HARDMAN & CO.

# THE MONTHLY

June 2019

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# Feature article: Where has all the cash gone?

## IMPORTANT INFORMATION

This feature article has not been commissioned by AstraZeneca. It has been prepared purely for informational purposes, and is not a recommendation to readers to buy or sell AZN shares. As Hardman & Co does not trade in shares, this article is not an inducement and is, therefore, MiFID II compliant.

## Pharmaceuticals & Biotechnology

Source: Refinitiv

## Market data

| | |
|---|---|
| EPIC/TKR | **AZN** |
| Price (p) | **5938** |
| 12m High (p) | 6540 |
| 12m Low (p) | 5110 |
| Shares (m) | 1311.8 |
| Mkt Cap (£m) | 78.7 |
| EV (£m) | 89.2 |
| Free Float* | 99% |
| Market | LSE |

## Description

AZN is ranked #13 globally and #17 in the US based on pharma sales. It has one of the more promising industry pipelines of new drugs largely because of its willingness to buy into new technologies/drugs to complement its 'in-house' activities.

## Company information

| | |
|---|---|
| CEO | Pascal Soriot |
| CFO | Marc Dunoyer |
| Chairman | Leif Johansson |

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www.astrazeneca.com

## Key shareholders

| | |
|---|---|
| Directors | 0.4% |
| BlackRock Inc | 8.0% |
| Capital Group | 5.0% |
| Investor AB | 4.1% |

## Diary

| | |
|---|---|
| 31 May- 4 Jun | ASCO |
| 25 Jul | 1H'19 results |

## Analysts


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# ASTRAZENECA

## Where has all the cash gone?

**Historically, AstraZeneca (AZN) was a leading global pharmaceutical company, but has slipped down the rankings following a period of patent expiry on major drugs, notably Nexium, Losec and Seroquel. Understandably, the financial performance, particularly operational cashflow, has suffered through this period and AZN has moved from a net cash ($339m) position in 2009 to net debt of $16.3bn at the end of 1Q'19, necessitating a cash call. Better planning, notably earlier cessation of share buy backs and re-basing its dividend, would have left it in a much stronger position. Meanwhile, its use of 'core' EPS greatly overstates true performance.**

- **Placing:** On 27 March 2019, AZN paid its final dividend for fiscal 2018, which cost the company $2.43bn. Just two days later, the company announced a Placing of shares at 6050p, a discount of 6.7% on the previous close and at an estimated cost of $70m, to raise $3.5bn for working capital.

- **EPS:** Like most companies, AZN uses a number of non-GAAP measurements to generate a 'core' EPS figure which is used in management KPIs and to calculate dividend cover. Because this calculation includes profits on asset disposals it overstates the performance vs. cashflow per share (CFPS).

- **Cashflow:** AZN has been through a 10-year period where operational cashflow has been in decline, to a point where the dividend has been uncovered for four years. Payment of the 2018 final dividend and an upfront payment to Daiichi Sankyo for trastuzumab has left net debt at ca.$17.5bn (net debt/EBITDA 2.5x).

- **Dividend policy:** AZN has a policy to "…maintain or grow dividend per share…", which is a key KPI on which long-term management remuneration is based. However, payment of a large dividend, followed two days later, by a cash call to shore up its balance sheet, at huge cost to shareholders, seems inappropriate.

- **Investment summary:** AZN is a good and well-run company, with one of the more promising R&D pipelines in the industry. However, the audit committee's comfort with the over-statement of underlying operating performance through the use of 'core' EPS, has left the dividend uncovered, resulted in increased debt, and necessitated a Placing of shares to raise fresh capital. The current market valuation leaves little scope for any R&D disappointments.

## Consensus financial summary and valuation

| Year end Dec ($bn) | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Product sales | 23.64 | 21.32 | 20.15 | 21.05 | 22.50 | 25.00 |
| Group revenues | 24.71 | 23.00 | 22.47 | 22.09 | 23.58 | 25.98 |
| Statutory EBIT | 4.11 | 4.90 | 3.68 | 3.39 | 4.12 | 5.00 |
| Underlying EBIT | 4.81 | 4.27 | 4.53 | 3.46 | 4.56 | 5.98 |
| 'Core' EBIT | 6.90 | 6.72 | 6.86 | 5.67 | 6.52 | 7.82 |
| Statutory EPS ($) | 2.23 | 2.77 | 2.37 | 1.70 | 1.75 | 2.00 |
| Underlying EPS ($) | 3.24 | 2.89 | 2.81 | 2.09 | 2.28 | 2.85 |
| 'Core' EPS ($) | 4.28 | 4.27 | 4.22 | 3.47 | 3.50 | 4.18 |
| OCFPS ($) | 2.73 | 3.39 | 2.96 | 2.67 | 2.44 | 3.50 |
| DPS ($) | 2.80 | 2.80 | 2.80 | 2.80 | 2.80 | 2.80 |
| Net cash/(debt) | -8.81 | -11.79 | -14.48 | -14.28 | -12.75 | -13.20 |
| EV/sales (x) | 4.74 | 5.25 | 5.56 | 5.32 | 4.89 | 4.48 |

Source: Refinitiv

# Thoughts on AstraZeneca

## Alarm bells

Two recent events should have triggered alarm bells in the minds of investors…

…the market capitalisation of AZN exceeded that of GSK…

…and insufficient operational cashflow to pay off a modest $1bn loan at maturity

Over the past two months, there have been two events which I did not expect to see during my time as a pharmaceuticals analyst in the City, in the absence of major corporate activity. First, despite a considerable difference in the size and market share of their respective pharmaceuticals businesses, both globally and in the US, the market capitalisation of AstraZeneca (AZN) exceeded that of GlaxoSmithKline (GSK) for the second time in March 2019 (the first time was on 13 November 2018). Secondly, on 29 March 2019, AZN announced a Placing of shares to raise $3.5bn, in part to fund the upfront payment ($675m) for acquisition of commercial rights to a Phase III drug (trastuzumab ((DS-8201)) from Daiichi Sankyo, but also to provide extra working capital to fund the repayment of $1bn 1.95% loan notes due for repayment on 18 September 2019. As an experienced industry follower, these events set off 'alarm bells' in my mind.

**Key recent events**

| Date | Event |
|---|---|
| 13 Nov 2018 | The market capitalisation of AZN exceeded that of GSK, albeit briefly |
| 21 Mar 2019 | The market capitalisation of AZN again exceeded that of GSK |
| 27 Mar 2019 | Payment of final dividend costing $2.43bn |
| 29 Mar 2019 | Announcement of Placing to raise $3.5bn |
| 2 Apr 2019 | Settlement of Placing and admission of new shares |

*Source: Hardman & Co Life Sciences Research*

### Follow the cash

While I have not actively followed AZN on a day-to-day basis for more than 10 years, I remember the company being cash rich and cash generative. Therefore, the need for a capital increase begged the question of where all its cash has gone. Indeed, this cash call came just two days after AZN had paid out a substantial dividend to shareholders, and prompted me to dig a little deeper into what has been happening at the company. The Placing was needed to prop up its balance sheet and provide working capital, because the company is not generating sufficient cash from operations to pay the upfront licensing fee and pay off what is, essentially, a relatively modest $1bn loan.

### Accounting for growth

I was very fortunate to spend most of my analytical career with two investment banks that were renowned for their strength in accounting practices – UBS Phillips & Drew (UBS) and HSBC James Capel (HSBC). These two firms were regularly at the top of the Extel rankings for two reasons:

- both encouraged analysts to undertake thought provoking fundamental company research and industry analysis; and
- both adopted a prescribed methodology for analysing the accounts of every company being researched in exactly the same way, so that comparative analysis could be performed.

What I learned from the HSBC and UBS models was that the EPS figure could be easily manipulated. This principle was demonstrated brilliantly by the research report conceived and edited by Richard Hannah at UBS, called '*Accounting for Growth*', which won several awards and was published subsequently as a book of the same name by the then head of research, Terry Smith. I was incredibly proud to have been involved in that report having identified and reported on some poor accounting practices at Reckitt & Colman and London International Group, one of which is again is being repeated at AZN.

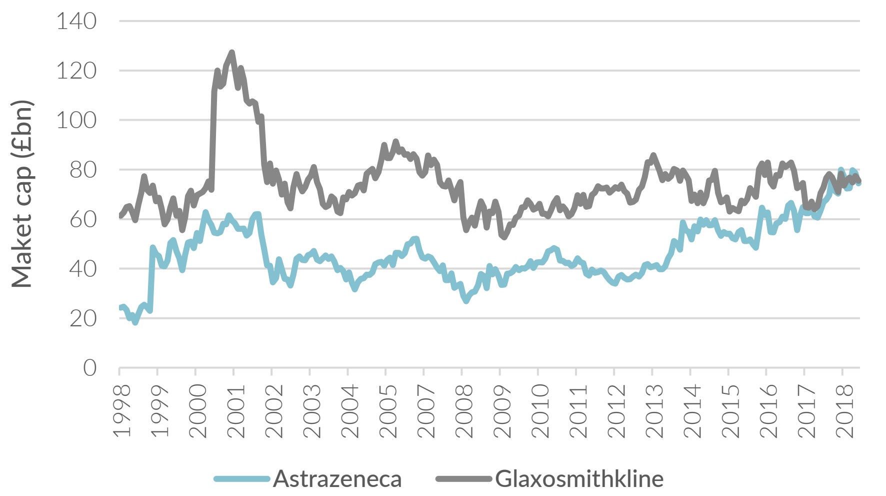
While that report focused on methods of manipulating EPS to portray companies as having better growth, it also highlighted the importance of cash. A recent article[1] in *AB (Accounting & Business) Magazine*, the official journal of the Association of Chartered Certified Accountants (ACCA) highlighted global discrepancies in the approach to cashflow statements and the need for change. This was reinforced by our report in 2018 on the lack of consistency in cashflow accounting[2].

# Market capitalisation

Main defence against Pfizer's approach was strong growth prospects and operating performance

As part of its defence against the unwanted take over proposal from Pfizer in 2013, AZN argued the case that it had a "…growing and accelerating late-stage pipeline…" and provided "…new long-term revenue targets for AZN's five key growth platforms…". Moreover, from 2017 to 2023, management stated that it was "…targeting strong and consistent revenue growth leading to annual revenues of greater than $45bn by 2023. Operating leverage is expected to result in core earnings growth in excess of revenue growth during this period". These statements, made in 2013, have been reiterated and reinforced over recent years. This has led to the perception in the market that AZN has one of the most productive R&D pipelines in the industry, and, certainly, one that is much stronger than GSK's. Even so, it is a big stretch from here to the reality of delivering on these targets to the extent that AZN should be valued at a higher amount than GSK.

**Market capitalisation of AZN and GSK – 1999-2019**




*Source: Refinitiv*

Even though stock markets discount the future, it is a big step to value the company the same as another that is ranked higher with twice the sales

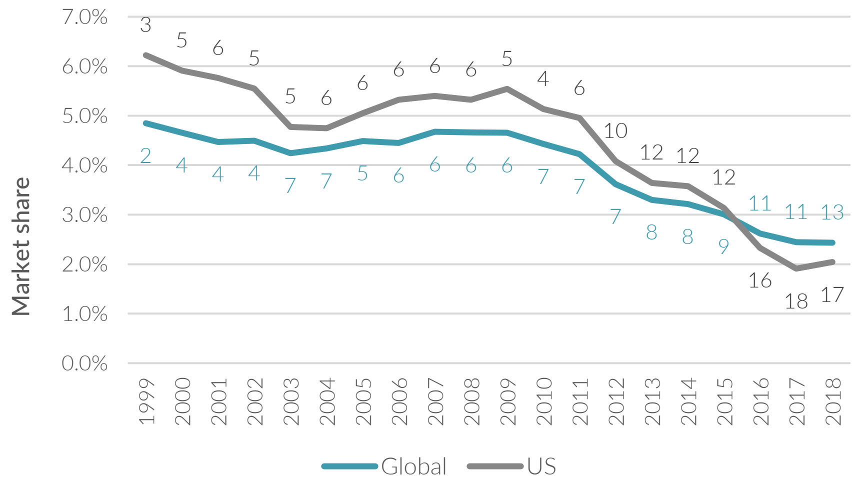
The rise in AZN's market capitalisation is inconsistent with its operational performance. Although it was always known that the company was likely to go through a difficult period when it lost patent protection on its major products – notably Nexium, Losec and Seroquel – the decline in global market share has been significant.

In 2008, AZN was ranked global #6 with 4.66% market share; however, in 2018, it was ranked #13 with 2.47% share. In the US, the fall has been even more dramatic, from #6 with 5.32% market share in 2008 to #17 with 2.04% share in 2018.

To put this in perspective, the company needs to more than double its sales in order to return to being a top-six player, both in the US and globally. This is precisely the target (sales of $45bn) that was set out in its Pfizer defence documentation. However, achieving this over the next four years appears a tall order.

[1] *Go with the flow*, by Jane Fuller in AB Magazine, May 2017
[2] *Cashflow accounting – the need for consistency*, by Hardman & Co, September 2017

Global and US market share and industry rank of AstraZeneca – 1999-2018




*Source: Hardman & Co Life Sciences Research*

# Cashflow analysis

Old spreadsheet has been dragged out of the archives and brought up-to-date

The second puzzle concerns its cash position. While I have looked regularly (annually) into AZN's results, it has been from the perspective of obtaining the relevant numbers to update our extensive pharmaceutical database (see '*Global Pharmaceuticals: 2018 industry statistics*' published on 9 April 2019[3]). The last time that I looked seriously into this company's full financial accounts was over 10 years ago when it had a net cash position, despite it spending considerable sums each year on share buy backs and payment of dividends. Therefore, to find itself in a position of having to approach shareholders to shore up its balance sheet seemed astonishing to me. Consequently, my old AZN spreadsheet has been dragged out of the archives and brought up-to-date in an attempt to better understand why the company is not generating much cash, and to identify just where all the surplus cash (historically) has gone.

## Earnings per share

Companies are inconsistent in the use of non-GAAP measures to generate so-called 'core' EPS

The first step is to look at the P&L account. The focus of the investment community on EPS has been, and always will be, the first valuation metric because it is quick and easy to obtain. However, companies always want to portray their results in the best possible light and adopt some form of 'non-GAAP' or 'core' EPS, which are often prepared in an inconsistent way that can lead to wide variances among companies, making direct comparisons very difficult. My aim is to generate for every company a consistently defined and calculated underlying EBIT, from which underlying EPS is derived, to enable peer comparisons.

### *AZN operating performance*

AZN's operating performance is well below the weighted industry average…

…in part due to higher R&D investment

In general, pharmaceutical companies have high margins, in part to reflect the enormous R&D costs of getting new drugs onto the market. In 2018, the weighted average pre-R&D operating margin for the global drug industry was 52.7%, from which 19.4% was invested into R&D to drive future growth, leaving an operating EBIT of 33.3%. Although the COGS (manufacturing plus distribution costs) for AZN were the same as the industry average, the overall operating performance was well below the industry average, generating an underlying EBIT of 16.5%, driven by relatively high SG&A costs and investment in R&D.

[3] https://www.hardmanandco.com/research/corporate-research/global-pharmaceuticals-2018-industry-statistics/

**AstraZeneca vs. global industry average**

| | Industry average* | AZN* | Δ |
|---|---|---|---|
| Cost of goods sold | -24.1% | -24.1% | - |
| Selling, general & administration | -25.6% | -40.1% | -14.5ppts |
| Other income/(expense) | +2.4% | +6.2% | +3.8ppts |
| **Pre-R&D margin** | **52.7%** | **42.0%** | **-10.7ppts** |
| R&D investment | -19.4% | -25.5% | -6.1ppts |
| **Underlying EBIT** | **33.3%** | **16.5%** | **-16.8ppts** |

**Corrected for non-cash amortisation and impairment charges*
*Source: Hardman & Co Life Sciences Research*

The reason for AZN's relatively high SG&A spend is unclear. It employs 31,600 worldwide in sales and marketing, with 59% of these in emerging markets. Sales per employee calculates as follows: globally $583k, established markets $956k, and emerging markets $324k. AZN's relatively high R&D spend is understandable, given the greater push for products into Phase III development. Despite this, its absolute R&D spend is still more than $1.5bn below the industry average for the top-10 ranked companies.

## *Reconciliation*

Some items included in 'core' EPS are contentious…

…and far from 'one-off'

The next issue concerns the composition of items from which EPS is calculated. Our aim is to have a consistency that allows direct comparisons among global peers in a particular industry. Over a period of more than 20 years, a standard set of rules has been applied about what constitutes underlying EBIT and earnings, which is important given that different approaches are taken by different companies. AZN is no exception.

The contentious points are as follows:

- Amortisation and impairment of intangible assets
- Restructuring charges
- Legal costs
- Profit (over book value) of asset disposals

## *Amortisation of intangible assets*

Our underlying EBIT does add back amortisation of goodwill so that comparisons can be made directly with peers that have not made acquisitions

While there is a cost associated with acquisitions which must be recognised, in order to compare the operating performance between companies that have made acquisitions with those that have not, we also add back the amortisation charge for the generation of underlying EBIT. Moreover, because amortisation is a non-cash item, it provides a better proxy for cash earnings. In the case of AZN, the company also adds back the amortisation and impairment of goodwill associated with acquisitions in order to generate its 'core' EBIT.

## *Restructuring charges*

AZN has had a restructuring charge every year for 10 years…

…in the range $807m to $1,558m

Restructuring costs are frequently added back to profits as most management teams consider them to be 'one-off', including AZN. However, we believe that restructuring charges simply reflect that operating costs have got out of control and need to be reined in. Also, it is usually a cash cost. So, to align with cash earnings, our policy is to not add them back. Furthermore, given that AZN has now had a restructuring charge, in the range from $807m and $1,558m, every year for the past 10 years, they can hardly be considered 'one-off'!

## *Legal costs*

Protection of IP is now a normal part of business in the pharmaceutical industry

Legal costs are now normal in the pharmaceutical industry and a genuine cost of doing business and protecting your intellectual property. I recall about 20 years ago when GSK first encountered a major legal cost, John Coombe, the CFO, stated that they were being shown as 'exceptional'; but, in his heart he felt that they would become a normal part of doing business. How right he was.

Therefore, once again such items should not be added back in an attempt to boost apparent performance, as they are recurring every year. For AZN in 2018, this happened to be a positive figure ($489m) largely the result of settling a legal dispute concerning Losec in Canada.

### *Profit on disposals*

Once an asset has been sold, it cannot be sold again

In 2019, AZN needs to make up $1.9bn just to stand still, or make more disposals…

…but eventually this will become an issue in a year where few, or no, disposals are made

Over the past four years, AZN has gone through a period of making disposals of older drugs that are no longer considered core to the business. These nearly always generate a substantial profit over book value on disposal, which AZN considers to be core, i.e. its 'non-core' asset suddenly becomes 'core' when it comes to earnings considerations. In my opinion, once something has been sold, it cannot be sold again and should not be included as part of 'core' earnings, especially when it represents only an accounting profit over book value, which has nothing to do with operations.

