Alliance Pharma

Acquisition impact and future growth opportunity

Alliance Pharma has developed through a series of 28 acquisitions as part of a buy and build strategy, culminating in the most recent £127.5m acquisition of 27 primarily dermatology and woundcare products and assets from Sinclair IS Pharma. Not only is this acquisition doubling the size of the company and enhancing EPS by 14%, it should provide the foundations of a more internationally oriented business that can more easily exploit the growth opportunities of its existing products (eg. Hydromol, MacuShield, Diclectin) as well as presenting itself as a credible partner for attracting in–licensing/M&A opportunities.

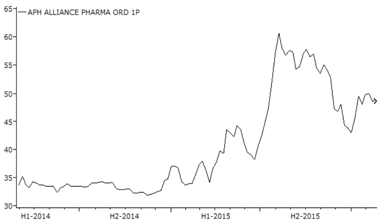
- **Acquisition – largest to date:** The acquisition of 27 products and related assets for £132.2m (inc. £4.7m inventory) represented a step change in the scale of its ambition. Funded by way of a Vendor Placing raising £83.5m (gross) including a £5m over-allotment option, and the draw-down of £51m (net) of Loan Notes.
- **Strategic rationale:** This acquisition accelerates growth – adding 14% to EPS short-term – and sustains the growth vs. bedrock sales model of APH. It also internationalises the business, providing a launch platform for key APH drugs; and more attractive for corporate development – both in-licensing and M&A.
- **Outlook:** We have upgraded our forecasts to reflect the acquisition with FY'16 sales and EBITDA doubling to £96.0m and £28.8m, respectively. We have increased EPS forecasts by 14% to 4.2p (previous 3.7p). Our forecasts do not include any contribution from Diclectin which should launch in the UK in 2016.
- **Risks:** Doubling the size of the business creates potential integration risk. However, extensive planning, human resource reallocation and the provision of transitional services with the Vendor should help mitigate this. Individual product risk (eg Nu-Seals) now becomes less meaningful.
- **Investment summary:** The shares are trading on a 2016 P/E of 13.2x with a CAGR growth rate of ca.9%. With a dividend yield of 2.5% (2016E), cover of 3.3x, it has the capacity to pursue its progressive dividend policy. After a period of no/low EPS growth the outlook is much more favourable, with the prospect of including Diclectin into forecasts once clarity on timing is better understood.

Financial summary and valuation

Year end Dec (£m)	2013	2014	2015E	2016E	2017E	2018E
Sales	45.3	43.5	48.2	96.0	99.8	103.7
Operating profit	13.9	12.4	13.3	28.0	29.9	31.8
Reported pre-tax profit	12.1	10.2	14.9	22.2	26.2	28.8
Underlying EPS (p)	4.2	3.3	3.4	4.2	4.6	4.9
Reported EPS (p)	3.8	3.2	4.4	3.7	4.3	4.7
DPS (p)	0.9	1.0	1.1	1.2	1.3	1.5
Net (debt)/cash	-24.8	-21.1	-72.4	-64.3	-51.1	-33.0
Net debt/EBITDA (x)	1.7	1.6	5.2	2.2	1.7	1.0
P/E (x)	11.4	14.6	14.0	11.4	10.5	9.7
EV/Sales (x)	6.6	6.9	6.2	3.1	3.0	2.9
EV/EBITDA (x)	20.5	22.7	21.6	10.4	9.7	9.2
Dividend Yield (%)	1.9%	2.1%	2.3%	2.5%	2.8%	3.0%

Source: Hardman & Co Life Sciences Research

Pharmaceuticals & Biotech



Source: Fidessa

Market data

EPIC/TKR	APH
Price (p)	48.0
12m High (p)	63.0
12m Low (p)	33.8
Shares (m)	468.2
Mkt Cap (£m)	224.7
EV (£m)	299.2
Free Float*	74%
Market	AIM

**As defined by AIM Rule 26*

Description

Alliance Pharma acquires, markets and distributes medical and healthcare brands in the UK and Europe (direct sales) and the ROW (via distributor network), through a buy and build strategy, generating relatively predictable strong cash flows.

Company information

CEO	John Dawson
CFO	Andrew Franklin
Chairman	Andrew Smith

01249 466 966
www.alliancepharma.co.uk

Key shareholders

Directors	13.9%
MVM Life Sciences	11.9%
Aviva	9.4%
Artemis	8.3%
Nigel Wray	8.0%
Slater Invest.	7.2%
Fidelity	6.1%

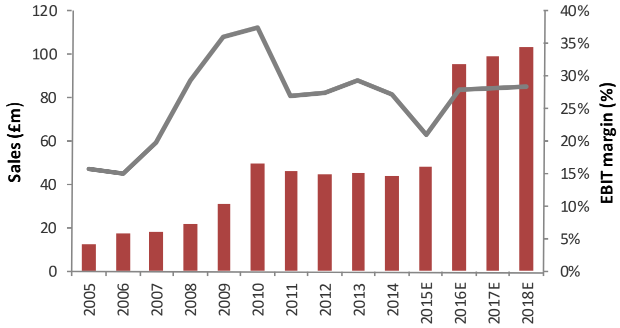
Next event

7 April	FY 2015 results
25 May	AGM
July	Trading update
Sept	Interims

Analysts

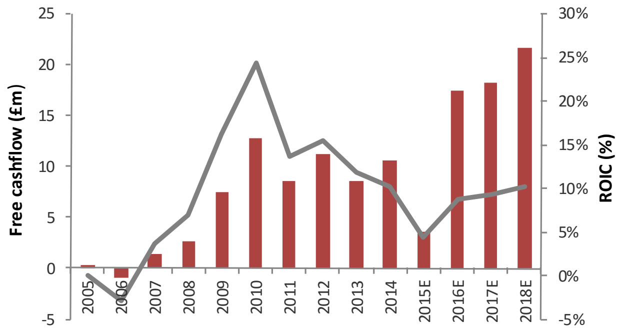
Martin Hall 020 7148 1433
mh@hardmanandco.com
Gregoire Pave 020 7148 1434
gp@hardmanandco.com

