hardman&co

Pharmaceuticals & Biotechnology

Source: Eikon Thomson Reuters

Market data	
EPIC/TKR	**APH**
Price (p)	93.2
12m High (p)	102.5
12m Low (p)	48.8
Shares (m)	514.2
Mkt Cap (£m)	479.2
EV (£m)	567.5
Free Float*	89%
Market	AIM

**As defined by AIM Rule 26*

Description

APH acquires, markets and distributes medical and healthcare brands in the UK, Europe, and the US (direct sales) and in the RoW (via a distributor network), through a buy-and-build strategy, generating relatively predictable and strong cashflows.

Company information	
CEO	Peter Butterfield
CFO	Andrew Franklin
Chairman	David Cook
	+44 1249 466 966
	www.alliancepharmaceuticals.com

Key shareholders	
Directors	11.1%
Fidelity	8.9%
MVM Life Sciences	7.9%
Slater Invests.	6.6%
Blackrock	5.0%
GVQ	3.9%
Artemis	3.6%

Diary	
19 Sep	1H'18 results

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Alliance Pharma

2018: a year of international progress

Alliance Pharma (APH) is continuing with its buy-and-build strategy, having evolved through 35 acquisitions over a period of 20 years into a profitable, cash-generative, specialty pharma business. The company has a mix of international growth brands – Kelo-cote, MacuShield, Vamousse – and a bedrock of solid, local, low-growth products. A fourth international growth brand in the portfolio, Nizoral, was acquired from J&J on 21 June 2018 in the APAC region. The cash consideration of £60m was funded by a Placing and an increased debt facility. Adding also to growth prospects, Diclectin (now registered as Xonvea®) was approved in the UK in July.

- **Strategy**: Since inauguration, APH has adopted a buy-and-build model, with 35 deals over 20 years assembling a portfolio of more than 90 products and establishing a strong track record. It is accelerating growth through investing in multi-market brands, with infrastructure supported by its bedrock products.

- **Trading update:** Underlying sales performance for 1H'18 was slightly better than forecast, at 4%, boosted by acquisitions (+8%). Kelo-Cote was exceptional, with CER growth of 88% (est) to £10.9m (£6.2m) offsetting a softer performance from the bedrock portfolio. Net debt at 30 June was also better, at -£86.3m.

- **Nizoral:** APH acquired the Nizoral brand (medicated anti-dandruff shampoos) from J&J in the APAC region for a cash consideration of £60.0m, increasing sales in this important region 2.6x and adding well-established multi-national distribution partners and new territories (India and Japan).

- **Xonvea (Diclectin):** Adding to the positivity, APH and its partner, Duchesney Inc, received approval for Xonvea (nausea and vomiting of pregnancy) in the UK after a year of dialogue with the MHRA. Launch will take place in autumn 2018. Plans are underway to submit for EMA approval in APH's nine European territories.

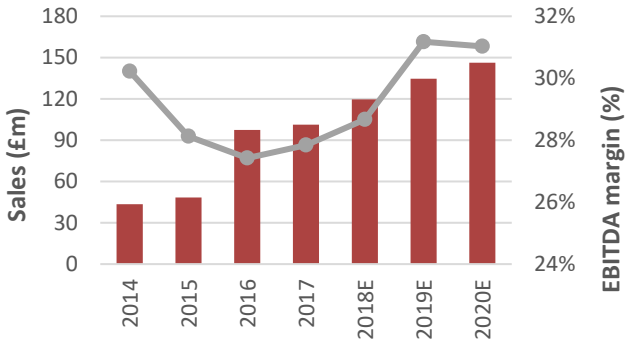
- **Investment summary:** Recent acquisitions look set to boost APH into generating underlying CAGR of 17% in sales and 10% in EPS over the next three years. On the back of this strong performance, the company is expected to continue with its progressive dividend policy. The shares are trading on a 2018E P/E of 20.1x, falling to 17.6x in 2019E, and carry a prospective dividend yield of 1.6%.

Financial summary and valuation

Year-end Dec (£m)	2015	2016	2017	2018E	2019E	2020E
Reported sales	48.3	97.5	101.3	119.7	134.0	144.0
EBITDA (underlying)	13.6	26.7	28.2	33.7	39.5	42.0
Reported pre-tax profit	15.2	22.2	*28.4	**28.9	32.7	35.9
Underlying EPS (p)	4.0	4.0	4.2	4.6	5.3	5.8
Reported EPS (p)	4.7	3.9	6.1	4.7	5.0	5.5
DPS (p)	1.1	1.2	1.3	1.5	1.6	1.8
Net (debt)/cash	-71.5	-76.1	-72.3	-87.7	-71.9	-54.7
Net debt/EBITDA (x)	5.3	2.8	2.6	2.6	1.8	1.3
P/E (x)	23.5	23.4	22.0	20.1	17.6	16.1
EV/sales (x)	11.7	5.8	5.6	4.7	4.2	3.9
EV/EBITDA (x)	41.7	21.2	20.1	16.8	14.4	13.5
Dividend yield (%)	1.2	1.3	1.4	1.6	1.7	1.9

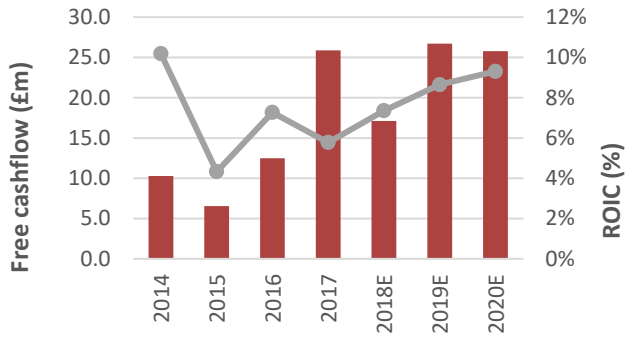
**Includes £5m Sinclair settlement less costs; **Includes £1.5m profit on disposal Unigreg JV*
Underlying figures exclude exceptional items and share-based costs
Source: Hardman & Co Life Sciences Research

Reported sales and EBITDA margin



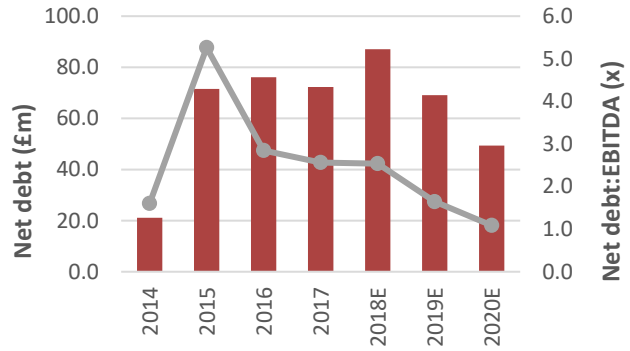
- The first full year of Nizoral sales in APAC contribute to strong group sales (statutory basis) in 2019E
- We forecast Xonvea sales of £1.8m from 2019, with rapid growth from 2020 following further EU launches
- Nizoral sales increase group EBITDA margins in 2018E and 2019E, balancing out costs of launching Xonvea in the UK
- The end of the TSA period (ca.2020) will result in an 'apparent' drop in the reported EBITDA margin because of the statutory accounting methodology for Nizoral

