Equity | Australia | Health Care

ABN·AMRO Morgans

28 August 2008

Ascent Pharmahealth

Sailing a difficult course

APH's FY08 result was in line with expectations; a 0.5cps dividend was the surprise. In the face of a challenging macro environment and with the integration of the Strides Asian businesses upon it, APH has a challenging year ahead. Hold.

Change of forecast

Hold

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Mod-High Volatility

Target price
A$0.30

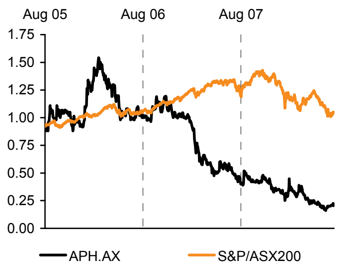
Price
A$0.22

Short term (0-60 days)
n/a

APH80828

Price performance

	(1M)	(3M)	(12M)
Price (A$)	0.20	0.23	0.40
Absolute %	10.0	-4.3	-45.0
Rel market %	9.1	9.1	-32.1
Rel sector %	5.6	-4.8	-40.7



Market capitalisation
A$56.54m (US$48.52m)

Average (12 mnth) daily turnover
A$0.07m (US$0.06m)

RIC: APH.AX, APH AU
Priced at close of business 27 Aug 2008.
Source: Bloomberg

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Key forecasts

	FY07A	FY08A	FY09F	FY10F	FY11F
EBITDA (A$m)	3.78	8.05	14.5	14.9	20.7 ▲
Reported net profit (A$m)	-18.0	4.18	10.6	10.9	14.2 ▲
Normalised net profit (A$m)[1]	2.88	5.18	10.6	10.9	14.2 ▲
Normalised EPS (c)[1]	2.08	3.66	4.11	4.22	5.53 ▲
Normalised EPS growth (%)	n/a	76.2	12.4	2.81	30.9
Dividend per share (c)	-0.01	0.50	1.00	1.00	2.00
Dividend yield (%)	-0.05	2.27	4.55	4.55	9.09
Normalised PE (x)	10.6	6.02	5.35	5.21	3.98
EV/EBITDA (x)	12.1	7.75	3.78	3.21	1.90
Price/net oper. CF (x)	6.34	-21.3	5.09 ▼	4.71 ▲	3.84 ▼
ROIC (%)	11.6	11.5	16.5	9.34	13.1

Use of ▲ ▼ indicates that the line item has changed by at least 5%. year to Jun, fully diluted
1. Pre non-recurring items and post preference dividends
Accounting Standard: IFRS
Source: Company data, ABN AMRO Morgans forecasts

FY08 result in line with expectations, maiden dividend was a surprise

APH reported normalised FY08 net profit of A$5.2m, up 13% on the pcp and in line with our forecast. A$1.0m in non-recurring items were reported, including A$0.3m in costs related to a deferred tax asset goodwill adjustment, as well as A$0.1m in stock provisions and A$0.6m in additional tax expense both related to the Strides acquisition. Before these adjustments, reported net profit was A$4.2m. Good cost control was a highlight of the result, with EBITDA margins improving to 12.3% (from 6.9%), despite gross margins deteriorating to 37.9% (from 39.9%). A fully-franked maiden dividend of 0.5cps is payable in December 2008. Majority shareholder (~55%) Strides Arcolab is not eligible to receive the dividend.

Recap on Strides: provides product and geographic diversification

The acquisition of the businesses of Strides in Australia and Asia was completed at end July 2008. Consideration was ~A$65m in scrip, at A$0.55 (8.8x FY08F EBITDA). Strides is involved in the manufacture and distribution of generic prescription and over-the-counter (OTC) products across Asia. Its main sales arm is Drug Houses of Australia (Asia), which is the leading generic group in Singapore. We view this acquisition as the minimum for APH to maintain a foothold in the sector.

Outlook: no guidance provided

While sales and earnings growth are expected, APH will not provide FY09 guidance until the full effect of recent PBS reforms have been reviewed. In order to better address the challenging environment, APH recently completed a strategic review of its cost structure and product range, writing off several minor products no longer relevant, with benefits to flow into FY09.

No changes to forecasts, A$0.30 target price and Hold maintained

Our DCF valuation is A$0.37. Our A$0.30 target price is at a 20% discount reflecting the highly competitive current environment. The key upside risk to our target price is the successful integration of the Strides business and the key downside risk relates to continuing margin pressure.