Moreover, in 2018, such disposals generated a book profit $1.89bn. Therefore, in the event that no disposals are made in a particular year, a massive amount of growth would be needed from the operational side of the business just to give a flat EBIT outcome. For example, under its own definition, in 2019, AZN must increase profits from operations by 54% ($1.89bn as a percentage of $3.46bn) in order to produce the same 'core' EBIT as in 2018. It will be interesting to see how the company handles this in the event that no, or few, disposals arise in a particular year.

**EPS reconciliation**

| Year-end Dec ($m) | 2018 | Comment |
|---|---|---|
| **Statutory EBIT** | **3,387** | Standard UK GAAP using IFRS |
| Diabetes alliance | -60 | Could be profit or loss from BMY alliance |
| Non-core business | -323 | Included in 'other income' |
| Amortisation of goodwill | 2,345 | Added back for comparative purposes |
| Exceptional items | -1,885 | 'One-off' profit on disposal of non-core assets |
| **Underlying EBIT*** | **3,464** | **Our standard method used across the industry** |
| Restructuring charges | 697 | Inefficiencies in the cost base, not one-off |
| Profit on disposals | 1,885 | AZN includes these 'one-off' gains |
| Non-core items | -374 | Net legal settlements; other gains or costs |
| **AZN 'core' EBIT** | **5,672** | |
| | | |
| Statutory EPS ($) | 1.70 | 28% decline vs. 2017 |
| **Underlying EPS ($)*** | **2.09** | **26% decline vs. 2017** |
| AZN 'core' EPS ($) | 3.47 | 18% decline vs. 2017 |

**Hardman & Co methodology*
*Source: Hardman & Co Life Sciences Research*

As can be seen for 2018, underlying EPS by our methodology was somewhat better than the statutory EPS figure, with the adding back of the amortisation charge being offset by removal of the exceptional profit on disposal. Even so, it is markedly lower than the 'core' EPS figure that the company likes to focus on.

### *10-year EPS summary*

Our underlying EPS is a good proxy for OCFPS…

…whereas 'core' EPS generally overstates the performance

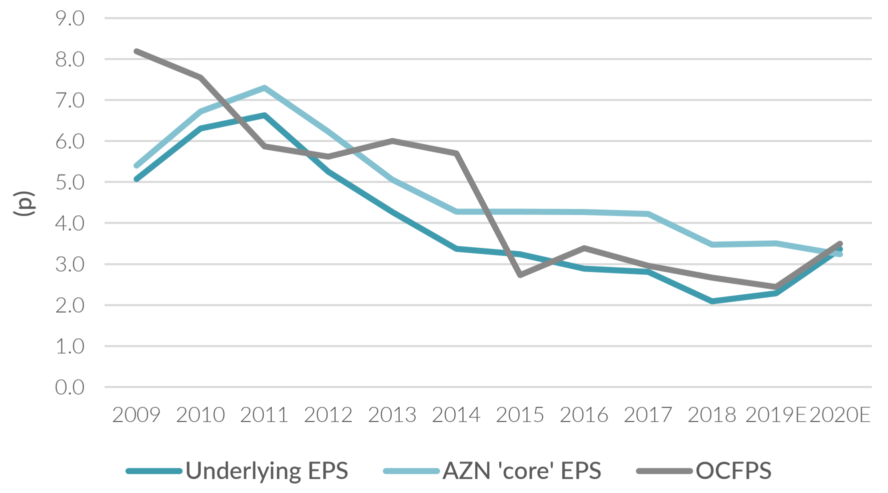
The importance of this can be seen from the 10-year EPS summary shown in the following table and chart. The company does not appear to have fared so poorly when looking at 'core' EPS (CAGR -4.3%) compared with underlying EPS (CAGR -8.5%). Moreover, when looking at the ratio between cash earnings and EPS, our underlying calculation shows that there is a good cash conversion rate and underlying EPS is a very good proxy for operational cashflow per share (OCFPS). In contrast, there is a very poor analogy (over-statement) between AZN's 'core' EPS and OCFPS.

**Comparison of EPS**

| Year-end Dec. ($) | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | CAGR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Statutory EPS | 5.24 | 5.60 | 7.34 | 4.99 | 2.04 | 0.99 | 2.23 | 2.77 | 2.37 | 1.70 | -10.6% |
| **Underlying EPS** | **5.07** | **6.31** | **6.63** | **5.25** | **4.27** | **3.37** | **3.24** | **2.89** | **2.81** | **2.09** | **-8.5%** |
| AZN ‘core’ EPS | 5.40 | 6.72 | 7.30 | 6.23 | 5.06 | 4.28 | 4.28 | 4.27 | 4.22 | 3.47 | -4.3% |
| **OCFPS** | **8.19** | **7.55** | **5.87** | **5.62** | **6.00** | **5.70** | **2.73** | **3.39** | **2.96** | **2.67** | **-10.6%** |
| | | | | | | | | | | | |
| OCFPS:EPS | 162% | 120% | 89% | 107% | 141% | 169% | 84% | 117% | 105% | 127% | - |
| OCFPS:’core’ EPS | 152% | 112% | 80% | 90% | 119% | 133% | 64% | 79% | 70% | 77% | |

*Source: Hardman & Co Life Sciences Research*

**Trend in EPS and cashflow per share**




*Source: Hardman & Co Life Sciences Research*

## Cashflow

The P&L (EBIT) is a simple proxy for the most important valuation metric, which is operational cashflow and OCFPS, as it shows the true operational returns of a business. However, it takes much longer to determine than EPS, which is why it is rarely used as a valuation metric. It is also influenced by both the movement in working capital and variations in cash tax payments, which tend to make it more volatile.

Operational cashflow has been in decline for 10 years…

The table of summary cashflows below shows that, in general, there has been a steady decline in operational cashflow at AZN to a point where, since 2014, it did not cover the capital expenditure and dividend payments. To compensate for this, management embarked on a series of disposals on mature/non-core drugs in the portfolio, which generated, overall, a net small positive outcome. However, a number of acquisitions of either companies or products to access new technologies have also been made, which have essentially been paid for by taking on debt. This has moved the company from a net cash position of $339m at the end of 2009 to -$14.7bn (net debt/equity 115%) by the end of 2018. At the end of 1Q’19, this had increased further to -$16.3bn (after payment of final dividend, but before settlement from the Placing and the upfront payment to Daiichi Sankyo).

…leaving the dividend uncovered…

…and racking up the debt

### *Share buybacks*

AZN has spent a total of $29.4bn on share buybacks to boost EPS

In total, between 1999 and 2013, AZN spent $29.4bn on share buybacks at an average price of $47.71/£28.87). For many years, largely until the approach from Pfizer, this had been detrimental to shareholders (share price trading lower than average cost price of share repurchases). At today’s share price, it can be argued that this has benefited shareholders. However, one of the consequences is that the company is now straddled with a huge amount of debt.

Are share buy backs the best investment that can be made?

It is a personal opinion, but I am against share buybacks. Ignoring the detailed economic argument and tax considerations, I consider this money to belong to the shareholders and not to management. If the Board feels that it has too much capital and an inefficient balance sheet, the money should be returned to its owners directly in the form of dividends. Also, management is effectively saying that an investment in its own shares is better than any other investment that could be made, and, in general, I am unconvinced that management teams within companies are appropriately qualified or informed to make this judgement.

The current CEO immediately terminated the buyback programme

To give credit to the current management team, one of the first things it did when appointed was to stop the share repurchase programme to preserve cash.

**Summary of AZN cashflow statements**

| Year-end Dec ($m) | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Operational cashflow** | **11,852** | **10,854** | **7,992** | **7,093** | **7,514** | **7,198** | **3,447** | **4,285** | **3,742** | **3,379** |
| Capital expenditure | -962 | -791 | -839 | -672 | -742 | -1,012 | -1,328 | -1,446 | -1,326 | -1,043 |
| Dividends | -2,977 | -3,361 | -3,764 | -3,665 | -3,461 | -3,521 | -3,486 | -3,561 | -3,519 | -3,484 |
| Acquisitions | -624 | -1,738 | -458 | -5,134 | -2,474 | -6,201 | -4,485 | -3,707 | -2,178 | -677 |
| Disposals | 269 | 210 | 1,772 | 0 | 35 | 0 | 1,130 | 1,427 | 1,376 | 2,350 |
| Share repurchases | 0 | -2,604 | -6,015 | -2,635 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Change in net cash/(debt)** | **7,796** | **2,989** | **-837** | **-5,100** | **1,450** | **-3,324** | **-4,330** | **-2,977** | **-2,693** | **201** |
| | | | | | | | | | | |
| Opening net cash/(debt) | -7,457 | 339 | 3,328 | 2,491 | -2,609 | -1,159 | -4,483 | -8,813 | -11,790 | -14,483 |
| **Closing net cash/(debt)** | **339** | **3,328** | **2,491** | **-2,609** | **-1,159** | **-4,483** | **-8,813** | **-11,790** | **-14,483** | **-14,282** |
| | | | | | | | | | | |
| Cash conversion ratio | 1.10 | 0.94 | 0.87 | 0.88 | 0.80 | 1.10 | 0.72 | 0.82 | 0.75 | 0.76 |
| Net debt/EBITDA | -0.02 | -0.21 | -0.16 | 0.22 | 0.10 | 0.50 | 1.09 | 1.68 | 1.91 | 1.98 |
| Return on invested capital | 23.3% | 26.9% | 27.7% | 18.9% | 15.2% | 14.4% | 12.8% | 11.4% | 9.8% | 9.8% |

*Summary of full cashflow statement only, numbers provided do not add-up to the change in net debt*
*Source: Company reports, Hardman & Co Life Sciences Research*

## *Dividends*

Cutting the dividend would have been detrimental to management remuneration…

AZN has a policy to "…maintain or grow dividend per share…" and is one of its stated KPIs on which long-term incentives for the management team are derived. It has just been pointed out that the dividend has been uncovered by operational cashflow less capital expenditure for a number of years and should have been cut, especially given the large increase in investment required to get the company back on to a positive growth trend. However, such a move would have been detrimental to remuneration packages.

…but Vodafone showed that investment for the future can be achieved without too much shareholder damage

In addition to remuneration influences, it is well known that anticipation of a cut in dividend is generally associated with a fall in the share price, as evidenced by the performance of Vodafone (VOD) over the last 12 months. Question marks over its ability to keep paying a high dividend has caused the shares to underperform. Moreover, on 14 May 2019, when the company formally announced its intention to rebase its annual dividend from €¢15.07 to €¢9.0 per share, to help fund the required investment in 5G technology, the share price reacted with a 4% fall. Therefore, the reluctance of management to undertake such a move is understandable.

Giving to Peter and then taking from Paul…

…at a huge cost to shareholders

On the other hand, what the Board of AZN has done is much less understandable and is avoiding having to make the right decision. What is the point in a company paying a dividend on one day (27 March) and two days later (29 March) announcing the need for a capital increase to bolster its balance sheet. What is more, the Placing (@6050p per share) was done at a 6.7% discount to the closing share price on 28 March, i.e. far more than the likely fall in share price on the announcement of a dividend cut, and probably cost the company $70m (est. 2%, the actual amount will be released along with 2Q'19 results in July) in fees. Therefore, the overall impact and cost to shareholders was considerably greater than that seen by Vodafone.

The 2019 dividend looks to be uncovered again

Current management guidance for 2019 financial performance suggests that operational cashflows will improve compared with those reported in 2018. However, this improvement will still be insufficient to cover the dividend, especially with the increased number of shares in issue. Based on our forecasts, this situation will also be repeated in fiscal 2020. Therefore, this discussion on dividends is likely to recur, and raises the question about whether AZN will require more working capital again next year if it gets close to breaching banking covenants (see below).

### *Disposals*

The strategy to sell valuable assets which are no longer core to the group is perfectly reasonable. This policy has generated $6.3bn of cash in the past four years and a further $515m has been recorded already during 1Q'19. As mentioned earlier, this could be problematical in a year when no such gains are made, putting huge pressure on the growth in operating profits in order for its 'core' EPS just to stand still. On the basis of guidance, reiterated with 1Q'19 results, AZN management is indicating that it expects to make further non-core disposals during 2019.

### *Net debt/EBITDA*

In the absence of the Placing, net debt/EBITDA was approaching 2.5x

Based on 2018 results, AZN's net debt/EBITDA ratio was 1.98x. Assuming that EBITDA remains largely unchanged in 2019 (guidance 'core' EPS of $3.50 (+3%) to $3.70 (+9%)), suggests that this ratio had risen to 2.25x by the end of 1Q'19. After the quarter had ended, the upfront payment of $675m (50% of the $1.35bn upfront with the remainder in 12 months' time) to Daiichi Sankyo for the rights to trastuzumab was made, in addition to an upcoming redemption of $500m of floating loan notes (early redemption took place on 18 April). Taken together, these items would probably have pushed the net debt/EBITDA ratio close to 2.5x in the absence of the Placing. While the banking covenants of AZN have not been disclosed, the need for a capital increase had probably become quite pressing in order to avoid breaching them.

## Audit committee activity

While "…all directors are collectively responsible for the success of the group…" it is the role of audit committee "…to assess the soundness of [our] financial reporting and internal controls…" and it is the responsibility of the audit committee to oversee, among other things, the financial reporting. The chairman of the audit committee, who retired at the conclusion of the AGM in April, has been a member of the committee since September 2008, i.e. throughout the period of declining cashflows highlighted in this report.

> *"….The Audit Committee spends a significant amount of its time considering the landscape of enduring risks, specific and current risks, and emerging risks…."*

*Source: AZN annual report 2018*

The financial reporting section of the report of the audit committee in the 2018 annual report (page 110) states that, among other items, it:

- reviewed, at least quarterly, the group's significant accounting matters including contingent liabilities, revenue recognition and deferred tax and, where appropriate, challenged management's decisions before approving the accounting treatment applied;
- reviewed the group's significant restructuring programmes initiated from 2013 onwards, including accounting for restructuring charges, and control over capital expenditure; and

- looked closely at intangible asset impairment reviews, legal provisions and other related charges, to ensure that items are appropriately accounted for in 'reported' and 'core' results.

In addition, the risk identification section states that the committee:

- considers the total landscape of enduring risks which are longstanding and business-as-usual in nature; and
- scans the horizon and identifies risks that may challenge the company in the future, it also considers emerging risks.

The audit report makes no mention of cashflows, dividend payments, or the definition and appropriateness of 'core' EPS

Interestingly, the report of the audit committee makes no mention of cashflows or the payment of dividends in either the financial reporting section or the risk identification and management section. The audit committee and the Board seem to accept that dividend cover should be based on the calculation of its definition of 'core' EPS divided by the dividend payment, even though this report highlights that 'core' EPS significantly overstates the position relative cash generation as shown by OCFPS, which shows clearly that the dividend has been, and will continue to be, uncovered for a number of years.

## Conclusions

It was known that the company faced a tough period…

…so early planning was essential

On the one hand, there is an acceptance that while AZN was going through a period of patent expiry on its major drugs there would be an associated decline in profitability and cashflows in the absence of new drugs to take their place. On the other hand, the timing of this period of decline was well known, and planning for these events should have started earlier, the first step being cash preservation and the cessation of any share buy-backs after 2008, and the re-basing of the dividend five years ago, when the share price was rising.

'Core' EPS gives a misleading picture of cashflows and implies that the dividend is covered

From our short forensic financial analysis, the dressing-up of earnings from statutory to core using non-GAAP measures can generate mis-leading outcomes, as evidenced by the large mis-match (over-statement) between AZN's core EPS and the operational cashflow per share. In contrast, the methodology for underlying EPS that we adopt generates an outcome which is closely aligned with, but generally understates, the OCFPS outcome.

The audit committee should hold its head in shame

The decision by the Board to authorise the final dividend payment and then announce a capital increase two days later, at enormous cost to shareholders, beggars belief. What is the audit committee doing?

Analysts should listen to 'guidance'…

…but be prepared to offer more realistic alternatives that allow peer group analysis and influence consensus

From an analytical point of view, far too much attention is spent on the R&D pipeline and not enough time is spent on forensic examination of the accounts. Also, analysts should not simply accept 'guidance' numbers provided by the company and always have outcomes that are '…in line with expectations…'. Analysts should not be afraid to offer investors more appropriate alternatives, based on their own, consistent accounting methodology, thereby allowing direct peer group comparisons and influencing the consensus.

At the time of writing, according to Refinitiv (formerly Thomson Reuters), there are 26 analysts currently active on AZN, with the following ratings: 17 buy, 6 hold, 3 sell. The consensus forecast for 2019 EPS ($3.50) is aligned with the latest management guidance for 'core' EPS (currently $3.50-$3.70), with growth of 19% and 20%, respectively, in fiscal years 2020 and 2021. However, this rate of EPS growth is not reflected in the forecast rate of sales growth (ca.10%), which implies considerable operating leverage needs to be delivered over the forecast period in order to achieve the EPS forecasts, particularly in the absence of further 'profit on disposals' after 2019, which are unforecastable.

From a valuation standpoint, AZN is trading around the same market capitalisation as GSK (see table below); however, allowing for the debt in each company, GSK has an EV of £104.7bn, whereas the EV of AZN is £88.4bn. Even so, group sales of GSK are almost double (pharma sales 1.4x greater) those of AZN, it is ranked higher in both the world and the US, and has higher margins. This suggests that market expectations for a productive and successful R&D pipeline are far greater for AZN than for GSK. Delivering on this and improving the cash generation will dictate where the shares go from here.

The current valuation leaves no room for disappointment

Also, to put AZN's valuation into perspective, a comparison has been made with Celgene (CELG), which has similar industry characteristics: fast-growth company (sales growth >20% p.a.); and ranked both globally and in the US at about the same level as AZN. In the face of a bid from Bristol-Myers-Squibb (BMY), the enterprise value of Celgene is standing at a significant market premium, currently at ca.$88bn, or 5.73x 2018 sales. On the day immediately prior to the announcement of BMY's approach, CELG was trading at 4.11x sales, i.e. a higher rating than GSK, reflecting faster growth, but below AZN's.

