EDISON

AFT Pharmaceuticals

Financial update

Australia and Maxigesic driving growth

Pharma & biotech

AFT Pharmaceuticals is a New Zealand-based specialty pharmaceutical company that currently sells over 130 prescription specialty generics and OTC products through its own salesforce in New Zealand, Australia and South-East Asia. It has been expanding its geographic footprint thanks mainly to Maxigesic, its paracetamol (acetaminophen)/ibuprofen combination product. Maxigesic is currently being sold in 10 countries and has distribution agreements in 124 in total. Further Maxigesic launches in the next two to three years should help drive revenues and margins.

Year end	Revenue (NZ$m)	PBT* (NZ$m)	EPS* (NZ$)	DPS (NZ$)	P/E (x)	Yield (%)
03/16	64.0	(10.8)	(0.11)	0.0	N/A	N/A
03/17	69.2	(18.5)	(0.19)	0.0	N/A	N/A
03/18e	80.6	(12.2)	(0.13)	0.0	N/A	N/A
03/19e	98.0	(0.5)	(0.01)	0.0	N/A	N/A

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

Stellar growth in Australia

Revenue in Australia was up 38% in the first half of FY18 compared to the first half of FY17 thanks in large part to Maxigesic sales doubling as well as strong hospital sales. Growth is expected to continue to be robust as patients switch from codeine containing products (which will no longer be available over the counter after 1 February 2018 due to re-scheduling) to Maxigesic.

Maxigesic licensed in 124 countries

Maxigesic is currently sold and launched in 10 countries (up from eight as of the end of FY17) and distribution agreements are in place in a total of 124 countries. The main rate-limiting steps are related to regulatory processes at the country level, so the launch rate has been slower than originally targeted (around 30-40 in FY18), though we expect these hurdles to be overcome in the next two to three years.

Intravenous version of Maxigesic a winner

In October, AFT announced that Maxigesic IV, the intravenous version of Maxigesic, achieved a highly statistically significant result ($p<0.001$) in the primary endpoint in a 276-patient pain trial. Maxigesic IV was superior to the IV version of paracetamol (which will have sales of ~US$300m in the US in 2017), IV ibuprofen and placebo. We expect AFT to file for FDA approval in the coming months.

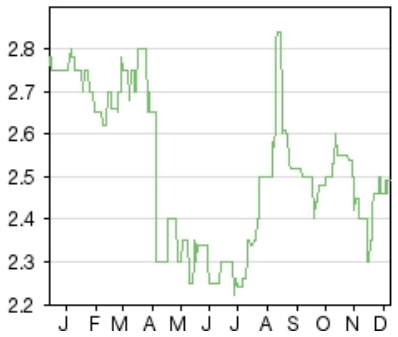
Valuation: NZ$460m or NZ$4.73 per share

We are reducing our valuation from NZ$461m or NZ$4.75 per share to NZ$460m or NZ$4.73 per share. We have reduced our near- and medium-term Maxigesic forecasts due to delayed launch timelines and reduced our estimates for Asian sales. The effect of these reductions was partly mitigated by higher estimates for Australia, higher gross margin estimates for the territories where AFT sells directly, as advancing our NPVs to the most recent period. Adjustments to launch timelines lead to delayed expected EBITDA break-even from FY18 to FY19.

12 December 2017

Price	**NZ$2.49**
Market cap	**NZ$242m**
	NZ$0.69/US$
Net debt (NZ$m) at 30 September 2017	16.1
Shares in issue	97.3m
Free float	10.8%
Code	AFT
Primary exchange	NZX
Secondary exchange	ASX

Share price performance



%	1m	3m	12m
Abs	3.8	(0.4)	(9.8)
Rel (local)	1.8	(3.7)	(21.2)
52-week high/low	NZ$2.8		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

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Investment summary

Company description: Expanding horizons

Founded in 1997 in a spare room in New Zealand, AFT Pharmaceuticals has grown to a large regional specialty pharmaceutical company selling more than 130 proprietary and in-licensed products, covering a wide range of therapeutic categories in the hospital, prescription and OTC markets. 93.9% of its H1 FY18 sales came from Australia and New Zealand, though this is down from 97.4% in FY16. The company's goal is to further expand beyond the confines of Australia and New Zealand, which account for only 2.2% of the developed world's population, mainly through distribution partnerships to sell Maxigesic and its line extensions.

Valuation: An attractive long-term play

Our DCF-based valuation of AFT is NZ$4.73 a share, based on a WACC of 10%. We assume a 22% CAGR for revenues over the next five years, from FY18 through FY22, fading to 2% terminal growth post 2026 and a terminal EBIT margin of 34%. The growth rate and margin expansion is highly dependent upon high growth in royalties from distribution relationships in the rest of world segment (everything outside of Australia, New Zealand and South-East Asia), driven in large part by Maxigesic.

