

AFT Pharmaceuticals

Growth despite COVID-19 challenges

Financial update

Pharma & biotech

24 November 2020

Price **NZ\$4.89**

Market cap **NZ\$511m**

NZ\$0.69/US\$

Net debt (NZ\$m) at 30 September 2020 34.3

Shares in issue 104.6m

Free float 31.3%

Code AFT

Primary exchange NZX

Secondary exchange ASX

Share price performance



% 1m 3m 12m

Abs (0.6) (2.2) 57.7

Rel (local) (0.8) (6.7) 41.3

52-week high/low NZ\$5.46 NZ\$3.10

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 FY21

Analysts

Maxim Jacobs +1 646 653 7027

Nathaniel Calloway +1 646 653 7036

healthcare@edisongroup.com

[Edison profile page](#)

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AFT Pharmaceuticals recently reported its results for the first half of FY21. Operating revenue grew by a strong 4% year-on-year to NZ\$48.8m driven mainly by 11% growth in Australia and despite the impact of COVID-19 across the business. Reported group operating profit was NZ\$2.4m compared to NZ\$13.7m in the same period a year ago (NZ\$3.9m if a one-time gain of NZ\$9.8m from the first half of FY20 is excluded). Importantly, AFT continues to guide to operating profit of NZ\$14–18m in FY21.

Year end	Revenue (NZ\$m)	PBT* (NZ\$m)	EPS* (NZ\$)	DPS (NZ\$)	P/E (x)	Yield (%)
03/19	85.1	(2.1)	(0.02)	0.0	N/A	N/A
03/20	105.6	3.4	0.03	0.0	N/A	N/A
03/21e	117.6	13.3	0.13	0.0	37.6	N/A
03/22e	139.4	25.9	0.21	0.0	23.3	N/A

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

Closer to FDA approval for Maxigesic

AFT received a complete response letter (CRL) from the FDA for the tablet form of Maxigesic in November. The only significant 'deficiency' cited in the application was that the FDA needed to inspect the manufacturing facilities, which they were unable to do by the PDUFA date due to COVID-19 related travel restrictions (which has become a relatively common problem for the industry). The timing of an inspection, whether physical or virtual, is unclear. Otherwise, the FDA only requested minor labelling changes and updated safety data.

Maxigesic launched in 34 countries

Maxigesic is now sold and launched in 34 countries, up from 28 at the end of March. The company expects to have Maxigesic launched in an additional nine countries in the second half of FY21. Licensing momentum was hurt by COVID-19 travel restrictions, but has been improving, though this may slow down again with the more recent lockdowns.

COVID-19 impact across the business

The pandemic has had an impact across the business, including product sales, supply and licensing negotiations for Maxigesic. This was mainly due to government restrictions limiting the ability to travel/export and restrictions that hampered the ability of consumers to have non-COVID-19 related medical visits and to have product dispensed at pharmacies. With vaccines likely to be approved shortly, we expect any further negative impact to be relatively brief.

Valuation: NZ\$629m or NZ\$6.02 per share

We are increasing our valuation from NZ\$596m or NZ\$5.94 per share to NZ\$629m or NZ\$6.02 per share, mainly due to rolling forward our NPV and lower net debt. This was partially offset by lower near-term operating profit forecasts due to slower than expected sales in the rest of world region. The company reported NZ\$5.9m in cash and NZ\$40.1m in debt at the end of the first half of FY21.

H121 results

AFT has reported revenue of NZ\$48.8m for the first half of FY21 (H121), the period ending 30 September 2020. This represents a 4% increase over the same period in the prior year. Revenue in Australia was up 11% to NZ\$28.6m. The OTC channel, which represents approximately 60% of revenue for Australia, grew 9% (to NZ\$17.2m). This was negatively affected by weak Maxigesic sales due to COVID-19 restrictions though this was offset in part by strong growth in eyecare as well as sales of hand sanitizer and face masks. The hospital channel grew by 13% to NZ\$8.6m and was helped by antibiotic sales in response to the pandemic. The prescription channel grew 17% thanks to new product introductions but was hampered due to a decline in visits to general practitioners for non-COVID-19 related purposes. Despite all these challenges, operating profits rose to NZ\$3.2m in Australia from NZ\$1.9m in the same period in FY20.

New Zealand revenue was flat at NZ\$13.7m. The OTC channel grew 3% to NZ\$7.6m thanks to allergy medicines and face masks. The hospital channel grew by 11% to NZ\$2.2m due to strong antibiotic sales. The prescription channel fell by 9% to NZ\$4.0m due to restrictions on visits to general practitioners and governments preventing pharmacists from dispensing more than 30 days of medicine. The operating loss (including head office costs) was NZ\$1.4m, 3% larger than in the same period last year.