Free cashflow and ROIC



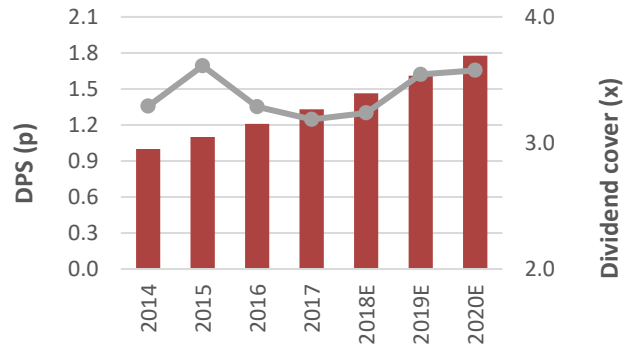
- APH is strongly cash-generative, with forecasts in the range £25m-£30m per annum with a full-year Nizoral contribution
- Underpinned by the established international star brands and the sustainable bedrock of established products
- The drop in 2018E FCF results from movement in working capital due, in part, to inventory purchases in connection with recent acquisitions
- Operating cashflow conversion is typically ca.90% of EBIT; free cashflow definition includes exceptional items

Net debt and Net debt/EBITDA



- Net debt will increase in 2018 due to the increased debt facility undertaken to part-fund the Nizoral acquisition
- At the point of closing the deal with J&J, management indicated that leverage would be 2.5x, which is expected to fall in subsequent years
- Financial covenants for the life of the credit facility remain at 3.0x to cover potential acquisition spikes

DPS and dividend cover



- Progressive dividend policy since payments commenced in 2009
- We forecast the full-year dividend to rise to 1.46p for 2018
- There is scope to increase the dividend

Source: Company data; Hardman & Co Life Sciences Research

1H'18 trading update

Key features

- **Sales:** In 1H'18, reported sales growth of 10% to £54.5m (£49.4m restated for adoption of IFRS 15) was slightly ahead of expectations. The composition of this growth is calculated to be 4.3% organic, 7.8% acquisitions and -1.8% currency.
- **Kelo-cote:** The star performer was the international brand Kelo-Cote, which saw sales grow 88% to £10.9m (£6.2m). In 2016, this scar treatment became APH's first product to have sales of £10m, a level that it is now achieving in half a year.
- **MacuShield:** Underlying sales of MacuShield grew 22% to £3.4m (£3.0m restated). This represents another half year of consistent growth, but was slightly below expectations.
- **Acquisitions:** Both of the products acquired in December 2017 have performed in line with forecasts. Vamousse (head lice) sales were £2.7m (vs. £2.6m forecast) and Ametop sales were estimated at £1.0m (vs. £1.0m forecast).
- **Adoption of IFRS 15:** 'Revenue from Contracts with Customers' has resulted in a restatement of 1H'17 numbers, lower by £0.9m, which is estimated to be ca.£2.0m for the full-year 2017, and to affect mostly UK-centric products. It is offset by an equivalent figure that has also been taken off the cost of goods sold.
- **Impact of currency:** APH has a natural currency hedge with overseas sales largely offset by overseas costs. However, in 1H'18, although sales were reduced by £0.9m due to forex, the effect on costs will be slightly lower due to some hedging of overseas costs.
- **Cashflow/net debt:** Although free cashflow (Hardman & Co definition) in 1H'18 was lower, as anticipated, than that seen in 1H'17, at £11.8m (£14.7m), it was better than forecasts, such that net debt at 30 June was -£86.3m, vs. our forecast of £89.0m, after increased working capital and paying for the acquisition of Nizoral. Leverage at 30 June was 2.4x, well below the banking covenants (3.0x).

1H'18 results – Actual vs. expectations

Interims to June (£m)	1H'17 actual	1H'18 actual	CER %	1H'18 forecast	Delta Δ
Kelo-Cote	6.2	10.9	+93%	8.0	+2.9
MacuShield	3.0	3.7	+22%	3.8	-0.1
Vamousse	-	2.7	-	2.6	+0.1
Ametop	-	1.0	-	1.0	-
Other products	40.2	36.2	-9%	38.6	-2.4
Group sales	**49.4**	**54.5**	**+5%**	**54.0**	**+0.5**
Underlying EBIT	14.0			15.0	
EBIT margin (%)	28.3%			27.5%	
Free cashflow*	14.7	11.8		8.2	+3.6
Net cash/(debt)	**-63.3**	**-86.3**		**-89.0**	**+2.7**

Numbers may not add up exactly due to rounding
**Hardman & Co definition, includes exceptionals*
Source: Hardman & Co Life Sciences Research

- **2018 forecasts:** There is nothing material in the half-year numbers/trading statement that would cause us to change full-year forecasts. However, the remainder of this report does highlight a number of changes resulting from the acquisition of Nizoral in June and the UK approval of Xonvea in July. Details of the changes are shown on page 11.

Nizoral acquisition

Nizoral* APAC sales


Korea 2% Shampoo


China 2% Shampoo


Japan 2% Lotion

Korea 2% Shampoo

Philippines 1% Shampoo


India 2% Shampoo

Johnson & Johnson

2017 sales: $25.0m/£18.5m

**Nizoral shampoo/lotion*
Source: J&J/Alliance Pharma

Deal with Johnson & Johnson (J&J)

Key features

- APH has acquired the exclusive rights to Nizoral in the Asia-Pacific region (APAC).
- The deal includes Nizoral shampoos (1% and 2%) and a lotion (Japan only).
- This is an established brand that will boost APH's already growing APAC sales by 2.6x.
- Existing APH presence and distributor relationships will facilitate a rapid and smooth handover.
- New countries and established distributor relationships will expand APH's presence in the APAC region.
- J&J to retain rights to Nizoral creams; J&J will not be allowed to sell ketoconazole products for hair/scalp for three years, nor Nizoral branded shampoos in perpetuity, in APAC.

Nizoral: anti-dandruff brand

History

The active pharmaceutical ingredient (API) in Nizoral is the antifungal agent ketoconazole, discovered in 1976 by J&J's R&D division, Janssen Research and Development. Oral and topical products containing ketoconazole enjoyed strong sales growth following first launch in the US in 1985, with sales peaking at $413m in 1998. Patent expiry of the active ingredient in the early 2000s and FDA withdrawal of the compound in oral medications in 2013 led to a weakening in J&J's worldwide Nizoral sales. Over the last 15-20 years, Nizoral has been repositioned and is now sold predominantly in OTC products, such as shampoos.