Financials: In the investing phase

AFT has grown revenues at a CAGR of 15% mostly in NZ and Australia over the past decade and the company seeks to replicate that success across the globe. We look for revenues to accelerate as Maxigesic is licensed and sold in new geographies. The company had been profitable in the past but has been loss-making since FY13 due to increased investment spending to develop new products and new markets. We expect a return to profitability in FY20 (with EBITDA break-even in FY19) due to a combination of revenue growth, higher gross margins, and R&D expenses plateauing and then falling after 2017. AFT currently has NZ$7.2m in cash and NZ$23.2m in debt that matures at the end of FY20. In September, the company entered into a new loan facility of US$10m, half of which we expect to be used in FY18 and half in FY19. Based on current estimates, we do not believe the company will require additional financing.

Sensitivities: Much depends on Maxigesic

The magnitude and duration of AFT's growth trajectory hinges on its ability to successfully establish AFT's products, especially Maxigesic, in new geographies (currently Maxigesic is marketed in 10 geographies but is partnered in 124 total). Without growth outside of Australia and New Zealand, AFT's forecast FY18-22 revenue CAGR would fall from 22% to 10%. AFT will need to depend on sales and distribution partners to grow this segment, with the quality of the partners determining how successful the company is in any given region. Also the magnitude of receiving regulatory clearance in a further 114 countries should not be underestimated and that has led to AFT not meeting its original target for 30-40 launches in FY18. Additionally, Maxigesic would be sold in an extremely competitive market, so it is very easy for a product launch to get lost in the shuffle. However, we view it as promising that the number of Maxigesic tablets sold has increased from 21m in FY16 to 74m in FY17, mainly due to growth overseas. It also faces various regulatory challenges, with different requirements in different countries. The most challenging will likely be the United States, where AFT is currently pursuing an NDA for the intravenous (IV) version of Maxigesic and is developing the NasoSURF Nebuliser. The FDA may require AFT to spend more on R&D than it is currently planning and may also push back expected approval timelines.

A diversified base business

Over the past decade, AFT has built a well-diversified portfolio of products, customers and geographies by focusing on identifying and developing differentiated products that meet a specific market need.

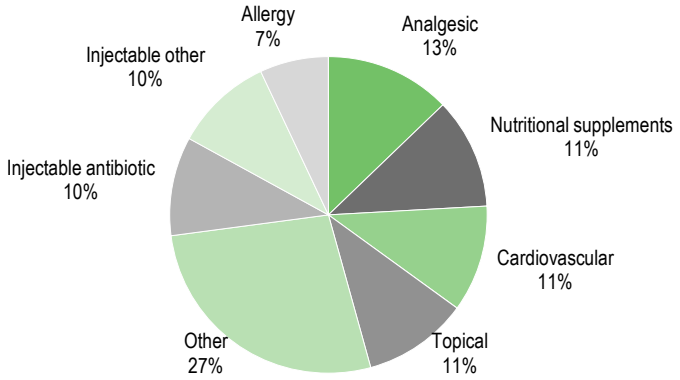
Exhibit 1: AFT geographic and product type diversification

Region	Number of products launched	% of operating revenue	% growth from H1 FY17 to H1 FY18	Sales channel mix
Australia	102	55.3%	38%	OTC: 55.6%, hospital: 33.6%, prescription: 10.8%
New Zealand	55	38.6%	5%	OTC: 41.2%, hospital: 20%, prescription: 38.8%
South-East Asia	8	1.7%	14%	OTC: 33.3%, hospital: 65.2%, prescription: 1.5%
Rest of World	4	4.4%	38%	OTC: 95.9%, hospital: 4.1%, prescription: 0%
Total	>130	100%	23%	OTC: 51.5%, hospital: 27.6%, prescription: 21%

Source: AFT Pharmaceuticals. Note: Number of products launched is as of 31 March 2017.

As of the end of FY17, AFT sold 102 products in New Zealand, 55 in Australia, eight in South-East Asia and four in the rest of the world, split between over-the-counter (OTC) products that do not require a prescription, hospital products and prescription products.

Exhibit 2: AFT portfolio snapshot (by revenue)



Source: AFT Pharmaceuticals. Note: Data reflects FY15.

AFT's salesforce of c 40 sells into the majority of hospitals in Australia and New Zealand, nearly all pharmacies including key local chains such as Chemist Warehouse and Green Cross Health, and all major supermarkets in New Zealand. AFT has in-market sales teams in Malaysia and Singapore and works with local distributors and marketers in the rest of South-East Asia. 93.9% of its H1 FY18 sales came from Australia and New Zealand, though revenues outside these areas continue to become a greater part of AFT's business.

