

**Market data**

EPIC/TKR	APH
Price (p)	69.6
12m High (p)	71.4
12m Low (p)	44.8
Shares (m)	475.0
Mkt Cap (£m)	330.6
EV (£m)	402.9
Free Float*	64%
Market	AIM

*As defined by AIM Rule 26

Description

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

Company information

CEO	John Dawson
COO	Peter Butterfield
CFO	Andrew Franklin
Chairman	Andrew Smith

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www.alliancepharmaceuticals.com**Key shareholders**

Directors	12.5%
MVM Life Sciences	11.7%
Artemis	10.1%
Fidelity	9.4%
Slater Invests.	7.3%
River & Merc	5.0%

Diary

27 March	Finals
May-18	AGM

Analysts

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Alliance Pharma

2017: strong operational cashflow

Alliance Pharma 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 – notably Kelo-Cote and MacuShield – and a bedrock of solid local low-growth brands. In a trading statement for 2017, strong sales of its international growth brands have underpinned group sales growth and helped generate strong underlying operational cashflow. The recent acquisitions of Vamousse (third international growth brand) and Ametop (bedrock brand) look set to further enhance future performance.

- ▶ **Trading update:** APH has continued its year-on-year growth trend with 2017 group sales of £103.3m (£97.5m), +6% and in line with our forecasts. At constant currency, sales grew 3%, benefiting from exceptional sales of its two international growth brands Kelo-Cote and MacuShield.
- ▶ **International brands:** The international growth brands were true to their name in 2017 with sales coming in above expectations. Kelo-Cote sales increased 33% to £13.3m (£10.1m), £0.6m better than forecast. MacuShield brought in £7.3m (£5.3m), representing 37% growth and beating expectations by £0.3m.
- ▶ **Acquisitions:** Towards the end of the trading period, APH completed two product acquisitions: Vamousse (head lice) from TyraTech and Ametop (local anaesthetic gel) from Smith & Nephew. Initial considerations of £9.7m and £5.6m, respectively, and inventories of £0.7m, were paid from cash resources.
- ▶ **Net debt:** Strong operational cashflow reduced underlying group debt ahead of expectations. However, end-of-period acquisitions were financed in cash, giving net debt of -£72.3m at 31st December 2017, vs. -£73.9m forecast. Net debt/EBITDA was 2.5x, comfortably within APH's 3.0x covenant limit.
- ▶ **Investment summary:** Recent acquisitions are forecast to boost APH to generate 8% CAGR in both sales and EPS over the next three years. On the back of this solid performance, the company is expected to continue with its progressive dividend policy. The shares are trading on a 2018E P/E of 14.5x and carry a prospective dividend yield of 2.1%, covered 3.3x.

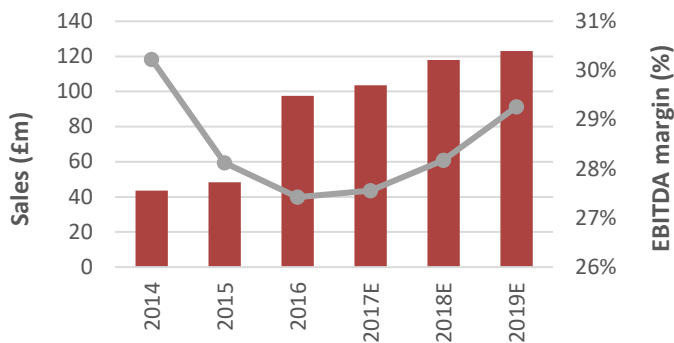
Financial summary and valuation

Year-end Dec (£m)	2014	2015	2016	2017E	2018E	2019E
Sales	43.5	48.3	97.5	103.3	118.0	126.0
EBITDA (underlying)	13.2	13.6	26.7	29.0	33.2	36.5
Reported pre-tax profit	10.2	15.9	22.2	*28.8	27.5	31.1
Underlying EPS (p)	3.3	4.2	4.1	4.3	4.8	5.4
Reported EPS (p)	3.2	4.9	3.9	4.8	4.5	5.1
DPS (p)	1.0	1.1	1.2	1.3	1.5	1.6
Net (debt)/cash	-21.1	-71.5	-76.1	-72.3	-59.1	-43.6
Net debt/EBITDA (x)	1.6	5.3	2.8	2.4	1.8	1.2
P/E (x)	21.1	16.6	16.8	16.2	14.5	13.0
EV/sales (x)	9.3	8.3	4.1	3.9	3.4	3.2
EV/EBITDA (x)	30.6	29.6	15.1	13.9	12.1	11.0
Dividend yield (%)	1.4	1.6	1.7	1.9	2.1	2.3