Nizoral formulations

1% shampoo

China, Philippines

Lotion

Japan

2% shampoo

China, India, Vietnam
South Korea, Thailand

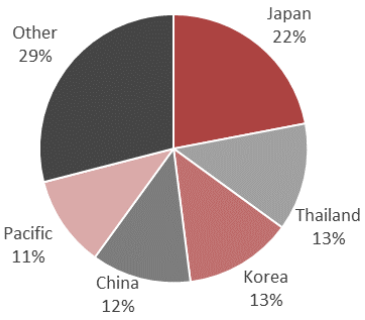
Source: J&J/Alliance Pharma

The brand has been de-prioritised by J&J globally, in line with the news in December 2017 that it was considering a disposal of Nizoral as part of a general streamlining of its portfolio. APH has acquired the rights solely for the APAC region.

Ketoconazole

Like all '-azole' drugs, ketoconazole targets synthesis of ergosterol, a component of the fungal cell membrane. Ketoconazole is the most commonly prescribed ingredient for seborrheic capitis and seborrheic dermatitis, which cause dandruff – dandruff affects up to half the population. Having been on the market in various forms for more than 30 years, ketoconazole has a well-established clinical profile.

Nizoral* sales – APAC region



2017 sales: $25.0m/£18.5m

**Nizoral shampoo/lotion*
Source: Alliance Pharma

Geographical sales performance

Nizoral rights to more than 15 APAC countries have been acquired by APH from J&J. In 2017, 70% of sales in APAC were generated fairly evenly among five countries, diminishing risk in the short term and permitting potential growth by APH in additional countries in the medium- to long-term. Under J&J, marketing spend was only ca.£300k p.a. (presumably in territories covered directly by the J&J sales team – Taiwan, Philippines and India).

Competition

There are two main competitors to Nizoral in APAC: Kang Wang shampoo is marketed by Bayer and includes a steroid in addition to ketoconazole; and Selsun Blue, marketed by Sanofi, which includes the antifungal agent selenium sulphide.

Next steps

Both APH and J&J have appointed representatives to a small management team that will oversee the transfer and integration process.

In order to have a smooth transition, APH has entered into a five-year manufacturing services agreement with J&J, for the supply of active pharmaceutical ingredient (API) and manufacture of the final product which is manufactured by J&J. Products not manufactured by J&J will continue to be undertaken by Contract Manufacturing Organisations (CMOs) appointed by J&J and approved by local health authorities. Nizoral will continue to be sold under the 'Johnson & Johnson' name until product licences have been re-registered to APH.

APH also has a two-year Transition Service Agreement (TSA) with J&J to allow time for the transfer of ca.30 Nizoral marketing authorisations to APH. Having undertaken exactly the same process with ca.100 licences as part of the Sinclair acquisition, this is expected to be relatively straightforward. The companies have, however, allowed for 12-month extensions to the TSA should the need arise.

During the TSA period, APH will also be integrating its acquisition of Vamousse, the shampoo for treatment of head lice, and we believe that it will be preparing to obtain the Vamousse licences in APAC, with the aim to sell it through distributor networks acquired through Nizoral in addition to its established channels. As medicated shampoos, the products are complementary and will likely provide a cross-selling opportunity.

Financial assessment

On 21 June 2018, APH concluded the acquisition of exclusive Nizoral marketing rights for the APAC region from J&J for £60.0m. The cash consideration was funded, in part, by a Placing of shares which raised £34.0m gross new capital, coupled with an extension of its loan facility by £35.0m, of which £27.9m was drawn down. This balance of equity and debt enabled the company to keep its net debt/EBITDA at around the 2.5x level immediately upon closure of the transaction, with a view for positive cashflow to reduce this to a target 2.0x within 12 months.

Deal summary

- **Nizoral performance:** Sales in 2017 were $25.0m/£18.5m and, applying costs on a *pro forma* basis, the EBITDA was $9.6m/£7.1m.
- **Deal metrics:** The cash consideration represents EV/sales of 3.2x and EV/EBITDA of 8.5x.
- **Placing:** £34.0m gross (£32.1m net of total acquisition costs) was raised via a Placing of 37.36m new Ordinary shares in the company @91p per share, which represented a 10.3% discount to the mid-market price on the day of the book build (19 June 2018).
- **Debt:** The remainder of the cash consideration was through a drawdown of £27.9m of the company's extended £35.0m debt facility, which gave a leverage of 2.5x at the time of the deal closure.
- **Integration:** APH has agreed a two-year TSA with J&J, which could be extended by periods of 12 months should the need arise, to allow for the transfer of ca.30 marketing authorisations.
- **Manufacturing:** APH has entered into a five-year Manufacturing Service Agreement (MSA) with J&J for the supply of drug substance, which will be finished and packaged by a local, approved contract manufacturing organisation (CMO).
- **Accounting:** APH will show two versions of its P&L. It will focus on the 'see-through' version, where Nizoral sales and costs will be shown as if APH were in full control of the product, which will give a better guide to the underlying performance. It will also provide statutory numbers under the TSA agreement with J&J, where the net profit in Euros will be recorded as sales. Under both versions, the EBITDA will be the same figure.

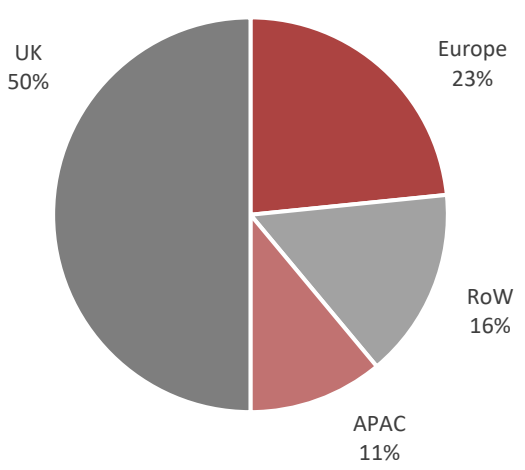
Transforming APH's business

The acquisition of Nizoral, the recent purchases of Vamousse and Ametop, and the UK approval of Xonvea, are changing APH's business and growth prospects considerably.

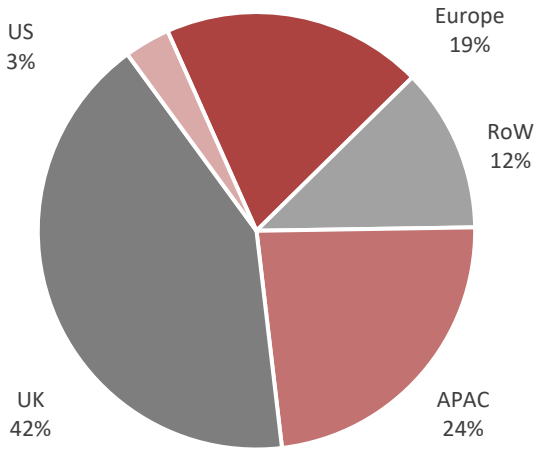
The APAC region represented 11% of APH sales in fiscal 2017, all from the acquisition of Sinclair products in 2015. Nizoral has the effect of doubling this business area and adding some new and well-respected distribution channels, particularly in Thailand (DKSH) and Singapore and Malaysia (Zuellig Pharma). Nizoral will fit neatly into APH's existing infrastructure and we would expect APH to increase its existing presence in Singapore to manage the commercial and operational aspects of the business.