Exhibit 3: Key AFT categories, select products and channels

Therapeutic category	Key products	Distribution channel	Current markets
Allergy	Allersoothe	OTC	Australia, Iraq, New Zealand
	Histaclear		
	Loraclear/Lorapaed		
	Maxiclear Hayfever & Sinus		
Analgesic	Maxigesic	OTC, hospital	Australia, Brunei, Iraq, Malaysia, New Zealand, Singapore, UAE
	Paracetamol Osteo-Tab		
	Paracetamol IV		
Cold & flu	Maxiclear Cold & Nasal	OTC	Australia, Iraq, New Zealand
	Maxiclear Cold & Flu		
Eye care	Hylo-Fresh/Forte	OTC	Australia, New Zealand
Injectable antibiotics	Cefazolin-AFT	Hospital	Albania, Australia, Kosovo, New Zealand, Singapore, UAE
	Cefepime-AFT		
	Ceftriaxone-AFT		
Injectable non-antibiotics	Nausicalm	Hospital	
	Provive		
	Granisetron-AFT		
	Ondansetron		
	Tropisetron-AFT		
Orphan	Fibroleve (aka Esbriet)	Prescription	New Zealand, Singapore, Malaysia
	Imatinib-AFT (aka Gleevec)		
Topical	Coco-Scalp	OTC	Australia, Iraq, New Zealand
	Crystaderm		
	Zostrix/ZoRub OA/HP		
	ZoRub for Chafing		
Vitamin and mineral	Ferro-F	OTC	Australia, New Zealand
	Ferro-Liquid		
	Ferro-Tab		
Other	Femme-Tab	Prescription	Australia, New Zealand
	Probenecid		
	Rubifen		

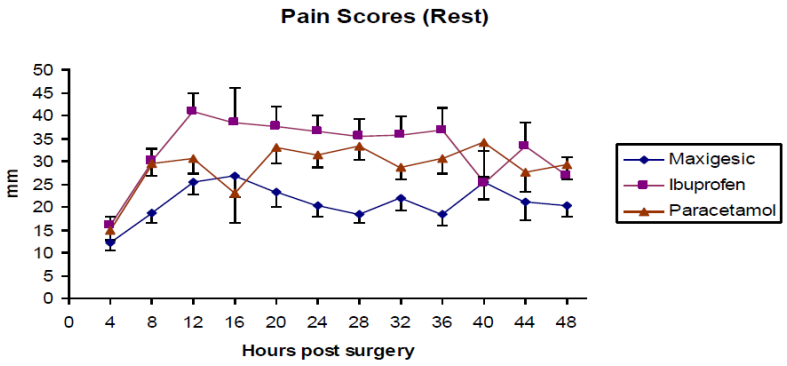
Source: AFT Pharmaceuticals reports

Maxigesic is a key product

While AFT has dozens of products, the key to AFT's success is Maxigesic, which uses a unique 3.3 to 1 acetaminophen to ibuprofen ratio formulation (500mg acetaminophen/150mg ibuprofen) for the purpose of pain relief. Maxigesic demonstrated approximately 33% lower average pain scores over 48 hours after oral surgery in adults compared with an equivalent dosage of either acetaminophen or ibuprofen alone in a 135-patient, randomised clinical trial.[1] Results were highly statistically significant (p=0.007 at rest and p=0.006 on activity vs acetaminophen and p=0.003 at rest and p=0.007 on activity vs ibuprofen).

1 Merry A et al., *British Journal of Anaesthesia* 104(1):80-8(2010)

Exhibit 4: Maxigesic vs ibuprofen and paracetamol (acetaminophen) post dental surgery



Source: New Zealand Medicines and Medical Devices Safety Authority

The strength of a paracetamol (acetaminophen) and ibuprofen combination was recently confirmed in an independent (non-company) sponsored study that was published in the *Journal of the American Medical Association* (JAMA)[2], a very prestigious journal. The efficacy of a single dosing of four different oral combination regimens (three that contained opioids, including Vicodin and Percocet) was studied in 416 patients with moderate to severe acute extremity pain. Importantly, no significant difference was seen between the efficacy of the Maxigesic-like regimen and those containing opioids, demonstrating its efficacy and potential for opioid sparing.

Exhibit 5: Comparing paracetamol (acetaminophen) and ibuprofen to opioid containing regimens

Regimen	Number of patients	Baseline pain score	Score 2 hours post-dose	Decline in score after 2 hours (primary endpoint)	% receiving rescue opioid
1,000mg acetaminophen + 400mg ibuprofen (similar to two tablets of Maxigesic)	101	8.9	4.6	4.3	18%
5mg oxycodone + 325mg acetaminophen (aka Percocet)	104	8.7	4.3	4.4	14%
5mg hydrocodone + 300mg acetaminophen (aka Vicodin)	103	8.6	5.1	3.5	18%
30mg codeine + 300mg acetaminophen (aka Tylenol 3)	103	8.6	4.7	3.9	23%

Source: Chang et al., Effect of a Single Dose of Oral Opioid and Nonopioid Analgesics on Acute Extremity Pain in the Emergency Department A Randomized Clinical Trial. *JAMA*. 2017;318(17): 1,661-1,667. Note: In the pain scale that was used, 0 indicated no pain while 10 indicated the worst possible pain. Also, two tablets of Maxigesic equals 1,000mg acetaminophen + 300mg ibuprofen, a slightly lower dose than what was used in this study.

