funds employed</b>	<b>1,632.1</b>	<b>1,747.3</b>	<b>2,047.0</b>	<b>2,032.1</b>	<b>2,025.8</b>
Net debt/(cash)	432.4	365.7	360.4	277.1	194.4
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	1,279.4	1,327.1	1,384.1
Minority interests	21.4	(3.1)	(3.1)	(3.1)	(3.1)
<b>Total funding sources</b>	<b>1,632.1</b>	<b>1,747.3</b>	<b>2,047.0</b>	<b>2,032.1</b>	<b>2,025.8</b>

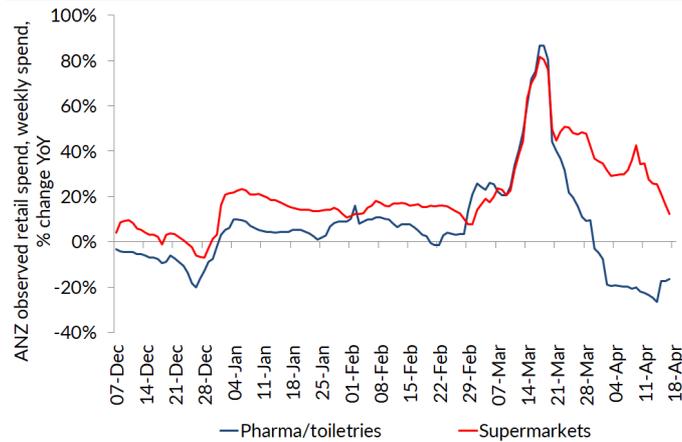
<b>Key Healthcare segment revenue (A\$m)</b>					
Community Pharmacy	3,871	3,704	5,169	5,097	5,231
% growth	-2.0	-4.3	39.6	-1.4	2.6
Institutional Healthcare	2,240	2,293	2,476	2,563	2,652
% growth	-4.6	2.4	8.0	3.5	3.5
Contract Logistics	454	518	725	761	800
% growth	-0.7	14.0	40.0	5.0	5.0
Consumer Products	109	114	118	120	123
% growth	9.0	4.9	3.5	2.0	2.5

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

## Key charts and tables

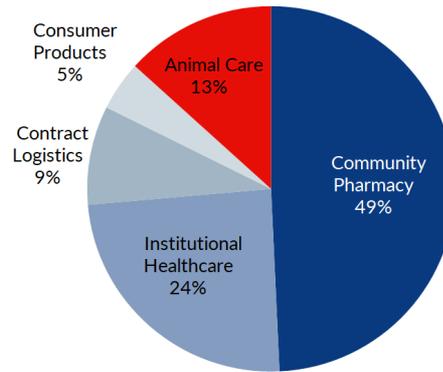
Australian spending data shows a clear spike in purchasing demand for pharmacy products through March, although this appears to have been short-lived (refer Figure 1), with a material moderation and weakening in recent weeks.

**Figure 1. ANZ data on Australian purchase trends for 'essentials'**



Source: Forsyth Barr analysis, ANZ

**Figure 2. EBO gross operating revenue breakdown**



Source: Forsyth Barr analysis, Company reports

**Figure 3. Earnings revisions (note forecasts are post IFRS16)**

A\$m	FY19A Actual	FY20E Old	FY20E New	% Chg	FY21E Old	FY21E New	% Chg	FY22E Old	FY22E New	% Chg
Revenue	6,930	8,679	8,902	2.7%	8,954	8,965	0.1%	9,238	9,246	0.1%
<b>EBITDA</b>	<b>261.6</b>	<b>333.1</b>	<b>338.4</b>	<b>1.7%</b>	<b>349.0</b>	<b>350.3</b>	<b>0.4%</b>	<b>365.3</b>	<b>365.7</b>	<b>0.1%</b>
Underlying NPAT	144.4	163.8	166.2	1.5%	175.8	176.7	0.5%	190.0	190.0	0.0%
Underlying EPS (cps)	94.7	101.3	102.8	1.6%	108.7	109.3	0.5%	117.5	117.5	0.0%
Dividend (NZ cps)	71.5	78.0	78.0	0.0%	83.0	83.0	0.0%	87.0	87.0	0.0%