In our opinion, management has the intention of internationalising Vamousse, which is complementary to Nizoral, and may go through the existing and new commercialisation channels.

Impact of recent acquisitions on APH sales



2017 reported sales: £101.3m



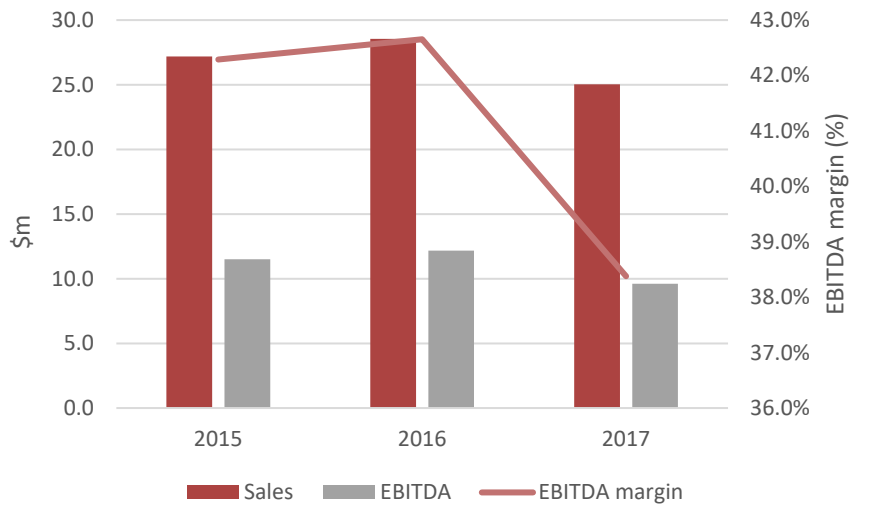
2017 *pro forma* sales: £127.0m

Both graphics have been adjusted (sales reduced by £2.0m est) for the adoption of IFRS 15, all of which has been applied to the UK
Source: Alliance Pharma, Hardman & Co Life Sciences Research

Sales and EBITDA progression

Given that J&J had announced its intention to focus on major global brands and to dispose of other brands it no longer considers core, it is unsurprising that the likes of Nizoral have received little marketing support and investment over recent years. This has resulted in a relatively static sales and EBITDA pattern. It does, however, highlight the strength of the brand, even in the absence of investment, and how, with some modest attention from APH, it could be brought back into growth.

Nizoral sales and EBITDA trend in APAC



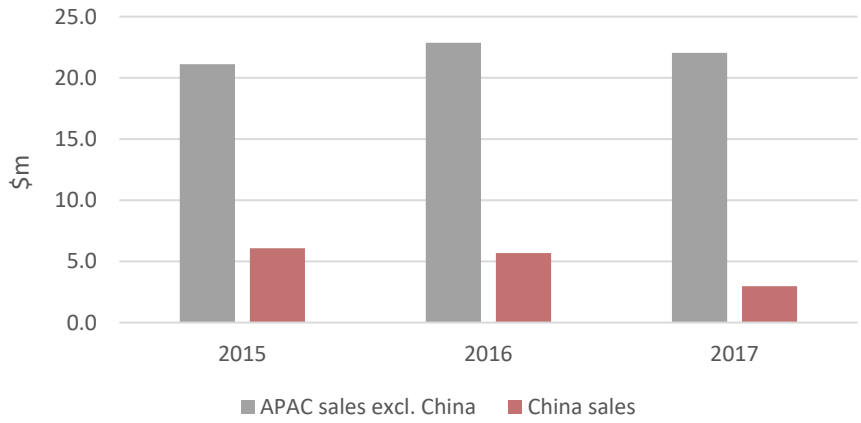
Source: J&J/Alliance Pharma

Change of Chinese distributor

In addition, J&J decided to change its Chinese distributor in 2017, which had a temporary detrimental impact on sales and profits. The outgoing distributor was passive, and J&J decided to move to a more proactive partner, Jointown. Initially, this led to unusual buying patterns, with the outgoing distributor buying up stock and saturating the market to maximise its returns.

The consequence was that Jointown made few sales in 2017. This led to a sales decline of ca.$3.5m/£2.7m last year and, in our opinion, much of this came straight off EBITDA. Excluding sales in China, the performance of Nizoral has been consistent, in the range of $21m-$23m, in APAC.

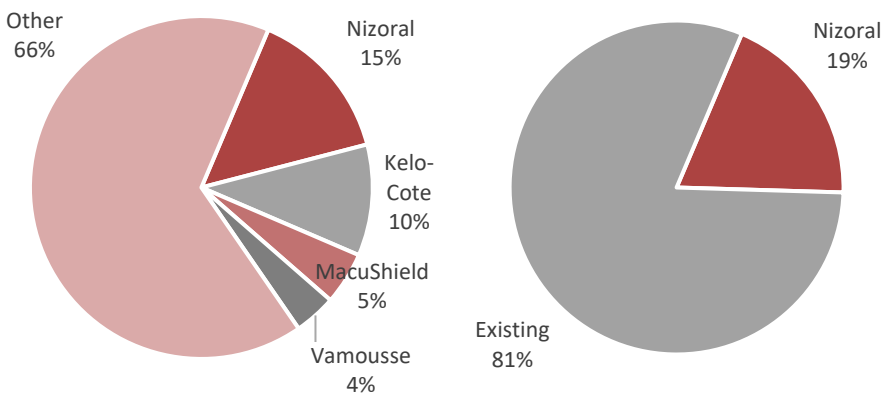
Impact of changing distributor in China



Source: J&J/Alliance Pharma

Analysis of the China sales data from J&J for the first five months of 2018 has reassured APH management that this effect has washed through and that normal sales levels have returned. Consequently, we believe that sales will revert to ca.$28m in 2018. However, due to a modest overlap in some costs during the initial two-year TSA period, *pro forma* EBITDA is likely to remain at ca.$9.5m/£7.0m. During this period, the focus will be on achieving transfer of marketing authorisations to APH and integrating the Nizoral business into APH systems. Consequently, expectations for sales and EBITDA growth are minimal.

***Pro forma* sales and EBITDA**



2017 *pro forma* sales: £127m **2017 *pro forma* EBITDA: £37.2m**

Source: Alliance Pharma, Hardman & Co Life Sciences Research

Xonvea (Diclectin) approved in UK

Route to UK launch

MHRA approval process

Following a lengthy process with UK regulator, the Medicines and Healthcare products Regulatory Agency (MHRA), Diclectin received UK marketing authorisation on 6 July 2018. It will be marketed under the brand name Xonvea®, for the treatment of nausea and vomiting of pregnancy (NVP), as a prescription-only medicine.