Sales & margin



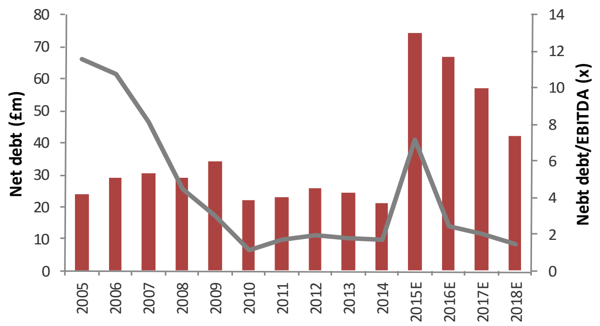
- After a period of strong headwinds from product issues, in 2010-14, sales growth expected to be ca.5% CAGR 2016-2018
- Acquisition of products from Sinclair IS Pharma effectively doubles the size of the sales base
- EBIT margin is underlying margin, before JV contributions and share based payments
- Target margin is 25-30%

Free cashflow & ROIC



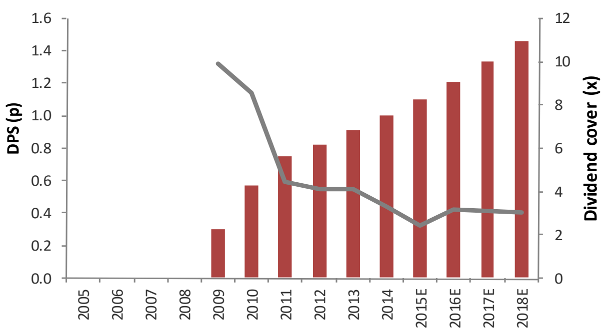
- Cashflow in 2012-14 was around £10m per annum, with the bulk of it used to pay dividends and acquisitions. Expected to rise to £18-22m in 2016-18
- Operating cashflow conversion is typically ca.100% of EBIT, impacted by swings in working capital
- Free cashflow of £5.5m in 2015 is attributed largely to working capital fluctuations and strategic decision to build inventory levels to protect against potential stock outs.
- 2015 ROIC impacted by year end acquisition of Sinclair IS portfolio, after which it should return to ca.10% in 2018

Net debt



- Net debt is expected to be ca.£72m at end 2015
- Main financial covenants specify maximum leverage (net debt/EBITDA) of 3.25x – expected to be 2.2x at end of 2016
- 2015 leverage at 5.2x includes all debt of Healthcare Products acquisition but not EBITDA. On a pro-forma basis, it is estimated to have been 2.7x
- Minimum interest cover (EBITDA/interest cost) of 4.0x. This is expected to be 9.0x in 2016
- Without significant acquisitions free cashflow will pay down debt

Dividends



- Progressive dividend policy since dividend commenced in 2009
- 1H 2015 dividend of 0.366p, up 10%
- Dividend cover of 3.3x in 2016
- Scope to increase future dividends

Source: Company data; Hardman & Co Life Sciences Research

Acquisition of medical products

Summary

Alliance's largest acquisition to date…

Alliance Pharma completed the acquisition of certain assets and businesses, referred to as the Healthcare Products business, from Sinclair IS Pharma on 17th December 2015. Key points are considered to be the following:

…£132.2m, financed by way of vendor placing and debt draw down

… focused on dermatology and woundcare

….EPS enhancing with ROIC exceeding WACC in 2017

- 27 products which are focused principally on dermatology and woundcare
- The total cost was £132.2m, comprising £127.5m for the assets/businesses and ca.£4.7m for inventory, the latter having been paid for in cash
- The acquisition was funded by way of a Vendor Placing raising £83.5m (gross proceeds) which included a £5m over-allotment option, and the draw-down of £51m (net) of Loan Notes
- Based on our new forecasts we expect it to be 14% EPS enhancing in 2016 and generate a ROIC of 9.4% in 2017 (higher that the company's WACC of 8%)
- The Acquisition constituted a reverse takeover under the AIM Rules

Sales in 12 months to 30th June 2015

Brand	Application	Sales (£m)	%
Kelo-cote	Hypertrophic scars	8.0	18.4%
Flamma franchise	Wound care	7.1	16.4%
Haemopressin	Bleeding oesophageal varices	4.0	9.2%
Aloclair	Mouth ulcers	4.0	9.2%
Optiflo	Catheter flushing	2.8	6.5%
Kelo-stretch	Stretch marks	2.7	6.2%
Oxyplastine	Humid eczema	2.4	5.5%
Atopiclair	Atopic dermatitis	2.0	4.6%
Papulex	Acne	1.8	4.2%
Fazol	Dermal fungal infections	1.7	3.9%
Tridesonit	Contact/atopic dermatitis	1.4	3.2%
Others	-	5.4	12.7%
Total sales		**43.3**	**100.0%**

Source: Hardman & Co Life Sciences Research

Description of acquired assets and businesses

The Healthcare Products Business can be summarised as follows:

- Focused on dermatology and woundcare, comprising 27 brands with sales in the 12 months ending June 2015 of £43.3m.
- The acquisition comes with 27 families of patents and patent applications which cover each of Aloclair, Atopiclair, Decapinol, Effadiane, Kelo-cote, Optiflo, Papulex and Sebclair with varying levels of longevity. The patent for its principal product, Kelo-cote, expires in February 2033.
- It has offices in the UK, France and Italy with other geographies reached by distributors. Distributor sales account for around 60% of the total. Its principal distributors, in revenue terms, are Menarini (Asia), Bard (UK – Optiflo), Conbio (China – Kelo¬cote), Recordati and Magpham Sarl (MEA – Oxyplastine). This compares with ca.10% for the current APH product portfolio. Consequently ca.35% of the Group's combined sales will be generated through its distributor

network; inherently lumpier and more challenging to forecast and manage given the buying patterns of distributors, but further internationalising the business in the process.

- Broader international exposure with sales in the UK of £6.3m (15%). The top 10 markets accounted for 69.7% of sales in year ending June 2015. Although sales into Europe represented ca.56% of sales, nearer 65% of sales are denominated in Euros. Underlying sales growth at constant exchange rates has been broadly flat, driven in part also by distributor buying patterns.
- Products are manufactured in Europe and the US by third-party manufacturers with three also being produced in India.
- Seven key products, accounted for ca.71% of the acquired sales. Five key brands, identified by management within Wound Care and Skin Care as its future growth drivers, accounted for 55% of acquired sales (£23.8m); either through geographic expansion, new product launches or the synergistic combination with APH's own product range.

