

EBOS Group

FY20 Preview — The Next Script

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NEUTRAL

We expect strong FY20 growth for EBOS Group (EBO) when the company reports on 20 August, with growth across all product categories, particularly Pharmacy Wholesale (introduction of Chemist Warehouse volumes), and helped by a stellar 3Q20 (boosted by consumer stock-piling). EBO's guidance for a "significant increase in earnings" has left plenty of scope for interpretation. We forecast NPAT of A\$166m, +15%, with 2H20 growth of +17%. Recent trading has likely been volatile as a result of COVID-19 and government restrictions, however, we expect the portfolio to show resilience with its key product exposures defensive and well positioned in the current backdrop. Outlook/trading insights will be of particular interest.

NZX Code	EBO	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$21.80	NPAT* (NZ\$m)	147.0	176.8	188.0	202.3	EV/EBITDA	14.2	10.8	10.4	10.0
Target price	NZ\$24.50	EPS* (NZc)	95.9	108.6	115.5	124.2	EV/EBIT	16.2	13.8	13.2	12.5
Risk rating	Medium	EPS growth* (%)	-2.6	13.2	6.3	7.6	PE	22.7	20.1	18.9	17.5
Issued shares	162.9m	DPS (NZc)	71.5	78.0	83.0	87.0	Price / NTA	25.1	18.5	13.4	10.2
Market cap	NZ\$3,550m	Imputation (%)	25	25	25	25	Cash div yld (%)	3.3	3.6	3.8	4.0
Avg daily turnover	291.5k (NZ\$6,489k)	*Based on normalised profits					Gross div yld (%)	3.6	3.9	4.2	4.4

Key points of interest

- Recent trading insights and any outlook comments:** Recent industry anecdotes are mixed and point to monthly volatility — with resilience in prescription medicines, while over-the-counter products have been more volatile. Regional pharmacies are also proving more resilient than CBD/mall locations, with foot traffic materially impacted for the latter as a result of COVID-19 related restrictions. 3Q20 was likely very strong, helped by consumer stockpiling. We look for insight on subsequent trading.
- Reiteration of recent regulatory changes — modestly positive for wholesalers:** Australia's 7th Community Pharmacy Agreement was signed in June 2020, bringing funding certainty through to 2025 and a modest net positive funding outcome for wholesalers. We have assumed a benefit of A\$6–7m per annum for EBO (c. 2–3% of earnings). Any greater insight from EBO will be of interest.
- M&A update:** EBO has a well signalled and consistent bolt-on acquisitive strategy. Gearing is conservative and we estimate headroom of c. A\$350–400m. It is difficult to judge the impact of COVID-19 — it may produce target options and/or a reset in valuation expectations, however, there is risk it slows decision making from vendors while uncertainty is rife.
- Voluntary escrow expires on 21 August for major shareholder:** The recent sell-down by major shareholder, Sybos Holdings, has weighed on EBO's share price through 2020. Sybos has reduced its stake to ~19% (from ~40%) via two block trades in November 2019 and June 2020. The current voluntary escrow period finishes on 21 August 2020, with risk of a further sell-down returning.

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

Requires pre-registration: <http://apac.directeventreg.com/registration/event/2543769>.

Figure 1. FY20 result expectations (A\$m)

A\$m	FY19A	FY20E	% chg	Consensus
EBITDA	261.6	338.4	29.4%	
EBITDA pre IFRS changes	261.6	299.6	14.5%	
Underlying NPAT	144.4	166.2	15.1%	163.1
Underlying EPS (A cps)	94.2	102.1	8.4%	
Dividend (NZ cps)	71.5	78.0	9.1%	77.4

Source: Forsyth Barr analysis, Company reports, Bloomberg consensus

Figure 2. EBITDA breakdown (A\$m)

A\$m	FY19A	FY20E	% chg	Like for like % chg*
Healthcare	226.6	294.8	30.1%	16.5%
Animal Care	48.3	58.2	20.6%	8.8%
Corporate costs	(13.3)	(14.6)	10.0%	19.0%
Total EBITDA	261.6	338.4	29.4%	14.5%