The need to find alternatives to opioids is clear. The rate at which people are dying from opioids is skyrocketing (see Exhibit 6). In 2015, there were over 50,000 drug overdose deaths in the United States and 63.1% of them involved an opioid.[3] It is a major driver for a significant increase in all-cause mortality in white non-Hispanic men and women in the United States.[4] And while some of these deaths occur because drug was obtained illegally, part of the problem is doctors are simply prescribing opioids more, increasing the opportunity for addiction. Between 2001 and 2010, the percentage of total emergency department visits that resulted in an opioid prescription increased from 20.8% to 31%.[5]

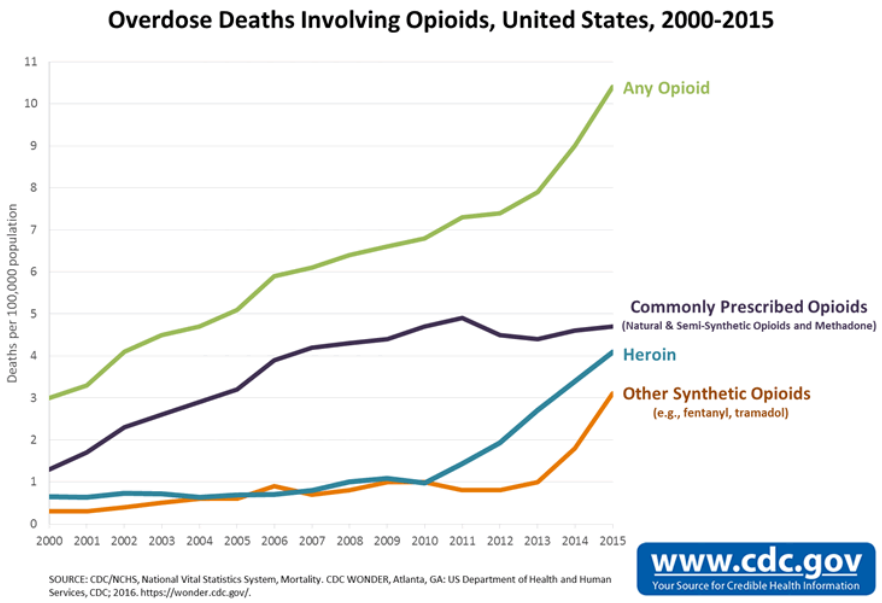
[2] Chang et al., Effect of a Single Dose of Oral Opioid and Nonopioid Analgesics on Acute Extremity Pain in the Emergency Department A Randomized Clinical Trial. *JAMA*. 2017;318(17):1661–1667.

[3] Kyriacou et al., Opioid vs Nonopioid Acute Pain Management in the Emergency Department. *JAMA*. 2017;318(17):1655–1656.

[4] Case et al., Rising morbidity and mortality in midlife among white non-Hispanic Americans in the 21st century. *PNAS*. vol. 112 no. 49 15078-15083

[5] Kyriacou et al., Opioid vs Nonopioid Acute Pain Management in the Emergency Department. *JAMA*. 2017;318(17):1655–1656.

Exhibit 6: Opioid overdose deaths in the United States



Source: Centers for Disease Control

Additionally, Maxigesic would reduce the risk of an accidental paracetamol (acetaminophen) overdose due to inadequate pain relief. According to the FDA, 48% of cases of acute liver failure are caused by acetaminophen overdose. Most alarmingly, liver injury can occur at doses just slightly higher than the current recommended maximum daily dose of 4 grams. Depending on the study, the median daily dose that led to injury was just 5.0-7.5 grams per day (something that can easily happen if you feel you need a little extra pain relief).