Overview of key products

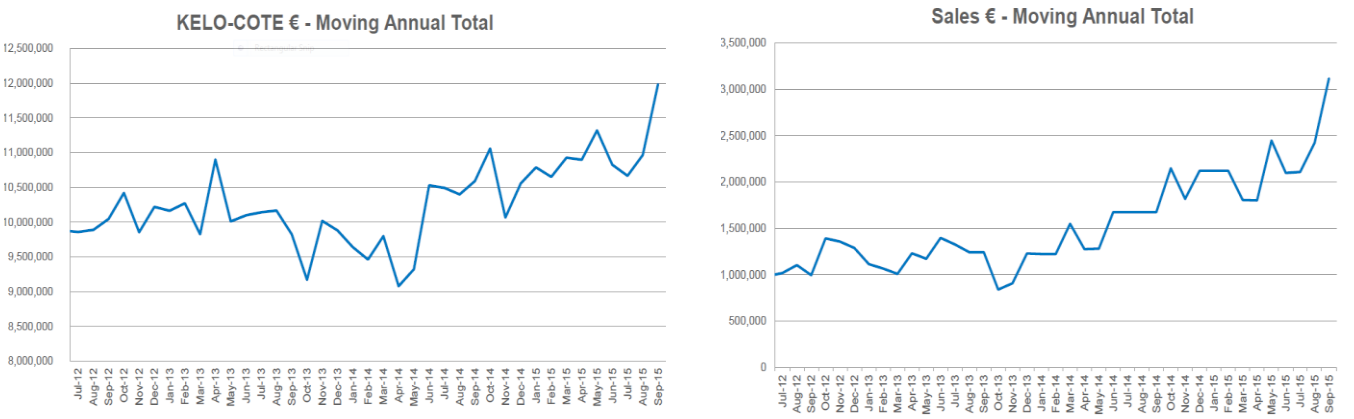
Product	Comments
Wound Care	
Kelo-cote	• Patented topical silicone gel for management and prevention of abnormal scares – prescription & OTC • Growth is primarily in Asia Pacific via distributors • Stronger growth particularly in China • Potential to in-licence silicone sheet
Flammacerium & Flamma franchise	• Hospital only product • Unique sterile cream to treat severe burns, prevent wound infection and relieve pain • Potential UK launch in 2016 • Potential US launch in Q1 2017, with Orphan Drug designation already granted
Aloclair	• OTC, fast acting treatment of mouth ulcers • Growth in UK, US and Portugal • Consolidate into APH consumer division alongside Anbesol and Ashton & Parsons • Launch Aloclair Ultra (long acting version) in the UK in 2016
Skin Care	
Kelo-stretch	• OTC dermo-cosmetic cream for treatment & prevention of stretch marks • Growth driven through distributor (Menarini) in emerging markets
Atopiclair	• Hospital, primary care and OTC product – steroid free for mild to moderate atopic dermatitis • Complementary to APH's Hydromol portfolio • Growth driven through distributor in emerging markets
Key Other	
Haemopressin	• Established product • Main markets UK & Germany
Optiflo	• Growth in UK driven by distributor agreement with Bard

Source: Hardman & Co Life Sciences Research

Kelo-cote – will become the Company's largest brand representing ca.9% of sales

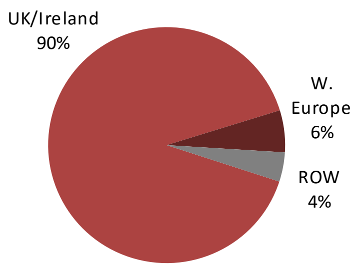
The key brand is Kelo-cote; a patented topical silicone gel for the management and prevention of excessive scar tissue seen with hypertrophic scars and keloids. With sales of ca.£8m and accounting for 18.5% of the acquired portfolio, it will represent ca.9% of the enlarged portfolio. Kelo-cote has exhibited annual growth of around 7% over the past 2-3 years, driven almost entirely by the increasing demand from China which represents ca.25% of the product's sales, as illustrated in the charts below. We envisage growth of ca.5-8% pa, towards the higher end if APH is able to in-licence Kelo-cote sheet.

Kelo-Cote sales (left hand chart) which includes China sales (right hand chart)



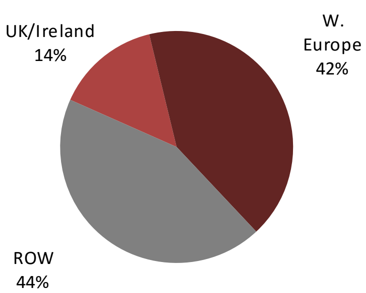
Source: Alliance Pharma

Alliance Pharma 2014 sales



Source: Hardman & Co Life Sciences Research

Healthcare Products 2015 sales £43.3m



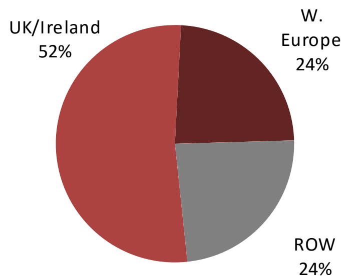
Source: Hardman & Co Life Sciences Research

Strategic rationale

Whilst the acquisition is attractive from a short term financial perspective, enhancing earnings by 14%, and driving short term growth, the true purpose of the acquisition is to create scale, not for the sake of scale itself, but because of the opportunities that scale and a significantly broader geographic base should bring to the group.