*Includes £5m Sinclair settlement less associated costs

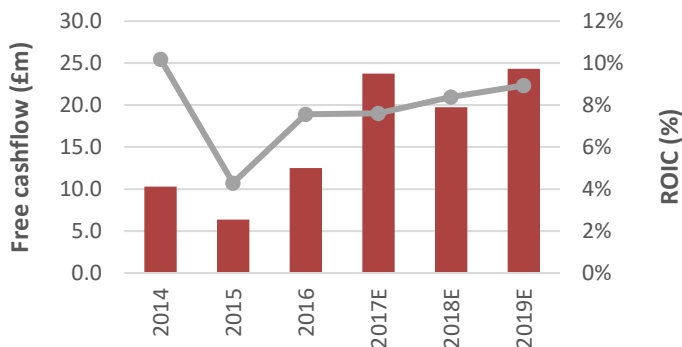
Source: Hardman & Co Life Sciences Research

Sales and EBITDA margin



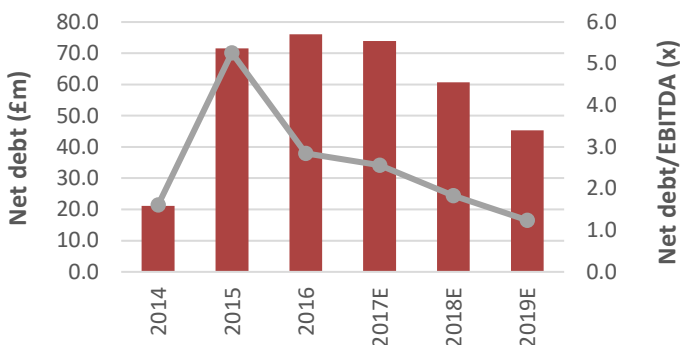
- ▶ Underlying sales growth of 3.0% for fiscal 2017, boosted at the reported level by forex
- ▶ The two international brands (Kelo-cote and MacuShield) are driving sales growth and Vamousse should add to this in the future
- ▶ EBITDA margin is before share-based payments
- ▶ Gross margins are rising modestly as the contribution from the international stars increases each year

Free cashflow and ROIC



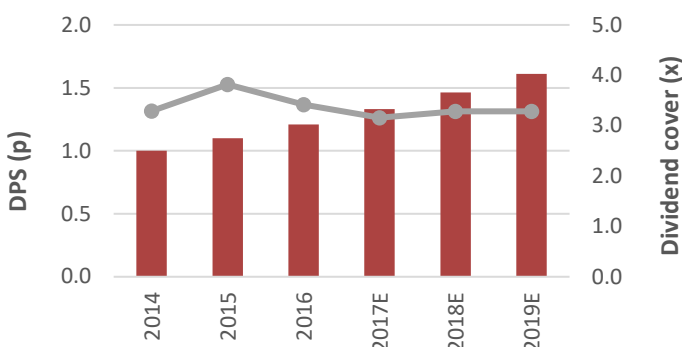
- ▶ 2016 investment and integration cost were offset by a big jump in gross profit generating a rise in free cashflow
- ▶ Driven by ex-Sinclair products acquired at the end of fiscal 2015
- ▶ Operating cashflow conversion is typically ca.90% of EBIT
- ▶ Dips in ROIC are caused by acquisitions made towards the end of the financial year (e.g. 2015)

Net debt and Net debt/EBITDA



- ▶ Net debt at 31st December 2017 was ca.£2m better than expected, at £72.3m, due largely to the positive underlying operational cashflow
- ▶ Financial covenants have been increased for the life of the Credit Facility from 2.5x to 3.0x to cover for acquisition spikes, and should fall back to around 2.0x in fiscal 2018
- ▶ Minimum interest cover (EBITDA/interest cost) of 4.0x – this is expected to be 8.8x in 2017

