AFT Pharmaceuticals

Margins improving

Financial update

Pharma & biotech

AFT Pharmaceuticals recently reported its H119 results. Operating revenue grew 4.1% compared to H118 and was negatively affected by the divestment of relatively low margin hospital products in New Zealand and Australia. Gross profit, however, grew 24.1% as gross margins improved to 46.7% from 39.1% a year ago thanks to reduced exposure to lower-margin products as well as high growth in the higher margin over-the-counter (OTC) segment. Sales outside of New Zealand and Australia, which are primarily driven by Maxigesic, grew 72.7% and now represent 10.2% of sales compared to 6.1% in H118.

Year end	Revenue (NZ$m)	PBT* (NZ$m)	EPS* (NZ$)	DPS (NZ$)	P/E (x)	Yield (%)
03/17	69.2	(18.5)	(0.19)	0.0	N/A	N/A
03/18	80.1	(12.9)	(0.13)	0.0	N/A	N/A
03/19e	91.2	(2.2)	(0.02)	0.0	N/A	N/A
03/20e	109.5	10.0	0.10	0.0	22.0	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Strong underlying growth in Australia continues

Revenue in Australia was up 6.9% in H119 compared to H118 and was negatively affected by the hospital product divestments. The hospital segment as a whole was down 10% whereas OTC products grew 17% and the prescription channel grew 10%. The company expects newly launched hospital products to replace the lost revenue around the end of FY19 or early FY20 but at higher margins.

Maxigesic continues to grow globally

Maxigesic is sold and launched in 15 countries (with key recent launches in Malaysia and Ireland) and distribution agreements are in place in a total of 128 (Russia, South Korea, Taiwan and Hong Kong being recent additions). Launches in several countries such as France, Mexico, Spain, Portugal and the Nordics are expected by the end of FY19.

IV Maxigesic expected to be filed in 2019

The company has a meeting with the FDA in which the regulatory agency asked for more clinical data prior to approval, although the company expects to be able to complete this quickly with a filing expected in the 2019 calendar year. We continue to view IV Maxigesic as a big opportunity as Mallinckrodt sells an IV formulation of paracetamol/acetaminophen in the US at a $350m annual run rate. Licensing discussions with US partners are ongoing.

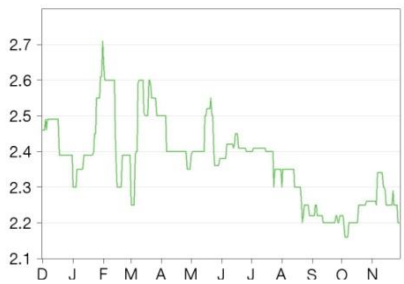
Valuation: NZ$478m or NZ$4.91 per share

We are maintaining our valuation of NZ$478m or NZ$4.91 per share as the impact of lower revenues due to divested products and a higher level of net debt was cancelled out by improved profitability and rolling forward our NPV. We continue to expect the company to be EBITDA breakeven for FY19.

30 November 2018

Price	**NZ$2.20**
Market cap	**NZ$214m**
	NZ$0.68/US$
Net debt (NZ$m) at 30 September 2018	34.5
Shares in issue	97.3m
Free float	21.6%
Code	AFT
Primary exchange	NZX
Secondary exchange	ASX

Share price performance



%	1m	3m	12m
Abs	(2.7)	(0.9)	(10.6)
Rel (local)	(4.4)	6.9	(14.3)
52-week high/low		NZ$2.7	NZ$2.2

Business description

AFT Pharmaceuticals is a specialty pharmaceutical company that operates primarily in Australasia but has product distribution agreements across the globe. The company's product portfolio includes prescription and over-the-counter drugs to treat a range of conditions and a proprietary nebuliser.

Next events

Additional Maxigesic launches	2018/2019
IV Maxigesic filing	2019

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Edison profile page

AFT Pharmaceuticals is a research client of Edison Investment Research Limited

H119 results

AFT recently reported operating revenue of NZ$38.0m for H119, ending 30 September 2018. This represents a 4.1% increase over H118 and would have been larger had it not been for the divestment of relatively low-margin hospital products that were being sold in Australia and New Zealand. Importantly, gross profit grew 24.1% as gross margins improved to 46.7% from 39.1% a year ago thanks to reduced exposure to lower margin products as well as high growth in the higher margin over-the-counter (OTC) segment. What is especially impressive is that despite revenue growing by NZ$1.5m compared to H118, cost of sales fell by NZ$2.0m over the same period. This greatly affected the profitability of the company with the operating loss (before items such as interest and other gains/losses) falling from NZ$6.7m in H118 to NZ$0.1m in H119.