**Comparison of AZN with GSK and Celgene**

| 2018 data | AstraZeneca | GlaxoSmithKline | Celgene |
|---|---|---|---|
| Share price* | 5938p | 1547p | $94.35 |
| Market cap | £77.9bn | £76.5bn | $73.3bn |
| Net debt | -£10.5bn | -£27.5bn | -$14.2bn |
| EV | £88.4bn | £104.0bn | $87.5bn |
| Group sales | $22.1bn | $40.4bn | $15.3bn |
| Pharma sales | $21.0bn | $30.4bn | $15.3bn |
| Global pharma rank | 13 | 8 | 16 |
| US pharma rank | 17 | 9 | 13 |
| EV/sales | 5.25x | 3.40x | 5.73x |

*Please note that different currencies have been used within the table*
**Share prices taken at close of business on 28 May 2019*
*Source: Hardman & Co Life Sciences Research*

# Full cashflow statement

| Cashflow statement | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Year-end Dec ($m)** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** |
| Operating profit | 11,543 | 11,494 | 11,312 | 8,148 | 3,712 | 2,137 | 3,153 | 3,601 | 2,159 | 1,502 |
| Depreciation | 943 | 1,098 | 1,086 | 1,023 | 1,007 | 898 | 853 | 656 | 1,229 | 1,408 |
| Amortisation | 1,144 | 1,643 | 1,464 | 1,495 | 3,576 | 2,384 | 1,999 | 1,701 | 1,807 | 2,345 |
| *Inventories* | *6* | *88* | *-256* | *-150* | *135* | *108* | *-315* | *-343* | *-548* | -13 |
| *Receivables* | *-256* | *10* | *-1,108* | *755* | *-383* | *311* | *152* | *1,610* | *83* | -523 |
| *Payables* | *1,579* | *-16* | *467* | *-1,311* | *414* | *2,089* | *114* | *-341* | *415* | -103 |
| Change in working capital | 1,329 | 82 | -897 | -706 | 166 | 2,508 | -49 | 926 | -50 | -639 |
| Exceptionals/provisions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | -200 | -463 | -597 | -424 | 258 | 865 | -782 | -1,650 | -415 | 157 |
| Net interest | -526 | -467 | -377 | -400 | -361 | -393 | -373 | -537 | -534 | -483 |
| Tax | -2,381 | -2,533 | -3,999 | -2,043 | -844 | -1,201 | -1,354 | -412 | -454 | -537 |
| **Operational cashflow** | **11,852** | **10,854** | **7,992** | **7,093** | **7,514** | **7,198** | **3,447** | **4,285** | **3,742** | **3,379** |
| Capital expenditure | -962 | -791 | -839 | -672 | -742 | -1,012 | -1,328 | -1,446 | -1,326 | -1,043 |
| Sale of tangible assets | 138 | 83 | 102 | 199 | 69 | 158 | 47 | 82 | 83 | 12 |
| **Free cashflow** | **11,028** | **10,146** | **7,255** | **6,620** | **6,841** | **6,344** | **2,166** | **2,921** | **2,499** | **2,348** |
| Dividends | -2,977 | -3,361 | -3,764 | -3,665 | -3,461 | -3,521 | -3,486 | -3,561 | -3,519 | -3,484 |
| Acquisitions | -624 | -1,738 | -458 | -5,134 | -2,474 | -6,201 | -4,485 | -3,707 | -2,178 | -677 |
| Disposals | 269 | 210 | 1,772 | 0 | 35 | 0 | 1,130 | 1,427 | 1,376 | 2,350 |
| Other investments | -106 | -39 | -11 | 4 | 33 | -127 | 223 | -250 | -122 | -332 |
| **Cashflow after investments** | **7,590** | **5,218** | **4,794** | **-2,175** | **974** | **-3,505** | **-4,452** | **-3,170** | **-1,944** | **205** |
| Share repurchases | 0 | -2,604 | -6,015 | -2,635 | 0 | 0 | 0 | 0 | 0 | 0 |
| Share issues | 135 | 494 | 409 | 429 | 482 | 279 | 43 | 47 | 43 | 34 |
| Effect of forex | 71 | 33 | -25 | -4 | -65 | -152 | -76 | 21 | -66 | -38 |
| Cash/(debt) acquired | 0 | -152 | 0 | -715 | 59 | 54 | 155 | 125 | -726 | 0 |
| **Change in net debt** | **7,796** | **2,989** | **-837** | **-5,100** | **1,450** | **-3,324** | **-4,330** | **-2,977** | **-2,693** | **201** |
| | | | | | | | | | | |
| Opening net cash/(debt) | -7,457 | 339 | 3,328 | 2,491 | -2,609 | -1,159 | -4,483 | -8,813 | -11,790 | -14,483 |
| **Closing net cash/(debt)** | **339** | **3,328** | **2,491** | **-2,609** | **-1,159** | **-4,483** | **-8,813** | **-11,790** | **-14,483** | **-14,282** |
| | | | | | | | | | | |
| OCFPS ($) | 8.19 | 7.55 | 5.87 | 5.62 | 6.00 | 5.70 | 2.73 | 3.39 | 2.96 | 2.67 |

*Source: Company reports, Hardman & Co Life Sciences Research*

# About the authors

### *Dr Martin Hall*

Martin's career in the City started as a healthcare analyst in 1987, working at Morgan Grenfell and then UBS. He joined HSBC in 1992, where he was Head of Global Pharmaceutical/Healthcare Equity Research. In 2005, he set up as an independent Life Sciences Analyst and Corporate Broker under the umbrella of Eden Financial Limited. Martin is acknowledged for his thought-provoking and opinionated research. He joined Hardman & Co in June 2013.

Martin qualified as a pharmacist (B.Pharm.Hons) at the School of Pharmacy, University of London, and has a PhD in Neuropharmacology, also from the University of London. After two years of post-doctoral research under a Royal Society Fellowship at the Collège de France, Paris, he became leader in Biochemical Pharmacology at the Parke-Davis Research Centre in Cambridge. Martin is a member of Royal Pharmaceutical Society of Great Britain.

### *Dr Dorothea Hill*

Dorothea joined the Life Sciences team as an Equity Research Analyst in August 2016. She began her career researching vaccines as part of an international Gates Foundation/Wellcome Trust collaboration, following which she undertook a PhD in genetics and vaccines for meningococcal disease at the University of Oxford. She has broad experience in the field of vaccines research and development, having worked on the molecular biology of bacterial pathogens, antigen discovery, molecular diagnostics, and next-generation sequencing technologies. Dorothea has authored 13 papers, including first author publications in the Lancet Infectious Diseases and in Nature's Scientific Reports. She is passionate about drug development and the commercialisation of medical innovation.

### *Dr Grégoire Pavé*

Greg is an analyst in the Life Sciences team at Hardman & Co, and has considerable experience in the field of drug discovery and development. In 2003, he enrolled in a team-leader post-doctoral position at Imperial College London, working on natural product synthesis. In 2005, he joined Cancer Research Technology, the development and commercial arm of Cancer Research UK, where he was involved in multiple oncology projects. Greg has broad experience in drug discovery and development projects, from target identification and validation through to clinical trials. He has also gained valuable experience in evaluating life science projects and their commercial opportunities. In addition, he has played a role of reviewer in peer-review journals from the American Chemical Society. He is also an author of 14 scientific papers and owner of four patents. Greg joined Hardman & Co in March 2016. He has a PhD in Medicinal Chemistry from the University of Orléans in France, and holds the IMC and PRINCE2 qualifications.

# Company research

Priced at 28 May 2019 (unless otherwise stated).

## Healthcare Equipment & Services

*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | AVO |
| Price (p) | 46.0 |
| 12m High (p) | 62.1 |
| 12m Low (p) | 31.0 |
| Shares (m) | 200.4 |
| Mkt Cap (£m) | 92.2 |
| EV (£m) | 85.8 |
| Free Float* | 61% |
| Market | AIM |

**As defined by AIM Rule 26*

### Description

Advanced Oncotherapy (AVO) is developing next-generation proton therapy systems for use in radiation treatment of cancers. The first system is expected to be installed in Harley Street, London, during 2019; it will be operated through a JV with Circle Health.

### Company information

| | |
|---|---|
| Exec. Chairman | Michael Sinclair |
| CEO | Nicolas Serandour |

+44 203 617 8728
www.advancedoncotherapy.com

### Key shareholders

| | |
|---|---|
| Board & Management | 11.4% |
| Liquid Harmony Ltd | 23.1% |
| DNCA Investments | 6.2% |
| Brahma AG | 4.1% |
| Barrymore Investments Ltd | 4.1% |
| AB Segulah | 3.3% |

### Diary

| | |
|---|---|
| May'19 | Final results |
| 2H'19 | Harley Street ready |

### Analysts

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# ADVANCED ONCOTHERAPY

## 2018 final results imminent

**AVO's goal is to deliver an affordable and novel proton beam therapy system (PBT), based on state-of-the-art technology developed originally at the world-renowned CERN. 2018 was characterised by the achievement of a number of technical milestones, the successful integration of all the module types that constitute the LIGHT accelerator, and the acceleration of the proton beam to an energy of 52MeV, sufficient to treat superficial tumours. Meanwhile, AVO has secured £12.3m of new money through a £10.0m secured debt facility with Credit Suisse and a £2.3m Subscription with predominantly Swiss investors.**

- **Strategy:** AVO is developing a compact and modular proton therapy (PT) system at an affordable price for the payor, financially attractive to the operator, and generating superior patient outcomes. AVO benefits from the technology know-how developed by CERN, Geneva, and relies on a base of world-class suppliers.

- **2018 results:** At the time of going to press, AVO was due to publish 2018 results. This gives AVO the opportunity to update the market on its commercial strategy for the LIGHT system, progress at the Harley Street site, and its financial position. We forecast net cash/(debt) of -£1.6m (prior to January's £10m raise).

- **New capital:** AVO has secured additional financing for a total amount of £12.3m through two facilities: the first is a two-year loan of £10m at 2%+LIBOR interest with Credit Suisse; the second is a Subscription of 5.9m shares @ 40p per share, raising £2.3m.

- **Use of proceeds:** The new funds will be used to support the manufacturing and testing of the first LIGHT system to be installed at Harley Street, ahead of verification and validation activities that will be carried out at AVO's testing and assembly site within the STFC site at Daresbury.

- **Investment summary:** Demand for PT is increasing worldwide, and the need for a small, flexible, affordable and close-to-patient system is desirable. AVO has attracted strong manufacturing partners, and discussions with potential customers are advancing. Progress at its flagship Harley Street site has been substantial, and installation of the first LIGHT system is planned to start in mid-2019. The latest technical update has brought further assurance and boosted confidence.

### Financial summary and valuation

| Year-end Dec (£m) | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| Sales | 0.0 | 0.0 | 0.0 | 21.5 | 65.5 | 111.5 |
| Gross profit | 0.0 | 0.0 | 0.0 | 1.9 | 11.4 | 27.6 |
| Administration costs | -12.9 | -14.0 | -13.7 | -14.0 | -14.3 | -14.6 |
| EBITDA | -12.6 | -13.6 | -14.3 | -11.6 | -5.0 | 8.1 |
| Underlying EBIT | -12.9 | -14.0 | -14.7 | -14.2 | -7.6 | 5.5 |
| Statutory EBIT | -14.5 | -17.0 | -18.0 | -18.4 | -10.8 | 2.6 |
| Underlying PTP | -14.9 | -14.3 | -15.4 | -15.7 | -9.4 | 3.7 |
| Statutory PTP | -16.5 | -17.3 | -18.6 | -19.8 | -12.7 | 0.8 |
| Underlying EPS (p) | -15.6 | -7.6 | -7.0 | -5.7 | -3.3 | 1.9 |
| Statutory EPS (p) | -18.9 | -9.7 | -8.8 | -7.4 | -4.6 | 0.8 |
| Net (debt)/cash | -9.2 | -1.6 | 0.9 | -6.8 | -14.4 | -17.7 |
| EV/EBITDA | -7.5 | -6.4 | -5.9 | -7.9 | -20.1 | 12.7 |

*Source: Hardman & Co Life Sciences Research*

## Financials

*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **AJB** |
| Price (p) | **420** |
| 12m High (p) | 482 |
| 12m Low (p) | 162 |
| Shares (m) | 408 |
| Mkt Cap (£m) | 1,710 |
| EV (£m) | 1,650 |
| Free Float* | 36.5% |
| Market | LSE full listing |

**As defined by LR 6.14 of the Listing Rules*

## Description

AJ Bell is one of the largest investment platforms in the UK. It serves both DIY and advised customers, and offers SIPPs, ISAs and general accounts. It aims to be easy to use and very competitively priced.

## Company information

| | |
|---|---|
| CEO | Andy Bell |
| CFO | Michael Summersgill |
| Chairman | Les Platts |

+44 345 40 89 100
www.ajbell.co.uk

## Key shareholders

| | |
|---|---|
| Invesco Perpetual | 25% |
| Andy Bell | 25% |
| Management and other | 23% |
| Michael Spencer | 3% |

## Diary

| | |
|---|---|
| 25 Jul | 3Q trading update |
| 24 Oct | 4Q trading update |
| 05 Dec | FY19 results |

## Analyst

Jason Streets 020 7194 7622
js@hardmanandco.com

# AJ BELL

## Platform for growth

AJ Bell is one of the largest and fastest-growing investment platforms in the UK. It serves both the adviser market and the DIY investor. Having transitioned to updated technology in 2014, it is well placed to ride the growth in the market and pick up disaffected clients from competitor platforms that are only now upgrading. We anticipate strong profit growth on the back of higher revenues and positive operational gearing. The interim results confirmed our expectations and were accompanied by a very confident outlook statement.

- **Strategy:** AJ Bell intends to be the easiest platform for investors and advisers to use, and to offer exceptional value – but not at the expense of service levels. It charges noticeably less than many of its competitors, putting it in a strong position as charges take a higher profile.

- **Plenty of scope for platform expansion:** Investment platforms are an obviously good way to concentrate the administration and custody of investments in one place, while offering a huge variety of investment choice, and freeing investors and advisers to focus on what they do best. There are still plenty of assets not yet corralled, as well as significant underlying growth.

- **Valuation:** We value the business on a DCF basis. At the current price, it is effectively assuming a discount rate of 6.7%, putting it over the top end of our wide range. Our central valuation of £912m would put it on a FY19E PER of 32x, which compares with Transact at 34x and Hargreaves Lansdown at 42x.

- **Risks:** There are inevitably market risks – revenue is linked to the value of assets and, to a lesser extent, the amount of trading on the platform. The business is also sensitive to tax and savings policies, which can have major impacts on investors' behaviour. The robustness of the technology is critical too.

- **Investment summary:** AJ Bell is a very attractive business, in our view. It is well positioned to benefit from the expected continuing growth in savings and the ever- higher proportion of those savings held on platforms. The business is highly cash-generative and holds significant net cash. These positive characteristics would seem to be well reflected in the current price.

### Financial summary and valuation

| Year-end Sep (£m) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| AuA (£bn) | 32 | 40 | 46 | 49 | 55 | 61 |
| Revenue | 64.5 | 75.6 | 89.7 | 104.0 | 116.0 | 130.0 |
| Net finance income | 0.0 | -0.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| PBT | 16.8 | 21.7 | 30.1 | 37.0 | 41.0 | 47.0 |
| Tax | -3.5 | -4.2 | -5.7 | -6.7 | -7.4 | -8.5 |
| Net profit | 13.3 | 17.5 | 22.6 | 28.5 | 33.6 | 38.6 |
| No. of shares (fully-diluted, m) | 394 | 396 | 402 | 408 | 408 | 408 |
| EPS (fully-diluted, p) | 3.4 | 4.4 | 6.1 | 7.4 | 8.2 | 9.5 |
| DPS (p) | 2.7 | 2.9 | 3.7 | 4.5 | 5.4 | 6.1 |
| PER (x) | 124.5 | 95.0 | 69.2 | 56.6 | 51.0 | 44.4 |
| Dividend yield | 0.6% | 0.7% | 0.9% | 1.1% | 1.3% | 1.5% |
| Dividend cover (x) | 1.3 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |

*Source: Hardman & Co Research*

## Pharmaceuticals & Biotechnology

Source: Refinitiv

### Market data

| | |
|---|---|
| EPIC/TKR | AGY |
| Price (p) | 12.4 |
| 12m High (p) | 29.0 |
| 12m Low (p) | 7.3 |
| Shares (m) | 636.2 |
| Mkt Cap (£m) | 78.6 |
| EV (£m) | 28.9 |
| Free Float* | 49.7% |
| Market | AIM |

*As defined by AIM Rule 26

### Description

Allergy Therapeutics (AGY) provides information to professionals related to prevention, diagnosis and treatment of allergic conditions, with a special focus on allergy vaccination. The emphasis is on treating the underlying cause and not just the symptoms.

### Company information

| | |
|---|---|
| CEO | Manuel Llobet |
| CFO | Nick Wykeman |
| Chairman | Peter Jensen |

+44 1903 845 820
www.allergytherapeutics.com

### Key shareholders

| | |
|---|---|
| Directors | 0.7% |
| Abbott Labs | 37.8% |
| Southern Fox | 22.7% |
| Odey | 6.9% |
| Blackrock | 5.3% |

### Diary

| | |
|---|---|
| 1H'20 | Start Ph.1 Polyvac Peanut trial |
| 2H'20 | Start Phase III Grass Trial |

### Analysts

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gp@hardmanandco.com

# ALLERGY THERAPEUTICS

## House dust mite vaccine – clinical progress

**AGY is a long-established specialist in the prevention, diagnosis and treatment of allergies. The Pollinex Quattro (PQ) platform, an ultra-short-course subcutaneous allergy immunotherapy (SCIT), continues to gain market share despite its availability in the EU on a 'named-patients' (NP) basis only. The aim of ongoing trials is to move the platform to full registration under the new regulatory framework. Following the success of 'Acarovac Plus' in NP, the 'Acarovac MPL' vaccine for house dust mite allergy is in clinical development to provide a registered vaccine. Results from the Phase I trial of Acarovac MPL were positive, demonstrating safety and tolerability.**

- **Strategy:** AGY is a fully-integrated pharmaceutical company focused on the treatment of allergies. There are three parts to its strategy: continued development of its European business via investment or opportunistic acquisitions; the US PQ opportunity; and further development of its pipeline.

- **Phase I trial:** AM101 was an open-label, exploratory trial investigating the safety and tolerability of Acarovac MPL in 16 adult patients with rhinoconjunctivitis due to house-dust mite (HDM) allergy. Seven injections of the SCIT were administered as a 6- to 12-week treatment course.

- **Successful endpoints:** Both the primary and secondary endpoints were positive. The vaccine was well tolerated and the safety profile was satisfactory – there were adverse events reported, but these were consistent with similarly formulated allergy vaccines. This allows progression to Phase II development.

- **Regulatory process:** Under the regulatory framework, there is a strong desire to have 'named-patient' products moved to full marketing approval. In addition to the primary aim of tolerability, strong secondary endpoints indicated a sustained immune response, which should prove helpful in subsequent regulatory discussions.

- **Investment summary:** The market has started to recover from the overly pessimistic view of the PQ Birch trial primary endpoint failure in March. However, AGY is still trading on 2019E EV/sales of only 0.7x, which is well below the multiples commanded by its direct competitors. All future trial designs are being improved as a consequence of the PQ Birch trial experience, in the expectation of enhancing the prospects of gaining full regulatory approval.