The market for Maxigesic

According to IMS, the worldwide market size for ibuprofen and acetaminophen tablets alone is over US$10bn, most of it concentrated in the US and Europe. With a differentiated combination product, there is no reason why AFT could not achieve meaningful market share with the right partners. In Australia alone, which is currently estimated to be a ~NZ$400m market by IMS, the potential is significant. Maxigesic sales in Australia had grown 133% in FY17 thanks to a rescheduling that allowed it to be sold in front of the counter and be advertised directly to consumers. This high rate of growth is likely to continue due to a decision by the Australian Therapeutic Goods Administration (TGA) that all products containing codeine (a key competitor to AFT's Maxigesic) are to be rescheduled to prescription-only as of 1 February 2018 due to the risk of dependence and adverse events associated with their use. In total, market research conducted by the company suggests that 40-47% of current consumers who buy 710 million OTC codeine analgesics each year in Australia would switch to another OTC analgesic rather than get a doctor's prescription. As AFT sold 13m Maxigesic tablets in Australia in FY17, this represents a significant opportunity for the company; we estimate it could be worth between NZ$20-30m annually (though we do not include this in our valuation yet).

Across the globe, AFT has partners for Maxigesic in 124 countries and the product is launched in 10, up from eight as of the end of FY17 (see Exhibit 7). AFT had previously stated that it was targeting one-third of these areas to have launches in FY18, one-quarter in FY19, another one-quarter in FY20 and the rest in FY21. However, launch timing is heavily dependent upon multi-step regulatory processes in each country and delays are relatively common so the company is behind its original plan. We continue to expect the company to launch in the bulk of its licensed countries in the next two to three years. While the exact economics will vary by the agreement, we believe that

between the transfer price and the net royalty to the company, AFT will book 8-20% of the product sales as revenue.

Exhibit 7: Status of select Maxigesic launches

Country	Status
Australia	Launched, high growth and significant potential with codeine rescheduling
New Zealand	Launched, increasing market share and potential for codeine rescheduling
United Arab Emirates	Launched, sales doubled in second year of sales
Italy	Launched, sales increasing significantly
UK	Launched
Singapore/Brunei	Launched
Serbia	Launched
Israel	Launched
Malta	Launched
Spain	Launch pending
Portugal	Launch pending
Belgium	Launch pending
Luxembourg	Launch pending
France	Launch pending
Nordics	Launch pending
Eastern Europe & Balkans	Launch pending
Kuwait & Iraq	Launch pending
Malaysia	Launch pending
Central America (Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica)	Launch pending
Ireland	Launch pending

Source: AFT Pharmaceuticals

Additional Maxigesic formulations

AFT intends to add a number of different formulations to its Maxigesic product line as a way of growing Maxigesic sales in both existing and new markets. Planned line extensions in these geographies could alone increase its addressable market by US$4.3bn (US$3.7bn OTC and US$622m for the hospital-based IV version) or over 40%.

Exhibit 8: Maxigesic planned line extension

Product	Target market/description	Global market size
Maxigesic oral liquid	Suspension oral liquid for paediatric use	US$1.8bn
Maxigesic powder sachets	Powder sachets for preparation of a lemon-flavoured hot drink for adult use	US$677m
Maxigesic PE tablets	Tablet for treatment of pains associated with cold and flu for adult use	US$886m
Maxigesic PE sachets	Powder sachets for treatment of pains associated with cold and flu for adult use	US$324m
Maxigesic IV	Injectable for post-operative use in adults either alone or to reduce the use of opioid analgesics	US$622m
Extension market size		US$4.3bn

Source: AFT Pharmaceuticals, IMS World Review Pack (August 2015), Newport 2017

Maxigesic IV is particularly interesting as it is a hospital-based product that would have more attractive pricing and less competition than the OTC line extensions. AFT recently ran a Phase III trial in the United States comparing Maxigesic IV to IV paracetamol (acetaminophen), IV ibuprofen and placebo in 276 patients following bunion surgery. The primary endpoint was improvement in the sum of pain intensity scores (SPID) and Maxigesic IV hit it with a p value of $p<0.001$. We expect the company to file for FDA approval in the coming months.

Importantly, Maxigesic IV will be an asset of particular interest to partners. The IV version of paracetamol (acetaminophen), sold under the brand name Ofirmev, is expected to have sales of around US$300m in the US this year. The company that originally developed it, Cadence Pharmaceuticals, was acquired for US$1.4bn in 2014 by Mallinckrodt.

The NasoSURF opportunity

The NasoSURF Nebuliser is a hand-held ultrasonic nasal mesh nebuliser for the intranasal delivery of medication and for the treatment of chronic sinusitis. AFT believes the NasoSURF Nebuliser has a unique combination of advantages over existing nebulisers including portability, a high delivery rate (reducing treatment time), control of particle size, control of dosage amount and breath activation to ensure medication is only delivered to the nose and not to the throat or lungs.

Exhibit 9: NasoSURF Nebuliser

Source: AFT Pharmaceuticals

For NasoSURF's first application, AFT will seek to use it to administer saline as a wash out in post-operative sinus surgery patients suffering from chronic sinusitis. In this setting, NasoSURF is registered as a Class I medical device, which is the class associated with the least regulatory burden (eg dental floss is a Class I medical device). Chronic sinusitis affects some 29.4 million Americans annually, with 20% of patients (c 5.9 million) not responding to existing pharmacological treatments and nearly 500,000 patients seeking expensive sinus surgery. Using a US$20 per patient price (assuming several treatments), the addressable market in the US is only US$10m.