Source: Forsyth Barr analysis, Company reports *Adj for IFRS-16

Ebos Group Ltd (EBO)

Priced as at 17 Aug 2020 (NZ\$) **21.80**

12-month target price (NZ\$)*	24.50
Expected share price return	12.4%
Net dividend yield	3.8%
Estimated 12-month return	16.2%

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

Spot valuations (NZ\$)	
1. DCF	22.67
2. Multiple approach	22.20
n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	4,379
(Net debt)/cash	(389)
Less: Capitalised operating leases	(298)
Value of equity	3,692

Profit and Loss Account (A\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	6,987	6,930	8,902	8,965	9,246
Normalised EBITDA	250	262	338	350	366
Depreciation and amortisation	(32)	(33)	(73)	(73)	(73)
Normalised EBIT	218	229	266	277	292
Net interest	(21)	(25)	(30)	(26)	(23)
Associate income	0	0	0	0	0
Tax	(58)	(59)	(70)	(74)	(80)
Minority interests	2	(1)	0	0	0
Normalised NPAT	137	145	166	177	190
Abnormals/other	0	(7)	0	0	0
Reported NPAT	137	138	166	177	190
Normalised EPS (cps)	90.4	94.5	102.1	108.5	116.8
DPS (NZ cps)	68.5	71.5	78.0	83.0	87.0

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	14.6	14.2	10.8	10.4	10.0
EV/EBIT (x)	16.8	16.2	13.8	13.2	12.5
PE (x)	22.1	22.7	20.1	18.9	17.5
Price/NTA (x)	n/a	25.1	18.5	13.4	10.2
Free cash flow yield (%)	3.2	2.5	4.0	6.6	6.7
Net dividend yield (%)	3.1	3.3	3.6	3.8	4.0
Gross dividend yield (%)	3.4	3.6	3.9	4.2	4.4

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	10.5	9.0	8.9	10.6	12.9
Interest cover EBITDA (x)	12.0	10.3	11.3	13.4	16.2
Net debt/ND+E (%)	28.3	22.7	21.9	17.0	11.9
Net debt/EBITDA (x)	1.7	1.4	1.1	0.8	0.5

Growth Rates	2018A	2019A	2020E	2021E	2022E
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	7.6
Normalised EPS (%)	4.8	4.6	8.0	6.3	7.6
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	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	75	72	72	70

Cash Flow (A\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	250.1	261.6	338.4	350.3	365.7
Working capital change	(7.1)	(62.5)	(80.9)	(4.6)	(13.9)
Interest & tax paid	(80.9)	(80.6)	(99.5)	(100.2)	(102.2)
Other	0	0	0	0	0
Operating cash flow	162.1	118.5	158.1	245.5	249.6
Capital expenditure	(58.0)	(34.2)	(25.0)	(25.0)	(25.0)
(Acquisitions)/divestments	(30.8)	(85.9)	0	0	0
Other	0	0	(7.3)	(8.0)	(8.7)
Funding available/(required)	73.3	(1.5)	125.8	212.5	215.9
Dividends paid	(92.0)	(103.0)	(120.3)	(127.1)	(131.8)
Equity raised/(returned)	0	168.2	0	0	0
(Increase)/decrease in net debt	(18.7)	63.6	5.4	85.4	84.1

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

Balance Sheet (A\$m)	2018A	2019A	2020E	2021E	2022E
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
Total funds employed	1,632.1	1,747.3	2,047.0	2,032.1	2,025.8
Net debt/(cash)	432.4	365.7	359.5	273.1	188.1
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	1,280.4	1,331.0	1,390.3
Minority interests	21.4	(3.1)	(3.1)	(3.1)	(3.1)
Total funding sources	1,632.1	1,747.3	2,047.0	2,032.1	2,025.8

Key Healthcare segment revenue (A\$m)					
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

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. Bolt-on acquisitions remain an area of optionality, not captured in our valuation, 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.
- **COVID-19:** EBO is an essential service and its products are largely defensive. However, consumer purchasing habits and government restrictions has likely created some volatility in trading patterns.
- **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 ROCE in excess of 15%.