Exhibit 1: H119 results by segment

NZ$000s	Revenues (H119)	Revenues (H118)	Loss before tax (H119)	Loss before tax (H118)
Australia	21,601	20,206	(519)	(171)
New Zealand	12,566	14,113	(2,862)	(2,294)
Asia	1,118	618	(152)	(371)
Rest of World	2,760	1,627	(731)	(3,737)
Total	38,045	36,561	(4,264)	(6,573)

Source: AFT Pharmaceuticals

Revenue in Australia was up 6.9% in H119 compared to H118 and was negatively affected by the hospital product divestments, which led to the hospital segment being down 10%. The company expects newly launched hospital products to replace the lost revenue around the end of FY19 or early FY20 but at higher margins. OTC products grew 17% thanks in part to Maxigesic doubling, while the prescription channel grew 10%.

New Zealand revenue was especially weak, declining 11.0% due both to the hospital product divestitures as well as no longer having the sole supplier contract for Metoprolol. The OTC segment was one highlight, growing 9%. Another was that gross profit in New Zealand improved by 23%. Sales outside of New Zealand and Australia, which are primarily driven by Maxigesic, grew 72.7% and now represent 10.2% of sales compared to 6.1% in H118.

Maxigesic launch update

Maxigesic is now sold and launched in 15 countries – Australia, New Zealand, Brunei, El Salvador, Israel, Iraq, Ireland, Italy, Malaysia, Malta, Nicaragua, Serbia, Singapore, United Arab Emirates and the UK. There are distribution agreements in place in a total of 128 (Russia, South Korea, Taiwan and Hong Kong are recent additions) with a key focus on signing distribution agreements in the US, Canada, Germany and parts of South America, such as Brazil, with discussions beginning or already underway in those countries.

Pipeline update

IV Maxigesic is getting closer to filing. Following a pre-NDA meeting with the FDA, the company believes it needs to do some additional clinical work on the product although it expects to be able to complete this quickly with a filing expected in the 2019 calendar year. The company has also submitted the data from the IV Maxigesic pivotal study to a major journal for publication, which should help increase its profile. We continue to view IV Maxigesic as a big opportunity as Mallinckrodt sells an IV formulation of paracetamol/acetaminophen (just one component of the paracetamol/acetaminophen and ibuprofen combination that is Maxigesic) in the US at a $350m annual run rate with the potential for meaningful upfront payments from any licensing agreement. AFT also recently licensed Maxigesic IV for the South Korean market to Kyongbo Pharm with registration expected in the coming months and sales expected to begin in FY20. AFT expects to launch IV Maxigesic in Australia in the same year.

With regards to NasoSURF, human factor studies for the product have led to some redesign work and clinical studies are now expected to commence in FY20 (previously FY19). On Pascomer, clinical studies are being planned and alternatives to fund its clinical development are being investigated.

Valuation

We are maintaining our valuation of NZ$478m or NZ$4.91 per share as the impact of lower revenues due to divested products and a higher level of net debt was cancelled out by improved profitability and rolling forward our NPV. Importantly, while we have kept our terminal growth assumption unchanged, we have increased our terminal EBIT margin estimate from 34% to 36% due to the significant increase in the gross margin during the quarter.

Exhibit 2: DCF sensitivity table (NZ$/share)

	Terminal EBIT margin				
Terminal revenue growth	**30%**	**34%**	**36%**	**40%**	**45%**
-2%	3.26	3.55	3.70	3.99	4.36
-1%	3.44	3.76	3.92	4.24	4.64
0%	3.66	4.01	4.18	4.53	4.97
1%	3.92	4.31	4.51	4.90	5.39
2%	4.25	4.69	**4.91**	5.35	5.90
3%	4.68	5.18	5.43	5.93	6.56
4%	5.24	5.83	6.12	6.71	7.44
5%	6.04	6.74	7.09	7.79	8.67

Source: Edison Investment Research

Financials

We have decreased our revenue estimates from NZ$99.6m to NZ$91.2m for FY19 and from NZ$120.7m to NZ$109.5m for FY20 mainly due to hospital product divestments in Australia and New Zealand, although part of the decrease is due to more conservative estimates for rest of world sales as registrations are taking longer than expected. We have also decreased our SG&A expense estimates for FY19 by NZ$2.0 and for FY20 by NZ$2.7m due to a lower than expected run rate. Additionally, we have reduced our R&D expense estimates by NZ$1.2m for FY19 and by NZ$1.5m for FY20 as R&D expenses have fallen faster than expected. Our FY19 EBITDA estimate is broadly unchanged (essentially breakeven) but our estimate for profit before tax has been reduced mainly due to finance costs and the other gains/(losses) line item.