Asia revenue fell by 7% to NZ\$2.2m. The OTC segment benefited from COVID-19 related stockpiling of Maxigesic in Singapore, while the hospital and prescription channels declined due to a transition to higher-margin products. This transition helped increase operating profit from NZ\$0.1m in H120 to NZ\$0.7m in H121. Importantly, e-commerce sales have commenced in China and sales are expected to begin in South Korea in the near future.

Exhibit 1: H121 results by segment

NZ\$000s	Revenues H121	Revenues H120	Operating profit before tax H121	Operating profit before tax H120
Australia	28,552	25,697	3,195	1,861
New Zealand	13,709	13,691	(1,425)*	(1,378)*
Asia	2,198	2,369	721	98
Rest of world	4,362	5,189	(69)	13,110**
Total	48,821	46,946	2,422	13,691

Source: AFT Pharmaceuticals. Note: *New Zealand profit before tax includes head office expenses. **Rest of world profit before tax includes a non-recurring gain of NZ\$9.8m; without this gain profit before tax for this region would have been NZ\$3.3m.

Rest of world revenues declined by 16% to NZ\$4.4m as licensing income fell by 88% due to delayed deal-signing as a result of COVID-19 related travel restrictions. Deal momentum has been improving according to management, though there may be additional issues as a second wave of lockdowns have occurred. To help mitigate this impact, AFT relocated one of its business development personnel to Switzerland. Revenue from ROW product sales grew by 57% to NZ\$3.9m. Sales were assisted by new launch orders shipped to Mexico, Germany, Belgium and Luxembourg, but were negatively affected by COVID-19 in India where Maxigesic is being manufactured. The company is currently in the process of diversifying its manufacturing base.

Maxigesic tablets are now sold and launched in 34 countries, up from 28 at the end of March. The company expects to have Maxigesic launched in an additional nine countries in the second half of FY21. To assist with sales and regulatory filings in Europe, AFT has set up an EU-based affiliate in Ireland. During the first half of FY20, 10 Maxigesic IV licensing and distribution agreements were signed, including in Germany, Austria, France and Italy. And since the end of the period there were additional signings for Maxigesic tablets in Greece and Pakistan and for Maxigesic IV in Hong Kong and the UK. The company continues to work on licensing agreements for both the tablet and

intravenous forms of Maxigesic in the US, Japan and China. The fact that the only significant 'deficiency' cited in the FDA new drug approval application for the tablet form of Maxigesic was due to COVID-19 related manufacturing facility inspection delays is a positive and should give potential partners comfort.

Exhibit 2: Maxigesic product country totals by status

	Maxigesic tablets		Maxigesic IV		Maxigesic oral solution	
	September 2020	March 2020	September 2020	March 2020	September 2020	March 2020
Licensed	125+	125+	90	80	122	122
Registered	46	44	20	3		
Sold in	34	28	3			

Source: AFT Pharmaceuticals

With regards to NasoSURF, engineering batches have been successfully completed and development work on a specific dose form has commenced. Clinical studies are planned for calendar year 2021. The 120-patient Pascomer Phase II/III clinical study is continuing to enrol patients, although there have been delays in recruitment due to COVID-19. Study completion is expected in the 2021 calendar year.

Valuation

We are increasing our valuation from NZ\$596m or NZ\$5.94 per share to NZ\$629m or NZ\$6.02 per share, mainly due to rolling forward our NPV and lower net debt. This was partially offset by lower near-term operating profit forecasts due to slower than expected sales in the rest of world region.

Exhibit 3: DCF sensitivity table (NZ\$/share)

Terminal revenue growth	Terminal EBIT margin				
	30.00%	34.00%	36.0%	40.0%	45.0%
-2%	4.06	4.40	4.57	4.91	5.33
-1%	4.28	4.65	4.83	5.20	5.67
0%	4.54	4.95	5.15	5.56	6.06
1%	4.86	5.31	5.54	5.99	6.55
2%	5.26	5.76	6.02	6.52	7.16
3%	5.77	6.35	6.64	7.22	7.94
4%	6.45	7.12	7.46	8.14	8.98
5%	7.40	8.21	8.61	9.42	10.43

Source: Edison Investment Research

Financials

We have decreased our revenue estimate for FY21 to NZ\$117.6m from NZ\$125.1m and for FY22 to NZ\$139.4m from NZ\$146.5m mainly due to delays in additional licence agreements and launches of Maxigesic in the rest of world region. We have lowered our SG&A estimate for FY21 by NZ\$5.8m and for FY22 by NZ\$6.2m. The reason for this was that SG&A expenses in the first half fell by 7% and we had forecast them increasing, so our new forecast puts these expenses more in line with the current run rate. We have also increased our R&D expense estimate by NZ\$1.5m in both years as this line item was higher than anticipated. After these changes, our FY21 normalised PBT estimate is NZ\$13.3m, compared to NZ\$15.5m previously, while our normalised FY22 PBT estimate is now NZ\$25.9m, compared to NZ\$27.2m previously.