APH – financial summary

Year to 30 Jun (A$m)	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS
Income statement	**2007A**	**2008A**	**2009F**	**2010F**	**2011F**
Divisional sales	54.5	65.6	96.7	99.8	103.0
Total revenue	54.5	65.6	96.7	99.8	103.0
EBITDA	3.8	8.0	14.5	14.9	20.7
Associate income	0.0	0.0	0.0	0.0	0.0
Depreciation	-1.2	-1.2	-1.3	-1.6	-1.9
EBITA	2.6	6.8	13.2	13.3	18.8
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0
EBIT	2.6	6.8	13.2	13.3	18.8
EBIT(incl associate profit)	2.6	6.8	13.2	13.3	18.8
Net interest expense	-0.2	-0.7	-0.5	0.0	0.4
Pre-tax profit	2.4	6.1	12.7	13.2	19.2
Income tax expense	0.5	-0.9	-2.1	-2.4	-4.9
After-tax profit	2.9	5.2	10.6	10.9	14.2
Minority interests	0.0	0.0	0.0	0.0	0.0
NPAT	2.9	5.2	10.6	10.9	14.2
Significant items	-20.9	-1.0	0.0	0.0	0.0
NPAT post abnormals	-18.0	4.2	10.6	10.9	14.2

Cash flow statement	2007A	2008A	2009F	2010F	2011F
EBITDA	3.8	8.0	14.5	14.9	20.7
Change in working capital	19.2	-6.8	-0.7	-0.5	-1.4
Net interest (pd)/rec	-0.2	-0.7	-0.5	0.0	0.4
Taxes paid	0.5	-0.9	-2.1	-2.4	-4.9
Other oper cash items	-18.5	-1.0	0.0	0.0	0.0
Cash flow from ops (1)	4.8	-1.5	11.2	12.0	14.8
Capex (2)	-0.8	-1.0	-2.5	-2.5	-2.5
Disposals/(acquisitions)	-57.1	-2.3	0.0	0.0	0.0
Other investing cash flow	2.9	0.0	0.0	0.0	0.0
Cash flow from invest (3)	-55.0	-3.3	-2.5	-2.5	-2.5
Incr/(decr) in equity	48.7	0.4	1.0	0.0	0.0
Incr/(decr) in debt	0.0	15.0	0.0	0.0	0.0
Ordinary dividend paid	0.0	0.0	-2.0	-2.6	-3.9
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0
Other financing cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from fin (5)	48.7	15.4	-1.0	-2.6	-3.9
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0
Inc/(decr) cash (1+3+5+6)	-1.5	10.6	7.6	7.0	8.4
Equity FCF (1+2+4)	4.0	-2.5	8.6	9.5	12.3

Balance sheet	2007A	2008A	2009F	2010F	2011F
Cash & deposits	13.5	2.1	9.8	16.7	25.2
Trade debtors	12.3	15.6	14.6	15.0	15.5
Inventory	11.6	11.4	14.5	15.0	15.4
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	51.5	51.2	111.3	111.3	111.3
Other intangible assets	10.2	10.4	9.7	9.1	8.5
Fixed assets	1.4	1.9	3.8	5.2	6.4
Other assets	2.9	2.8	2.8	2.8	2.8
Total assets	103.4	95.5	166.5	175.2	185.1
Short-term borrowings	2.7	2.0	0.8	0.8	0.8
Trade payables	27.9	12.1	13.5	13.9	13.5
Long-term borrowings	0.0	5.9	7.2	7.2	7.2
Provisions	0.0	0.0	0.0	0.0	0.0
Other liabilities	2.6	1.1	1.1	1.1	1.1
Total liabilities	33.2	21.2	22.6	23.0	22.6
Preference shares	0.0	0.0	0.0	0.0	0.0
Hybrid equity					
Share capital	97.1	96.7	166.3	174.6	185.0
Other reserves	2.2	2.5	2.5	2.5	2.5
FCTR					
Unrealised gains/losses					
Retained earnings	-29.1	-24.9	-24.9	-24.9	-24.9
Other equity	0.0	0.0	0.0	0.0	0.0
Total equity	70.1	74.3	143.9	152.2	162.6
Minority interest	0.0	0.0	0.0	0.0	0.0
Total shareholders' equity	70.1	74.3	143.9	152.2	162.6
Total liabilities & SE	103.4	95.5	166.5	175.2	185.1

