BÉLL POTTER

Analyst

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Authorisation

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Recommendation

Hold (unchanged)
Price
\$1.51

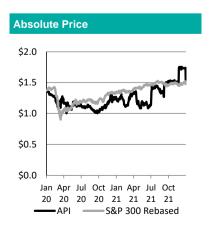
Target (12 months) \$1.53 (previously \$1.73)

GICS Sector

Healthcare Equipment and Services

Expected Return	
Capital growth	1.3%
Dividend yield	1.3%
Total expected return	2.6%
Company Data & Ratios	
Enterprise value	\$945.1m
Market cap	\$745.1m
Issued capital	492.7m
Free float	100%
Avg. daily val. (52wk)	\$2.6m
12 month price range	\$1.06 - \$1.77

Price Performance					
	(1m)	(3m)	(12m)		
Price (A\$)	1.75	1.51	1.26		
Absolute (%)	-13.18	0.33	20.24		
D-1 (0/)	40.40	0.40	0.40		



SOURCE: IRESS

Australian Pharmaceutical Industries (API)

WOW Gets Cold Feet

WOW unable to make the numbers stack up

Following completion of due diligence the WOW Board has decided to withdraw its cash bid for API. The bid, which was highly conditional and non-binding, had the support of the API Board. API will now proceed with the WES bid at \$1.55 (less the 2 cps final dividend).

The notice from WOW withdrawing the bid is brief on detail citing only that the company had not been able to validate the financial return it requires. Fair enough, however, one wonders what, if anything, was uncovered during the due diligence process that led to this conclusion. The key risks in the transaction related to the ACCC sign off, WOW's future interaction with the Pharmacy Guild and the 19.3% blocking stake held by Wesfarmers. These should have been identified prior to the bid and the due diligence exercise itself should have been relatively straight forward.

The WOW bid valued API at ~\$1.01bn (Enterprise value) which implied a year 1 return on invested capital (based on BPe for FY23) of ~7% before any synergy savings or other value add. So why did WOW and before them SIG pull out? In SIG's case it is not unreasonable to assume its internal management issues (which have since emerged) were a contributing factor, while for WOW the potential of a modest 7% return on capital combined with a likely protracted period of less than 100% ownership of API may have contributed. WOW may have been required to pursue a messy takeover bid rather than the more efficient Scheme of Arrangement (SoA). All of these factors were in plain sight at the time of the WOW bid announcement, hence API investors can quite rightly only ponder the motivation of the ill fated WOW bid.

Investment View: Retain Hold, Price Target reduced to \$1.53

No changes to earnings. Price target reduced to \$1.53 matching the WES cash offer (after the 2 cps final dividend). If anything the episode highlights the superior strategy of the WES group in establishing its 19% holding prior to going to public with its bid. We now expect the WES Scheme meetings to proceed later this quarter. The WES bid remains subject to ACCC sign off and the normal SoA approvals.

Earnings Forecast							
August Year End	FY21	FY22e	FY23e	FY24e			
Revenues	4,004.0	4,095.1	4,112.8	4,136.1			
EBITDA \$m	104.8	115.1	147.7	118.1			
NPAT (underlying) \$m	39.4	44.0	63.3	44.1			
NPAT (reported) \$m	1.2	40.5	63.3	44.1			
EPS underlying (cps)	7.8	8.9	12.7	8.9			
EPS growth %	72%	13%	44%	-30%			
PER (x)	19.3	17.1	11.9	17.0			
FCF yield (%)	3.5%	7.5%	12.8%	10.3%			
EV/EBITDA (x)	9.0	8.2	6.4	8.0			
Dividend (cps)	3.5	4.4	6.4	5.8			
Franking	100%	100%	100%	100%			
Yield %	2.3%	2.9%	4.2%	3.8%			
ROE %	0.3%	8.8%	12.9%	8.6%			

SOURCE: BELL POTTER SECURITIES ESTIMATES

Australian Pharmaceutical Industries (API)

- API is vertically integrated wholesaler, franchise owner and retailer.
- The wholesale business services a portion of Australia's ~5,350 community pharmacies. Its core business is to acquire pharmaceuticals from originators and other manufacturers for distribution to pharmacy.
- Most aspects of the wholesale business are heavily regulated, yet despite recent industry restructure, API has continued to manager the profitability of the business through margin clawback. The clawback period is now at end, hence no further margin improvement is possible.
- The jewel in the crown for API is the Priceline Pharmacy chain. With 495 stores and
 more than 7.0 million members in the loyalty program, the business is a powerful retail
 presence. The company continues to invest heavily in marketing spend and remaining
 at the forefront on product innovation and product and brand renewal.
- Target price is determined via capitalised earnings model with the cross check of a DCF model.
- In 2019 the company acquired a majority ownership of the Clearskin Clinics business which is hopes to grow through new store openings and enhanced product offerings.

Key Risk Areas

- Regulatory risk key aspects of the company's business are subject to Federal Government regulation. Further adverse change to the PBS for example may adversely impact the company's ability to realise our forecast earnings.
- Relationship with Franchisee's The retail business is dependent upon the ongoing support of Franchisee's. Each of the full line distributors are eager to source successful pharmacy operators hence API needs to keep the offering to them competitive.
- **Generic Pharmaceuticals** The growth of generic pharmaceuticals will continue to erode margins in the pharmacy wholesale business.
- Bad Debt Risk API is exposed to any increase in pharmacy bad debt. There is an
 elevated risk bad debt levels may increase due to the ongoing changes in the PBS.
 Bad debt expense each year is already material to NPAT. Mitigating this risk, API
 always strives to gain security over anything other than standard trading terms.

Australian Pharmaceutical Industries as at 7 January 2022

RecommendationHoldPrice\$1.51Target (12 months)\$1.53

Table 1 - Financial sumn	nary										
Profit & Loss (A\$m)	FY20	FY21	FY22e	FY23e	FY24e	Valuation Ratios (A\$m)	FY20	FY21	FY22e	FY23e	FY24e
Year Ending August						Year Ending August					
Total revenues *	4,019.6	4,004.0	4,095.1	4,112.8	4,136.1	Reported EPS (cps)	- 1.7	0.1	8.2	12.8	8.9
Revenues growth	0.2%	-0.4%	2.3%	0.4%	0.6%	Normalised EPS (cps)	4.6	7.8	8.9	12.8	8.9
Gross profit	474.5	494.5	520.9	547.3	552.2	EPS growth (%)	-39%	72%	13%	44%	-30%
EBITDA	83.2	104.8	115.1	147.7	118.1	PE(x)	33.1	19.3	17.1	11.9	17.0
EBITDA margin %	2.1%	2.6%	2.8%	3.6%	2.9%	EV/EBITDA (x)	11.4	9.0	8.2	6.4	8.0
Depreciation	17.7	17.4	17.5	24.0	24.0	EV/EBIT (x)	18.1	13.5	11.9	8.9	12.4
Amortisation	13.3	17.4	18.0	18.0	18.0						
EBIT (ex one one off costs)	52.2	70.0	79.6	105.7	76.1	NTA (cps)	39	38	46	55	62
EBIT margin %	1.3%	1.7%	1.9%	2.6%	1.8%	P/NTA (x)	3.9	4.0	3.3	2.8	2.4
Net interest	(19.1)	(15.3)	(16.7)	(15.2)	(13.0)	Book Value (cps)	93	90	95	101	105
Pre tax profit	33.1	54.7	62.9	90.5	63.1	Price/Book (x)	1.6	1.7	1.6	1.5	1.4
Tax expense	(9.9)	(15.3)	(18.9)	(27.2)	(18.9)	DPS (cps)	2.0	3.5	4.4	6.4	5.8
NPAT- normalised	23.2	39.4	44.0	63.4	44.2	Payout ratio %	44%	45%	50%	50%	65%
Net abnormal items	(31.1)	(38.2)	(3.5)	-	-	Dividend Yield %	1.3%	2.3%	2.9%	4.2%	3.8%
Reported NPAT	-7.9	1.2	40.5	63.4	44.2	Franking %	100%	100%	100%	100%	100%
Attributable to Parent	-8.4	0.7	40.5	63.4	44.2	FCF yield %	23.8%	3.5%	7.5%	12.8%	10.3%
A 10 (AA)	=1/00		= 1/22	= 1/00	T1/0 /	5.4					
Cross coefficient	FY20	FY21	FY22e	FY23e	FY24e	Performance Ratios	0.504	0.40/	0.00/	4.00/	0.007
Gross cashflow	239.5	100.8	152.9	168.7	139.1	ROA	-0.5%	0.1%	2.6%	4.0%	2.8%
Net interest	(13.0)	(10.1)	(16.7)	(15.2)	(13.0)	ROE	-1.7%	0.3%	8.7%	12.8%	8.6%
Other specials	- (40.0)	- (40.0)	-	-	- (00.0)	ROIC	5.2%	6.6%	7.6%	9.7%	6.8%
Tax paid	(10.9)	(18.9)	(14.8)	(24.9)	(20.9)	Assessment debt/Essette	04 40/	00.00/	07.00/	70.00/	F7 40/
Operating cash flow	215.6	71.8	121.4	128.6	105.3	Average net debt/Equity	81.4%	96.6%	87.9%	70.2%	57.4%
Capex	(39.9)	(45.9)	(63.0)	(31.4)	(26.0)	Net debt/Assets	13.0%	18.0%	15.4%	11.2%	7.8%
Free cash flow	175.7	25.9	58.4	97.2	79.3	Gearing	30.6%	38.5%	33.9%	26.4%	19.5%
Acquistion of intangibles	-	-	(3.0)	(3.0)	(3.0)	Net debt/EBITDA	2.4	2.6	2.1	1.2	1.1
Other - investing	-	- (00.0)	-	-	-	Interest cover (x) EBIT/NI	2.7	4.6	4.8	7.0	5.9
Other investing cash flows	81.0	(32.9)	-	-	-	On the state of th	E)/00	E)/04	EV/00-	EV(00-	E)/0.4-
Asset sales	10.0	9.9	-	-	-	Segement Results	FY20	FY21	FY22e	FY23e	FY24e
(Reduction)/Increase in borrowings	(219.0)	(19.3)	(34.2)	- (00.4)	- (0.4.0)	Pharmacy - external sales	2,977.0	3,011.0	3,034.5	3,051.0	3,070.3
Dividends paid	(19.9)	(17.4)	(17.4)	(33.4)	(24.3)	Growth	3.9%	1.1%	0.8%	0.5%	0.6%
Other	4.6	16.7	-		-	Wholesale GP	211.0	217.0	223.9	244.1	245.6
Change in cash held	32.4	(17.1)	3.8	60.8	52.0	Retail Rev (incl disp)	939.0	875.0	924.3	981.2	981.2
Cash at beginning of period	28.2	56.1	38.8	42.6	103.4	Growth	-8.3%	-6.8%	5.6%	6.2%	0.0%
Cash at year end	60.7	38.8	42.6	103.4	155.3	Retail GP	204.5	216.0	221.8	235.5	235.5
Deleves Chart (ACm)	EVan	FY21	EV22-	FY23e	FY24e	Manufacturing Rev	63.3 25.3	63.0	63.0	-	-
Balance Sheet (A\$m)	FY20		FY22e			Manufacturing GP		13.5	13.5	-	
Cash	60.7	38.8	42.6	103.4	155.3	Clearskin Clinics Revenues	40.3	55.0	73.3	80.6	84.7
Receivables	537.9	589.1	585.0	587.5	590.9	Growth Classifier CD	-12%	36%	35%	10%	5%
Other current assets	368.2	353.0	348.4	348.9	351.9	Clearskin GP	33.7	48.0	61.6	67.7	71.1
Other current assets	6.5	8.9	8.9	8.9	8.9	Total CB	4,019.6	4,004.0	4,095.1	4,112.8	4,136.1
Property, Plant and Equipment	109.8	109.8	155.3	162.7	164.7	Total GP	474.5	494.5	520.9	547.3	552.2
Intangible assets Other pen current	264.4	255.3	240.3	225.3	210.3	Warehouse & Distribution	145.5	143.1	141.6	143.1	149.9
Other non current Deferred tax assets	46.1	32.0	30.0	22.0	16.0	Marketing & sales	190.0	192.3	193.0	193.5	220.8
	20.6	22.1	22.1	22.1	22.1	Admin and General Other income	111.4	95.1	114.6	112.9	113.4
Other Total assets	125.7	1,530.0	1,538.7	91.0	76.0 1,596.1	Add back: One off costs	-7.0 (17.6)	-6.0 0.0	-8.0 -	-8.0 -	-8.0
Total assets	1,555.5	1,550.0	1,556.7	1,37 1.0	1,390.1	EBIT	34.6	70.0	79.6	105.7	76.1
Trade payables	775.5	719.6	735.2	736.1	742.5						
Provision for income tax	-	-	4.1	6.3	4.4	Interim results (A\$m)	1H21	2H21	1H22e	2H22e	
Debt (including leases)	260.8	314.2	280.0	280.0	280.0	Total revenues *	1,980.5	1,920.2	2,129.5	1,965.7	
Other liabilities	48.9	55.7	55.7	55.7	55.7	EBIT	29.4	40.6	41.4	38.2	
						Net interest	(7.5)	(7.8)	(8.0)	(8.7)	
Total Liabilities	1,085.2	1,089.5	1,075.0	1,078.2	1,082.6	Pre tax profit	21.9	32.8	33.4	29.5	
Net Assets	454.7	440.5	463.7	493.6	513.5	Tax expense	(5.9)	(9.4)	(10.0)	(8.9)	
Share capital	566.5	566.5	566.5	566.5	566.5	NPAT- normalised	16.0	23.4	23.4	20.7	
Retained earnings	96.9	81.2	104.4	134.3	154.2						
Reserves	(212.5)	(208.9)	(208.9)	(208.9)	(208.9)						
		, ,	, ,								
Profits reserve	-	-	-	-	-						
Profits reserve Shareholders Equity	- 450.9	438.8	461.9	491.9	511.7						
	450.9 3.8										

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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