### Financial summary and valuation

| Year-end Jun (£m) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| Sales | 48.5 | 64.1 | 68.3 | 74.0 | 80.0 | 88.0 |
| R&D investment | -16.2 | -9.3 | -16.0 | -16.0 | -20.0 | -15.0 |
| Underlying EBIT | -12.3 | -2.9 | -6.4 | -7.2 | -9.0 | -1.9 |
| Reported EBIT | -12.5 | -2.6 | -7.4 | -8.2 | -10.0 | -2.9 |
| Underlying PBT | -12.5 | -3.0 | -6.5 | -7.4 | -9.3 | -2.3 |
| Statutory PBT | -12.2 | -2.7 | -7.5 | -8.4 | -10.3 | -3.3 |
| Underlying EPS (p) | -2.4 | -0.5 | -1.1 | -1.1 | -1.6 | -0.5 |
| Statutory EPS (p) | -2.3 | -0.4 | -1.3 | -1.3 | -1.6 | -0.5 |
| Net (debt)/cash | 20.0 | 18.8 | 12.5 | 12.8 | 0.4 | -30.5 |
| Capital increase | 11.0 | 0.0 | 0.0 | 10.4 | 0.3 | 0.3 |
| P/E (x) | -5.2 | -26.3 | -11.2 | -10.9 | -7.8 | -25.0 |
| EV/sales (x) | 1.0 | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 |

*Forecasts have not been revised following the PQ Birch trial result and may be subject to change*
*Source: Hardman & Co Life Sciences Research*

# ARBUTHNOT BANKING GROUP

## Positive AGM statement

**The 2018 results showed the great progress made in profitably deploying the capital ABG generated from the partial sale of its stake in Secure Trust Bank (STB) – see our note, *2019 results: growth and diversity*, published on 30 April 2019. The 9 May *AGM statement* confirmed these trends have continued. End-April loans and deposits were up 13% and 18% on end-April 2018. The Asset Based Lending division broke even in March, nine months ahead of plan. The Specialist Finance business is progressing with its soft launch and expects to be fully operational in 3Q'19. At end-April, Arbuthnot Direct had opened 161 term savings accounts, raising £9m of deposits – ahead of ABG's expectations.**

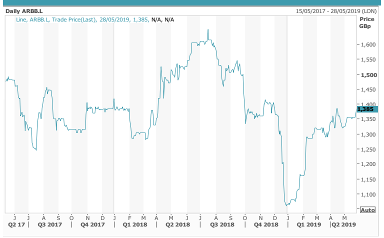
- **ABG news:** On 17 May, ABG announced the admission of its ordinary shares to trade on the NEX Exchange Growth market (as well as AIM). It also issued 152k new non-voting shares to trade exclusively on NEX. We believe this has been done as a cheap option to facilitate further non-voting, but equity issues if required.
- **Peer news:** STB's 15 May *trading statement* saw a 5% share price rise that day, with a positive tone and indications that competition is easing in some areas. Close Brothers' 22 May *trading statement*, in contrast, saw a 6% fall. However, the read- across to ABG was positive, with stable credit and margins.
- **Valuation:** The average of our approaches is £17.46 (previously £17.52), 1.3x 2020E NAV. Since our last report, there has been a small change in the STB share price, which feeds through to the sum-of-the-parts model. Despite the 2019 year-to-date rally, the current share price is still around the 2018 NAV (1,283p).
- **Risks:** As with any bank, the key risk is credit. ABG's existing business should see below-market volatility, and so the main risk lies in new lending. We believe management is cognizant of the risk and, historically, has been very conservative. Other risks include reputation, regulation and compliance.
- **Investment summary:** ABG offers strong-franchise and continuing-business (normalised) profit growth. Its balance sheet strength gives it wide-ranging options to develop organic and inorganic opportunities. The latter are likely to increase in uncertain times. Management has been innovative, but also very conservative, in managing risk. Having a profitable, well-funded, well-capitalised and strongly growing bank priced at book value appears anomalous.

### Financial summary and valuation

| Year-end Dec (£000) | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Operating income | 34,604 | 41,450 | 54,616 | 67,905 | 76,790 | 86,903 |
| Total costs | -35,926 | -46,111 | -54,721 | -64,982 | -71,795 | -77,484 |
| Cost:income ratio | 104% | 111% | 100% | 96% | 93% | 89% |
| Total impairments | -1,284 | -474 | -394 | -2,731 | -1,860 | -2,944 |
| Reported PBT | -2,606 | -1,966 | 2,534 | 6,780 | 7,332 | 10,757 |
| Adjusted PBT | 2,982 | 1,864 | 3,186 | 7,416 | 9,332 | 12,757 |
| Statutory EPS (p) | 86.3 | 1,127.3 | 43.9 | -134.5 | 40.5 | 59.1 |
| Adjusted EPS (p) | 13.5 | 17.1 | 47.5 | 40.3 | 51.1 | 69.7 |
| Loans/deposits | 82% | 76% | 75% | 71% | 77% | 80% |
| Equity/assets | 5.5% | 18.5% | 12.8% | 9.0% | 8.5% | 7.8% |
| P/adjusted earnings (x) | 100.7 | 79.5 | 28.6 | 33.7 | 26.6 | 19.5 |
| P/BV (x) | 1.70 | 0.90 | 0.89 | 1.06 | 1.06 | 1.04 |

*Source: Hardman & Co Research*

### Financials



*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | ARBB/ARBN |
| Price (p) | 1,360 |
| 12m High (p) | 1,640 |
| 12m Low (p) | 1,065 |
| Shares (m) | 15.4 |
| Mkt Cap (£m) | 210 |
| Loans to deposits | 80% |
| Free Float* | 42% |
| Market | AIM / NEX |

**As defined by AIM Rule 26*

### Description

Arbuthnot Banking Group (ABG) has a well-funded and capitalised private bank, and has been growing commercial banking very strongly. It holds a 9.85% stake in Secure Trust Bank (STB).

### Company information

| | |
|---|---|
| Chair/CEO | Sir Henry Angest |
| COO/CEO Arb. Latham | Andrew Salmon |
| Group FD, Deputy CEO AL | James Cobb |

+44 20 7012 2400
www.arbuthnotgroup.com

### Key shareholders

| | |
|---|---|
| Sir Henry Angest | 56.1% |
| Liontrust | 6.5% |
| Miton Asset Mgt. | 4.4% |
| Slater Investments | 4.0% |
| R Paston | 3.6% |
| M&G IM | 3.5% |

### Diary

| | |
|---|---|
| Jul'19 | Interim results |

### Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

# ARTIFICIAL SOLUTIONS

## 1Q results confirm underlying trends

**Artificial Solutions (AS) is a vendor of highly advanced artificial intelligence (AI)-based conversational solutions. Major global enterprises use its Teneo technology platform to automate their customer interactions. The AI market overall is growing at ca.40% p.a. The 1Q'19 results show that a combination of new customer wins across regions and extended/expanded commitments with existing customers are driving AS's strong growth rates. Customers include Shell, AT&T, Vodafone and Volvo. A growing list of global systems integrator partners is increasingly contributing to order intake and revenue growth, while taking the company into new segments.**

- **1Q'19 results:** 1Q revenue was SEK12.6m (€1.17m), up 2% YoY, with an EBITDA loss, as expected, of SEK27.7m (€2.56m) vs. SEK20.9m loss a year ago (we use 10.8 SEK:€ conversion rate). Order intake backlog was up 28% YoY to SEK40.8m (€3.78m), despite specific sizeable deals slipping into 2Q'19, some of which have since closed.
- **Solid customer traction:** Despite lengthy sales cycles that are an inevitable consequence of the focus on large, global enterprises, 1Q saw extensive customer activity. New contracts were signed with: i) a US public sector organisation; ii) a major postal services organisation in Asia; and iii) a large airline. Existing contracts were extended with each of AT&T, Shell and Vodafone.
- **Partner revenue share growth:** An important strategic initiative for a number of years has been cultivation of a productive base of SI partners. In 1Q, 50% of revenue came from partners, a metric that will oscillate quarterly. New partner additions in 1Q were Capgemini and Deloitte. The new Teneo Fusion platform and the Teneo Developers application are designed to facilitate ease of use for partners.
- **Risks:** Competing with some of the world's largest technology companies brings challenges, such as keeping pace with developments, retaining talent and creating enterprise mindshare vs. strong brands. Systems integrators are a route to market but may reduce the company's visibility into potentially lengthy sales cycles; however, to date, AS has proven adept at managing these factors.
- **Investment summary:** AS has the proven technology platform and an experienced management with which to monetise the opportunity, in our view. 1Q'19 results confirm an expanding list of large-scale customers, strong order intake (with further acceleration expected), growing SI deal flow and a significant new platform release. Enterprise interest in productive and scalable AI capabilities is high, and we think the company is well-placed to benefit from this demand.

### Financial summary and valuation

| Year-end Dec (€m) | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|
| Revenue | 7.06 | 6.09 | 8.39 | 11.47 | 17.96 |
| Gross profit | 3.67 | 3.23 | 4.62 | 6.54 | 10.60 |
| Gross margin | 52% | 53% | 55% | 57% | 59% |
| EBITDA | -6.79 | -9.26 | -6.86 | -2.70 | 3.44 |
| EBIT | -9.44 | -11.58 | -9.41 | -5.51 | 0.35 |
| Pre-tax profit | -10.93 | -14.24 | -8.81 | -4.75 | 1.45 |
| Net income | -10.93 | -14.24 | -8.81 | -4.75 | 1.45 |
| EPS (diluted, €) | -0.50 | -0.65 | -0.40 | -0.22 | 0.07 |
| EV/revenue (x) | 11.2 | 12.9 | 9.4 | 6.9 | 4.4 |
| EV/EBITDA (x) | N/M | N/M | N/M | N/M | 22.9 |
| EV/EBIT (x) | N/M | N/M | N/M | N/M | 164.1 |

*Source: Hardman & Co Research*

### Technology

*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | **ASAI.SE** |
| Price (SEK) | **29.2** |
| 12m High (SEK) | 90.0 |
| 12m Low (SEK) | 15.2 |
| Shares (m) | 22.0 |
| Mkt Cap (SEKm) | 642 |
| EV (SEKm) | 819 |
| Free Float* | 20% |
| Market | Nasdaq First North |

**As defined by AIM Rule 26*

### Description

Artificial Solutions is a leading global vendor of artificial intelligence (AI) software to large enterprises. Headquartered in Sweden, the company comprises ca.104 people.

### Company information

| | |
|---|---|
| CEO | Lawrence Flynn |
| CFO | Chris Bushnell |
| Chairman | Åsa Hedin |

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www.artificial-solutions.com

### Analysts

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# CITY OF LONDON INVESTMENT GROUP

## Mixed market trends

**After four months of steady growth in Emerging Market and global equities, May saw something of a setback. While the MSCI Emerging Markets is still up approximately 3% year to date, it is down almost 9% on the end-April figure. It is not hard to see the main reason for this, with the US administration threatening to raise more tariffs on Chinese goods. Consensus seemed to be that both sides were keen to reach an agreement; however, views have now diverged with some commentators suggesting that the Chinese side may wait for a new US president. Unfortunately, this story still seems to have much further to run.**

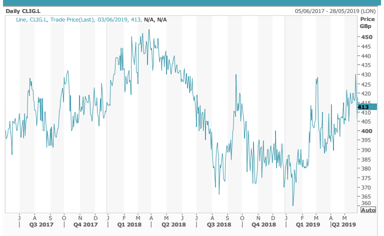
- **Share buybacks:** As we suggested in our latest report, City of London was most likely to return further capital through buybacks. This has turned out to be the case; 126,000 shares were bought back in May for a total of £515,374 at an average price of 409p.
- **Funds under management:** As of the end of April, FUM had grown to $5.39bn from $4.62bn as of the end of December. The May figure is likely to be adversely affected by market movements.
- **Valuation:** The prospective P/E of 11.7x is at a significant discount to the peer group. The historical yield for the ongoing dividend of 6.7% is attractive and should, at the very least, provide support for the shares in the current markets.
- **Risks:** Although emerging markets can be volatile, City of London has proved to be more robust than some other EM fund managers, aided by its good performance and strong client servicing. Further EM volatility could increase the risk of such outflows, although increased diversification is also mitigating this.
- **Investment summary**: Having shown robust performance in challenging market conditions, City of London is now reaping the benefits in a more supportive environment. The valuation remains reasonable. FY'17 and FY'18 both saw dividend increases and, unless there is significant market disruption, more should follow in the next few years.

### Financial summary and valuation

| Year-end Jun (£m) | 2016 | 2017 | 2018 | 2019E* | 2020E | 2021E |
|---|---|---|---|---|---|---|
| FUM ($bn) | 4.00 | 4.66 | 5.11 | 5.37 | 5.77 | 6.19 |
| Revenue | 24.41 | 31.29 | 33.93 | 31.42 | 34.16 | 36.24 |
| Statutory PTP | 7.97 | 11.59 | 12.79 | 10.88 | 12.49 | 13.53 |
| Statutory EPS (p) | 23.3 | 36.9 | 39.5 | 34.6 | 39.8 | 43.1 |
| DPS (p) | 24.0 | 25.0 | 27.0 | 27.0 | 27.0 | 27.0 |
| Special dividend (p) | | | | 13.5 | | |
| **P/E (x)** | 17.4 | 11.0 | 10.3 | 11.7 | 10.2 | 9.4 |
| **Dividend yield** | 5.9% | 6.2% | 6.7% | 10.0% | 6.7% | 6.7% |

*Source: Hardman & Co Research*
**2019 figures include a special dividend of 13.5p*

### Financials



*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | **CLIG** |
| Price (p) | 405.0 |
| 12m High (p) | 433.0 |
| 12m Low (p) | 360.0 |
| Shares (m) | 26.6 |
| Mkt Cap (£m) | 107.6 |
| EV (£m) | 89.4 |
| Market | LSE |

### Description

City of London (CLIG) is an investment manager specialising in using closed- end funds to invest in emerging and other markets.

### Company information

| | |
|---|---|
| CEO | Barry Olliff |
| CFO | Tracy Rodrigues |
| Chairman | Barry Aling |

+44 207 860 8346
www.citlon.com

### Key shareholders

| | |
|---|---|
| Directors & staff | 16.8% |
| Blackrock | 10.0% |
| Cannacord Genuity | 8.0% |
| Eschaton Opportunities Fund Management | 4.8% |
| Polar Capital | 4.1% |

### Diary

| | |
|---|---|
| 16 Jul | Pre-close trading statement |
| 16 Sep | Preliminary results statement |
| 9 Oct | 1Q FUM announcement |
| 10 Oct | Ex-div. date for final |

### Analyst

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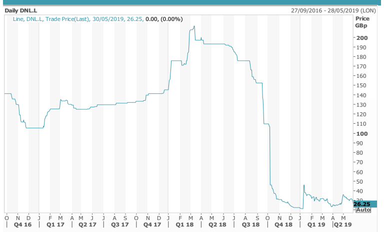
HARDMAN&CO.

## Pharmaceuticals & Biotechnology



*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | DNL |
| Price (p) | 27.0 |
| 12m High (p) | 193.1 |
| 12m Low (p) | 20.8 |
| Shares (m) | 61.7 |
| Mkt Cap (£m) | 16.7 |
| EV (£m) | 9.8 |
| Free Float* | 20% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Diurnal (DNL) is a UK-based specialty pharma company targeting patient needs in chronic, potentially life-threatening, endocrine (hormonal) diseases. Alkindi is DNL's first product in the market in Europe for the paediatric population, with first sales already started in key countries, while Chronocort is in Phase III trials.

## Company information

| | |
|---|---|
| CEO | Martin Whitaker |
| CFO | Richard Bungay |
| Chairman | Peter Allen |

+44 29 2068 2069
www.diurnal.co.uk

## Key shareholders

| | |
|---|---|
| Directors | 3.0% |
| IP Group | 44.1% |
| Finance Wales | 18.8% |
| Invesco | 11.7% |
| Oceanwood Capital | 5.7% |

## Diary

| | |
|---|---|
| 14 Jun | General Meeting |
| 4Q'19 | Alkindi US NDA submission |
| 4Q'19 | Chronocort EMA MAA |

## Analysts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Grégoire Pavé 020 7194 7628
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# DIURNAL GROUP

## Capital increase to boost working capital

DNL is a commercial-stage specialty pharma company focused on diseases of the endocrine system. Its two lead products are targeting rare conditions where medical need is currently unmet, with the aim of building a long-term 'Adrenal Franchise'. The first product, Alkindi®, is being launched in key EU markets, and this was expected to be followed by the adult version, Chronocort®. After unexpected Phase III results, the positive feedback from the EMA has cleared the regulatory path for Chronocort in CAH. DNL has submitted subsequently an Intend to Submit letter to the EMA for MAA. Also, up to £6.35m is being raised through a Placing and Open Offer.

- **Strategy:** DNL aims to create a valuable 'Adrenal Franchise' that can treat patients with chronic cortisol deficiency diseases from birth through to old age. Once Alkindi and Chronocort are established in the EU and the US, the long-term vision is to expand DNL's product offering to other related conditions.

- **Intend to Submit letter:** Following the positive Scientific Advice meeting with the EMA in March 2019, together with its written response, DNL has submitted an Intend to Submit letter for Marketing Authorisation Application (MAA) for Chronocort as a treatment for patients with congenital adrenal hyperplasia (CAH).

- **On schedule:** The Intend to Submit letter is part of the regulatory process prior to MAA filing. It formally notifies the regulator of the intended submission date, with a request for the appointment of rapporteurs, after which DNL will submit the regulatory dossier for Chronocort. DNL aims to submit the MAA in 4Q'19.

- **Capital increase:** DNL has announced a capital increase of up to £6.35m (gross) through a conditional Placing (£5.35m firm) and Open Offer (£1.0m) of 24.2m Ordinary shares at 26p. The net proceeds will be used mainly to support the regulatory filings of Chronocort (MAA in the EU) and Alkindi (NDA in the US).

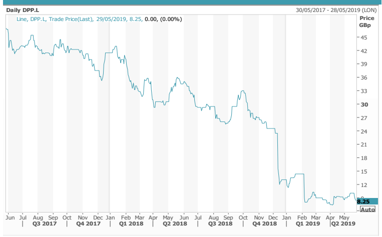
- **Investment summary:** Alkindi, a cortisol replacement therapy designed for children under 18 years of age, is DNL's first product on the market. It should be followed by Chronocort for adults – a larger market – which now has a clear pathway for regulatory approval in both Europe and the US. Despite this, the share price is still languishing well below valuations determined by peer group and DCF (225p) analyses, due largely to an awareness of the need for more capital.

## Financial summary and valuation

| Year-end Jun (£m) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| Sales | 0.00 | 0.00 | 0.07 | 1.14 | 2.14 | 5.56 |
| SG&A | -1.99 | -3.23 | -6.21 | -5.50 | -7.12 | -8.76 |
| R&D | -3.89 | -8.34 | -10.02 | -10.00 | -10.85 | -10.31 |
| EBITDA | -5.87 | -11.56 | -16.16 | -14.52 | -16.03 | -14.06 |
| Underlying EBIT | -5.88 | -11.56 | -16.17 | -14.53 | -16.05 | -14.07 |
| Reported EBIT | -6.99 | -12.08 | -16.98 | -15.38 | -16.94 | -15.01 |
| Underlying PBT | -5.95 | -11.64 | -16.30 | -14.45 | -16.03 | -14.12 |
| Statutory PBT | -7.06 | -12.16 | -16.91 | -15.30 | -16.92 | -15.06 |
| Underlying EPS (p) | -12.48 | -17.05 | -25.68 | -19.84 | -21.97 | -19.08 |
| Statutory EPS (p) | -15.02 | -18.04 | -26.78 | -21.23 | -23.41 | -20.59 |
| Net (debt)/cash | 26.88 | 16.37 | 17.28 | 4.23 | -10.17 | -23.64 |
| Capital increase | 24.52 | 0.05 | 13.40 | 1.14 | 2.14 | 5.56 |

*Source: Hardman & Co Life Sciences Research*

## Consumer & Leisure



*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **DPP.L** |
| Price (p) | 8.5 |
| 12m High (p) | 36 |
| 12m Low (p) | 7 |
| Shares (m) | 250 |
| Mkt Cap (£m) | 21 |
| EV (£m) | 19 |
| Free Float* | 64% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

DP Poland (DPP) has the master franchise for Domino's Pizza in Poland. It has 60 stores, of which 42 are corporately owned. It is rolling out steadily and trialling a partnership with takeaway.com.