Source: Forsyth Barr analysis

## 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%.

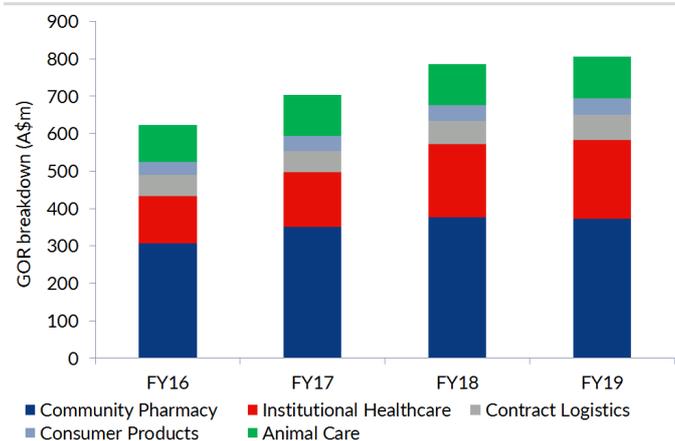
### Financial structure

- **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

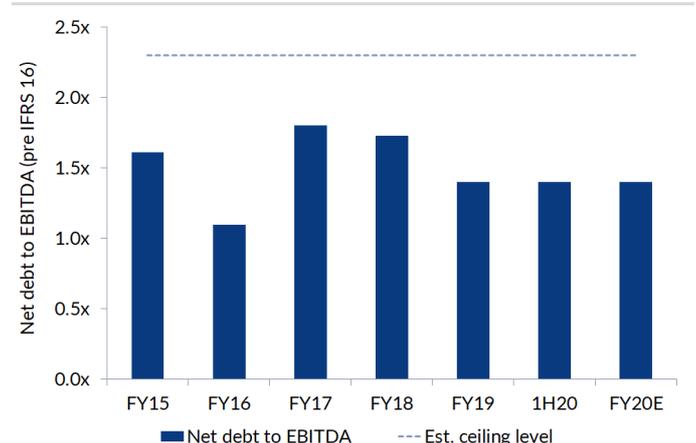
- **Regulatory change:** EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. Any change can impact EBO given its role in the supply chain.
- **Suppliers opting for a direct distribution model:** This could result in a loss of scale 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 4. Gross operating revenue through time**