DPS and dividend cover



- ▶ Progressive dividend policy since dividend commenced in 2009
- ▶ Interim dividend of 0.44p, +10% – forecast to rise to 1.33p for the full year (also +10%)
- ▶ Dividend cover of ca.3.2x in 2017 and ca.3.3x in 2018 based on current forecasts
- ▶ There is scope to increase the dividend

Source: Company data; Hardman & Co Life Sciences Research

Full-year 2017 trading update

Key features

- ▶ **Sales:** Underlying sales growth of 3% was boosted by currency to a reported figure of £103.3m (£97.5m), which was broadly in line with our forecasts.
- ▶ **Growth drivers:** The main driver of growth was sales of its two international brands, MacuShield and Kelo-Cote, which increased 37% and 33% respectively, together beating expectations by +£0.9m.
- ▶ **Forex:** Reported sales benefited from both US\$ and Euro weakness, which added £2.7m. This was slightly less than our £3.0m forecast, and accounts for the difference between reported and forecasts sales. Readers are reminded that overseas costs will also be higher due to the weakness of sterling.
- ▶ **Cash generation:** The rising contribution to sales of high-margin growth brands, coupled with close control of working capital, led to a strong underlying generation of operational cashflow.
- ▶ **Acquisitions:** Vamousse was acquired in December 2017; as the third international growth brand it should add to future cash generation. Together with Ametop (bedrock product), the acquisitions had a total cash cost of £16.0m incl. £0.7m of inventory.
- ▶ **Net debt:** The resulting group net debt at 31st December 2017 was -£72.3m (-£76.1m), better than expected by £1.6m. Net debt to EBITDA was quoted at less than 2.5x, implying an underlying EBITDA of £28.9m for 2017.

Full-year 2017 – actual vs expectations

Year-end Dec (£m)	2016 actual	2017 actual	2017 CER growth %	2017 forecast	Delta Δ
Kelo-Cote	10.1	13.3	31.7%	12.7	+0.6
Macushield	5.3	7.3	37.7%	7.0	+0.3
Group sales	40.4	103.3	3.1%	103.5	+2.2
Underlying EBITDA	26.7	*28.9	8.4%	29.0	-0.1
Net cash/(debt)	-76.1	-72.3	nm	-73.9	+1.6

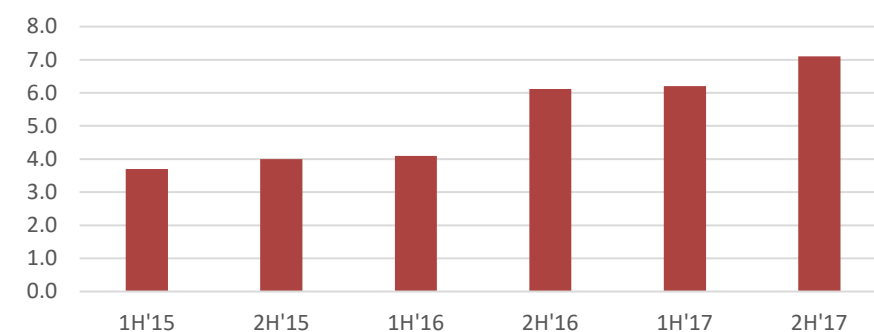
*Estimated

Source: Alliance Pharma; Hardman & Co Life Sciences Research

International brands

Kelo-Cote

Progression of Kelo-Cote sales (£m)



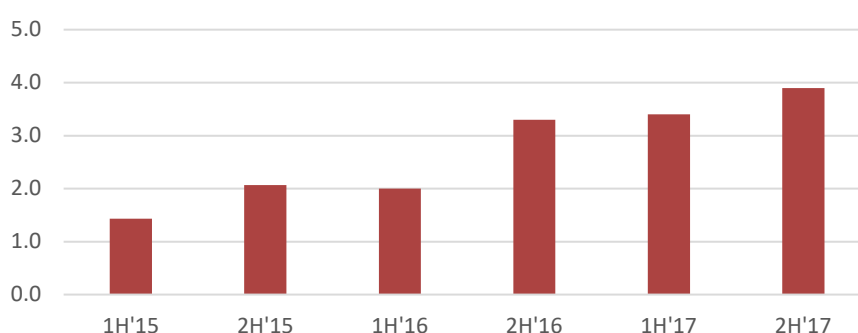
Figures 1H'15-1H'16: Hardman pro forma estimates
Source: Alliance Pharma; Hardman & Co Life Sciences Research