Diclectin tablet – Canada

Source: Duchesnay

APH and its partner, Duchesnay Inc (Canada), have been engaged with the MHRA regarding the licensing of Diclectin following the initial submission of the regulatory dossier in 2015. In July 2017, the decision from the MHRA was that the application was 'not approvable', based on the current submission package. Subsequent discussions with the MHRA and the Commission on Human Medicines (CHM), however, led to an updated Marketing Authorisation Application being submitted.

Given that Diclectin is widely used in North America, management retained optimism that the product would receive approval in 2018. With a positive opinion received from the MHRA and the CHM in June 2018, followed by the final approval in July, this confidence was clearly justified.

Launch timeline - UK

APH is expected to launch Xonvea in the UK this coming autumn. Our sales model – discussed below – estimates that UK sales could reach £6.0m by 2021, and then up to £10m p.a. at peak. The initial benefit to sales in fiscal 2018 and 2019, however, will be more than offset by the short-term launch and marketing costs.

Rights in-licensed from Duchesnay

For the UK rights agreement, APH paid a licensing fee of £1.5m to Duchesnay, with £0.5m on signing, £0.5m on regulatory submission, and the balance of £0.5m now payable due to UK approval. APH has also in-licensed the rights to Xonvea in a further nine European countries, for another £1.0m. Under both agreements, Duchesnay will manufacture Xonvea for APH and will receive royalties on net sales, which APH will account for as part of COGS.

Submissions in nine additional European territories

Filing submissions for regulatory approval in the continental European countries are being prepared by APH, and, therefore, additional international launches can be expected in the medium term. The total potential market opportunity is ca.£30m for APH in European markets outside of the UK.

Unmet need

Nausea and vomiting of pregnancy (NVP)

Morning sickness is very common in pregnancy; however, the severity of the condition is extremely variable. In an extensive review of 26 publications involving 39,710 expectant mothers, the incidence of NVP was 73.4%[1], and the symptoms

[1] https://www.pregnancysicknesssupport.org.uk/resources/literature-review/incidence-of-nausea-and-vomiting-in-pregnancy-nvp/

lasted a median of 41 days. The severity of the condition determines the likelihood that a patient will seek treatment, and also the number of tablets that will be taken.

The four classifications of the frequency and severity of NPV are:

- Hyperemesis gravidarum – occurs in 3% of patients and requires hospitalisation
- Severe – occurs in about 11%
- Moderate – occurs in about 30%
- Mild – occurs in about 26%

Diclectin used by >33 million women in Canada since launch…

…and given category A safety rating by FDA

Diclectin – established safety and efficacy profile

Diclectin has been used by more than 33 million women for more than 30 years, having been sold in Canada since 1976. It is also approved in the US, where it is sold as Diclegis, having received authorisation from the FDA in 2013 and a category A safety rating. As such, Diclectin has an established efficacy and safety profile with extensive real-world data. The active ingredients (doxylamine and pyridoxine) of Diclectin have been used for many years. The formulation is film-coated (to prevent the actives being broken down by acid in the stomach), and it is a delayed release formulation, so that it can be taken at night for a maximum effect in the morning.

Sales model in Europe

Applying the known market share figure derived from the US (12% in 2016)[2] to APH's markets in Europe indicates that Diclectin will be a £40m opportunity for the group by five years after launch, as highlight below:

- Ex-factory sales of ca.£10m in the UK, five years from the end of 2018.
- Ex-factory sales of ca.€35m/£30m from Europe on a staggered launch strategy over five years, expected to start around the end of 2019.

Xonvea – UK market opportunity based on 2016 data

	Example 2016 data
United Kingdom	
Live births	779,499
NVP patients	545,649
Price for five to six weeks (£)	168.0
Utilisation	**12.2%**
Gross sales (£m)	11.2
Opportunity: net sales (£m)	**9.8**
Top nine Europe	
Live births	2,558,540
NVP patients	1,790,978
Price for five to six weeks (€)	193.2
Utilisation rate (year three from US)	**12.2%**
Gross sales (€m)	42.3
Net sales (€m)	**34.5**
Opportunity: net sales (£m)	**30.0**

Live birth statistics taken from Eurostat
Source: Hardman & Co Life Sciences Research

[2] http://www.hardmanandco.com/docs/default-source/company-docs/alliance-pharma-documents/25.01.17-potential-of-diclectin.pdf

Changes to forecasts

In principle, the changes to forecasts from the Nizoral acquisition are straight-forward, with the simple addition of ca.$28m/£22m of sales in each of the next three years and, at the EDITDA level, a normalised (allowing for Chinese distributor change) rate of $9.5m/£7.0m being included. In practice, the changes will be more complicated:

- During the TSA period, variable by territory until product licences are transferred, APH will not report the sales and costs incurred by J&J in its statutory P&L.
- APH will report the accrued net income due from J&J through its sales line during the TSA. Moreover, this will be calculated from invoices that are drawn up in local currencies, less costs, but paid as a lump sum in EUR. Therefore, there is currency exposure from the trading quarter to the payment date (105 days).
- Integration/infrastructure costs will be incurred from 2019 as marketing authorisations start to be transferred.
- From the financing side, net interest will rise by an estimated £1.3m p.a. in respect of the extra debt, and the dividend payment will rise by £0.55m to reflect the increased number of shares in issue following the Placing.

The net effect of all of this will be a minimal benefit to EPS in the first 12 months, which rises modestly each year until the TSA has finished and full integration of all the product licences has been achieved (in 2021).

For Xonvea, the up-front launch costs for UK and Europe have been included from 2H'18 and 2H'19 respectively. Material sales are not expected to flow through until 2019 in the UK and 2021 in EU. Details are shown in the table below:

Changes to forecasts (all at constant currency)

Year-end Dec (£m)	2017	2018E	2019E	2020E
Previous sales forecast	103.3	118.0	127.0	135.0
Adoption of IFRS 15	-2.0	-2.1	-2.2	-2.4
J&J net profit transfer	-	3.7	7.4	7.5
Xonvea sales (UK + EU)	-	0.1	1.8	4.5
Statutory sales	**101.3**	**119.7**	**134.0**	**144.0**
Pro forma product sales	127.0	137.7	148.2	158.7
Previous statutory EBITDA	31.1	32.6	33.8	36.9
Previous underlying EBITDA forecast	28.2	32.6	35.3	38.4
Nizoral EBITDA contribution	-	3.7	7.4	7.5
Integration/infrastructure costs	-	-	-0.6	-0.9
Xonvea EBITDA contribution	-	-2.6	-2.6	-3.0
Revised underlying EBITDA	28.2	33.7	39.5	42.0
Underlying EBITDA margin	27.8%	28.2%	29.5%	29.2%
Current net interest	-2.4	-2.9	-2.3	-1.6
Additional finance costs	-	-0.6	-1.3	-1.2
Increased dividend cost	-	-0.5	-0.6	-0.7
Previous underlying basic EPS (p)	4.24	4.76	5.27	5.85
Revised underlying basic EPS (p)	-	4.64	5.31	5.80

Source: Hardman & Co Life Sciences Research

'See-through' accounts

APH will be providing a 'see-through' P&L account during the TSA period to provide investors with a clearer view of the underlying performance of the group. Under this version, sales and costs of Nizoral will be included as if the product were being sold by APH. It will also provide a clear picture of growth when this does occur, at the end of the TSA period (estimated at the end of 2020).