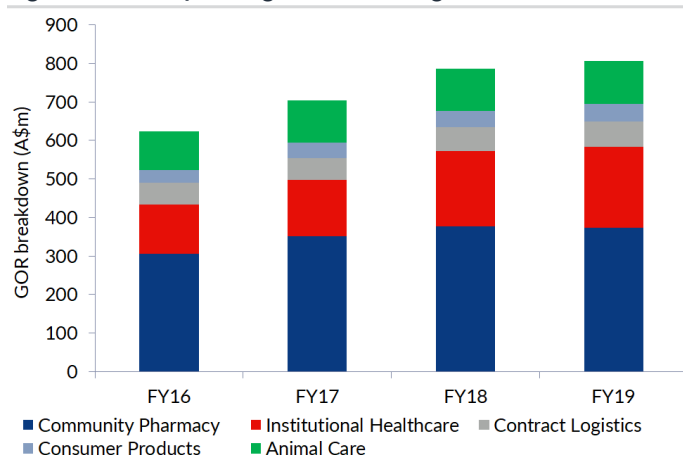
Financial structure

- **Gearing:** EBO targets a long term net debt to EBITDA range of 1.7-2.3x. We estimate current balance sheet headroom of c.A\$350-400m which provides runway for small to mid-size bolt-on acquisitions.

Risk factors

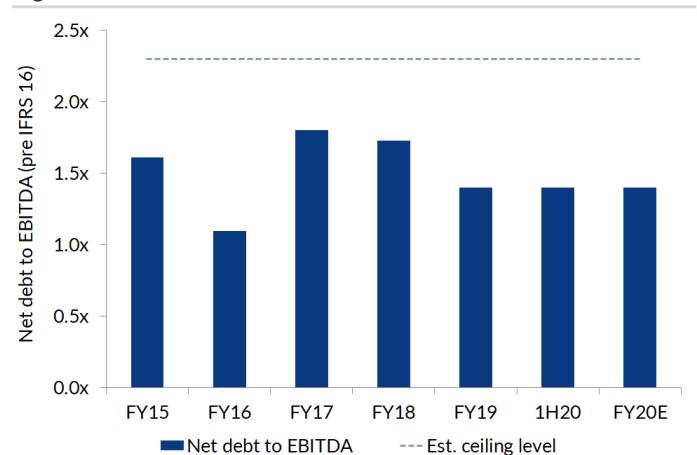
- **Regulatory change:** EBO's Healthcare segment operates in a challenging backdrop, with high levels of government regulation and price deflation. Any change can impact EBO given its role in the supply chain.
- **Suppliers opting for a direct distribution model:** This could result in a loss of scale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

Figure 3. Gross operating revenue through time

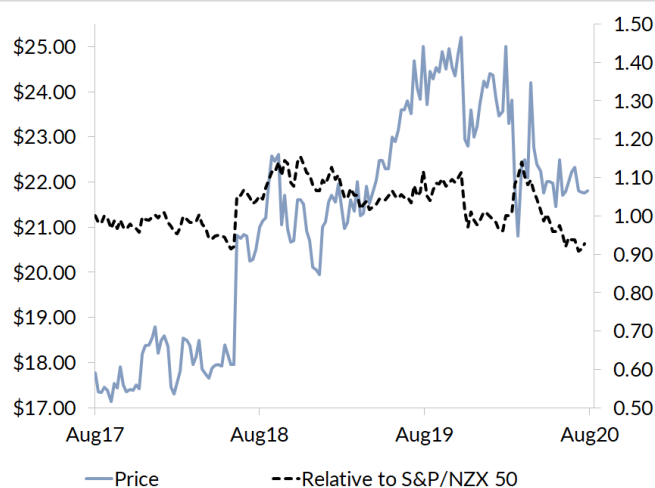


Source: Forsyth Barr analysis, Company reports

Figure 4. Net debt to EBITDA



Source: Forsyth Barr analysis, Company reports

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Sybos Holdings	18.7%
FMR	6.2%