Since being acquired from Sinclair Pharma in December 2015, sales of Kelo-Cote have continued to show strong growth, benefiting from more targeted marketing support and new geographical launches. This scar treatment product is now sold in 65 countries, and with 33% growth in sales to £13.3m (£10.1m) in 2017, £0.6m above expectations, Kelo-Cote has consolidated its position as APH's #1 product.

MacuShield

APH's fastest-growing product is MacuShield, an eye supplement, which was acquired in February 2015. The UK remains its biggest single market, thus making it less vulnerable to currency movements. MacuShield achieved sales growth of 37% to £7.3m (£5.3m) in 2017, £0.3m above expectations.

Progression of MacuShield sales (£m)



Source: Alliance Pharma; Hardman & Co Life Sciences Research

Acquisitions

APH added two new products to its portfolio in December 2017: Ametop (bedrock brand) from Smith & Nephew (S&N) and Vamousse (international brand) from TyraTech – see Hardman & Co report 'Acquisitions to boost growth prospects' published on 11th January:

<http://www.hardmanandco.com/docs/default-source/company-docs/alliance-pharma-documents/11.01.18-acquisitions-to-boost-growth-prospects.pdf>

Vamousse – key acquisition features:

- ▶ Initial cash consideration of \$13.0m/£9.7m, plus deferred payments up to \$4.5m/£3.3m based on achieving certain sales growth targets
- ▶ MAT sales in the year to 31st December 2016 were \$6.6m/£4.9m and are thought to have been broadly flat in 2017
- ▶ Launched in the US and UK in 2014 for the treatment of head lice. Its USP is that it is a fast-acting, pesticide-free product that kills 100% of lice and eggs within 15 minutes of application.

Ametop – key acquisition features:

- ▶ Cash consideration of \$7.5m/£5.6m
- ▶ Sales in year to 31st October 2017 were \$2.8m/£2.2m
- ▶ Topical anaesthetic gel that is used to numb the skin prior to venopuncture or insertion of a cannula. S&N has been selling the product for over 10 years; therefore, it is well established in the market and will join APH's 'bedrock' group of products.

Financial forecasts

Profit & Loss

- ▶ **International brands:** Sales of Kelo-Cote and MacuShield were ahead of forecasts by £0.9m collectively.
- ▶ **Forecasts:** Publication of this trading statement has not resulted in any changes to our forecasts for fiscal years 2018 and 2019.