All our forecasts are at constant currency, based on the actual exchange rates for 2017, again to provide investors with a better understanding of the underlying growth rates. However, to give readers a guide to sensitivity, the estimated contribution to EBITDA from the Nizoral acquisition in 2019 is £7.4m at CER, which would reduce to £7.0m if it were translated at the exchange rate used in the acquisition announcement (USD 1.35; EUR 1.13).

'See-through' profit & loss account

Year-end Dec (£m)	2017	2018E	2019E	2020E
GBP:EUR	1.141	1.141	1.141	1.141
GBP:USD	1.289	1.289	1.289	1.289
Sales	**101.3**	**126.8**	**148.2**	**158.7**
Cost of goods	-42.4	-52.3	-61.4	-65.2
Gross profit	59.0	74.5	86.8	93.5
Admin & marketing	-31.7	-42.2	-48.9	-52.8
Underlying EBITDA	**28.2**	**33.7**	**39.5**	**42.0**
EBITDA margin	27.8%	26.6%	26.7%	26.5%
Reported EBITDA	31.1	33.8	38.0	40.5
Depreciation	-0.7	-1.2	-1.5	-1.5
Amortisation	-0.3	-0.2	-0.2	-0.2
Other income	0.0	0.0	0.0	0.0
Underlying EBIT	**27.3**	**32.3**	**37.8**	**40.3**
Share-based costs	-1.5	-1.5	-1.5	-1.5
Exceptional items	*4.4	**1.5	0.0	0.0
Statutory EBIT	30.2	32.4	36.3	38.9
Net interest	-2.4	-3.5	-3.7	-3.0
Other financials	0.6	0.1	0.1	0.1
U/lying pre-tax profit	**24.8**	**28.8**	**34.1**	**37.3**
Extraordinary items	0.0	0.0	0.0	0.0
Reported pre-tax	**28.4**	**28.9**	**32.7**	**35.9**
Underlying tax	-4.8	-5.8	-6.8	-7.5
Tax rate	19%	20%	20%	20%
Exceptional tax	5.3	0.0	0.0	0.0
Tax payable/credit	0.5	-5.8	-6.8	-7.5
Underlying net income	**20.1**	**23.0**	**27.3**	**29.8**
Statutory net income	28.9	23.1	25.9	28.4
Ordinary 1p shares:				
Weighted average (m)	473.8	496.0	514.2	514.2
Underlying basic EPS (p)	**4.24**	**4.64**	**5.31**	**5.80**
Statutory basic EPS (p)	6.10	4.66	5.03	5.53

**Includes £5.0m warranty settlement for Kelo-stretch*
***Profit on disposal of 60% share of Unigreg JV*
Source: Hardman & Co Life Sciences Research

Financials and investment case

Profit & Loss

- **Sales:** The J&J profit transfer, based on the net profit from Nizoral sales in the APAC region, will be included in APH sales. Once this is known at the end of each quarter, APH will take a transaction hedge to cover the EUR amount.
- **EBITDA margin:** This will be variable over the forecast period due to investment in launching Xonvea and the accounting of Nizoral during the TSA period.

Profit & loss account						
Year-end Dec (£m)	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
GBP:EUR	1.284	1.223	1.141	1.141	1.141	1.141
GBP:USD	1.432	1.354	1.289	1.289	1.289	1.289
Sales	**48.3**	**97.5**	**101.3**	**119.7**	**134.0**	**144.0**
Cost of goods	-19.6	-42.6	-42.4	-47.0	-50.8	-54.3
Gross profit	28.7	54.8	59.0	72.6	83.2	89.7
Admin & marketing	-15.6	-28.8	-31.7	-40.3	-45.4	-49.4
Underlying EBITDA	**13.6**	**26.7**	**28.2**	**33.7**	**39.5**	**42.0**
EBITDA margin	28.1%	27.4%	27.8%	28.2%	29.5%	29.2%
Reported EBITDA	17.5	26.0	31.1	33.8	38.0	40.5
Depreciation	-0.3	-0.3	-0.7	-1.2	-1.5	-1.5
Amortisation	-0.2	-0.1	-0.3	-0.2	-0.2	-0.2
Other income	0.0	0.0	0.0	0.0	0.0	0.0
Share of JV profits/(loss)	0.2	0.3	0.0	0.0	0.0	0.0
Underlying EBIT	**13.3**	**26.3**	**27.3**	**32.3**	**37.8**	**40.3**
Share-based costs	-0.6	-0.7	-1.5	-1.5	-1.5	-1.5
Exceptional items	4.5	0.0	4.4	1.5	0.0	0.0
Statutory EBIT	17.0	25.6	30.2	32.4	36.3	38.9
Net interest	-1.1	-2.8	-2.4	-3.5	-3.7	-3.0
Other financials	-0.7	-0.6	0.6	0.1	0.1	0.1
U/lying pre-tax profit	**12.2**	**23.5**	**24.8**	**28.8**	**34.1**	**37.3**
Extraordinary items	0.0	0.0	0.0	0.0	0.0	0.0
Reported PBT	**15.2**	**22.2**	**28.4**	**28.9**	**32.7**	**35.9**
Underlying tax	-1.4	-4.9	-4.8	-5.8	-6.8	-7.5
Underlying tax rate	11.3%	20.7%	19.1%	20.0%	20.0%	20.0%
Exceptional tax	-1.1	0.8	5.3	0.0	0.0	0.0
Tax payable/credit	-2.5	-4.1	0.5	-5.8	-6.8	-7.5
Underlying net income	**10.8**	**18.7**	**20.1**	**23.0**	**27.3**	**29.8**
Statutory net income	12.7	18.1	28.9	23.1	25.9	28.4
Ordinary 1p shares:						
Period-end (m)	468.2	472.6	475.0	514.2	514.2	514.2
Weighted average (m)	272.7	469.4	473.8	496.0	514.2	514.2
Fully-diluted (m)	299.2	505.0	513.7	535.9	554.1	554.1
U/lying basic EPS (p)	**3.97**	**3.98**	**4.24**	**4.64**	**5.31**	**5.80**
Statutory basic EPS (p)	4.65	3.85	6.10	4.66	5.03	5.53
U/lying fully-dil. EPS (p)	**3.62**	**3.70**	**3.91**	**4.30**	**4.92**	**5.38**
Stat. fully-dil. EPS (p)	4.24	3.58	5.63	4.32	4.67	5.13
DPS (p)	**1.10**	**1.21**	**1.33**	**1.46**	**1.61**	**1.77**

**Includes £5.0m warranty settlement for Kelo-stretch*
***Profit on disposal of 60% share of Unigreg JV*
Source: Hardman & Co Life Sciences Research

Balance sheet

- **Intangible assets:** Nizoral will be included at cost on the balance sheet as part of the intangibles, and will not be amortised.
- **Leverage:** At the point of closing the deal with J&J, management indicated that leverage would be 2.5x. We expect net/debt/EBITDA to fall in subsequent fiscal years.