- It internationalises Alliance Pharma which has organically developed a modest direct presence in France and Germany, bringing ca.£16.3m of additional sales in France, Italy, Germany and Spain. It strengthens APH's existing geographic footprint, both through direct sales forces in Europe (UK, France and Germany) and via its combined network of distributors serving the APAC, MEA, LATAM and US regions. Previously the UK accounted for 90% of sales. This is expected to be reduced to ca.50-55%.
- It should create a higher industry profile and potentially improved access to further acquisitions and in-licensing deals such as Diclectin.
- It should create an enlarged launch platform to accelerate the growth and development of APH opportunities; mostly notably the 2015 acquisition of MacuShield and the UK licence for Diclectin, as well as APH's largest product franchise, Hydromol:
    - MacuShield, acquired in February 2015, which is being sold for the prevention of age-related macular degeneration. Around 25% of MacuShield's sales are generated ex-UK (mainly Ireland, Holland and Germany) as well as Australia and some smaller markets. The opportunity now exists to promote MacuShield in other European markets such as Spain, Italy as well as exploiting the Healthcare Products international distribution network
    - Diclectin, which was in-licensed from Duchesnay Inc in September 2015, for the treatment for nausea and vomiting in pregnancy (NVP) for the UK market. Given the enlarged European presence, it is possible that once approval is granted in the UK that further territories could be licensed. Diclectin was submitted for registration in the UK in June 2015 with a view to launching it sometime during 2016. Market access activities throughout

Combined sales



Source: Hardman & Co Life Sciences Research

the NHS were initiated in Q4 2015 but as yet we don't know exactly when launch will occur. However, we estimate the UK addressable market of 0.3-0.6m women (moderate to severe NVP) could be worth as much as £60m, assuming pricing of ca.£100 for a 6-week course. Whilst price comparisons with the US and penetration rates should not be directly compared, given the UK's slower adoption rates of new technology, Diclectin could ultimately generate sales of £15m if it were to achieve a 25% share of the market. There is currently no licensed product in the market so the opportunity is a substantial one. This could apply to other European markets.

- Hydromol is currently APH's largest product, with 2015 sales of £6.6m (ca.14% of sales) growing at 10%. With a ca.4% share of the £140m emollient market in the UK, the increased scale should enable the company to appropriately support the brand in the UK but it also opens up the possibility to launch into some of the enlarged group's European territories. Whilst emollients such as Hydromol are reimbursed in the UK, this is not the case in most European markets and consequently, we are not altering our Hydromol forecasts – but it does potentially create some further upside.

- It creates an enlarged entity that is potentially more capable of participating at the M&A table as well as presenting a more attractive destination company for in-licensing opportunities ex-UK.
- Economies of scale which should drive increased revenue and EBITDA growth and margins.
- The acquisition brings with it a complementary portfolio of growth vs "bedrock" brands similar to that of APH with 5 identified brands (Kelo-cote, Flamma franchise including Flammacerium which was granted orphan drug designation in the USA by the FDA in 2014, Aloclair, Kelo-stretch and Atopiclair) accounting for £23.8m or 55% of the acquired sales.

Future opportunities

Alliance Pharma has identified the following opportunities for the enlarged group which are not included in our forecasts:

- Improved European footprint provides scope for:
  - Hydromol expansion
  - Gaining additional territories for Diclectin
  - In-market intelligence and operating synergies on more acquisition leads
  - Launch of Optiflo (catheter flushing solution) outside the UK

- Launch of Flammacerium in the US for prevention of infection in severe burns patients who are unsuited for skin grafts. Flammacerium is a silver sulfadiazine cream with cerium nitrate to reduce the occurrence of immunosuppression which can occur in severely burned patients. Fammacerium has been granted Orphan Drug Status, which confers seven-year market exclusivity. Discussions with the FDA to determine the registration requirements for approval are ongoing with a potential launch in 2016/17. We have not included this within our forecasts.

Financial impact of acquisition

Transaction multiples

Alliance Pharma provided the market with 12-months numbers for the three financial reporting periods ending in June 2015, together with adjustments which assumed the elimination of the central overhead costs (ca.£5m) of Sinclair IS Pharma which, in effect, will not be transferring with the business and, therefore, should not be assessed in the deal metrics:

APH paid 3.1x sales and 9.4x EBITDA on an adjusted basis (assuming costs savings that aren't transferred in the acquisition)

Transaction multiples based on £132.2m acquisition cost

	£m	EV multiples
Sales	43.3	3.1x
Gross profit	22.3	5.9x
EBITDA (reported by Sinclair IS Pharma)	9.0	14.7x
EBITDA (post-identified synergies of £5m which are not transferred by Sinclair IS Pharma)	14.0	9.4x

Source: Alliance Pharma

Historic and forecast financials

We show below the actual sales for fiscal years ending June 2013-2015, which reflect the performance of the acquired business within Sinclair IS Pharma and also include a share of the parent's central overhead costs. Going forward, these figure will not be declared separately by Alliance Pharma, although EBIT will benefit from the £5m of cost savings identified by management, offset by integration costs of £1.7m and financing costs of £2.2m in 2016. Different accounting for amortisation will also add £3.7m to EBIT.

Healthcare Products Business – Actuals

12 months ending	June 2013	June 2014	June 2015
Sales	46.5	46.1	43.3
% growth		-1%	-6%
COGS	-20.1	-23.3	-21.1
Gross Profit	**26.4**	**22.8**	**22.2**
Gross margin	56.8%	49.5%	51.3%
Admin	-36.1	-18.4	-17.2
% growth		-49%	-7%
Operating Profit	**-9.7**	**4.4**	**5.0**
Finance costs	0.0	0.0	0.0
Pre-tax profit (pre-ex)	**-9.7**	**4.4**	**5.0**
Taxation	1.3	0.4	0.4
Net Income	**-8.4**	**4.8**	**5.4**
EBITDA reconciliation			
Operating Profit	-9.7	4.4	5.0
Depreciation/Amort.	3.8	3.6	3.8
Exceptional	12.2	0.0	0.2
EBITDA (adjusted)	**6.3**	**8.0**	**9.0**
EBITDA margin	13.5%	17.4%	20.8%
Amort. goodwill charge	3.7	3.5	3.7

Source: Alliance Pharma, Hardman & Co Life Sciences Research

Sales, stripping out the effect of the Euro's depreciation in 2014, have been essentially flat over the period 2013-2015. Special trading terms were provided by Sinclair IS Pharma to some of its distributors in FY 2014, resulting in a 720bp decline in gross margins, as the company looked to boost its top-line, arguably ahead of a potential disposal, as well as the launch of Kelo-stretch which is a lower margin product. Gross margins partially recovered (+180bp) in FY 2015 to 51.3%. The outlook for the portfolio is for gross margins of ca.52-53% which, when combined with the 58-59% level of APH, is expected to generate gross margins for the enlarged group of ca.55%.