## Company information

| | |
|---|---|
| CEO | Peter Shaw |
| CFO | Maciej Jania |
| Chairman | Nicholas Donaldson |

+44 20 3393 6954
www.dppoland.com

## Key shareholders

| | |
|---|---|
| Directors | 5.2% |
| Cannacord Genuity | 13% |
| Pageant Holdings | 17% |
| Fidelity | 10% |
| Octopus Investments | 5% |

## Diary

| | |
|---|---|
| May'19 | AGM |
| Jul'19 | 1H trading update |
| Sep'19 | Interim results |

## Analyst

Jason Streets 020 7194 7622
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# DP POLAND

## Trialling with takeaway.com

**The company raised £5.5m net in a placing in February, which should fund store growth through to 2020 and support its innovative online marketing programme. January and February comparisons were tough because of the TV advertising conducted in the same period last year. The growth focus will be on splitting territories and larger cities. DPP is also looking to sell some stores to sub-franchisees and maybe close some underperformers. It has started a trial with takeaway.com.**

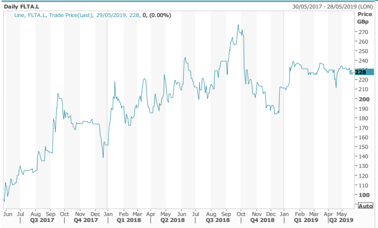
- **Strategy:** DPP has spent its first few years proving the Domino's Pizza model in Poland. It has scope to double the number of operations over the next few years. As the stores mature, the success should show up in reported profits. DPP aims to be smarter than its competitors in its marketing – using digital media, rather than expensive display advertising.
- **Competitive market:** The new food delivery aggregators have money to spend and are impacting DPP's above-the-line promotional activity, with aggressive (and possibly unsustainable) marketing activity. DPP is now trialling a partnership with takeaway.com. It allows DPP full control of product, service and delivery, while piggy-backing on its marketing spend. Early signs are positive.
- **Valuation:** With no reported profits expected for the next few years, we value DPP on a per-store basis. In our initiation research, published on 18 September 2018 (*Fully proven model rolls out*), we derived a central value of around £80m, to reflect the delay in the maturing of the business; we now discount that for a further year, to £72m, or 29p per share.
- **Risks:** The biggest short-term risk to DPP is the deep pockets of the new disruptors: the food delivery aggregators. This has already impacted DPP's growth, as it struggles to get its message across, against competitors spending 20x or even 25x what DPP is spending. Another hot summer without the world cup to compensate would not be helpful.
- **Investment summary:** DPP has a powerful retail consumer franchise in a fast-developing economy. A Domino's Pizza franchise takes time to reach profitability, leaving management with a choice between growth and short-term losses. Disruptive competitive activity pushes the path to profitability further into the future, but also grows the delivery market. The model remains sound, in our view.

### Financial summary and valuation

| Year-end Dec (£000) | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|
| Revenue | 7.6 | 10.4 | 12.4 | 12.7 | 16.3 |
| Store EBITDA | 1.5 | 0.7 | 0.7 | 0.4 | 0.6 |
| Group EBITDA | -1.6 | -1.8 | -1.9 | -2.1 | -1.6 |
| EBIT | -2.5 | -2.7 | -3.9 | -3.2 | -2.8 |
| Finance costs | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 |
| PBT | -2.5 | -2.6 | -3.8 | -3.2 | -2.8 |
| PAT | -2.5 | -2.6 | -3.8 | -3.2 | -2.8 |
| EPS (p) | -1.9 | -1.9 | -2.5 | -1.4 | -1.1 |
| EPS (adjusted, p) | -1.8 | -1.9 | -2.6 | -1.4 | -1.1 |
| Net cash | 6.0 | 4.1 | 1.7 | 3.2 | -0.2 |
| Shares issued (m) | 129 | 142 | 150 | 230 | 250 |
| EV/Sales (x) | 3.6 | 2.6 | 1.6 | 1.5 | 1.2 |

*Source: Hardman & Co Research*

## Support Services



*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | **FLTA** |
| Price (p) | 228 |
| 12m High (p) | 282 |
| 12m Low (p) | 180 |
| Shares (m) | 29 |
| Mkt Cap (£m) | 66 |
| EV (£m) | 64 |
| Free Float* | 33% |
| Market | AIM |

**As defined by AIM Rule 26*

### Description

Filta Group (Filta) provides cooking oil filtration, fryer and drain management services in North America and Europe to commercial kitchens.

### Company information

| | |
|---|---|
| CEO | Jason Sayers |
| CFO | Brian Hogan |
| Chairman | Tim Worlledge |

+44 1788 550100
www.filtaplc.com

### Key shareholders

| | |
|---|---|
| Directors | 67% |
| Gresham House | 12.5% |
| Blackrock | 5.6% |
| Ennismore FM | 5.0% |
| Cannacord Genuity | 3.7% |

### Diary

| | |
|---|---|
| Jun'19 | AGM |
| Sep'19 | Interim results |
| Apr'20 | Preliminary results |

### Analyst

Jason Streets 020 7194 7622
js@hardmanandco.com

# FILTA GROUP

## Strong and transformative year in 2018

Filta provides cleaning services to commercial kitchens in North America, the UK and, more recently, mainland Europe. The company reported a strong set of figures for FY18 in April, in line with our expectations. In addition to buying in the European master franchise, it has made a major step in acquiring Watbio, which will increase the company-owned operations and reinforce the UK side of the business. Revenues should prove both consistent and persistent, and there is scope for continuing growth for many years, in our view.

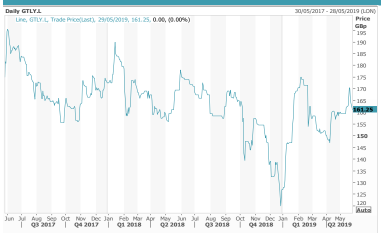
- **Strategy:** Filta provides a professional service, via franchisees, to kitchens to filter their cooking oil, improving taste and saving money. Grease emanating from commercial kitchens also causes problems and needs managing. There is scope for Filta to become the major player in the UK grease management business.
- **FY18 results and outlook:** Filta delivered adjusted EBITDA of £2.64m, up 25% on the previous year and broadly in line with our expectations. Adjusted EPS was up 7% at 5.4p and the full-year dividend was up 26% to 1.64p. The new year is said to have started well, with growth in all core businesses.
- **Valuation:** Filta has no directly comparable companies. We have used a DCF to derive a value range of 226p to 282p per share, using a 10% discount rate and a mid-term (2021-25) growth rate of between 6% and 12%. Our central estimate is 262p. No account is taken of future added-value acquisitions.
- **Risks:** In addition to normal commercial risks, Filta is dependent on the behaviour of its franchisees, which it cannot control but can help to influence by means of thorough training. It has also recently made a sizeable acquisition, the integration of which will inevitably involve managing some unknowns.
- **Investment summary:** Filta is an attractive business, in our view, combining the capital-light franchise model in North America and Europe with company-owned operations in the UK. With only a tiny proportion of the market currently served and with little or no competition, we see potential for years of profitable growth ahead. Please see our initiation report *'Cleaning up in commercial catering'* published on 3 April 2019.

### Financial summary and valuation

| Year-end Dec (£000) | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Revenue | 7,925 | 8,469 | 11,547 | 14,213 | 26,363 | 29,626 |
| EBITDA | 594 | 1,193 | 2,116 | 2,642 | 4,850 | 5,350 |
| Underlying EBIT | 450 | 1,011 | 2,059 | 1,941 | 4,000 | 4,550 |
| Reported EBIT | 450 | -249 | 1,699 | 1,782 | 3,850 | 4,350 |
| Underlying PTP | 376 | 932 | 1,968 | 1,900 | 3,750 | 4,300 |
| Statutory PTP | 376 | -329 | 1,608 | 1,742 | 3,600 | 4,100 |
| Underlying EPS (p) | 1.39 | 3.66 | 5.05 | 5.39 | 9.88 | 11.25 |
| Statutory EPS (p) | 1.39 | -1.51 | 3.85 | 4.88 | 9.37 | 10.57 |
| Net (debt)/cash | -619 | 3,271 | 2,992 | 2,040 | 2,723 | 5,289 |
| Shares issued (m) | 22 | 23 | 27 | 27 | 29 | 29 |
| P/E (x) | 162.0 | 61.5 | 44.5 | 42.3 | 23.1 | 20.3 |
| EV/EBITDA (x) | 83.5 | 40.1 | 27.6 | 22.9 | 13.1 | 11.5 |

*Source: Hardman & Co Research*

## Business Support Services



*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **GTLY** |
| Price (p) | **161** |
| 12m High (p) | 180 |
| 12m Low (p) | 118 |
| Shares (m) | 110.8 |
| Mkt Cap (£m) | 177 |
| EV (£m) | 177 |
| Free Float* | >40% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Gateley provides legal services predominantly through its UK offices. In 2015, it was the first, and remains the only, full-service commercial law firm to float.

## Company information

| | |
|---|---|
| CEO | Michael Ward |
| Finance Director | Neil Smith |
| Chairman (non-exec.) | Nigel Payne |

+44 121 234 0000
www.gateleyplc.com

## Key shareholders

| | |
|---|---|
| Executive Directors | 4.9% |
| Liontrust | 10.1% |
| Miton | 5.0% |
| Premier | 3.8% |

## Diary

| | |
|---|---|
| 16 Jul | Trading update |

## Analyst

Steve Clapham 020 7194 7622
sc@hardmanandco.com

# GATELEY (HOLDINGS) PLC

## Strong 2H performance

This month, Gateley issued a trading update ahead of final results, confirming a strong 2H performance – our forecasts are unchanged. A broad-based law-led professional services group, Gateley is a leader in serving the UK mid-market. It is delivering on its pre-IPO plan, growing revenue, profit, breadth of service offering and geographical footprint since flotation. The interims were notable for strong cash generation and organic revenue growth, and a significant contribution (10% of revenues) from acquisitions. Gateley has also made two highly complementary acquisitions this year, for shares and cash, which are adding to the excellent organic growth. A recent placing has improved liquidity.

- **Current trading:** The group issued its trading statement, ahead of results, due on 16 July. Trading has remained strong, revenues this year should exceed £102m, and EBITDA will be not less than £19m. This was reassuring commentary and in line with our forecasts, which we have not changed. It also included a reference to increased dividends, and the CEO made additional positive comments (see below).
- **News:** The CEO commented, "I am delighted that the business has broken the £100m turnover barrier for the first time and delivered another excellent performance, whilst continuing to take advantage of further opportunities to diversify our revenue streams through complementary acquisitions."
- **Sector:** The legal sector is growing profitably, and more firms, notably DWF recently, are coming to the market, following Gateley's lead. A larger sector is a positive, as it improves investor understanding and ability to compare. This should favour Gateley, which has improved from 48th to 44th position in the latest industry rankings, and for which we forecast continued growth.
- **Valuation:** The 2019E P/E is 14.3x, falling to just 12.4x in 2020E, on numbers we believe are conservative. We forecast the dividend yield to reach 5% this year, and it should continue to grow. Professional service companies like this have limited capital expenditure, with working capital the main element of cash outflow, as the business grows, allowing the creation of strong returns and high free cashflow generation – an attractive combination.
- **Investment summary:** Gateley is a fully invested, consistent performer in a new and exciting space, which is likely increasingly to attract investor attention. It is a high-quality professional services group with significant growth potential, an excellent track record of delivery, a strong management team, and a strategy to diversify further in complementary professional services.

## Financial summary and valuation

| Year-end Apr (£m) | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|
| Sales | 67.1 | 77.6 | 86.1 | 102.7 | 112.9 |
| EBITDA* | 12.9 | 14.9 | 16.5 | 19.5 | 22.1 |
| PBT (adjusted) | 12.0 | 13.8 | 14.1 | 16.0 | 18.5 |
| EPS (adjusted, p) | 9.1 | 9.4 | 10.6 | 11.3 | 13.0 |
| DPS (p) | 5.6 | 6.6 | 7.0 | 8.0 | 8.8 |
| Net cash | -4.2 | -4.8 | -0.7 | -0.5 | 6.8 |
| P/E | 17.7 | 17.1 | 15.2 | 14.3 | 12.4 |
| EV/EBITDA | 13.4 | 11.9 | 10.5 | 9.2 | 7.8 |
| Dividend yield | 3.5% | 4.1% | 4.3% | 5.0% | 5.5% |

**Pre-share-based costs; Source: Hardman & Co Research*

# GENEDRIVE PLC

## No news updates; year-end approaching

**genedrive plc (GDR) is a commercial-stage company focused on point-of-care (PoC) molecular diagnostics. Its Genedrive® molecular diagnostic platform is at the forefront of this technology, offering a rapid, low-cost, simple-to-use device with high sensitivity and specificity in the diagnosis of infectious diseases. Rapid analysis of patient samples greatly aids clinical and public health decision-making, particularly in remote areas of developing countries. Strategic progress in 2018 generated the first product sales in hepatitis C and, in 1H'19, delivered the first product sales in the Bio-threat market to the US Department of Defense (DoD).**

- **Strategy:** Now that the Genedrive technology platform has received CE marking, management has completely re-focused the company onto the commercialisation pathway for gene-based diagnostics in Hepatitis C, tuberculosis, Bio-threats, and antibiotic-induced hearing loss (AIHL), divesting its Services unit in June 2018.

- **Interim results:** The mix of group sales in the period was significantly changed compared with 1H'18, with a considerably greater contribution from product sales in 1H'19. 1H'19 was the first reporting period to include commercial product sales from the DoD, and it was the first full period without the Services business.
- **Sales:** Product sales (consisting of Genedrive unit, HCV assay and DoD sales) contributed £0.8m (£0.0m) to the £1.5m gross income in the six-month period. This included the first commercial order from the DoD of \$0.9m/£0.7m. An additional order, of \$0.5m/£0.4m, was made in 2H'19 – a solid validation of GDR.
- **Risks:** The platform technology has been de-risked through the receipt of CE marking for its assay for detection of HCV infection. The main risk is commercial, given that it often takes time for new technologies to be adopted. However, partnering with major global and local experts reduces this risk.

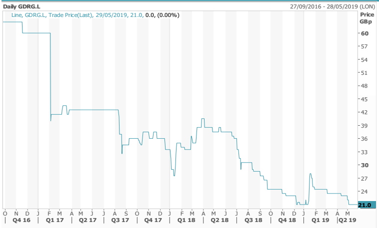
- **Investment summary:** Genedrive technology ticks all the boxes of an 'ideal' *in vitro* diagnostic that satisfies the need for powerful molecular diagnostics at the point of care/need. The hepatitis C market is a very large global opportunity, and the HCV-ID test has excellent potential, even in developing countries. With strong partners being signed for different countries, such as the NHS in the UK, and evidence of early sales traction, GDR is at a very interesting inflection point.

### Financial summary and valuation

| Year-end Jun (£000) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| Group sales | 5,063 | 5,785 | 1,938 | 2,529 | 4,055 | 7,014 |
| Underlying EBIT | -5,259 | -4,812 | -5,276 | -4,435 | -2,979 | -205 |
| Reported EBIT | -5,426 | -7,292 | -7,375 | -3,820 | -3,010 | -247 |
| Underlying PBT | -5,828 | -5,316 | -5,794 | -5,046 | -3,867 | -1,112 |
| Statutory PBT | -6,497 | -7,487 | -7,788 | -4,107 | -3,897 | -1,155 |
| Underlying EPS (p) | -49.8 | -23.1 | -26.9 | -14.8 | -9.3 | -1.5 |
| Statutory EPS (p) | -56.2 | -34.9 | -31.9 | -11.4 | -9.4 | -1.6 |
| DPS (p) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net (debt)/cash | -3,877 | -70 | -2,096 | -3,765 | -5,922 | -5,741 |
| Capital increases | 0 | 6,023 | 0 | 3,318 | 0 | 0 |
| P/E (x) | -0.4 | -0.9 | -0.8 | -1.4 | -2.2 | -13.8 |
| EV/sales (x) | 1.9 | 1.7 | 5.0 | 3.8 | 2.4 | 1.4 |

*Source: Hardman & Co Life Sciences Research*

### Pharmaceuticals & Biotechnology



*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | GDR |
| Price (p) | 21.0 |
| 12m High (p) | 37.5 |
| 12m Low (p) | 18.0 |
| Shares (m) | 34.0 |
| Mkt Cap (£m) | 7.1 |
| EV (£m) | 9.7 |
| Free Float* | 42% |
| Market | AIM |

**As defined by AIM Rule 26*

### Description

Genedrive is a disruptive platform designed to bring the power of central laboratory molecular diagnostics to the point-of-care/need setting in a low-cost device, offering fast and accurate results, initially for diagnosis of serious infectious diseases such as hepatitis.

### Company information

| | |
|---|---|
| CEO | David Budd |
| CFO | Matthew Fowler |
| Chairman | Ian Gilham |

+44 161 989 0245
www.genedriveplc.com

### Key shareholders

| | |
|---|---|
| Directors | 1.7% |
| Calculus | 19.4% |
| M&G | 15.2% |
| BGF | 12.8% |
| Odey | 5.5% |
| River & Merc. | 5.4% |

### Diary

| | |
|---|---|
| 30 Jun | End of 2019 fiscal year |
| 1H'20 | WHO decision on HCV-ID prequalification |

### Analysts

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mh@hardmanandco.com
Dorothea Hill 020 7194 7626
dmh@hardmanandco.com
Grégoire Pavé 020 7194 7628
gp@hardmanandco.com

HARDMAN&CO.

## Speciality Chemicals

*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **HAYD** |
| Price (p) | **2.0** |
| 12m High (p) | 28.5 |
| 12m Low (p) | 1.8 |
| Shares (m) | 317.7 |
| Mkt Cap (£m) | 6.4 |
| EV (£m) | 2.0 |
| Free Float* | 100% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Haydale is involved in the production and functionalisation of nanomaterials, with key growth areas being silicon carbide (75% of revenues), functionalised inks and graphene composites.