Balance sheet

@31st December (£m)	2015	2016	2017	2018E	2019E	2020E
Shareholders' funds	162.4	179.3	203.4	253.0	270.6	289.9
Cumulated goodwill	26.0	26.0	26.0	26.0	26.0	26.0
Total equity	188.5	205.3	229.4	279.0	296.6	316.0
Share capital	4.7	4.7	4.8	5.1	5.1	5.1
Reserves	157.8	174.5	198.6	247.8	265.4	284.8
Provisions/liabilities	1.5	1.7	3.4	3.4	3.4	3.4
Deferred tax	37.0	29.7	24.7	24.7	24.7	24.7
Long-term loans	59.0	57.6	41.8	57.2	49.3	40.7
Short-term debt	15.8	25.8	41.7	41.7	33.8	25.2
less: Cash	3.2	7.2	11.2	11.2	11.2	11.2
Invested capital	**272.5**	**286.8**	**303.9**	**368.9**	**370.7**	**372.9**
Fixed assets	1.0	1.8	3.4	3.7	3.3	3.0
Intangible assets	233.9	238.5	252.6	312.6	312.6	312.6
JV assets	2.9	2.9	2.9	0.0	0.0	0.0
Goodwill	26.0	26.0	26.0	26.0	26.0	26.0
Inventories	12.9	15.4	14.2	16.8	18.8	20.3
Trade debtors	*8.8*	*20.5*	*17.3*	*25.1*	*28.2*	*30.3*
Other debtors	*2.8*	*6.2*	*6.3*	*7.5*	*8.4*	*9.0*
Tax liability/credit	*-2.1*	*-2.5*	*-2.4*	*-2.6*	*-2.7*	*-2.8*
Trade creditors	*-1.2*	*-5.7*	*-6.7*	*-7.4*	*-8.0*	*-8.5*
Other creditors	*-12.7*	*-16.3*	*-9.9*	*-13.0*	*-15.9*	*-16.9*
Debtors less creditors	-4.3	2.2	4.7	9.7	10.0	11.0
Invested capital	**272.5**	**286.8**	**303.9**	**368.9**	**370.7**	**372.9**

Source: Hardman & Co Life Sciences Research

Key metrics

Year-end Dec (£m)	2015	2016	2017	2018E	2019E	2020E
Net cash/(debt)	-71.5	-76.1	-72.3	-87.7	-71.9	-54.7
Net debt/EBITDA (x)	5.3	2.8	2.6	2.5	1.8	1.3
Net debt/equity (%)	-38%	-37%	-32%	-31%	-24%	-17%
NAV/share (p)	35	38	43	49	53	56
Stock days	71	53	53	47	49	50
Debtor days	58	77	68	65	73	74
Creditor days	57	48	57	57	57	57
Interest cover (x)	11.0	9.2	9.1	9.0	10.2	13.3
Dividend cover (x)	3.6	3.3	3.2	3.2	3.3	3.3
Cap-ex/depreciation (x)	2.7	3.4	3.4	1.3	0.7	0.8
NOPAT	11.8	20.9	17.6	25.8	30.2	32.2
After-tax ROIC	4.3%	7.3%	5.8%	7.0%	8.2%	8.6%
Cap-ex/sales	1.3%	1.2%	2.2%	1.3%	0.7%	0.8%

Source: Hardman & Co Life Sciences Research

Cashflow

- **Consideration:** The cash consideration of £60.0m was part-funded by the Placing of shares, which raised gross new funds of £32.1m; the remainder being paid with new debt.
- **Amortisation:** There will be no change to the amortisation charge, as the full cost will be held on the balance sheet and, consistent with other consumer products, is expected to maintain value, provided it receives appropriate marketing support.
- **Dividend costs:** The increase in the number of shares in issue to pay for Nizoral will increase accrued dividend costs by £0.55m in 2018, which will be paid during calendar 2019.

Cashflow

Year-end Dec (£m)	2015	2016	2017	2018E	2019E	2020E
Underlying EBIT	13.3	26.3	27.3	32.3	37.8	40.3
Depreciation	0.2	0.3	0.7	1.2	1.5	1.5
Amortisation	0.2	0.1	0.3	0.2	0.2	0.2
Inventories	*-7.0*	*-2.4*	*1.1*	*-2.6*	*-2.0*	*-1.4*
Receivables	*2.3*	*-14.1*	*4.0*	*-7.8*	*-3.0*	*-2.1*
Payables	*-3.3*	*10.1*	*-3.0*	*0.7*	*0.6*	*0.6*
Change in working capital	-8.0	-6.5	2.1	-9.6	-4.4	-3.0
Exceptionals/provisions	4.5	0.0	4.0	1.0	0.0	0.0
Other	-0.1	-0.3	0.5	0.0	0.0	0.0
Cashflow from ops.	**10.1**	**20.0**	**34.9**	**25.1**	**35.1**	**39.0**
Net interest	-1.0	-3.0	-2.6	-3.5	-3.7	-3.0
Tax paid/received	-1.9	-3.0	-3.7	-4.3	-5.6	-7.1
Operational cashflow	**7.2**	**13.9**	**28.6**	**17.3**	**25.7**	**28.9**
Capital expenditure	-0.6	-1.1	-2.2	-1.5	-1.0	-1.2
Capitalised R&D	0.0	-0.3	-0.5	-0.5	-0.5	-0.5
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Free cashflow	**6.6**	**12.5**	**25.9**	**15.3**	**24.3**	**27.3**
Acquisitions	-133.9	-6.0	-17.5	-60.0	-1.5	-1.9
Disposals	0.0	0.0	0.0	2.4	0.5	0.0
Dividends	-2.6	-5.2	-5.4	-6.7	-7.5	-8.3
Other investments	0.0	-1.0	0.2	0.0	0.0	0.0
CF after investments	**-129.9**	**0.3**	**3.1**	**-49.0**	**15.7**	**17.2**
Share repurchases	0.0	0.0	0.0	0.0	0.0	0.0
Capital increases	79.8	1.3	0.7	32.1	0.0	0.0
Currency effect	-0.1	-6.2	0.0	0.0	0.0	0.0
Change in net debt	**-50.2**	**-4.6**	**3.8**	**-15.4**	**15.7**	**17.2**
Opening net cash/(debt)	-21.1	-71.4	-75.9	-72.1	-87.5	-71.7
Closing net cash/(debt)	**-71.4**	**-75.9**	**-72.1**	**-87.5**	**-71.7**	**-54.5**
Hardman CF/share (p)	2.4	2.7	5.5	3.1	4.7	5.3