AFT is also seeking approval in the US for NasoSURF to deliver midazolam for conscious sedation in the dental and ambulatory surgery markets (midazolam, in its IV form, is already used for procedural sedation). The company has completed a pre-IND meeting with the FDA and the development pathway has been clarified by the agency. We expect the first drug pharmacokinetic (PK) and clinical studies to commence in the FY18-19 timeframe, with licence negotiations occurring concurrently.

Intranasal conscious sedation is an effective alternative to intravenous conscious sedation and is faster acting than currently available oral medications. If approved, AFT expects the NasoSURF Nebuliser to be the only intranasal method of conscious sedation in major markets. In the US, approximately 125 million dental procedures suitable for conscious sedation were performed in 2009 and approximately 25.7 million ambulatory surgical procedures suitable for conscious sedation were performed in 2006. Using IMS data, the US addressable market for conscious

sedation in dental and ambulatory surgeries is c US$3bn at US$20 per treatment. Market research conducted by the company suggests that dentists would use the product in 45% of cases.

In the longer term, AFT may seek approval for NasoSURF Nebuliser to deliver drugs for a number of conditions such as seizure, pain, agitation, opiate overdose, hypoglycaemia, vaccines and sexual dysfunction.

NasoSURF will be targeted at physicians and hospitals, and revenues will come in three forms: the sale of the NasoSURF Nebuliser device to physicians/hospitals (approximately US$300 each); a per use charge through the sale of radio frequency identifier (RFID) cards, which programme the device for use with particular drugs; and consumables, such as mouthpieces and nasal prongs. We currently do not include the NasoSURF device in our valuation, because the product is still in development.

Valuation

Our DCF-based valuation of AFT is NZ$4.73 a share based on a WACC of 10%. We assume a 22% CAGR for revenues over the next five years, from FY18 through FY22, fading to 2% terminal growth post 2026 and a terminal EBIT margin of 34%. With these assumptions, the terminal value represents 68% of the calculated DCF value of the company. The growth rate and margin expansion are highly dependent upon high growth in royalties from distribution relationships outside of Australia, New Zealand and South-East Asia, driven in large part by Maxigesic. Without this growth AFT's revenue CAGR through 2022 would fall from 22% to 10%.

Exhibit 10: DCF sensitivity table (NZ$/share)

	Terminal EBIT Margin				
Terminal Revenue Growth	15%	25%	34%	38%	42%
-2%	2.26	2.98	3.62	3.90	4.19
-1%	2.34	3.12	3.82	4.13	4.44
0%	2.44	3.29	4.06	4.41	4.75
1%	2.55	3.50	4.36	4.74	5.12
2%	2.70	3.77	4.73	5.16	5.58
3%	2.88	4.10	5.20	5.69	6.18
4%	3.13	4.55	5.84	6.41	6.98
5%	3.48	5.18	6.72	7.41	8.09

Source: Edison Investment Research

Our current valuation of NZ$460m or NZ$4.73 per share is down from our previous valuation of NZ$461m or NZ$4.75 per share. We have reduced our near- and medium-term Maxigesic forecasts due to delayed launch timelines, but our long-term sales estimates are largely unchanged as we view the delays as related to regulatory processes and not the ultimate commercial success of the product. We have also reduced our estimates for South-East Asia sales as the 14% growth in H118 was much slower than anticipated and a marked deceleration from the 55% growth seen in FY17 compared to the previous year. The effect of these reductions was partly mitigated by higher estimates for Australia (which currently represents 55% of sales), where growth has accelerated to 38% in H118 compared to 19% last year thanks to strong Maxigesic sales following its rescheduling that allowed it to be sold in front of the counter and be advertised directly to consumers. As mentioned previously, the 1 February 2018 rescheduling of codeine-based painkillers to a level that requires a prescription has the potential to markedly boost sales. We have also increased our gross margin estimates for the direct sales segment of the business (everything but the rest of world segment, where sales come from distribution partners) over the next couple of years as the company reported a gross margin of 39%, up 3% points compared to the 36% seen in H1 FY17. The DCF value of the company also improved due to rolling forward the NPVs.

Peer group comparison

We have compared AFT to a selection of other global generic and consumer pharmaceutical companies with market caps between approximately US$1bn and US$12bn. The gross margins of these companies range from -4% for Impax, a generic specialty pharmaceutical company, to 74% for Taro, which has a niche in developing hard-to-formulate dermatology generics. Our model estimates that AFT's gross margin should increase from 39% in H1 FY18 to 68% in 2025 (up from a 2025 estimate of 65% previously) thanks to high-margin Maxigesic licensing income from the Rest of World segment, which could lead to Price/Sales multiple expansion on a growing sales base.