EBIT of £5m and EBITDA of £9m were reported in FY 2015, implying an EBITDA margin of 20.8%, up from 13.5% in 2013 as a consequence of changes in cost allocations. AHP estimates that there will be minimum cost synergies of £5m as the historic cost base assumed a full allocation of Sinclair IS Pharma's central overheads, which will not transfer with the products and businesses that APH Is acquiring. Consequently, the underlying EBITDA margin of the Sinclair business in 2015 was estimated to be ca.32.3% (Reported EBITDA + Cost savings).

Financial assessment

The following table shows our changes to forecasts each year in the period 2015 to 2018 as a consequence of the acquisition. As stated by management, the Sinclair business is accretive to earnings, with 2016 forecasts rising from 3.66p to 4.19p, +14%. Low double digit rises are also forecast for fiscal years 2017 and 2018.

Changes to forecasts

	-------------------- Old forecasts -------------------				-------------------- New forecasts -------------------			
Year end Dec (£m)	**2015E**	**2016E**	**2017E**	**2018E**	**2015E**	**2016E**	**2017E**	**2018E**
Sales	47.60	49.53	52.50	55.49	48.15	95.95	99.77	103.75
Operating profit	11.80	12.76	13.75	14.71	15.90	25.31	28.92	30.89
Reported pre-tax profit	11.60	12.16	13.34	14.59	15.60	22.21	26.23	28.80
Reported EPS (p)	3.50	3.66	4.02	4.39	4.80	3.63	4.28	4.71
Underlying pre-tax profit	12.20	12.90	14.10	15.50	12.26	24.86	27.43	29.70
Underlying EPS (p)	3.40	3.66	4.02	4.39	3.40	4.19	4.54	4.90
DPS (p)	1.10	1.21	1.33	1.46	1.10	1.21	1.33	1.46

2015 reported pre-tax profit includes £6.7m payment from Sanofi less c.£3.7m of legal & acquisition-related costs

Source: Hardman & Co Life Sciences Research

Financials & Investment case

Profit & Loss

Sales

Group sales growth of ca.4-5%

We have assumed only modest growth (2-3%) for the acquired products, comprising 5-7% for the growth brands (Kelo-cote, Flamma franchise, Aloclair, Kelo-stretch and Atopiclair) and a broadly flat performance from the acquired "bedrock" products which account for ca.45% of acquired sales.

Gross profit

Gross margins of 55%...and likely to trend upwards in future

Cost of goods sold (COGS) are expected to be ca.45% of the sales in FY2016, implying a gross margin of 55% which will be down from an estimated 59% in 2015 as a consequence of the lower gross margins (52-53%) of the acquired product portfolio. Gross margins are expected to trend upwards from this level in future years.

Marketing expenses (SG&A)

SG&A expenses rising to ca.£24.8m in FY'16 (+64%), reflecting inclusion of acquired sales and admin infrastructure

Operating expenses associated with marketing are expected to rise to £24.8m (25.9% of sales) in 2016 from £15.1m (31.4%) in 2015 as a result of the inclusion of the Healthcare Products business' sales infrastructure and administrative costs associated with its offices in UK (London and Chester), Paris and Milan. We anticipate a modest downward trend in these costs as a percentage of sales in future years.

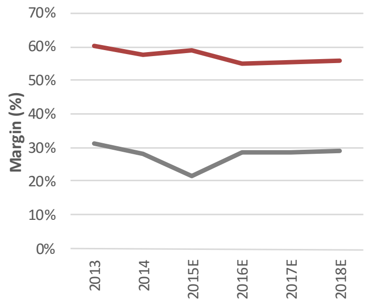
Profitability

We are forecasting that Healthcare Products will contribute ca.£15.0m to EBITDA in the 2016 full year results for the combined entity. This appears to be a big step up from the £9m reported for Sinclair for the year ending June 2015 but assumes the inclusion of £5m of cost savings. Most of this will translate through to EBIT given that the £3.7m amortisation (of goodwill) costs that Sinclair IS Pharma included in its P&L will be excluded by APH. Alliance Pharma will adopt its usual accounting treatment – acquired intangible assets are included on the balance sheet at the lower of cost with annual impairment reviews being conducted.

EBITDA margins (pre-integration costs) for the acquired products rise from 20.8% to ca.33.0%

We have assumed integration costs will amount to £1.7m in 2016. EBITDA margins for the acquired products, therefore, are expected to rise from 20.8% in the year to end June 2015 to around an underlying 33.0% in the year to end 2016, although this number will not be reported separately, the acquired business having been fully integrated into APH. Group EBITDA is consequently expected to rise from £13.9m to £28.8m in 2016.

Gross and EBITDA margin



Source: Hardman & Co Life Sciences Research

Taxation

We have assumed a 20% tax rate in 2015, rising to 23% in 2016-18 as a consequence of the acquisition. The Healthcare Products profits are derived in higher tax jurisdictions than APH which is largely UK-based.