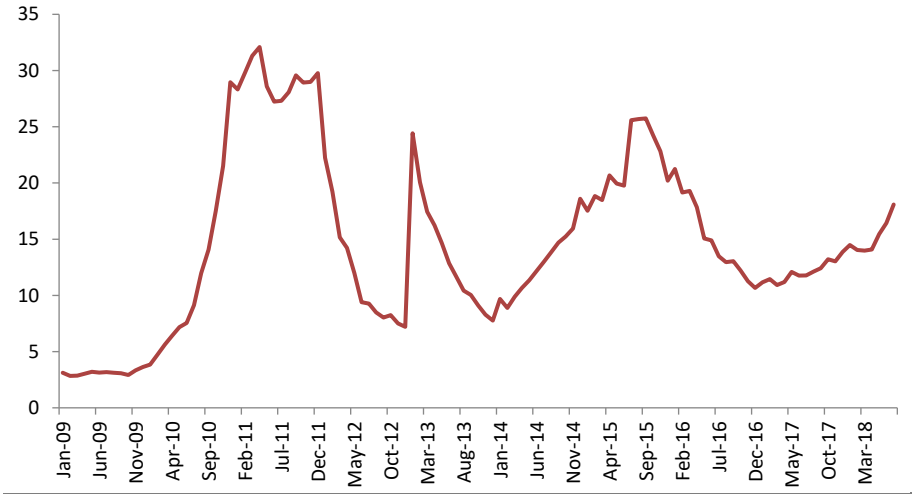
Definition of free cashflow includes exceptional items
Source: Hardman & Co Life Sciences Research

Valuation

APH is trading on a 2018E PE of 20.1x, falling to 17.6x in 2019E with a full 12-month contribution from the Nizoral acquisition, with an underlying CAGR EPS 2017-20E of ca.11%. However, this includes the establishment of its US operation, the launch investment in Xonvea in both the UK and EU, and the 'depleted' profit contribution from Nizoral during the TSA period. The prospective dividend yield is 1.6% with a progressive dividend policy that is currently covered 3.2x.

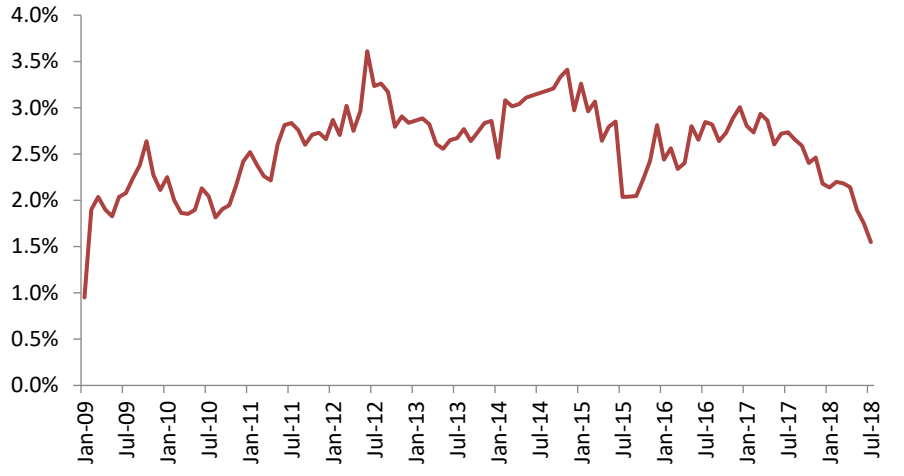
APH is generating ROIC of 8%-9%, with some of the free cashflow being reinvested into product acquisitions, as evidenced recently with Ametop and Vamousse. We forecast underlying free cashflow to be in the range of £25.0m-£30.0m when full contributions from Nizoral are included, which will be used primarily to pay down borrowings, or to fund small, bolt-on acquisitions.

EV/EBITDA (prospective 12 months)



Source: Hardman & Co Life Sciences Research

Dividend yield (prospective 12 months)



Source: Hardman & Co Life Sciences Research

Company matters

Registration

Incorporated in England and Wales with company registration number: 04241478

UK Headquarters:

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www.alliancepharmaceuticals.com

Board of Directors

Board of Directors

Position	Name	Nominations	Remuneration	Audit
Chairman	David Cook	M	M	C
Chief Executive Officer	Peter Butterfield			
Chief Financial Officer	Andrew Franklin			
Non-executive director	Nigel Clifford	C	C	M
Non-executive director	John Dawson	M		

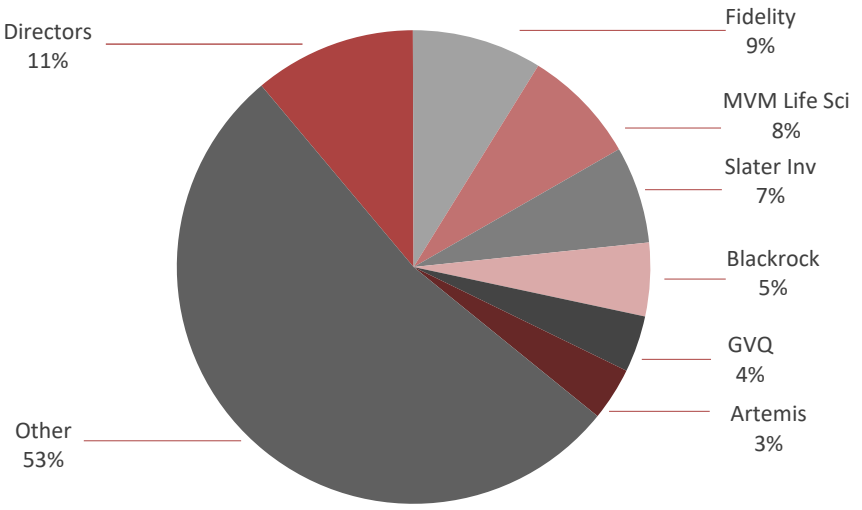
M = member; C = chair
Source: Company reports

Share capital

Number of Ordinary shares in issue on 24 July 2018: 514,205,522.

Number of options outstanding: 39.90 million.

Key shareholders



Source: Company website, Hardman & Co Life Sciences Research

Notes

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(Disclaimer Version 4 – Effective from January 2018)

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In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are' (b) 'written material from a third party that is commissioned and paid for by an[sic] corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public;'

The fact that we are commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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Hardman & Co team

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