## Company information

| | |
|---|---|
| CEO | Keith Broadbent |
| CFO | Laura Redman-Thomas |
| Chairman | David Banks |

+44 1269 842946
www.haydale.co.uk

## Key shareholders

| | |
|---|---|
| Quilter Plc | 11.0% |
| Anthony Best | 8.3% |
| Nichola Audley Money-Kyrle | 5.1% |
| Davis & Monique Newlands | 4.1% |
| Others | 71.5% |
| Quilter Plc | 11.0% |

## Diary

| | |
|---|---|
| Aug'19 | Final results |

## Analyst

Paul Singer 020 7194 7622
ps@hardmanandco.com

# HAYDALE

## A material change

**New and experienced management is re-focusing and re-orientating the business with a major cost-saving programme. Commercial developments are progressing well, and medium-term financial issues have now been addressed. We consider the long-term risk/reward balance to remain favourable and the shares to be attractively valued but we believe they are likely to tread water until there is evidence that the new management team is delivering on its objectives.**

- **Strategic positionings:** The group is focusing on three businesses: i) silicon carbide – nanofibers (SiC) in the US is developing export and new markets with a new high-margin product launch, and is expected to see overall 30% sales growth in the medium term; ii) functionalised inks (15% of revenues) – focus on a number of sectors, including biomedical sensors and pressure sensor inks in the Far East and UK, with high-margin product launches; iii) graphene composites.
- **Financial developments:** The group has recently completed a £5.8m fund raise, with a deep-discounted opening offer and funds being used for working capital, balance sheet support and growth investments. Our forecasts are in line with management's objective to achieve cash breakeven by December 2020. Gross margins should attain ca.65%, with the group remaining in a net cash position.
- **Cost base reduction programme:** Management continues to resize its overhead base to reflect the changes in the sales focus to silicon carbide and smart inks, as opposed to graphene composites. This includes reducing the group's central costs, e.g. marketing and travel, and has already led to a reduction in its annualised SG&A costs of more than £1.0m, with more to come.
- **Investment summary:** Haydale remains well positioned competitively, with a proprietary and recently enhanced nanomaterial functionalisation plasma process. Commercial traction is slow but good, with a healthy order book, and the group has been financially derisked. While we consider the risk/reward balance to remain favourable on a long-term basis, the shares are likely to tread water until there is clear evidence that the new management team is delivering on its objectives.

## Financial summary and valuation

| Year-end Jun (£m) | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Sales | 3.0 | 3.4 | 3.9 | 5.3 |
| Gross profit | 2.1 | 2.0 | 2.2 | 3.4 |
| Grant income | 0.9 | 0.8 | 0.7 | 0.7 |
| EBITDA | -4.3 | -4.9 | -4.6 | -2.2 |
| Underlying EBIT | -5.0 | -5.7 | -5.5 | -3.1 |
| Reported EBIT | -5.3 | -6.0 | -5.8 | -3.4 |
| Underlying PTP | -5.3 | -5.8 | -5.4 | -3.0 |
| Underlying EPS (p) | -0.3 | -22.4 | -2.8 | -0.8 |
| Statutory EPS (p) | -0.3 | -23.7 | -3.0 | -0.9 |
| Net (debt)/cash | 0.8 | 4.2 | 4.0 | 1.0 |
| EV/sales (x) | **0.8** | **0.7** | **0.6** | **0.5** |

*Source: Hardman & Co Research*

## General Retailers

Source: Refinitiv

## Market data

| | |
|---|---|
| EPIC/TKR | **KOOV** |
| Price (p) | **6.7** |
| 12m High (p) | 28 |
| 12m Low (p) | 6 |
| Shares (m) | 402 |
| Mkt Cap (£m) | 27 |
| EV (£m) | 22 |
| Free Float* | 40% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Koovs is an online retailer of fashion across India. It has an experienced management team, growing brand awareness and the highest Net Promoter Score (NPS) in its vertical.

## Company information

| | |
|---|---|
| CEO | Mary Turner |
| CFO | Rob Pursell |
| Chairman | Waheed Alli |

+44 20 7151 0170
www.koovs.com

## Key shareholders

| | |
|---|---|
| Waheed Alli (Dir.) | 12% |
| Anant Nahata (Dir.) | 11% |
| Michinoko | 5% |
| Ruffer | 5% |
| Hindustan Times Media | 15% |
| Future Group | 16% |

## Diary

| | |
|---|---|
| Jun'19 | Preliminary results |

## Analyst

Jason Streets 020 7194 7622
js@hardmanandco.com

# KOOVS PLC

## Koovs refinanced for the future

**The first part (£3.7m) of the investment by the Future Group (FLFL), which, when completed, will take its stake up to 29.99%, has been received. The second part (£10.5m), in the form of a compulsory convertible, will be subscribed following approval at an EGM. Koovs is now well placed to build on the success it has had to date in creating India's leading fashion e-tailer. The cash injection and the support of Future should enable it to resume its growth path and surf the growth of Indian e-commerce. Calendar 1Q saw GOV up 67% as operations began to get back on track.**

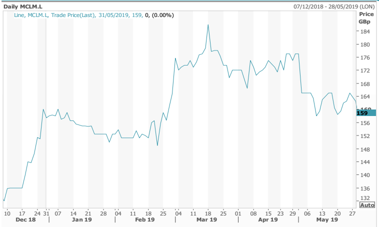
- **Strategy:** Koovs sells affordable fashion online in India. It has an established customer base of half a million active users, and has been growing brand recognition rapidly. It has achieved the highest NPS across its vertical. Its success will come on the back of the growing Indian economy breeding millions of online shoppers.
- **Partner benefits:** FLFL is a huge, nationwide bricks-and-mortar fashion retailer. It is also a vertically integrated business manufacturing its own brands, as well as selling well-known international labels. With Koovs leveraging FLFL's scale and distribution, its revenue and margins should improve much faster.
- **Valuation:** Conventional valuation metrics are unhelpful. We take our forecast EBITDA for Dec-22, apply a Boohoo/ASOS multiple and discount the value back to today. Even at a 25% discount, the EV comes out at £357m, including the funds to be raised. The current price is a poor indicator of the inherent value.
- **Risks:** Now it is refinanced, we see the two key risks being slower uptake of e-commerce in India than we forecast, and damaging discounting by Koovs' direct and indirect competitors. Koovs also needs to manage the relationship with FLFL successfully to optimise its benefits.
- **Investment summary:** With the money raised and the new partners on board, Koovs becomes an exciting way to play the last big world retail market to move online. The prize, if it gets it right, is a billion-pound company and more. It is likely to be a bumpy, exciting ride, but investors have the reassurance of a highly experienced management team in charge, and the backing of two major Indian corporations straddling both retail and media.

## Financial summary and valuation

| Year-end Mar (£m) | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| Visits (m) | 79 | 66 | 116 | 166 | 246 | 312 |
| Conversion | 1.6% | 1.4% | 1.4% | 2.3% | 2.8% | 3.5% |
| No. of orders (m) | 1.25 | 0.92 | 1.62 | 3.74 | 6.75 | 10.93 |
| AOV (£) | 14.75 | 16.37 | 16.74 | 19.00 | 20.58 | 23.29 |
| GOV (£m) | 18.5 | 14.8 | 27.2 | 71.1 | 139.0 | 254.6 |
| Net sales | 12.5 | 9.6 | 16.9 | 44.3 | 86.6 | 158.6 |
| Weighted margin | 43% | 46% | 49% | 53% | 57% | 61% |
| Trading profit | 0.3 | 1.3 | 3.6 | 12.1 | 25.8 | 70.4 |
| Trading margin | 2% | 14% | 21% | 27% | 30% | 44% |
| EBITDA | -20.0 | -14.5 | -19.4 | -18.9 | -7.8 | 17.2 |
| No. of shares (m) | 175 | 175 | 356 | 420 | 420 | 420 |
| EV/sales (x) | 1.1 | 1.5 | 1.0 | 0.4 | 0.2 | 0.1 |

*Source: Hardman & Co Research*

## Financials



Source: Refinitiv

## Market data

| | |
|---|---|
| EPIC/TKR | **MCL** |
| Price (p) | 156.0 |
| 12m High (p) | 186.0 |
| 12m Low (p) | 127.0 |
| Shares (m) | 129.8 |
| Mkt Cap (£m) | 202.0 |
| EV (£m) | 208.2 |
| Free Float* | 60% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Morses Club PLC (MCL) is number two in UK home credit. It is growing the business organically and by acquisition, and is developing a range of related products, where it has a competitive advantage.

## Company information

| | |
|---|---|
| CEO | Paul Smith |
| CFO | Andy Thomson |
| Non-Exec. Chairman | Stephen Karle |

+44 330 045 0719
www. morsesclubplc.com

## Key shareholders

| | |
|---|---|
| Hay Wain | 36.82% |
| Woodford Inv. Mgt. | 9.33% |
| Miton Asset Mgt. | 9.03% |
| JO Hambro | 6.74% |
| Majedie Asset Mgt. | 5.34% |
| Artemis Inv. Mgt. | 4.98% |
| Legal and General | 3.22% |

## Diary

| | |
|---|---|
| 25 Jun | AGM |

## Analyst

Mark Thomas 020 7194 7622
mt@hardmanandco.com

# MORSES CLUB PLC

## Positive takeaways from FY'19 results

**We took two key messages from the FY'19 results; see our note, '*Steady, reliable core, growth in new business lines'*, published 3 May. First the core business is in a reliable, steady state with modest organic volume growth. It should generate profit growth from acquisitions and technology-driven efficiency improvements. The agent remains core to the group but incremental returns can be generated from managing them better. Controlled growth is being driven from the new business lines. Management has indicated it expects FY'22 pre-tax profits of £3m-£5m from its online lending acquisition, CTL (consideration was £8.5m). Our absolute valuation range is now 181p to 243p.**

- **FY'19 results:** Looking through the accounting noise, revenue was up 6%, credit issued by 2.4%, and the net loan book by 6%. Efficiency continued to improve with adjusted pre-tax profits up 14.6%. Impairments remained well controlled (22.4% of revenue, like-for-like FY'18 22.5%). Customer numbers increased by 3% to 235k.

- **Outlook:** The CTL deal could introduce some noise (both real and accounting). It will transform the profit and loss account, being a lower-cost but higher-impairments business than home collect. Although FY'19 was a beat against our forecasts, we have at this stage left our FY'20 forecast EPS largely unchanged.

- **Valuation:** We detailed a range of valuation approaches and sensitivities in our initiation note, *Bringing home collect into the 21st century*, published 2 February 2017, and did so again in our results note. The range in absolute valuation methodologies is now 181p to 243p (previously 169p to 223p).

- **Risks:** Credit risk is high (albeit inflated by accounting rules) but MCL adopts the right approach to affordability and credit assessment. Regulatory risk is a factor, although high customer satisfaction suggests a limited need for change. MCL was the first major HCC company to get full FCA authorisation.

- **Investment summary:** MCL is operating in an attractive market. It has a dual-fold strategy that should deliver an improved performance from existing businesses and new growth options. It conservatively manages risk and compliance, especially in new areas. The agent network is the competitive advantage over remote lenders. We forecast an 11.0x February 2020 P/E and a 5.8% February 2020 dividend yield, with 1.6x cover (adjusted earnings).

### Financial summary and valuation

| Year-end Feb (£m) | 2016 | 2017 | 2018* | 2019* | 2020E* | 2021*E |
|---|---|---|---|---|---|---|
| Reported revenue | 90.6 | 99.6 | 110.4 | 117.0 | 139.1 | 150.6 |
| Total impairments | -18.8 | -24.3 | -24.7 | -26.2 | -37.1 | -45.2 |
| Total costs | -53.4 | -56.7 | -65.6 | -67.1 | -77.0 | -78.6 |
| EBITDA | 19.3 | 19.9 | 20.1 | 23.7 | 25.0 | 26.8 |
| Adjusted PBT | 16.8 | 17.7 | 18.6 | 22.0 | 22.9 | 24.7 |
| Statutory PBT | 10.4 | 11.2 | 15.5 | 20.2 | 20.6 | 22.3 |
| Statutory EPS (p) | 6.1 | 6.6 | 9.7 | 12.5 | 13.0 | 14.1 |
| Adjusted EPS (p) | 10.2 | 10.8 | 11.4 | 13.6 | 14.2 | 15.3 |
| P/adjusted earnings (x) | 15.2 | 14.5 | 13.7 | 11.5 | 11.0 | 10.2 |
| P/BV (x) | 3.6 | 3.3 | 3.0 | 2.9 | 2.6 | 2.5 |
| P/tangible book | 4.5 | 3.9 | 3.5 | 3.3 | 3.0 | 2.7 |
| Dividend yield | n/m | 4.1% | 4.5% | 5.0% | 5.8% | 6.4% |

**IFRS9 basis (2018 pro forma]; Source: Hardman & Co Research*

# MURGITROYD

## Global market and global presence

**Growth continues to be driven by a number of different inputs. The industry statistics confirm a strong market background. The European Patent Office (EPO) announced (12 March) a 4.6% rise in patent applications in 2018. Murgitroyd has a good footprint in the USA – a strong market. It has expanded its service offering and, although this is slightly lower-margin, it brings a pipeline of higher-margin attorney business opportunities via its larger multi-service clients. Murgitroyd expands its specialisms, in part, through acquisitions. Together, these business streams generate attractive levels of cashflow, after substantial investment in business development functions.**

- **Strategy**: Four years of significant investment in the US and pan-European footprint, software and business development, as well as back-office efficiencies, put Murgitroyd in a strong competitive position to help offset any weakness in individual markets. This is a broadly-based business with good cash generation.
- **Did you know**? April 26 was World Intellectual Property day. On this date, in 1970, the convention establishing the World Intellectual Property Organization (WIPO) entered into force. The day was established by the WIPO in 2000. This is a highly structured market.
- **Acquisition and Board:** It has previously been announced that Edward Murgitroyd is to become group CEO. On 5 April, he stood down from the deputy chairmanship, with Willie MacDiarmid taking on that role. He is chair of a JV between Hermes Capital and EDF Renewables, as well as other businesses, and has been CEO and COO of several major quoted businesses.
- **Risks:** The offer of a broad suite of services to a broad customer base, in focused markets, balances the group. This is a reasonably stable, growing global market, with pricing pressure as an ongoing feature. This is not new, and Murgitroyd's global strategy is designed around this given feature, delivering cash well.
- **Investment summary:** Four years of significant investment in the pan-European footprint, and in software and business development, as well as back-office efficiencies, have put Murgitroyd in a strong position for both client-service (the fuller-suite range of services) and productivity (a value-engineered proposition).

**Financial summary and valuation (NB forecasts under review)**

| Year-end May (£m) | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| Sales | 38.4 | 39.8 | 42.2 | 44.3 | 43.9 |
| EBITDA | 4.6 | 4.5 | 4.6 | 4.2 | 4.5 |
| PBT (adjusted) | 4.2 | 4.2 | 4.3 | 3.9 | 4.1 |
| EPS (adjusted, p) | 33.6 | 34.8 | 35.3 | 28.7 | 30.8 |
| DPS (p) | 13.3 | 14.8 | 16.0 | 17.0 | 21.0 |
| Net (debt)/cash | -0.4 | 0.7 | 2.8 | 2.2 | 2.8 |
| Net debt/EBITDA (x) | 0.1 | cash | cash | cash | cash |
| P/E (x) | 16.9 | 16.3 | 15.7 | 19.7 | 18.2 |
| EV/Sales (x) | 1.3 | 1.2 | 1.2 | 1.1 | 1.1 |
| EV/EBITDA (x) | 10.6 | 10.8 | 10.6 | 11.6 | 10.8 |
| FCF yield | 6.2% | 5.7% | 7.2% | 6.2% | 5.8% |
| Dividend yield | 2.4% | 2.6% | 2.8% | 3.0% | 3.8% |

*Source: Hardman & Co Research*

**Support Services**

*Source: Refinitiv*

**Market data**

| | |
|---|---|
| EPIC/TKR | MUR |
| Price (p) | 565 |
| 12m High (p) | 730 |
| 12m Low (p) | 450 |
| Shares (m) | 9.0 |
| Mkt Cap (£m) | 50.9 |
| EV (£m) | 48.8 |
| Free Float* | 53% |
| Market | AIM |

**As defined by AIM Rule 26*

**Description**

Murgitroyd offers a global service to clients on patents, trademarks, etc. It operates from 15 offices worldwide, and over 50% of its revenues are from the USA.

**Company information**

| | |
|---|---|
| CEO | Edward Murgitroyd |
| CFO | Keith Young |
| Chairman | Ian Murgitroyd |

+44 141 307 8400
www.murgitroyd.com

**Key shareholders**

| | |
|---|---|
| Directors | 32.0% |
| Ian Murgitroyd (director) | 26.7% |
| Lyontrust Inv. | 16.9% |
| Schroder Inv. | 9.9% |
| Mawer Inv. | 4.7% |
| G. E. Murgitroyd | 4.3% |

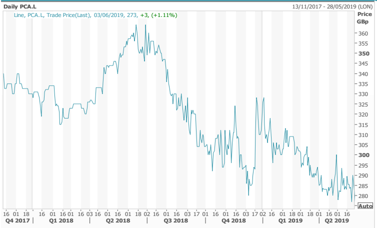
**Diary**

| | |
|---|---|
| Sep'19 | Final results |
| Oct'19 | AGM |

**Analyst**

Mike Foster 020 7194 7633
mf@hardmanandco.com

## Real Estate



Source: Refinitiv

## Market data

| | |
|---|---|
| EPIC/TKR | **PCA** |
| Price (p) | 280 |
| 12m High (p) | 360 |
| 12m Low (p) | 280 |
| Shares (m) | 45.9 |
| Mkt Cap (£m) | 130.0 |
| EV (£m) | 212.0 |
| Market | Main, LSE |

## Description

A real estate investor, diversified by sector (office, industrial predominate) and location, but not in London and minimal exposure to retail. There is an emphasis on city centre locations. The York development site comprises 6% of assets.

## Company information

| | |
|---|---|
| Chairman | Stanley Davis |
| CEO | Neil Sinclair |
| CFO | Stephen Silvester |
| Executive director | Richard Starr |

+44 20 3301 8330
www.palacecapitalplc.com

## Key shareholders

| | |
|---|---|
| AXA | 7.7% |
| Miton | 7.4% |
| J.O.Hambro | 7.3% |
| Stanley Davis (Chairman) | 3.6% |

## Diary

| | |
|---|---|
| 4 Jun | Final results |
| Jul'19 | 4Q'19 div. paid |

## Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

# PALACE CAPITAL

## Progress in Birmingham and results due 4 June

The portfolio update of 2 May showed year-on-year increases in underlying values. A positive lease event at the Birmingham asset resulted in a profit and cash upgrade, announced on 7 May. The loan-to-value (LTV) stood at 33%. Palace Capital took the "strategic decision to hold back on letting some of our vacant space where we see the opportunity to drive value and income potential." Construction has recently commenced for the Hudson Quarter, York, mixed residential-commercial development inside the city walls. This is one of several factors underpinning significant medium-term expansion in capacity to pay growing dividends.

- **Results due on 4 June:** The upcoming results, to year-end March, follow on from the recent positive portfolio update listing rising values. For this reason, Brexit notwithstanding, we look forward to the forthcoming results with confidence, although UK real estate cannot escape the political turbulence.

- **Cash sum received from tenant equating to 129% of Priory House capital value:** The tenant has paid £2.85m to surrender the lease early. The latest value for Priory House, Birmingham is £2.2m, an interesting figure given the £2.85m cash being received. The £2.2m latest valuation was the equivalent of £35 per sq. ft.

- **Priory House, Birmingham:** Note, our FY'20E includes £2.85m income for the lease surrender here. By definition, lease surrender premiums are not recurring items. Nonetheless, the prospects for re-letting are good, in our view. Either way, this is excellent evidence of value creation in discussions with tenants.