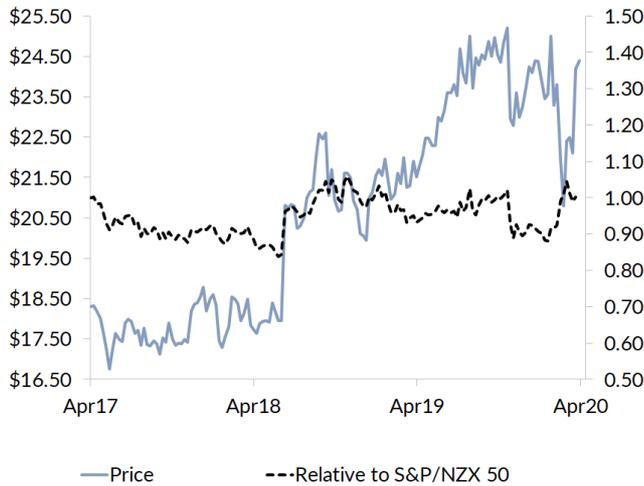


Source: Forsyth Barr analysis, Company reports

**Figure 5. Net debt to EBITDA**



Source: Forsyth Barr analysis, Company reports

**Figure 6. Price performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

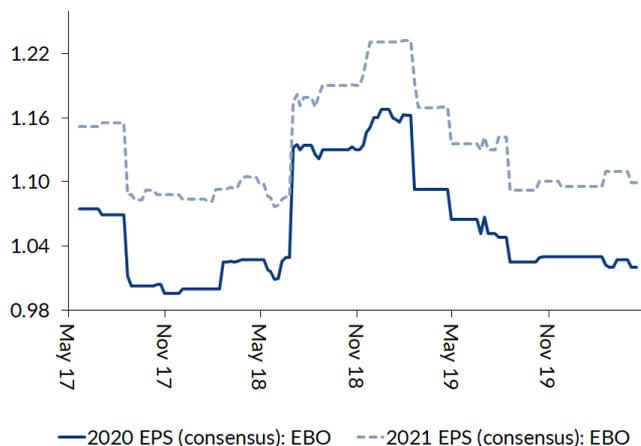
Shareholder	Latest Holding
Sybos Holdings	28.1%
FMR	10.1%

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

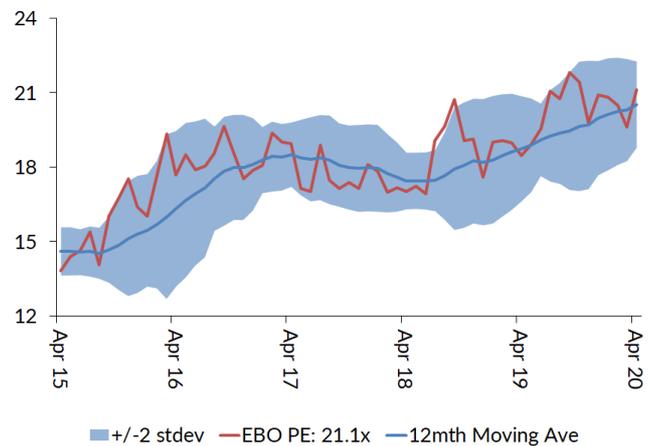
**Figure 8. International valuation comparisons**

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				2020E	2021E	2020E	2021E	2020E	2021E	
<i>(metrics re-weighted to reflect EBO's balance date - June)</i>										
<b>EBOS Group</b>	<b>EBO NZ</b>	<b>NZ\$24.18</b>	<b>NZ\$3,688</b>	<b>22.1x</b>	<b>20.8x</b>	<b>11.3x</b>	<b>10.9x</b>	<b>14.4x</b>	<b>13.8x</b>	<b>3.4%</b>
AUSTRALIAN PHARMA INDUS	API AT	A\$1.15	A\$567	12.1x	12.0x	6.5x	6.5x	9.1x	9.1x	6.5%
SIGMA HEALTHCARE	SIG AT	A\$0.70	A\$742	43.1x	26.8x	16.8x	13.5x	27.5x	19.9x	3.9%
MCKESSON CORP	MCK US	US\$120.02	US\$19,259	8.0x	7.4x	7.1x	7.0x	8.1x	7.9x	1.5%
AMERISOURCEBERGEN CORP	ABC US	US\$79.18	US\$16,234	12.6x	9.8x	8.2x	6.9x	10.2x	8.0x	2.2%
HENRY SCHEIN INC	HSIC US	US\$46.51	US\$6,669	11.3x	12.3x	7.9x	7.9x	10.3x	10.0x	n/a
PATTERSON COS INC	PDCO US	US\$16.88	US\$1,596	11.1x	10.5x	8.3x	8.1x	10.1x	10.0x	6.2%
SINOPHARM GROUP CO-H	1099 HK	CN¥17.26	CN¥53,863	7.7x	6.8x	4.8x	4.3x	5.2x	4.7x	4.3%
<b>Compcop Average:</b>				<b>15.1x</b>	<b>12.2x</b>	<b>8.5x</b>	<b>7.8x</b>	<b>11.5x</b>	<b>9.9x</b>	<b>4.1%</b>
<b>EBO Relative:</b>				<b>46%</b>	<b>70%</b>	<b>33%</b>	<b>41%</b>	<b>26%</b>	<b>39%</b>	<b>-17%</b>

 EV = Current Market Cap + Actual Net Debt  
 Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compcop metrics re-weighted to reflect headline (EBO) companies fiscal year end

**Figure 9. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**


Source: Forsyth Barr analysis

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