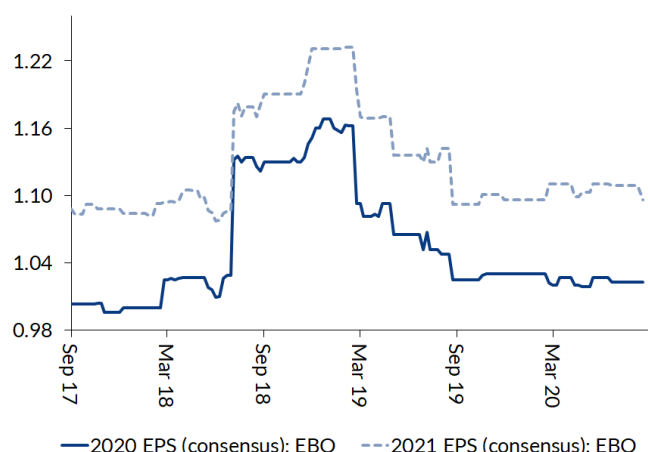
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

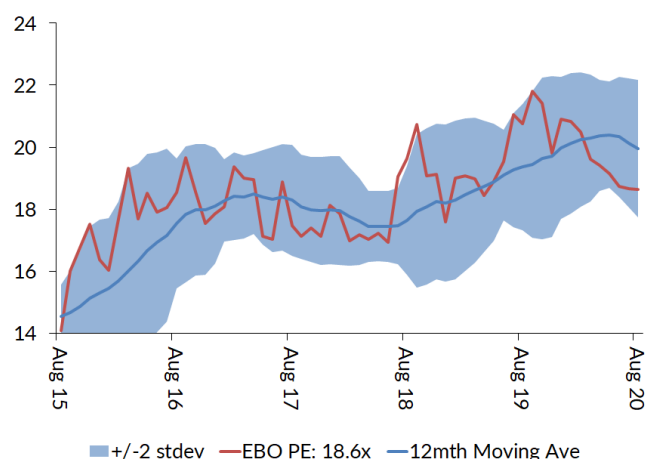
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect EBO's balance date - June)										
EBOS Group	EBO NZ	NZ\$21.80	NZ\$3,550	20.1x	18.9x	10.9x	10.6x	13.9x	13.4x	3.8%
AUSTRALIAN PHARMA INDUS	API AT	A\$1.14	A\$562	16.1x	13.6x	7.4x	6.4x	13.1x	10.8x	5.3%
SIGMA HEALTHCARE	SIG AT	A\$0.69	A\$731	<0x	23.9x	27.5x	11.7x	<0x	17.4x	2.4%
MCKESSON CORP	MCK US	US\$158.67	US\$25,735	26.5x	10.2x	8.4x	8.0x	12.2x	9.4x	1.1%
AMERISOURCEBERGEN CORP	ABC US	US\$103.75	US\$21,180	16.4x	12.7x	10.5x	8.8x	12.9x	9.9x	1.7%
HENRY SCHEIN INC	HSIC US	US\$67.23	US\$9,598	20.1x	22.4x	12.8x	13.4x	17.5x	17.6x	n/a
PATTERSON COS INC	PDCO US	US\$26.92	US\$2,592	<0x	19.1x	<0x	12.5x	<0x	15.9x	3.9%
SINOPHARM GROUP CO-H	1099 HK	CN¥18.78	CN¥58,606	8.7x	8.0x	3.8x	3.5x	4.3x	3.8x	3.7%
Compco Average:				17.6x	15.7x	11.7x	9.2x	12.0x	12.1x	3.0%
EBO Relative:				14%	20%	-7%	15%	16%	10%	26%

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 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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