- **Risks:** The normal risks of real estate apply. Weighted average length of unexpired lease to break is ca.5.4 years. Generally, covenants are good. Retail exposure (bar Wickes and Booker) is minimal. Gearing, at 30% LTV, is conservative, and although expected to increase as the York development progresses, management has previously stated an intention to keep below 40%.

- **Historical performance strength:** In each of the past five years, Palace Capital's accounting return has been in the first or second quartile vs. our small basket of six most comparable regional UK REITs. (Note that in FY'18, this excludes the distorting effect of equity.) Since 2013, NAV has more than doubled.

## Financial summary and valuation

| Year-end Mar (£m) | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Income | 14.3 | 16.7 | 18.0 | 18.7 |
| Finance cost | -3.0 | -3.4 | -3.9 | -4.1 |
| Declared profit | 12.6 | 13.3 | 10.7 | 9.4 |
| EPRA PBT (adj. pre-revaluation) | 6.3 | 7.3 | 9.2 | 9.4 |
| EPS reported (p) | 36.4 | 35.9 | 20.0 | 17.2 |
| EPRA EPS (p) | 21.2 | 18.7 | 16.8 | 17.2 |
| DPS (p) | 18.5 | 19.0 | 19.0 | 19.0 |
| Net debt | -68.6 | -82.4 | -87.2 | -116.3 |
| Dividend yield | 6.4% | 6.6% | 6.6% | 6.6% |
| Price/EPRA NAV | 64.9% | 69.4% | 69.5% | 69.0% |
| NAV (p) | 434.2 | 400.2 | 407.7 | 410.5 |
| EPRA NAV (p) | 443.0 | 414.8 | 414.2 | 417.1 |

Source: Hardman & Co Research

## Real Estate

*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **PHP** |
| Price (p) | 133 |
| 12m High (p) | 135 |
| 12m Low (p) | 106 |
| Shares (m) | 1,110 |
| Mkt Cap (£m) | 1,476 |
| EV (£m) | 2,620 |
| Market | Premium, LSE |

## Description

Primary Health Properties (PHP) is a REIT acquiring and owning modern primary medical properties in the UK, and is expanding into the Republic of Ireland (RoI).

## Company information

| | |
|---|---|
| CEO | Harry Hyman |
| CFO | Richard Howell |
| Chairman | Steven Owen |

+44 20 7451 7050
www.phpgroup.co.uk

## Key shareholders

| | |
|---|---|
| Directors | 1.0% |
| CCLA | 5.4% |
| Blackrock | 4.9% |
| Investec Wealth | 3.3% |
| Vanguard Group | 2.8% |
| Troy Asset | 2.3% |

## Diary

| | |
|---|---|
| 11 Jun | AGM |
| Jul'19 | Interim results |

## Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com

# PRIMARY HEALTH PROPERTIES

## Onwards and upwards

**PHP purchases modern standing stock, and forward-funds repeat development partners. No development risk is taken, on the forward funding, and the strategy is focused tightly on this sector. The PHP-MedicX (MXF) offer, which completed on 14 March, was 'all-shares', on the basis of 0.77 new PHP per one MedicX share. The merger adds to capabilities for sourcing investments and enhances cost (fee and finance-related) efficiencies. 91% of PHP income is backed by the UK or RoI government. Occupancy consistently exceeds 99%. PHP acquires primary medical assets, which are localised hubs providing community-based GP surgeries and other closely related medical services.**

- **Dividend prospects**: The DPS growth is fuelled by an EPRA EPS trend that is rising faster than our model for DPS in the coming years. Cover is building and, at some stage, this should feed through to accelerating DPS growth. Indeed, our DPS growth estimate of 4.5% for 2020 is above the 3.7% we forecast for 2019.
- **Good long-term performance:** This asset class generated greater annual returns, with lower annual volatility through the whole cycle (2007-17), compared with all other major UK asset classes. 10-year returns (from that peak) averaged 7.9% for UK primary medical assets, vs. gilts 6.0%, all-property 4.9% and equities 5.9%.
- **Valuation:** The shares trade at a premium to historical EPRA NAV. In the time-frame of the table below, PHP shares have always traded at above NAV and EPRA NAV. At the last balance sheet, assets were valued at a net initial yield (NIY) of 4.85%.
- **Risks:** Debt maturity is over eight years, from a wide variety of bank and bond sources. PHP reduced cost of debt again in 2018. 2018 DPS cash cover was over 100%, and grew in 2018. Undrawn facilities exceed £200m.
- **Investment summary: PHP has seen 22 years of unbroken dividend growth**. Its merger with complementary MedicX effectively adds well over £800m of investment assets of as high a quality as PHP's, at nil stamp duty cost, saving £4m a year in synergy efficiencies and adding complementary routes to purchase new assets. Expansion into higher cash-generating Irish assets and a falling debt cost enhance EPRA EPS.

**Financial summary and valuation**

| Year-end Dec (£m) | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|
| Income | 66.5 | 71.3 | 76.4 | 118.3 | 135.5 |
| Finance cost | -32.5 | -31.6 | -29.7 | -45.3 | -50.7 |
| Declared profit | 43.6 | 91.9 | 74.3 | 100.7 | 112.2 |
| EPRA PBT (operating) | 26.7 | 31.0 | 36.8 | 60.7 | 72.2 |
| EPS reported (p) | 7.8 | 15.3 | 10.5 | 9.8 | 9.8 |
| EPRA EPS (diluted, p) | 4.7 | 5.1 | 5.2 | 5.9 | 6.3 |
| DPS (p) | 5.12 | 5.25 | 5.40 | 5.60 | 5.85 |
| Net debt | -663.2 | -726.6 | -670.2 | -1212.1 | -1333.3 |
| Dividend yield | 4.0% | 4.1% | 4.2% | 4.3% | 4.5% |
| Price/EPRA NAV (x) | 1.44 | 1.31 | 1.26 | 1.23 | 1.18 |
| NAV per share (p) | 83.5 | 94.7 | 102.5 | 103.3 | 107.1 |
| EPRA NAV per share (p) | 91.1 | 100.7 | 105.1 | 107.4 | 111.2 |

*Source: Hardman & Co Research*

## Food Producers

*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **RE.** |
| Price (p) | **160** |
| 12m High (p) | 344.0 |
| 12m Low (p) | 175.5 |
| Shares Ord (m) | 40.4 |
| Shares Prefs (m) | 72.0 |
| Mkt Cap Ord (£m) | 64.6 |
| Mkt Cap Prefs (£m) | 61.2 |
| EV (£m) | 364.2 |
| Free Float | 30% |
| Market | MAIN |

## Description

R.E.A. Holdings (REA) is engaged in the operation and further development of palm oil plantations in East Kalimantan, Indonesia. The group also owns stone quarrying rights and concessions, and coal mining concessions, which have been contracted out to third-party operators.

## Company information

| | |
|---|---|
| Managing Director | Carol Gysin |
| Chairman | David Blackett |

+44 207 436 7877

www.rea.co.uk

## Key shareholders

| | |
|---|---|
| Directors | 28.6% |
| M & G Investment Mgt. | 15.0% |
| Alcatel Bell Pension Fund | 10.1% |
| Artemis UK | 8.8% |
| Aberforth Partners | 7.3% |

## Diary

| | |
|---|---|
| 20 Jun | AGM |
| Sep'19 | Interim results |

## Analyst

Yingheng Chen 020 7194 7638

yc@hardmanandco.com

# R.E.A. HOLDINGS

## FFB production remains encouraging

**REA's FY'18 results showed a marked recovery in the group's FFB production, with a 50.8% increase YoY, to a record level of 800,050mt, while CPO production increased by over 51%, to 217,721mt. FFB production for the first four months was off to a strong start, with production at some 221,000mt, ahead of management's budget, and representing an 11% increase on the same period in 2018. However, the palm oil price continues to trade at a much weaker level compared with same period last year, averaging ca.$510/mt in May, while the PKO price is at ca.$580/mt.**

- **Production:** So far, the weather pattern has been very stable and good for crop production, and the group continues to see a rise in yield from the increased fertiliser regime, which started in 2H'16. REA is expecting FFB production of some 900,000mt in FY'19.

- **PBJ and financing position:** In August 2018, REA completed the sale of its PBJ estate to Malaysian operator KLK for $85m, equivalent to ca.$11,333/planted ha. The completion of this transaction transformed the group's operation into a more geographically concentrated development project, as well as releasing some financial pressure on the balance sheet.

- **Financing:** The management team recognises the need to deleverage REA's indebtedness. Net debt, with the sale of PBJ, was $189.5m at end-FY'18, from $211.7m in FY'17. Net debt to equity was 72.5%, down from 76.5% in FY'17. A further reduction in cost of borrowings should help reduce some funding risk.

- **Sector valuation:** Palm plantation stocks have fallen out of favour with investors in recent years, due largely to the weak commodity prices. The Asian Palm Oil Plantation Index fell 13.8% in 2018, while the Asian palm plantation sector suffered an 18.2% decrease in valuation, ending at $11,021/planted ha at end-December 2018, vs. $13,468/planted ha at end-December 2017.

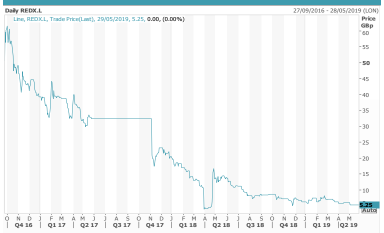
- **Investment summary:** For investors attracted by palm oil assets, now could be an opportunistic time to review the sector, as commodity prices and demand face a brighter outlook in 2H'19. We expect REA to have ca.33,423ha of mature plantations by end-2019, in addition to stronger agricultural production across the estates.

### Financial summary and valuation

| Year-end Dec ($m) | 2015R | 2016 | 2017 | 2018 | 2019E |
|---|---|---|---|---|---|
| Sales | 90.5 | 79.3 | 100.2 | 105.5 | |
| EBITDA | 14.1 | 16.8 | 20.7 | 12.8 | |
| Reported EBIT | -6.6 | -5.0 | -2.2 | -10.8 | Forecasts |
| Pre-tax profit | -12.2 | -9.3 | -21.9 | -5.5 | under |
| EPS (c) | -59.0 | -48.2 | -67.0 | -54.4 | review |
| DPS (p) | 0.0 | 0.0 | 0.0 | 0.0 | pending |
| P/E (x) | - | - | - | - | guidance |
| Net (debt)/cash | -196.7 | -205.1 | -211.7 | -189.5 | |
| Planted hectares (ha) | 37,097 | 42,846 | 44,094 | 36,500 | |
| EV/planted hectare ($/ha)* | 8,680 | 7,471 | 7,245 | 8,529 | |
| CPO production (mt) | 161,844 | 127,697 | 143,916 | 217,721 | |

**EV/planted ha includes mkt. cap. of 9% pref. shares; R=restated. Source: Hardman & Co Research*

## Pharmaceuticals & Biotechnology




*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | REDX |
| Price (p) | 5.3 |
| 12m High (p) | 14.5 |
| 12m Low (p) | 4.8 |
| Shares (m) | 126.5 |
| Mkt Cap (£m) | 6.6 |
| EV (£m) | 0.2 |
| Free Float* | 81% |
| Market | AIM |

*As defined by AIM Rule 26*

### Description

Redx Pharma (REDX) is focused on the discovery and development of proprietary, small molecule therapeutics to address areas of high unmet medical need, in cancer and fibrosis. The aim is to develop putative drugs through early trials and then to partner them for late-stage development and commercialisation.

### Company information

| | |
|---|---|
| CEO | Lisa Anson |
| CFO | James Mead |
| Chairman | Iain Ross |

+44 1625 469 900
www.redxpharma.com

### Key shareholders

| | |
|---|---|
| Directors | 0.6% |
| Jon Moulton | 18.2% |
| Seneca Partners | 12.6% |
| AXA | 9.7% |
| Aviva | 8.2% |
| Paul & Thelka Blackmore | 4.0% |

### Diary

| | |
|---|---|
| 1H'19 | Resume RXC004 Ph. I/IIa |
| 1H'19 | Dev. candidate for NASH |

### Analysts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dmh@hardmanandco.com
Grégoire Pavé 020 7194 7628
gp@hardmanandco.com


# REDX PHARMA

## Looking to extend its cash runway

**REDX is a clinical-stage biotechnology company focused on drugs targeting oncology and fibrotic diseases. A streamlined pipeline in these two disease areas is aimed at progressing drug candidates to deliver clinical proof-of-concept. 2019 is predicted to be a busy year for REDX, with several major milestones. REDX received authorisation from the MHRA to re-commence the Phase I/IIa trial of RXC004 in solid tumours with a revised protocol at a lower dose. Meanwhile, management is in active discussions with both shareholders and third-party healthcare investors regarding initiatives to strengthen its balance sheet and extend its cash runway.**

- **Strategy:** REDX is focused on the discovery and early clinical development of small molecule therapeutics in oncology and fibrotic disease. It is also focused on taking assets through proof-of-concept clinical trials and then partnering them for late-stage development and commercialisation.

- **Strengthening the balance sheet:** The recent receipt in February of a loan repayment extended the cash runway into July 2019, and REDX initiated specific measures to reduce its cost base. One such measure is the agreement with Alderley Park to reduce its accommodation footprint in the company.

- **Cash position:** In order to extend its cash position, REDX is also investigating two separate initiatives: i) a short-term convertible debt financing that will provide REDX with tranches of capital through the emission of convertible notes, and ii) the out-licensing of the pre-clinical pan-RAF research programme.

- **Clinical trial with RXC004 to re-commence:** Following the formal approval from the MHRA to restart the Phase I/IIa trial with its oral porcupine inhibitor, RXC004, in patients with advanced solid tumours, we expect REDX to announce the dosing of the first patient imminently.

- **Investment summary:** The management team is moving forward with an updated business plan that focuses cash resources on progressing its drug leads in oncology and fibrotic disease to proof-of-concept early clinical development. Big pharma can be willing to pay handsome prices for novel and/or de-risked assets with clinical data, reinforcing REDX's strategy. This can generate good returns and shareholder value for companies such as REDX.

### Financial summary and valuation

| Year-end Sep (£m) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| Other income | 2.38 | 1.29 | 1.32 | 1.00 | 1.00 | 1.00 |
| R&D investment | -14.32 | -13.00 | -7.42 | -11.06 | -11.29 | -13.54 |
| SG&A (corp. cost) | -2.21 | -5.70 | -2.81 | -2.59 | -2.74 | -2.88 |
| Underlying EBIT | -14.15 | -17.41 | -8.92 | -12.65 | -13.03 | -15.42 |
| Underlying PBT | -14.61 | -17.74 | -8.90 | -12.64 | -13.02 | -15.42 |
| Statutory PBT | -15.41 | 1.65 | -10.15 | -12.94 | -13.35 | -15.76 |
| R&D tax credit | 0.64 | -0.12 | 1.30 | 1.94 | 1.98 | 2.37 |
| Underlying EPS (p) | -17.83 | -15.80 | -6.01 | -6.70 | -5.72 | -3.06 |
| Statutory EPS (p) | -19.81 | 1.35 | -6.99 | -6.89 | -5.89 | -3.22 |
| Disposals | 0.00 | 30.47 | 0.00 | 0.00 | 0.00 | 0.00 |
| Net (debt)/cash | 3.76 | 23.81 | 6.47 | 8.95 | -2.56 | -16.73 |
| Capital increase | 9.30 | 11.07 | 0.00 | 14.10 | 0.00 | 0.00 |

*Source: Hardman & Co Life Sciences Research*

## Pharmaceuticals & Biotechnology


*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **STX** |
| Price (p) | **114.0** |
| 12m High (p) | 119.5 |
| 12m Low (p) | 24.0 |
| Shares (m) | 117.0 |
| Mkt Cap (£m) | 133.4 |
| EV (£m) | 123.7 |
| Free Float* | 32.5% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Shield Therapeutics (STX) is a commercial-stage pharmaceutical company delivering innovative specialty pharmaceuticals that address patients' unmet medical needs, with an initial focus on anaemia associated with renal and gastrointestinal disorders.

## Company information

| | |
|---|---|
| CEO | Carl Sterritt |
| CFO (Interim) | Tim Watts |
| Chairman | James Karis |

+44 207 186 8500
www.shieldtherapeutics.com

## Key shareholders

| | |
|---|---|
| Directors | 8.9% |
| W. Health | 48.1% |
| MaRu AG | 10.8% |
| R. Griffiths | 7.8% |
| C. Schweiger | 4.8% |
| USS | 4.4% |

## Diary

| | |
|---|---|
| Jun'19 | AGM |
| 27 Jul | Feraccru PDUFA date |

## Analysts

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mh@hardmanandco.com
Dorothea Hill 020 7194 7626
dmh@hardmanandco.com
Grégoire Pavé 020 7194 7628
gp@hardmanandco.com

# SHIELD THERAPEUTICS

## FDA PDUFA date approaching

**STX is a commercial-stage pharmaceutical company delivering specialty products that address patients' unmet medical needs, with an initial focus on treating iron deficiency (ID) with Feraccru®. Following the IPO and EU approval of Feraccru, both in February 2016, STX has made good progress with its clinical and commercial strategy, most recently demonstrating, in a phase 3 trial, that oral Feraccru is as effective as intravenous iron. Management has secured commercialisation agreements and is now awaiting an FDA decision in 3Q'19. The remaining risks lie in US approval and in successful execution of commercialisation.**

- **Strategy:** STX's strategy is to out-license the commercial rights to its products to partners with marketing and distribution expertise in target markets. These agreements allow STX to retain its IP and to continue to invest in its R&D pipeline, while benefiting from immediate and long-term value.

- **Feraccru:** A novel iron replacement therapy, Feraccru is approved across Europe for treatment of ID in adults with or without anaemia. ID results from depletion of iron stores, affecting production of red blood cells (which carry oxygen). Feraccru is well tolerated, having a similar side-effect profile to placebo.

- **Valuation:** A DCF analysis with conservative assumptions generated a risk-adjusted valuation for Feraccru of £184m. This assumes successful commercialisation across Europe and the US in selected patient sub-segments with ID anaemia, to reach annual sales of $640m/£490m at peak.

- **Risks:** All drug companies carry development risk. However, STX has limited risk because of Feraccru's simplicity and clinical profile. Also, Feraccru has already received more than one regulatory approval, and is generating sales. The main risks are commercial execution and the FDA decision on US approval.

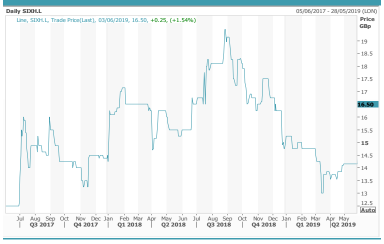
- **Investment summary:** STX is at an exciting juncture. It has delivered on all goals set at the time of its IPO in 2016. Feraccru has been validated by regulatory approval, and the commercial deals in Europe are likely to be repeated in the US. Given its advancement since IPO and its potential, Given Feraccru's benefits over existing iron therapies, and the discrepancy between our rNPV/share of 166p and the current share price of 114p, STX is an interesting opportunity.