Profit & Loss account

Year end Dec (£000)	2013	2014	2015E	2016E	2017E	2018E
Sales	**45,275**	**43,536**	**48,152**	**95,953**	**99,773**	**103,749**
Cost of goods	-17,944	-18,493	-19,742	-43,179	-44,399	-45,650
Gross Profit	27,331	25,043	28,409	52,774	55,374	58,100
Admin & marketing	-12,917	-12,510	-15,100	-24,813	-25,501	-26,310
Underlying EBITDA	14,632	13,159	13,866	28,796	30,773	32,689
EBITDA margin	32.3%	30.2%	28.8%	30.0%	30.8%	31.5%
Depreciation	-266	-307	-307	-535	-600	-600
Amortisation	-422	-488	-250	-300	-300	-300
Other income	0	0	0	0	0	0
Underlying EBIT	**13,944**	**12,364**	**13,309**	**27,961**	**29,873**	**31,789**
Share based costs	-632	-571	-600	-1,200	-1,200	-1,200
Share of JV profit/(loss)	-48	319	194	250	250	300
Exceptional items	0	-622	3,000	-1,700	0	0
Statutory EBIT	13,312	11,171	15,903	25,311	28,923	30,889
Net financials	-1,231	-1,014	-1,050	-3,106	-2,698	-2,089
U/lying pre-tax profit	**12,713**	**10,728**	**12,259**	**24,855**	**27,425**	**29,700**
Exceptional items	0	0	0	0	0	0
Reported pre-tax	12,081	10,157	14,853	22,205	26,225	28,800
Underlying tax	-2,166	-2,034	-2,942	-5,095	-6,034	-6,623
Exceptional tax	-259	262	-21	0	0	0
Reported taxation	-2,425	-1,772	-2,963	-5,095	-6,034	-6,623
Tax rate	20%	17%	20%	23%	23%	23%
Underlying net income	**10,547**	**8,694**	**9,317**	**19,760**	**21,392**	**23,077**
Statutory net income	9,656	8,385	11,890	17,110	20,192	22,177
Weighted shares (m)	250.8	264.1	272.0	468.2	468.2	468.2
Fully diluted shares (m)	265.0	265.6	275.1	471.3	471.3	471.3
U/lying basic EPS (p)	**4.20**	**3.29**	**3.42**	**4.22**	**4.57**	**4.93**
U/lying fully-dil. EPS (p)	**3.98**	**3.27**	**3.39**	**4.19**	**4.54**	**4.90**
Statutory basic EPS (p)	3.85	3.17	4.37	3.65	4.31	4.74
Stat. fully-dil. EPS (p)	3.64	3.16	4.32	3.63	4.28	4.71
DPS (p)	**0.91**	**1.00**	**1.10**	**1.21**	**1.33**	**1.46**

Source: Company reports; Hardman & Co Life Sciences Research

Key metrics

Year end Dec (£000)	2013	2014	2015E	2016E	2017E	2018E
Growth						
Sales	-1%	-4%	11%	99%	4%	4%
Gross profit	0%	-9%	13%	86%	5%	5%
U/lying operating profit	10%	-12%	8%	110%	7%	6%
Fully diluted EPS	71%	-18%	3%	24%	8%	8%
DPS	10%	10%	10%	10%	10%	10%
Operating ratios						
Cost of goods	39.6%	42.5%	41.0%	45.0%	44.5%	44.0%
Gross margin	60.4%	57.5%	59.0%	55.0%	55.5%	56.0%
Admin & marketing costs	28.5%	28.7%	31.4%	25.9%	25.6%	25.4%
Underlying EBITDA	32.3%	30.2%	28.8%	30.0%	30.8%	31.5%
Underlying EBITA	31.7%	29.5%	28.2%	29.5%	30.2%	30.9%
Underlying EBIT	30.8%	28.4%	27.6%	29.1%	29.9%	30.6%
Statutory EBIT	29.4%	25.7%	33.0%	26.4%	29.0%	29.8%
Effective tax rate (%)	18.0%	19.0%	20.0%	23.0%	23.0%	23.0%

Source: Hardman & Co Life Sciences Research

Balance sheet

- Net debt at end 2015 is estimated to have been ca.£72.4m, comprising cash of £8.0m, long term loans of £76.7m and bank overdrafts of £3.7m
- Inventory levels rose in 2015 to an estimated £12.4 attributed to two factors, namely the purchase of ca.£4.7m of stock in the recent acquisition and the intentional build-up of inventory (ca.£2m) over the course of 2015

Balance sheet

@ 31st Dec (£000)	2013	2014	2015E	2016E	2017E	2018E
Shareholders' funds	64,668	70,780	160,544	171,990	185,952	201,277
Cumulated goodwill	1,144	1,144	1,144	1,144	1,144	1,144
Total equity	65,812	71,924	161,688	173,134	187,096	202,421
Share capital	2,641	2,641	4,680	4,680	4,680	4,680
Reserves	62,027	68,139	155,864	167,310	181,272	196,597
Provisions/l-t liabilities	389	356	129	129	129	129
Deferred tax	6,294	6,115	6,309	6,309	6,309	6,309
Long-term loans	20,881	19,235	76,683	76,683	76,683	76,683
Bank overdrafts	5,020	3,309	3,705	3,705	3,705	3,705
less: Cash	687	1,434	7,965	16,119	29,303	47,354
Invested capital	**96,122**	**98,361**	**239,405**	**242,697**	**243,475**	**240,749**
Fixed assets	592	396	537	802	1,018	1,250
Intangible assets	85,967	87,731	226,977	231,079	236,442	242,372
Goodwill	1,144	1,144	1,144	1,144	1,144	1,144
Inventories	5,468	5,914	12,404	14,265	13,795	12,910
Trade debtors	9,131	6,645	7,349	14,646	15,229	15,835
Other creditors	1,510	1,677	815	1,625	1,690	1,757
Trade creditors	1,118	1,693	1,807	3,953	4,065	4,179
Tax liability	1,154	959	959	959	959	959
Other creditors	7,413	5,227	12,614	24,991	30,017	38,742
Debtors less creditors	956	443	-4,416	-7,351	-11,683	-19,687
Invested capital	**96,122**	**98,361**	**239,405**	**242,697**	**243,475**	**240,749**

Source: Company reports; Hardman & Co Life Sciences Research

Balance sheet metrics

@ 31st Dec (£000)	2013	2014	2015E	2016E	2017E	2018E
Net cash/(debt)	-24,771	-21,110	-72,423	-64,269	-51,085	-33,034
Gearing (%)	-37.6%	-29.4%	-44.8%	-37.1%	-27.3%	-16.3%
Net debt/EBITDA (x)	1.7	1.6	*5.2	2.2	1.7	1.0
NOPAT	11,434	10,015	10,648	21,530	23,002	24,478
After-tax ROIC	11.9%	10.2%	4.4%	8.9%	9.4%	10.2%
Interest cover (x)	10.9	11.4	9.6	9.0	11.1	15.2
Dividend cover (x)	4.4	3.3	3.1	3.5	3.4	3.3
Cap-ex/depreciation (x)	1.1	0.4	1.5	1.6	1.4	1.4
Cap-ex/sales (%)	0.7%	0.3%	0.9%	0.8%	0.8%	0.8%
NAV/share (p)	24.4	26.6	57.4	36.1	39.2	42.6
Stock days	44	50	94	54	50	45
Debtor days	74	56	56	56	56	56
Creditor days	23	33	33	33	33	33