Exhibit 11: Peer comparison

Company	Identifier	Year-end	Currency	Price	Market cap (m)	Gross margin	Price/earnings (x)		Price/sales (x)
							Trailing 12M	1Y forward	Trailing 12M
Perrigo	PRGO.K	Dec	US$	87.87	12,280	39%	N/A	16.2	2.46
Impax	IPXL.OQ	Dec	US$	15.88	1,180	-4%	N/A	16.1	1.49
Taro Pharmaceutical	TARO.K	Mar	US$	110.4	4,180	74%	13.4	13.6	5.59
Prestige Brands	PBH	Mar	US$	44.9	2,320	56%	21.8	15.3	2.39
Mayne Pharma Group	MYX.AX	Jun	A$	0.61	944	57%	9.8	N/A	1.64
Average					**4,181**	**44%**	**14.98***	**15.30***	**2.98**
AFT Pharmaceuticals	AFT.NZX	Mar	NZ$	2.46	239	39%	N/A	N/A	3.14

Source: Edison Investment Research, Bloomberg, Thomson Reuters, Finviz. Note: *Average excluding negative P/E. Prices as of 29 November 2017.

Financials

Recently, AFT reported results for the first half of FY18. Revenues grew to NZ$36.6m, up 23% from NZ$29.8m in the first half of FY17. Australia and the rest of world region were the main growth drivers, each growing 38% compared to H1 FY17. New Zealand returned to growth, up 5% compared to the prior period. Revenues in New Zealand had fallen by 6% in FY17 due to issues with Metoprolol as well as weakness in the pharmacy channel, likely due to mild cold/flu and allergy seasons. Growth in New Zealand was helped by the launch of Crystawash and Crystasoothe extensions of its Crystaderm product as well as by growth in the hospital channel thanks to the addition of new products. As mentioned previously, we have reduced our near- and medium-term Maxigesic forecasts due to delayed launch timelines, which has affected our financial forecasts for AFT as Maxigesic is a major growth driver for the company (see Exhibit 12).

Exhibit 12: Edison forecast changes

	2018e		2019e	
	Old	New	Old	New
Revenue (NZ$m)	97.7	80.6	124.2	98.0
PBT, normalised (NZ$m)	(0.6)	(12.2)	14.7	(0.5)
EPS, normalised (NZ$)	(0.01)	(0.13)	0.15	(0.01)

Source: Edison Investment Research

AFT has grown revenues at a CAGR of 15% in NZ and Australia over the past decade and the company seeks to replicate that success across the globe. We look for revenues to accelerate as Maxigesic is licensed and outside its core region. The company had been profitable in the past but has been loss-making since FY13 due to increased investment spending to develop new products and new markets. We expect a return to profitability in FY20 (and EBITDA break-even in FY19) due to a combination of revenue growth, higher gross margins, and R&D expenses plateauing and then falling after 2017. AFT currently has NZ$7.2m in cash and NZ$23.2m in debt that matures at the end of FY20. In September, the company entered into a new loan facility of US$10m, half of which we expect to be used in FY18 and half in FY19. Based on current estimates, we do not believe the company will require additional financing.