The company reported a cash position of NZ$7.4m at the end of H119 after drawing down an additional US$5m from the Capital Royalty Group (CRG) facility in August and owe US$27.8m in the US denominated debt (which grew by NZ$3.1m due to US dollar strength during H119), that is due 31 March 2020. The company is working with CRG to expand and extend the current facility.

Exhibit 2: Edison forecast changes

NZ$m	2019e		2020e	
	Old	**New**	**Old**	**New**
Revenue	99.6	91.2	120.7	109.5
PBT, normalised	0.04	(2.22)	9.86	10.04
EPS, normalised (NZ$)	0.00	(0.02)	0.10	0.10

Source: Edison Investment Research

Exhibit 3: Financial summary

NZ$000	2017	2018	2019e	2020e
March	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP
PROFIT & LOSS				
Revenue	69,205	80,071	91,225	109,547
Cost of Sales	(43,207)	(45,880)	(49,301)	(53,946)
Gross Profit	25,998	34,191	41,924	55,601
EBITDA	(15,125)	(10,479)	1,647	11,933
Operating Profit (before amort. and except.)	(14,982)	(10,353)	1,749	12,035
Intangible Amortisation	183	214	180	180
Exceptionals	0	0	0	0
Other	2,245	741	1,912	2,008
Operating Profit	(12,554)	(9,398)	3,841	14,222
Net Interest	(3,531)	(2,527)	(3,968)	(2,000)
Profit Before Tax (norm)	(18,513)	(12,880)	(2,219)	10,035
Profit Before Tax (reported)	(16,085)	(11,925)	(127)	12,222
Tax	(58)	(58)	76	0
Profit After Tax (norm)	(18,571)	(12,938)	(2,143)	10,035
Profit After Tax (reported)	(16,143)	(11,983)	(51)	12,222
Average Number of Shares Outstanding (m)	97.1	97.2	97.3	97.3
EPS - normalised (NZ$)	(0.19)	(0.13)	(0.02)	0.10
EPS - normalised (c)	(19.12)	(13.30)	(2.20)	10.31
EPS - (reported) (NZ$)	(0.17)	(0.12)	(0.00)	0.13
Dividend per share (c)	0.00	0.00	0.00	0.00
Gross Margin (%)	37.6	42.7	46.0	50.8
EBITDA Margin (%)	N/A	N/A	1.8	10.9
Operating Margin (before GW and except.) (%)	N/A	N/A	1.9	11.0
BALANCE SHEET				
Fixed Assets	4,171	8,291	11,333	14,053
Intangible Assets	2,548	5,118	7,619	10,120
Tangible Assets	386	330	421	640
Investments	1,237	2,843	3,293	3,293
Current Assets	54,060	48,312	50,847	59,824
Stocks	18,718	24,412	26,294	29,259
Debtors	19,362	16,954	16,434	18,287
Cash	15,980	6,946	8,120	12,279
Other	0	0	0	0
Current Liabilities	(15,019)	(18,489)	(14,410)	(15,892)
Creditors	(15,019)	(18,489)	(14,410)	(15,892)
Short term borrowings	0	0	0	0
Long Term Liabilities	(23,426)	(30,654)	(41,938)	(41,938)
Long term borrowings	(23,426)	(30,654)	(41,938)	(41,938)
Other long term liabilities	0	0	0	0
Net Assets	19,786	7,460	5,833	16,047
CASH FLOW				
Operating Cash Flow	(15,473)	(8,319)	761	9,161
Net Interest	(3,531)	(2,527)	(3,968)	(2,000)
Tax	(58)	(58)	76	0
Capex	(1,598)	(2,853)	(2,874)	(3,002)
Acquisitions/disposals	0	(3,002)	(702)	0
Financing	9,042	877	0	0
Dividends	0	(412)	0	0
Net Cash Flow	(11,618)	(16,294)	(6,707)	4,159
Opening net debt/(cash)	(4,894)	7,446	23,708	33,818
HP finance leases initiated	0	0	0	0
Other	(722)	32	(3,403)	0
Closing net debt/(cash)	7,446	23,708	33,818	29,659

Source: Edison Investment Research, company accounts

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