**Net debt is impacted by acquisition whereas EBITDA has minimal contribution in 2015*
Source: Company reports; Hardman & Co Life Sciences Research

- A new 5-year £100m debt facility was taken out at the time of the Healthcare Products acquisition, replacing its existing financing facilities and comprising:
    - a £65m term loan (repayable quarterly at £6m in 2016, £8m pa in 2017 and 2018 and £10m pa and thereafter with the balance repaid at the end of the 5th year); a £35m revolving credit facility; a £25m accordion facility in addition to its existing £5m working capital facility

Cashflow

- 2015 free cashflow is estimated to have been £5.5m; below historic run rates of £8-10m
- Attributed largely to working capital outflows and intentional inventory build during the year
- Consideration for acquisitions made in 2015-2017 include the full cost of Healthcare Products (£132.2m including £4.7m of inventory) as well as the purchases of MacuShield (£5.5m in 2015, £4m in 2016 and £2m in 2017) and Diclectin in 2015 (£1m)
- Free cashflow is expected to rise to £18-22m over the next three years, driven by underlying growth and ca.£5m of cost “synergies“ from the recent acquisition
- Net debt is forecast to fall from £72.4m in 2015 to ca.£33m in 2018

Cashflow

Year end Dec (£000)	2013	2014	2015E	2016E	2017E	2018E
Operating profit	13,944	12,364	13,309	27,961	29,873	31,789
Depreciation	266	307	307	500	600	600
Amortisation	422	1,110	250	300	300	300
Stocks	-75	-446	-2,500	-3,375	470	885
Trade/other receivables	-1,134	1,823	-1,368	-7,641	-4,679	-875
Trade & other payables	-1,574	-1,781	-1,470	7,161	3,163	795
Cashflow from ops.	**12,292**	**13,255**	**8,528**	**24,907**	**29,727**	**33,495**
Net interest	-1,303	-866	-935	-3,106	-2,698	-2,089
Tax	-2,516	-2,028	-1,656	-4,445	-5,366	-6,293
Operational cashflow	**8,473**	**10,361**	**5,937**	**17,356**	**21,664**	**25,113**
Capital Expenditure	-298	-111	-448	-800	-816	-832
Capitalised R&D	-63	-58	-14	0	0	0
Free cashflow	**8,112**	**10,192**	**5,475**	**16,556**	**20,848**	**24,281**
Acquisitions	-9,554	-3,316	-138,700	-4,000	-2,000	0
Dividends	-2,040	-2,398	-2,641	-4,402	-5,663	-6,230
Other investments	4,660	-854	3,253	0	0	0
Cashflow after invest.	**1,178**	**3,624**	**-132,613**	**8,154**	**13,184**	**18,051**
Share repurchases	0	0	0	0	0	0
Share issues	82	8	81,300	0	0	0
Currency effect	0	29	0	0	0	0
Change in net debt	**1,260**	**3,661**	**-51,313**	**8,154**	**13,184**	**18,051**
Opening net cash	-26,031	-24,771	-21,110	-72,423	-64,269	-51,085
Closing net cash	**-24,771**	**-21,110**	**-72,423**	**-64,269**	**-51,085**	**-33,034**
Hardman CF/share (p)	3.2	3.9	2.0	3.5	4.5	5.2

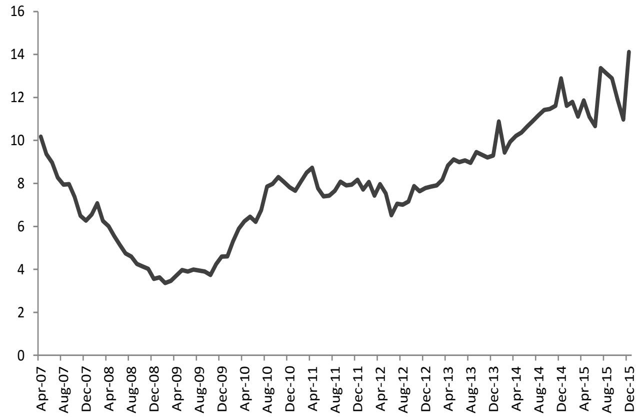
Source: Company reports; Hardman & Co Life Sciences Research

Valuation

Alliance Pharma is currently trading on a 2016 P/E of 13.2x with a CAGR EPS growth rate 2015-2018 of ca.9% – some 2-3 P/E points below its more recent trading levels. This excludes potential revenues from the launch of Diclectin in 2016, the timing of which is still unclear, which are expected to lead to EPS upgrades. Pre-launch costs for Diclectin, however, are expected to have been incurred in 2H 2105 as previously indicated by management at the time of its interim results. The shares have a dividend yield of 2.5% with a progressive dividend policy that is currently covered 3.3x times.

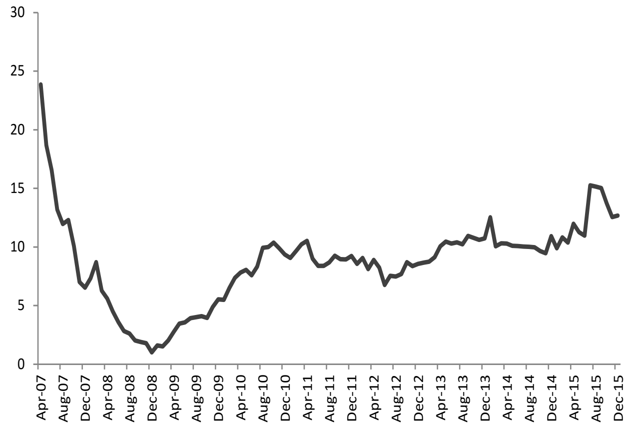
APH has historically generated a 5 year ROIC of 10-12%, with free cashflow largely being reinvested in product acquisitions. We expect free cashflow to annualise at around £18-20m per annum over the next few years. Whilst this will initially be used to pay down group borrowings, there remains the capacity and likelihood that further bolt-on acquisitions will take place, given that the balance sheet still has up to £30m of unutilised banking facilities, and the Company remains well within its banking covenants. This could lead to further earnings and ROIC-enhancing acquisitions.