Profit & Loss account						
Year-end Dec (£m)	2014	2015	2016	2017	2018E	2019E
GBP:EUR	-	1.284	1.223	1.141	1.141	1.141
GBP:USD	-	1.432	1.354	1.289	1.289	1.289
Sales	43.5	48.3	97.5	103.3	118.0	126.0
Cost of goods	-18.5	-19.6	-42.6	-44.2	-49.5	-52.9
Gross profit	25.0	28.7	54.8	59.1	68.5	73.1
Admin & marketing	-12.5	-15.6	-28.8	-31.1	-37.0	-38.6
Underlying EBITDA	13.2	13.6	26.7	29.0	33.2	36.5
EBITDA margin	30.2%	28.1%	27.4%	28.1%	28.1%	29.0%
Depreciation	-0.3	-0.3	-0.3	-0.5	-1.2	-1.5
Amortisation	-0.5	-0.2	-0.1	-0.3	-0.2	-0.2
Other income	0.0	0.0	0.0	0.0	0.0	0.0
Share of JV profits/(loss)	0.3	0.2	0.3	0.3	0.3	0.3
Underlying EBIT	12.4	13.1	26.3	28.3	31.8	34.8
Share-based costs	-0.6	-0.6	-0.7	-1.5	-1.5	-1.5
Exceptional items	-0.6	4.5	0.0	*4.8	0.0	0.0
Statutory EBIT	11.2	17.0	25.6	31.6	30.3	33.3
Net interest	-1.0	-1.1	-2.8	-2.8	-2.9	-2.3
Other financials	0.0	0.1	-0.6	0.0	0.1	0.0
U/lying pre-tax profit	10.7	12.8	23.5	25.5	28.9	32.5
Extraordinary items	0.0	0.0	0.0	0.0	0.0	0.0
Reported PBT	10.2	15.9	22.2	28.8	27.5	31.1
Underlying tax	-2.0	-1.4	-4.1	-5.2	-6.2	-7.0
Exceptional tax	0.3	-1.1	0.0	-0.9	0.0	0.0
Tax payable/credit	-1.8	-2.5	-4.1	-6.1	-6.2	-7.0
Tax rate	17.4%	15.6%	18.6%	21.0%	22.4%	22.5%
Underlying net income	8.7	11.5	19.4	20.3	22.8	25.5
Statutory net income	8.4	13.5	18.1	22.7	21.4	24.1
Ordinary 1p shares:						
Period-end (m)	264.1	468.2	472.6	475.0	475.0	475.0
Weighted average (m)	264.1	272.7	469.4	472.6	475.0	475.0
Fully diluted (m)	265.6	299.2	505.0	508.1	510.5	510.5
U/lying basic EPS (p)	3.29	4.20	4.14	4.30	4.80	5.37
Statutory basic EPS (p)	3.17	4.93	3.85	4.81	4.50	5.07
U/lying fully-dil. EPS (p)	3.27	3.83	3.85	4.00	4.46	5.00
Stat. fully-dil. EPS (p)	3.16	4.50	3.58	4.48	4.18	4.71
DPS (p)	1.00	1.10	1.21	1.33	1.46	1.61

*Warranty receipt: a £5m accrual in 2017 due to Kelo-stretch, with £4.0m cash received in 2017 and £1m to be received in cash by 30th June 2018, less modest associated costs

Source: Hardman & Co Life Sciences Research

Balance sheet

- **Forecasts:** Updated slightly to reflect new information in the trading statement. Better-than-expected growth of high-margin international products and improved working capital have resulted in a lower level of net debt, at -£72.3m (£1.6m better than forecast) on 31st December 2017.

Balance sheet						
@31st December (£m)	2014	2015	2016	2017	2018E	2019E
Shareholders' funds	70.8	162.4	179.3	195.7	210.1	226.5
Cumulated goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Total equity	74.4	188.5	205.3	221.7	236.1	252.5
Share capital	2.6	4.7	4.7	4.7	4.7	4.7
Reserves	68.1	157.8	174.5	190.9	205.3	221.8
Provisions/liabilities	0.4	1.5	1.7	1.7	1.7	1.7
Deferred tax	6.1	37.0	29.7	29.7	29.7	29.7
Long-term loans	19.2	59.0	57.6	53.7	44.6	36.8
Short-term debt	3.3	15.8	25.8	25.8	21.8	14.0
less: Cash	1.4	3.2	7.2	7.2	7.2	7.2
Invested capital	98.4	272.5	286.8	299.4	300.6	301.6
Fixed assets	0.4	1.0	1.8	3.4	3.7	3.3
Intangible assets	85.3	233.9	238.5	238.5	238.5	238.5
JV assets	2.7	2.9	2.9	2.9	2.9	2.9
Goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Inventories	5.9	12.9	15.4	17.0	19.4	20.7
Trade debtors	6.6	8.8	20.5	21.8	24.8	26.5
Other debtors	1.7	2.8	6.2	6.5	7.5	8.0
Tax liability/credit	-1.0	-2.1	-2.5	-2.0	-2.1	-2.2
Trade creditors	-1.7	-1.2	-5.7	-5.9	-6.6	-7.0
Other creditors	-5.2	-12.7	-16.3	-8.8	-13.6	-15.1
Debtors less creditors	0.4	-4.3	2.2	11.6	10.1	10.2
Invested capital	98.4	272.5	286.8	299.4	300.6	301.6