Closing price (A$)		0.22	Price target (A$)		0.30
Valuation metrics					
Preferred methodology	DCF		Val'n (A$)	$	0.37
DCF valuation inputs					
Rf		6.50%	10-year rate		6.50%
Rm-Rf		4.50%	Margin		2.0%
Beta		2.03	Kd		8.50%
CAPM (Rf+Beta(Rm-Rf))		15.6%	Ke		15.6%
Equity (E/EV)		90.0%	NPV cash flow (A$m)		94.0
Debt (D/EV)		10.0%	Minority interest (A$m)		0.0
Interest rate		8.50%	Net debt (A$m)		-1.8
Tax rate (t)		30.0%	Investments (A$m)		0.0
			Equity market value (A$m)		95.8
WACC		14.6%	Diluted no. of shares (m)		258.0
			DCF valuation (A$)		**0.37**

Multiples	2008A	2009F	2010F	2011F
Enterprise value (A$m)	62.4	54.7	47.8	39.3
EV/Sales (x)	1.0	0.6	0.5	0.4
EV/EBITDA (x)	7.7	3.8	3.2	1.9
EV/EBIT (x)	9.1	4.1	3.6	2.1
PE (pre-goodwill) (x)	6.0	5.4	5.2	4.0
PEG (pre-goodwill) (x)	4.0	3.6	3.5	2.7

At target price	2008A	2009F	2010F	2011F
EV/EBITDA (x)	10.2	5.2	4.5	2.9
PE (pre-goodwill) (x)	8.1	7.2	7.0	5.4

Comparable company data (x)		2009F	2010F	2011F
Australian Pharmaceutical	EV/EBITDA	3.3	3.1	2.5
Year to 31 Aug	EV/EBIT	4.4	4.2	3.4
	PE	9.6	8.0	6.6
Sigma Pharmaceuticals	EV/EBITDA	6.6	6.3	6.0
Year to 31 Jan	EV/EBIT	8.0	7.6	7.2
	PE	13.0	12.2	11.0

Per share data	2008A	2009F	2010F	2011F
No. shares	141.5	258.0	257.1	257.3
EPS (cps)	3.0	4.1	4.2	5.5
EPS (normalised) (c)	3.7	4.1	4.2	5.5
Dividend per share (c)	0.5	1.0	1.0	2.0
Dividend payout ratio (%)	0.0	0.0	23.8	18.1
Dividend yield (%)	2.3	4.5	4.5	9.1

Growth ratios	2008A	2009F	2010F	2011F
Sales growth	20.3%	47.4%	3.2%	3.2%
Operating cost growth	13.4%	42.9%	3.2%	-3.1%
EBITDA growth	113.0%	79.7%	3.0%	39.1%
EBITA growth	161.4%	93.1%	0.4%	41.7%

Operating performance	2008A	2009F	2010F	2011F
Asset turnover (%)	16.5	18.5	14.6	14.3
EBITDA margin (%)	12.3	15.0	14.9	20.1
EBIT margin (%)	10.4	13.7	13.3	18.3
Net profit margin (%)	7.9	11.0	10.9	13.8
Return on net assets (%)	9.2	9.2	8.7	11.6
Net debt (A$m)	5.8	-1.8	-8.8	-17.2
Net debt/equity (%)	7.8	-1.3	-5.8	-10.6
Net interest/EBIT cover (x)	9.4	26.0	266.1	-51.1
ROIC (%)	11.5	16.5	9.3	13.1

Internal liquidity	2008A	2009F	2010F	2011F
Current ratio (x)	2.0	2.6	3.0	3.7
Receivables turnover (x)	4.7	6.4	6.7	6.7
Payables turnover (x)	2.9	6.4	6.2	6.0

Source: Company data, ABN AMRO Morgans forecasts

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Absolute performance, long-term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. The target price is the level the stock should currently trade at if the market accepted the analyst’s view of the stock, provided the necessary catalysts are in place to effect the change in perception. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from ‘fair’ value. Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

For listed property trusts (LPTs) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more; a Hold 5-10%; and a Sell less than 5%.

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A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

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