EV/EBITDA (12 month prospective)



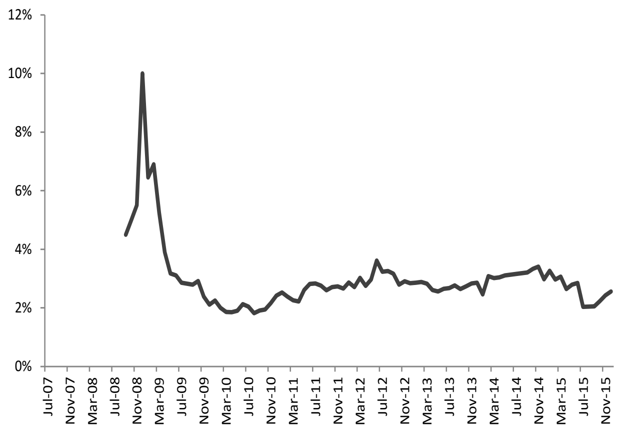
- The de-rating experienced in 2007 was driven by a legacy project, where Alliance Pharma had been investing in drug development. This project ended in 2008
- The growth in EV/EBITDA multiple over the last three years highlights the (now) defensive nature of Alliance Pharma's earnings as well as the growth opportunities
- EBITDA margins of ca.30% and their relative stability underpin multiple
- Margins are expected to increase towards 32%, thus arguing for further multiple expansion

P/E (12 month prospective)



- Over the period 2010-14 Alliance Pharma's P/E demonstracted considerable stabilty, reflecting the resilience of the underlying cash flows and underlying organic growth
- The rise in 2015 can be attributed to the opportunities seen for MacuShield and Diclectin as well as expectations of growth resumption
- Given the healthy post-tax ROIC (10.2% five year average), combined with the strong balance sheet and cash flows, the integration and execution of its 2015 acquisitions (MacuShield, Diclectin and most recent Sinclair IS Pharma products) and anticipated bolt-on acquisitions will help drive EPS and hence the share price

Dividend yield (12 month prospective)



- Alliance Pharma provides investors a 2.5% dividend yield (FY16E)
- Given the expected cash flow (ca.£18m FCF per annum), balance sheet (net debt/EBITDA of 2.2x FY16E) and dividend cover (3.3x FY16E) this looks safe.
- Scope to increase dividend payments

Source: Company data; Hardman & Co Life Sciences Research

Disclaimer

Hardman & Co provides professional independent research services. Whilst every reasonable effort has been made to ensure that the information in the research is correct, this cannot be guaranteed.

The research reflects the objective views of the analysts named on the front page. However, the companies or funds covered in this research may pay us a fee, commission or other remuneration in order for this research to be made available. A full list of companies or funds that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/

Hardman & Co has a personal dealing policy which debars staff and consultants from dealing in shares, bonds or other related instruments of companies which pay Hardman for any services, including research. They may be allowed to hold such securities if they were owned prior to joining Hardman or if they were held before the company appointed Hardman. In such cases sales will only be allowed in limited circumstances, generally in the two weeks following publication of figures.

Hardman & Co does not buy or sell shares, either for its own account or for other parties and neither does it undertake investment business. We may provide investment banking services to corporate clients.

Hardman & Co does not make recommendations. Accordingly, we do not publish records of our past recommendations. Where a Fair Value price is given in a research note this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities/companies but has no scheduled commitment and may cease to follow these securities/companies without notice.

Nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell securities by us.

This information is not tailored to your individual situation and the investment(s) covered may not be suitable for you. You should not make any investment decision without consulting a fully qualified financial adviser.

Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the Financial Conduct Authority (FCA) under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259. However, the information in this research report is not FCA regulated because it does not constitute investment advice (as defined in the Financial Services and Markets Act 2000) and is provided for general information only.

Hardman & Co Research Limited (trading as Hardman & Co)
11/12 Tokenhouse Yard
London
EC2R 7AS
T +44 (0) 207 929 3399

Follow us on Twitter @HardmanandCo

(Disclaimer Version 2 – Effective from August 2015)

Hardman Team

Management Team			
+44 (0)20 7929 3399			
John Holmes	jh@hardmanandco.com	+44 (0)207 148 0543	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)207 148 0544	CEO

Marketing / Investor Engagement		
+44 (0)20 7929 3399		
Richard Angus	ra@hardmanandco.com	+44 (0)207 148 0548
Max Davey	md@hardmanandco.com	+44 (0)207 148 0540
Neil Pidgeon	nrp@hardmanandco.com	+44 (0)207 148 0546

Analysts

+44 (0)20 7929 3399

Agriculture		**Bonds**	
Doug Hawkins	dh@hardmanandco.com	Brian Moretta	bm@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com		
Meghan Sapp	ms@hardmanandco.com		
Building & Construction		**Consumer & Leisure**	
Tony Williams	tw@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Mike Foster	mf@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
Financials		**Life Sciences**	
Brian Moretta	bm@hardmanandco.com	Martin Hall	mh@hardmanandco.com
Mark Thomas	mt@hardmanandco.com	Gregoire Pave	gp@hardmanandco.com
Media		**Mining**	
Derek Terrington	dt@hardmanandco.com	Ian Falconer	if@hardmanandco.com
Oil & Gas		**Property**	
Stephen Thomas	st@hardmanandco.com	Mike Foster	mf@hardmanandco.com
Mark Parfitt	mp@hardmanandco.com		
Services		**Special Situations**	
Mike Foster	mf@hardmanandco.com	Steve Clapham	sc@hardmanandco.com
		Paul Singer	ps@hardmanandco.com
Technology		**Utilities**	
Mike Foster	mf@hardmanandco.com	Nigel Hawkins	nh@hardmanandco.com

Hardman & Co

11/12 Tokenhouse Yard
London
EC2R 7AS
United Kingdom

Tel: +44(0)20 7929 3399
Fax: +44(0)20 7929 3377

www.hardmanandco.com