Source: Hardman & Co Life Sciences Research

Key metrics						
Year-end Dec (£m)	2014	2015	2016	2017	2018E	2019E
Net cash/(debt)	-21.1	-71.5	-76.1	-72.3	-59.1	-43.6
Net debt/EBITDA (x)	1.6	5.3	2.8	2.5	1.8	1.2
Net debt/equity (%)	-28%	-38%	-37%	-33%	-25%	-17%
NAV/share (p)	27	35	38	41	44	48
Stock days	48	71	53	57	56	58
Debtor days	66	58	77	75	72	74
Creditor days	33	57	48	48	48	48
Interest cover (x)	11.4	10.8	9.2	9.8	10.9	14.9
Dividend cover (x)	3.3	3.8	3.4	3.2	3.3	3.3
Cap-ex/depreciation (x)	0.4	2.7	3.4	4.4	1.3	0.7
NOPAT	10	12	22	23	25	27
After-tax ROIC	10.2%	4.3%	7.6%	7.5%	8.3%	9.1%
Cap-ex/sales (%)	0.3%	1.3%	1.2%	1.9%	1.3%	0.8%

Source: Hardman & Co Life Sciences Research

Cashflow

- ▶ **Free cashflow:** Growth in high-margin brands, coupled with close control of working capital, have led to strong underlying generation of operational cash flow.
- ▶ **Acquisitions:** Towards the end of the trading period, £16m cash was invested in the acquisitions of Vamousse and Ametop.
- ▶ **Leverage:** Despite the acquisitions, net debt to EBITDA still reduced from 2.8x in 2016 to 2.5x in 2017. APH expects leverage will continue to reduce to below 2.0x during 2018.

Cashflow						
Year-end Dec (£m)	2014	2015	2016	2017	2018E	2019E
Underlying EBIT	12.4	13.1	26.3	28.3	31.8	34.8
Depreciation	0.3	0.2	0.3	0.5	1.2	1.5
Amortisation	1.1	0.2	0.1	0.3	0.2	0.2
<i>Inventories</i>	-0.4	-7.0	-2.4	-1.6	-2.4	-1.3
<i>Receivables</i>	2.8	2.3	-14.1	3.6	-3.1	-1.7
<i>Payables</i>	-1.8	-3.3	10.1	-0.2	0.7	0.4
Change in working capital	-1.8	-8.0	-6.5	1.8	-4.8	-2.6
Exceptionals/provisions	0.0	4.5	0.0	4.0	1.0	0.0
Other	1.4	-0.1	-0.3	0.0	0.0	0.0
Cashflow from ops.	13.4	9.9	20.0	34.8	29.4	33.9
Net interest	-0.9	-1.0	-3.0	-2.8	-2.9	-2.3
Tax paid/received	-2.0	-1.9	-3.0	-4.6	-5.3	-6.4
Operational cashflow	10.5	7.0	13.9	27.5	21.2	25.2
Capital expenditure	-0.1	-0.6	-1.1	-2.0	-1.5	-1.0
Capitalised R&D	-0.1	0.0	-0.3	-0.3	-0.3	-0.3
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Free cashflow	10.3	6.4	12.5	25.2	19.5	23.9
Acquisitions	-3.3	-133.9	-6.0	-17.1	0.0	-1.5
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	-2.4	-2.6	-5.2	-5.7	-6.3	-7.0
Other investments	-0.5	0.0	-1.0	0.0	0.0	0.0
CF after investments	4.1	-130.1	0.3	2.3	13.1	15.5
Share repurchases	0.0	0.0	0.0	0.0	0.0	0.0
Capital increases	0.0	79.8	1.3	0.5	0.0	0.0
Currency effect	0.0	-0.1	-6.2	1.0	0.0	0.0
Change in net debt	4.1	-50.4	-4.6	3.8	13.1	15.5
Opening net cash/(debt)	-25.2	-21.1	-71.6	-76.1	-72.3	-59.1
Closing net cash/(debt)	-21.1	-71.6	-76.1	-72.3	-59.1	-43.6
Hardman CF/share (p)	3.9	2.3	2.7	5.3	4.1	5.0

Source: Hardman & Co Life Sciences Research

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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>

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman is not inducing the reader of our research to trade through us, since we do not deal in any security.

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