Exhibit 13: Financial summary

NZ$000	2015	2016	2017	2018e	2019e
March	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP
PROFIT & LOSS					
Revenue	56,241	64,014	69,205	80,580	98,023
Cost of Sales	(35,083)	(40,435)	(43,207)	(45,329)	(51,266)
Gross Profit	21,158	23,579	25,998	35,251	46,757
EBITDA	(9,659)	(7,821)	(15,125)	(9,385)	1,316
Operating Profit (before amort. and except.)	(9,530)	(7,667)	(14,982)	(9,242)	1,459
Intangible Amortisation	99	114	183	183	183
Exceptionals	0	0	0	0	0
Other	(546)	(618)	2,245	2,712	1,179
Operating Profit	(9,977)	(8,171)	(12,554)	(6,348)	2,821
Net Interest	(1,908)	(3,145)	(3,531)	(3,000)	(2,000)
Profit Before Tax (norm)	(11,438)	(10,812)	(18,513)	(12,242)	(541)
Profit Before Tax (reported)	(11,885)	(11,316)	(16,085)	(9,348)	821
Tax	282	42	(58)	(300)	0
Profit After Tax (norm)	(11,156)	(10,770)	(18,571)	(12,542)	(541)
Profit After Tax (reported)	(11,603)	(11,274)	(16,143)	(9,648)	821
Average Number of Shares Outstanding (m)	1.2	96.8	97.1	97.3	97.3
EPS - normalised (NZ$)	(9.46)	(0.11)	(0.19)	(0.13)	(0.01)
EPS - normalised fully diluted (c)	(945.74)	(11.12)	(19.12)	(12.89)	(0.56)
EPS - (reported) (NZ$)	(9.84)	(0.12)	(0.17)	(0.10)	0.01
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	37.6	36.8	37.6	43.7	47.7
EBITDA Margin (%)	N/A	N/A	N/A	N/A	1.3
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	1.5
BALANCE SHEET					
Fixed Assets	2,488	3,249	4,171	5,268	7,236
Intangible Assets	1,669	2,111	2,548	2,744	4,516
Tangible Assets	411	407	386	374	570
Investments	408	731	1,237	2,150	2,150
Current Assets	30,725	62,055	54,060	46,770	52,678
Stocks	14,686	17,686	18,718	21,137	23,607
Debtors	11,251	16,288	19,362	16,640	21,741
Cash	4,700	28,055	15,980	8,993	7,330
Other	88	26	0	0	0
Current Liabilities	(10,148)	(13,511)	(15,019)	(13,795)	(17,029)
Creditors	(10,148)	(13,511)	(15,019)	(13,795)	(17,029)
Short term borrowings	0	0	0	0	0
Long Term Liabilities	(20,739)	(23,161)	(23,426)	(28,244)	(33,244)
Long term borrowings	(20,739)	(23,161)	(23,426)	(28,244)	(33,244)
Other long term liabilities	0	0	0	0	0
Net Assets	2,326	28,632	19,786	9,999	9,641
CASH FLOW					
Operating Cash Flow	(11,479)	(11,326)	(15,473)	(7,519)	(2,368)
Net Interest	(1,908)	(3,145)	(3,531)	(3,000)	(2,000)
Tax	282	42	(58)	(300)	0
Capex	(483)	(694)	(1,598)	(2,179)	(2,294)
Acquisitions/disposals	0	0	0	0	0
Financing	12,859	38,357	9,042	877	0
Dividends	(763)	(1,652)	0	(132)	0
Net Cash Flow	(1,492)	21,582	(11,618)	(12,253)	(6,662)
Opening net debt/(cash)	11,889	16,039	(4,894)	7,446	19,251
HP finance leases initiated	0	0	0	0	0
Other	(2,658)	(649)	(722)	448	0
Closing net debt/(cash)	16,039	(4,894)	7,446	19,251	25,914

Source: AFT Pharmaceuticals accounts, Edison Investment Research

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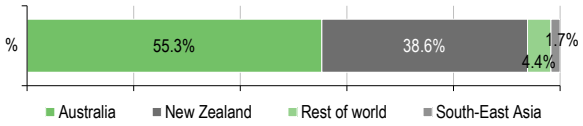
Revenue by geography



Management team

Chief Executive Officer: Dr Hartley Atkinson

Hartley has a master's of pharmaceutical chemistry with distinction (1983) and a doctorate in pharmacology from Otago University (1989). He published 17 research papers and two book chapters prior to entering industry. Before establishing AFT Pharmaceuticals, Hartley had eight years in multinational pharmaceutical companies in various positions including medical director and sales and marketing director.

Chairman: David Flacks

David is chair of the NZ Markets Disciplinary Tribunal and a member of the Takeovers Panel. Directorships include Vero Insurance, Asteron Life, Harmoney Corp and NZ Venture Investment Fund. David is a director of specialist corporate law firm Flacks & Wong, having recently retired from Bell Gully after many years as a senior corporate partner.

Chief Financial Officer: Malcolm Tubby

Malcolm is a qualified chartered accountant in the United Kingdom and New Zealand with a wealth of senior corporate governance expertise in the commerce sector including roles in significant public companies as chief financial officer. He has experience in senior positions in public and private companies in pharmaceuticals, beverages, insurance and aged care facilities in Australia and New Zealand. Malcolm has been involved in the AFT board since its foundation.

Director International Business Development: Louise Clayton

Louise has over 20 years' functional experience with international business, key accounts, sales and marketing teams, with a core focus on brand growth and development within local and international markets such as Australia, the US, Asia, and the UK. Having worked with brands within the supplement, OTC, health, and beauty Channels, her experience has given her the opportunity to drive international brands through a variety of management roles encompassing sales, brand marketing, product sourcing/new product development, and new market expansion.

Principal shareholders	(%)
Atkinson Family Trust	75.4%
Capital Royalty Partners	13.4%
National Nominees New Zealand Limited	3.6%
JP Morgan	1.3%
HSBC	1.0%

Companies named in this report

Perrigo Company PLC (PRGO), Impax Laboratories Inc (IPXL), Taro Pharmaceutical Industries Ltd (TARO), Prestige Brands Holdings Inc (PBH), Mayne Pharma Group Ltd (MYX), Mallinckrodt (MNK)