Exhibit 4: Edison forecast changes

	FY21e		FY22e	
	Old	New	Old	New
Revenue (NZ\$m)	125.1	117.6	146.5	139.4
PBT, normalised (NZ\$m)	15.5	13.3	27.2	25.9
EPS, normalised (NZ\$)	0.15	0.13	0.23	0.21

Source: Edison Investment Research

The company reported NZ\$5.9m in cash and NZ\$40.1m in debt at the end of the first half of FY21. AFT raised approximately NZ\$12m through the issuance of new equity (c 3.2m shares at NZ\$3.75 per share) during the first half, using NZ\$3m to pay off debt. The company had expected to use more of the cash to pay off its debt but instead built inventory (inventory increased by NZ\$13.3m compared to the same period in the prior year) to mitigate the business impact of COVID-19 related supply and freight difficulties. We believe AFT will be able to further pay down the debt from operating cash flow and is not in need of additional financing.

Exhibit 5: Financial summary

	NZ\$000	2019	2020	2021e	2022e
Year end 31 March		NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP
PROFIT & LOSS					
Revenue		85,127	105,597	117,570	139,439
Cost of Sales		(44,397)	(57,332)	(64,045)	(69,711)
Gross Profit		40,730	48,265	53,526	69,728
EBITDA		6,205	10,894	15,426	27,692
Operating Profit (before amort. and except.)		6,320	11,708	16,240	28,506
Intangible Amortisation		(204)	(286)	(286)	(286)
Exceptionals		0	9,784	0	0
Other		0	0	0	0
Operating Profit		6,116	21,206	15,954	28,220
Net Interest		(8,375)	(8,329)	(2,935)	(2,603)
Profit Before Tax (norm)		(2,055)	3,379	13,306	25,903
Profit Before Tax (reported)		(2,259)	12,877	13,020	25,617
Tax		(168)	(185)	(74)	(3,586)
Profit After Tax (norm)		(2,223)	3,194	13,232	22,316
Profit After Tax (reported)		(2,427)	12,692	12,946	22,030
Average Number of Shares Outstanding (m)		97.3	97.3	104.6	104.6
EPS - normalised (c)		(2.28)	3.28	12.65	21.34
EPS - (reported) (NZ\$)		(0.03)	0.12	0.12	0.21
Dividend per share (c)		0.00	0.00	0.00	0.00
Gross Margin (%)		47.8	45.7	45.5	50.0
EBITDA Margin (%)		7.3	10.3	13.1	19.9
Operating Margin (before GW and except.) (%)		7.4	11.1	13.8	20.4
BALANCE SHEET					
Fixed Assets		12,334	31,716	35,424	38,465
Intangible Assets		8,239	26,984	30,704	33,629
Tangible Assets		357	315	295	411
Investments		3,738	4,417	4,425	4,425
Current Assets		51,261	55,336	64,485	78,882
Stocks		25,158	22,734	35,995	39,595
Debtors		19,187	25,969	16,567	22,856
Cash		6,916	6,119	11,815	16,323
Other		0	514	108	108
Current Liabilities		(58,504)	(25,102)	(19,906)	(19,121)
Creditors		(16,368)	(22,993)	(19,713)	(19,121)
Short term borrowings		(41,750)	(2,000)	0	0
Other		(386)	(109)	(193)	0
Long Term Liabilities		0	(44,695)	(38,195)	(34,195)
Long term borrowings		0	(41,200)	(34,700)	(30,700)
Other long term liabilities		0	(3,495)	(3,495)	(3,495)
Net Assets		5,091	17,255	41,808	64,031
CASH FLOW					
Operating Cash Flow		9,610	21,999	11,287	18,839
Net Interest		(8,375)	(6,936)	(2,935)	(2,603)
Tax		(168)	(185)	(74)	(3,586)
Capex		(3,465)	(6,562)	(3,952)	(4,141)
Acquisitions/disposals		(1,419)	0	0	0
Financing		0	3	11,652	0
Dividends		(134)	(566)	(187)	0
Net Cash Flow		(3,951)	7,753	15,792	8,509
Opening net debt/(cash)		23,708	34,834	37,081	22,885
HP finance leases initiated		0	0	0	0
Other		(7,175)	(10,000)	(1,596)	0
Closing net debt/(cash)		34,834	37,081	22,885	14,377

Source: company reports, Edison Investment Research

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia