Company Snapshot – Aspen Pharmacare

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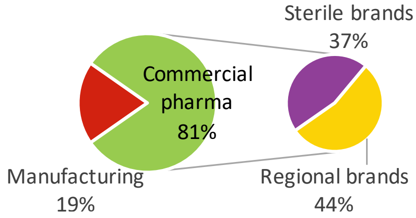
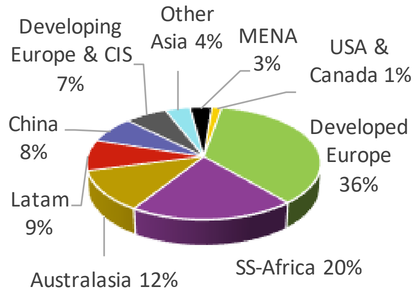
Company Overview

- Aspen Pharmacare manufactures and supplies branded and generic/post-patent pharmaceutical products, with sales across many Emerging and Developed markets.
- The group was historically positioned as an emerging market, broad-range generic pharmaceutical manufacturer and distributor. While Aspen retains the manufacture and distribution of certain generics on a regional basis, in recent years and in response to generic market dynamics, the group has pivoted its strategy to become a niche global player focused on selected therapeutic categories (Anaesthetics - Aspen is the second-largest provider of injectable anticoagulants worldwide after Sanofi and Thrombotics - Aspen is the largest player in anaesthetic products worldwide (ex-US) with a 20% market share.
- Furthermore, in a series of acquisitions, the group also owns and controls the entire value chains of these focused therapeutic products from API (active pharmaceutical ingredient) to FDF (finished dose form) marketing and distribution.
- Aspen has an extensive manufacturing base with its primary API and finished dose facilities located in South Africa, France and Germany.

Divisional Revenue FY20



Geographic Revenue FY20



Key Investment Drivers

1. In my opinion, a key feature of Aspen's investment case is its **proven top management team/founders**. Stephen Saad and 'Gus' Attridge have displayed strategic vision, a thorough understanding of the industry evolution and the entrepreneurial courage to take the necessary steps and successfully navigate the occasional challenges en route to building a global generic pharmaceutical powerhouse.
2. A key factor of this vison is the consistent emphasis on building a **substantial manufacturing base**, a principle that has served the group well throughout its evolution and which has proven to be a competitive advantage. In the 'early days' the consolidation of manufacturing in the SA hub provided economies of scale while exporting to the many emerging markets that, individually were too small to support profitable manufacturing. And now, in the latter of the group's evolution, it's now expanded manufacturing base has enabled the group to generate cost efficiencies throughout the value chains of its focused therapeutic products. This will lower the overall cost of manufacture per unit and thus allow for more competitive pricing in markets where there is limited pricing power, driving more tender wins / market share gains. Furthermore, the manufacturing capability has ensured consistency of products for sale.
3. Finally, Aspen has a niche position of **scale in emerging markets**, particularly sub-Saharan Africa, Latin America and increasingly also China, south-east Asia and eastern Europe, while also enjoying a natural forex hedge in its cost base by virtue of its geographic diversification.
4. Aspen's **key medium-term earnings growth drivers** are as follows:
   a. Anaesthetics: Supply constraints alleviated by the imminent completion of its complex and niche sterile manufacturing capability in South Africa, opening way for market share gains. A further short-term opportunity also exists whereby Aspen could potentially partner with multinationals and access IP not ordinarily accessible, by using its sterile fill capacity for the manufacture of a COVID-19 vaccine.
   b. Anticoagulants: Restructuring initiatives to over-come the drag of a sub-critical mass, and hence an inefficient sales force in certain Developed Market regions while retaining the manufacturing and supply contracts and positively impacting manufacturing unit cost dynamics.
   c. Improved organic growth through integration of product to improve manufacturing utilisation, increased volume, lower cost per unit, driving more competitive pricing.
   d. Earnings and price delta opportunity on further de-gearing via asset sales, passing the peak in capex cycle and operational restructuring/refinements.

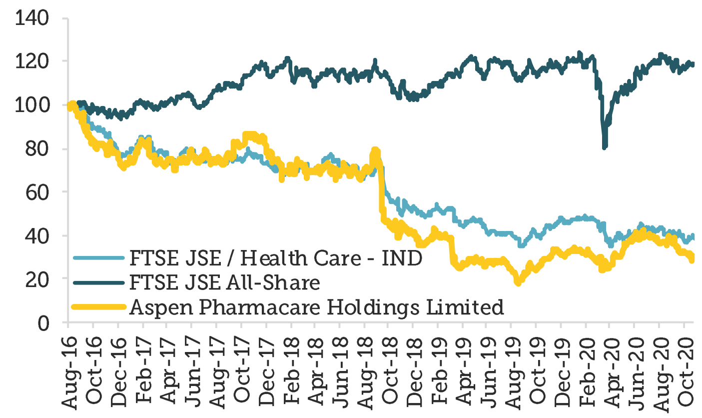
Key Risks

- While necessary, the timing of the repositioning of the group towards a niche focused global player was unfortunate. Intense regulatory pricing pressure and operational teething problems, together with the substantial up-scaling of M&A activity, working capital requirements and capital expenditure peak, combined to ramp up gearing levels to unprecedented levels, thereby substantially raising business risk levels. While much progress has been made to de-risk the business (asset sales and M&A initiatives to drive operating efficiencies such as the recent sale of selected commercial rights in Japan and Europe), much remains to be done amid **ongoing operating environment headwinds**.
- Aspen's management continually hint at **returning to M&A/acquisitive growth as a key strategy**, particularly in its recent review and refinement of its portfolio via acquisitions and disposals, and as gearing pressure dissipates. However, these pronouncements carry some **multiple/pricing risk in the face of much market scepticism regarding the ongoing relevance, effectiveness and business risk of Aspen's 'acquire, improve, de-level' model**.
- **While Aspen's valuation looks un-demanding, it is unlikely to see a valuation benefit (and potentially further valuation multiple de-rating) from a return to this model until it can provide undeniable proof of its delivery on the promised margin uplift from its most transformative transactions.**
- **Heightened regulatory (especially pricing) and competition risk**, particularly in the context of the yet unknown post-pandemic impact on State Health budgets and private healthcare funding.
- Heightened **forecast risk in terms of volatility and timing as a result of the disruptions to supply chains and normal trading patterns and additional costs from COVID-19**, both during the pandemic and possible changes in consumer behaviour thereafter, especially in terms of elective surgery.

Share Price Performance

Figure 1: Share Price (ZAR)

Figure 2: Indexed Performance



Source: Factset

Key Financials and Estimates

	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021e	FY2022e	FY2023e	CAGRe
Revenue (bn)	35.6	41.2	38.3	38.9	38.6	41.0	42.4	42.9	
growth (%)	*-1.5*	*15.7*	*-7.0*	*1.5*	*-0.6*	6.1	3.4	1.2	3.6
Operating Profit (bn)	9.30	10.60	9.68	9.30	8.96	9.05	9.24	8.80	
margin (%)	26.1	25.7	25.3	23.9	23.2	22.1	21.8	20.5	+-268 bps
growth (%)	*13.0*	*14.0*	*-8.7*	*-3.9*	*-3.7*	1.0	2.1	-4.7	-0.6
Net Profit (bn)	4.30	5.10	5.62	2.00	4.61	6.19	6.62	6.46	
growth (%)	*-17.3*	*18.6*	*10.2*	*-64.5*	*131.0*	34.3	6.9	-2.4	11.9
Earnings Per Share	11.72	15.01	15.23	12.01	10.65	13.62	14.47	14.33	
growth (%)	*-1.5*	*28.1*	*1.5*	*-21.2*	*-11.3*	27.8	6.2	-0.9	10.4
Dividends Per Share	2.48	2.87	3.15	0.00	-	1.52	2.73	2.87	
growth (%)	*14.8*	*15.7*	*9.8*	*-100.0*	-	-	79.2	4.9	

Source: Factset

Key Ratios

	FY2016	FY2017	FY2018	FY2019	FY2020
Net debt:Ebitda (x)	3.11	3.12	4.34	3.72	3.34
EBIT Interest cover	4.04	4.82	4.52	3.94	6.22
ROE	11.22	11.92	12.16	3.85	7.47
ROA	4.46	4.62	4.53	1.57	3.61
ROIC	8.40	8.07	7.43	3.67	5.34
WACC	10.14	10.38	11.77	10.13	11.29
ROIC/WACC	0.77	0.79	0.60	0.34	0.47
Cash Flow ROIC	4.75	8.83	8.35	6.32	8.29
FCF	396.16	44.25	46.27	39.96	16.19
FCFC YELD	0.91	3.82	4.13	7.76	9.50
Book value per share	3.89	3.04	2.39	0.84	-

Source: Factset, Bloomberg

Valuation

Figure 3:12m Forward P/E

Source: Factset

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