## Financial summary and valuation

| Year-end Dec (£m) | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|
| **Gross revenues** | **0.34** | **0.64** | **11.88** | **2.83** | **2.00** |
| Sales | 0.30 | 0.64 | 0.86 | 0.63 | 2.00 |
| R&D | -2.03 | -4.71 | -4.30 | -4.73 | -2.51 |
| Other income | 0.04 | 0.00 | 11.03 | 2.20 | 0.00 |
| EBITDA | -10.29 | -17.92 | -1.80 | -6.30 | -6.45 |
| Underlying EBIT | -10.47 | -18.34 | -2.25 | -6.75 | -6.90 |
| Reported EBIT | -12.46 | -20.95 | -5.17 | -9.67 | -9.82 |
| Underlying PBT | -10.43 | -18.35 | -2.24 | -6.73 | -6.93 |
| Statutory PBT | -15.60 | -20.99 | -5.15 | -9.65 | -9.85 |
| Underlying EPS (p) | -9.73 | -15.08 | 0.96 | -4.62 | -5.60 |
| Statutory EPS (p) | -14.84 | -17.43 | -1.54 | -7.86 | -8.03 |
| Net (debt)/cash | 20.98 | 13.30 | 9.78 | 6.02 | 0.83 |
| Capital increase | 33.51 | 11.88 | 0.00 | 0.00 | 0.00 |

*Source: Hardman & Co Life Sciences Research*

## Industrial Engineering



*Source: Refinitv*

### Market data

| | |
|---|---|
| EPIC/TKR | **SIXH** |
| Price (p) | 15.0 |
| 12m High (p) | 18.5 |
| 12m Low (p) | 13.0 |
| Shares (m) | 113.1 |
| Mkt Cap (£m) | 17.0 |
| EV (£m) | 30.6 |
| Free Float* | 72.1% |
| Market | AIM |

**As defined by AIM Rule 26*

### Description

The 600 Group is a designer and manufacturer of industrial products active in machine tools, components and laser marking. The US represents around 65% of group sales and the UK 15%.

### Company information

| | |
|---|---|
| Executive Chairman | Paul Dupee |
| CFO | Neil Carrick |

+44 1922 707110
www.600group.com

### Key shareholders

| | |
|---|---|
| Haddeo Partners | 20.8% |
| Mr D Grimes (MD of ILS) | 6.6% |
| Mr A Perloff and Maland Pension Fund | 5.8% |
| Miton Group | 3.4% |
| Others | 63.4% |
| Haddeo Partners | 20.8% |

### Diary

| | |
|---|---|
| Jun/Jul'19 | Final results |

### Analyst

Paul Singer 020 7194 7622
ps@hardmanandco.com

# THE 600 GROUP

## Strengthened balance sheet and healthy trading

Monies from the buyout of the pension scheme liability have now been received. Trading is good, with a healthy and improved order book with growth enhanced by new product launches and new market entry. The group remains competitively well positioned, with a world-class reputation in machine tools and laser marking. The shares stand at a discount to the peer group and to a DCF valuation, and we now believe they offer an appealing yield.

- **Recent developments:** Monies from the buyout of the pension scheme liability have now been received. The £4.1m (net of tax) received is slightly better than expected. The monies strengthen the balance sheet and are to be used for possible acquisitions, and provide greater financial flexibility for the group.

- **Prospects:** The most recent trading update is positive, with 2H'18/'19 trading solid and results in line with management expectations. Despite the macroeconomic and political (trade war/Brexit) uncertainties, enquiry and quotational activity have remained good, with further progress in the group's order book.

- **Restructuring programme:** The group has undertaken a UK restructuring programme to reduce capex requirements and further improve margins in both 2H'18/'19 and the medium term. Opportunities are also available for operational and distribution synergy benefits.

- **Competitive position:** The 600 Group has strong global brand recognition, with, as a key differentiator, the provision of high-service/customer support. The group is regarded as well positioned within highly competitive and fragmented industries, where barriers to entry are generally low.

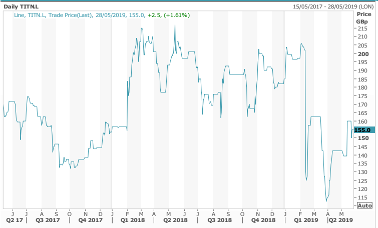
- **Investment summary:** The shares offer the opportunity to invest in a de-risked cyclical stock with good operational leverage, enhanced by new product launches and new market entry. Cyclicality has been de-risked through development of repeat/recurring business and activities in high-margin, economically less sensitive spares/services operations. The risk/reward profile is favourable, and the shares stand at a discount to the peer group with an appealing yield, in our view.

### Financial summary and valuation

| Year-end Mar ($m) | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|
| Sales | 58.8 | 66.0 | 69.7 | 73.9 |
| Gross profit | 20.5 | 23.0 | 24.4 | 25.8 |
| EBITDA | 4.5 | 4.9 | 5.4 | 6.0 |
| Underlying EBIT | 3.8 | 4.2 | 4.8 | 5.4 |
| Underlying PTP | 2.7 | 3.1 | 3.7 | 4.4 |
| Underlying EPS (c) | 2.7 | 3.2 | 3.1 | 3.6 |
| Statutory EPS (c) | 2.7 | 3.7 | 3.1 | 3.6 |
| Net (debt)/cash | -17.1 | -15.6 | -15.7 | -8.9 |
| Dividend (p) | 0.00 | 0.50 | 0.60 | 0.72 |
| P/E (x) | 5.6 | 6.1 | 6.1 | 5.5 |
| Dividend yield | | 3.3% | 4.0% | 4.8% |

*Source: Hardman & Co Research*

## Construction & Materials



Source: Refinitiv

## Market data

| | |
|---|---|
| EPIC/TKR | TON |
| Price (p) | 155.0 |
| 12m High (p) | 208.0 |
| 12m Low (p) | 112.5 |
| Shares (m) | 11.1 |
| Mkt Cap (£m) | 17.2 |
| EV (£m) | 15.5 |
| Free Float* | 97% |
| Market | AIM |

*As defined by AIM Rule 26

## Description

Titon designs, manufactures and supplies a comprehensive range of passive and powered ventilation products; plus, handles, hinges and locking for doors and windows. "The home of domestic ventilation systems and door and window hardware".

## Company information

| | |
|---|---|
| Executive Chairman | Keith Ritchie |
| Chief Executive | David Ruffell |

+44 1206 713 800
www.titonholdings.com

## Key shareholders

| | |
|---|---|
| Rights & Issues IT | 11.4% |
| MI Discretionary UF | 7.2% |
| Chairman | 8.8% |
| Other Directors | 7.9% |
| Founder/NED | 15.7% |
| Family | 6.8% |

## Diary

| | |
|---|---|
| 30 Sep | Year-end |
| Dec'19 | Preliminary results |

## Analyst

Tony Williams 020 7194 7
tw@hardmanandco.com

# TITON HOLDINGS PLC

## You need hands

Failure to applaud is the original meaning of the idiom 'to sit on your hands'; it originated in the theatre, when an unimpressed audience refused to clap. In the modern lexicon, it means to remain idle when things go awry and when action is required. Titon has had a charmed run over the past three years but this year has met with a tough South Korean crowd. But "it is not in Titon's nature to sit on its hands", and its decisive action will produce results in fiscal 2020 and 2021, and win the critical success Titon is used to.

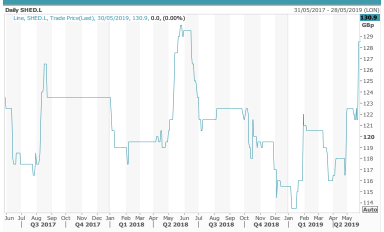
- **Hand 1:** On 15 May, Titon promulgated its half-year figures, which were impressive with EBITDA rising 29% to £1.35m, EBIT margins widening from 4.9% to 6.9% and underlying pre-tax profit surging 26% to £1.30m. However, the comparatives were flattered by the restatement of fiscal 2018 due to an accounting issue.
- **Hand 2:** On 14 February, Titon issued an unscheduled trading statement in respect of its star-turn South Korean business. There had been a slowdown in the new residential market and a structural shift in product preference, which meant that the trading performance would be substantially lower than forecast at that time.
- **Hand 3:** In South Korea, the group has been quick to act, lowering overheads and costs. At the same time, it has enacted plans to introduce new ventilation (mechanical and natural) to the market early in 2020. More broadly, too, the South Korean economy, number 12 in the World, continues to grow at 2.6% (2019) and 2.8% (2020), according to Statista, and is the envy of its peers.
- **Hand 4:** The UK is something of a Steady Eddie (supported by 1%-2% Brexit-compliant GDP growth) while Continental Europe and the US should move from loss to profit this year. That said, fiscal 2019 will be unpopular with group pre-tax profit sharply lower (due to current period issues in South Korea). Revised numbers for 2020 and 2021, though, show Titon returning to growth and into double digits.
- **Hand 5:** The Hardman UK Building Materials Sector comprises 23 companies with a market value of £8.55bn and a valuation of 9.2x EV/EBITDA on a trailing 12-month basis (priced on 28 May) or 12.5x weighted by market capitalisation. Titon is on just 5.8x (albeit rising 6.6x prospective). At the same time, the Sector's Total Shareholder Return (TSR) is 1.0% actual or 8.8% weighted. Titon is at -22.0%, having been at +17.7% in calendar 2018. Investors will stand up and clap again.

## Financial summary and valuation

| Year-end Sep (£m) | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|
| Net revenue | 29.9 | 28.3 | 30.1 | 31.8 |
| EBITDA | 2.67 | 2.42 | 2.47 | 2.75 |
| Underlying EBIT | 2.02 | 1.71 | 1.69 | 1.89 |
| Underlying PBT | 2.77 | 2.21 | 2.30 | 2.60 |
| Underlying EPS (p) | 18.2 | 16.1 | 16.7 | 18.9 |
| Statutory EPS (p) | 18.2 | 14.5 | 16.7 | 18.9 |
| Net (debt)/cash | 3.4 | 3.0 | 3.7 | 4.5 |
| Shares issued (m) | 11.1 | 11.1 | 11.1 | 11.1 |
| P/E (x) | 8.5 | 9.6 | 9.3 | 8.2 |
| EV/EBITDA (x) | 5.8 | 6.6 | 6.2 | 5.3 |
| DPS (p) | 4.75 | 4.75 | 5.00 | 5.50 |
| Dividend yield | 3.1% | 3.1% | 3.2% | 3.5% |

Source: Hardman & Co Research

## Real Estate



*Source: Refinitiv*

| Market data | |
|---|---|
| EPIC/TKR | SHED |
| Price (p) | 130 |
| 12m High (p) | 130 |
| 12m Low (p) | 113 |
| Shares (m) | 87.8 |
| Mkt Cap (£m) | 114 |
| EV (£m) | 176 |
| Market | AIM |

### Description

This REIT focuses on strategically located (e.g. urban "last mile"), smaller (typically ca.70,000 sq. ft.) single-let industrial and logistics properties, servicing high-quality tenants. The market is in strategic under-supply.

### Company information

| | |
|---|---|
| CEO | Richard Moffitt |
| Chairman | Nigel Rich |

www.urbanlogisticsreit.com
+44 20 7591 1600

### Key shareholders

| | |
|---|---|
| Directors | 1.2% |
| Allianz | 11.8% |
| Rathbone | 11.0% |
| Janus Henderson | 10.5% |
| Sir John Beckwith | 8.0% |
| Premier | 7.9% |
| GLG | 4.4% |

### Diary

| | |
|---|---|
| Mid-Jul'19 | AGM |
| Nov'19 | Interim results |


### Analyst

Mike Foster 020 7194 7633
mf@hardmanandco.com


# URBAN LOGISTICS

## Plenty of future growth stored up

**Urban Logistics' (SHED) results (24 May 2019) were robust. Prospects for continuing value-adding investment and capital recycling are clear and strong. SHED owns "mid-box", "last mile" distribution warehouses. Just as important is that this asset class is clearly placed to benefit consistently from engrained market trends in logistic requirements. SHED's marketplace is broader than the rising demand for logistics space from online (or multichannel) retail, but this driver alone sustains strong demand. Supply is strictly constrained by the dominant trend – that the cost of new-build is generally above the current valuations placed on assets in SHED's category (last-mile logistics).**

- **FY'19 (March): Results** showed an encouraging total accounting return (NAV rise plus dividend) at over 17% and solid asset growth at 41%. The scale of this underlines the sustainable ambition and another year of success since the IPO in April 2016 – and the dichotomy of a sub-NAV share price. Occupancy is 100%.
- **Sector dynamics:** Attention focuses on the different, "big-box" sector. Asset price rises there have bid net initial yields (NIYs) below 6.0%. SHED's average purchase NIY is 7.1%. There is no obvious logic; demand is just as strong and, in SHED's "mid-box" specialism, supply is falling and demand rising.
- **Valuation:** 20% of SHED space has short leases, meaning prospects for growing rental income are clear: current rents are at sub-market levels. SHED adds value through asset management. 80% of tenants are top credit score graded. The share price valuation, at 94% 2019 EPRA NAV, thus appears modest.
- **Risks:** 5.5-year leases mean that there are reversionary rent rises to come, but also that new leases must be secured. In the past ca.20 years, aggregate rent rises have been minimal. So, once rents and values rebase to higher levels and omni-channel retail growth tails off, new macro drivers need to be found.
- **Investment track record:** SHED listed on AIM in April 2016 and has since built a £185m portfolio of warehouses, generating annualised NAV and dividend returns of 17.7%. Across the market, nationwide, vacancies are low, at ca.5% (SHED nil), so there are many years of growth "baked in", yet to come. Market rents have risen to ca.25% above SHED's current £4.83 sq. ft. level.

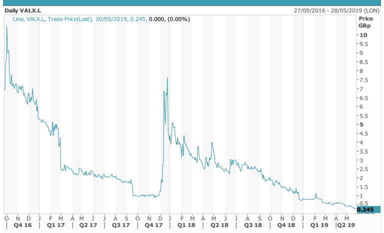
### Financial summary and valuation

| Year-end Mar (£m) | 2017 | 2018 | 2019 | 2020E |
|---|---|---|---|---|
| Rental income | 2.28 | 5.56 | 10.80 | 12.40 |
| Finance costs | -0.60 | -0.93 | -2.20 | -2.80 |
| EPRA operating profit | 1.76 | 4.06 | 8.30 | 10.00 |
| Declared profit | 4.89 | 9.86 | 18.88 | 18.00 |
| EPS reported (p) | 34.12 | 19.50 | 22.29 | 20.52 |
| EPRA EPS (diluted, pre-LTIP, p) | 7.82 | 6.12 | 7.20 | 8.21 |
| DPS (p) | 6.23 | 6.32 | 7.00 | 7.50 |
| Net debt | 16.52 | 44.39 | 61.64 | 67.23 |
| Dividend yield | 4.7% | 4.8% | 5.4% | 5.8% |
| Price/EPRA NAV (x) | 1.12 | 1.06 | 0.94 | 0.88 |
| NAV per share (p) | 118.23 | 123.64 | 137.37 | 147.54 |
| EPRA NAV per share (p) | 116.11 | 122.49 | 138.18 | 148.00 |

*Source: Hardman & Co Research*

HARDMAN&CO.

## Pharmaceuticals & Biotechnology



*Source: Refinitiv*

### Market data

| | |
|---|---|
| EPIC/TKR | **VAL** |
| Price (p) | **0.25** |
| 12m High (p) | 3.44 |
| 12m Low (p) | 0.24 |
| Shares (m) | 681.6 |
| Mkt Cap (£m) | 1.7 |
| EV (£m) | 1.4 |
| Free Float* | 100% |
| Market | AIM |

**As defined by AIM Rule 26*

### Description

ValiRx (VAL) is a clinical-stage biopharmaceutical company focused on novel treatments for cancer. It currently has two products in Phase I/II and has completed Phase II clinical trials. Its business model focuses on out-licensing or partnering drug candidates after clinical trials.

### Company information

| | |
|---|---|
| CEO | Dr Satu Vainikka |
| CFO | Gerry Desler |
| Chairman | Oliver de Giorgio-Miller |

+44 203 008 4416
www.valirx.com

### Key shareholders

| | |
|---|---|
| Directors | 0.3% |
| EHGOSF | 4.5% |

### Diary

| | |
|---|---|
| 21 Jun | General Meeting |
| 2H'19 | Read-out VAL201 |

### Analysts


Martin Hall 020 7194 7631
mh@hardmanandco.com
Dorothea Hill 020 7194 7626
dmh@hardmanandco.com
Grégoire Pavé 020 7194 7628
gp@hardmanandco.com


# VALIRX

## New opportunity ahead

**VAL is a clinical-stage biopharmaceutical company focused on the development of therapeutics for the treatment of cancer. The company has two leading assets: VAL201 (Phase I/II) – a peptide for advanced prostate cancer and potential to treat other hormone-induced indications; and VAL401 (completed Phase II) – a novel reformulation of risperidone, for advanced lung cancer. Both drugs are targeted at multi-billion-dollar markets that are inadequately served by current drugs. To boost its portfolio, VAL is acquiring the IP of FIT Biotech's gene delivery platform, which will be developed through a JV with ABO. A new financing facility is under negotiation.**

- **Strategy:** VAL operates as a virtual business, outsourcing most of its activities. The core strategy is to develop its therapeutic assets through the clinical pathway, and seek a partner/licensing deal to complete the development programme and regulatory submissions to commercialise the products.

- **2018 results:** Final results provided the market with operational and financial updates. VAL201 is progressing well, while ValiSeek has agreed Letters of Intent with two partners to advance VAL401. VAL raised a total of £3.7m to advance its clinical and pre-clinical assets. Net cash at the end of the period was £0.06m.

- **Acquisition/JV:** VAL has acquired the IP for the clinically relevant gene delivery asset of FIT Biotech. Concomitantly, it has entered into a genetic therapeutic and diagnostic-based JV with ABO to develop the asset further. This acquisition provides VAL with a technology with applications in many indications.

- **EHGOSF agreement update:** Following completion of the first tranche of the Subscription agreement, VAL raised £0.33m through the issue of 71m shares. VAL is now renegotiating the whole financing facility with EHGOSF, which will encompass both the Subscription and the Convertible Loan facility.

- **Investment summary:** VAL appears to be under-appreciated by the market. Reasons for this include the lack of institutional shareholders and a continuing need for more capital to advance its clinical programmes, thereby building value. On the back of clinical progress, the company is attracting potential commercial partners to help pay for the costs of late-stage development. This should be the catalyst needed to attract institutional investors into the company.

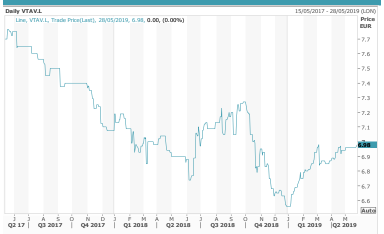
### Financial summary and valuation

| Year-end Dec (£m) | 2015 | 2016 | 2017 | 2018 | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Sales | 0.08 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| SG&A | -1.64 | -1.67 | -1.47 | -1.68 | -1.85 | -1.94 |
| R&D | -1.54 | -2.38 | -1.75 | -1.70 | -2.20 | -2.64 |
| EBITDA | -2.88 | -3.94 | -2.94 | -3.24 | -3.91 | -4.44 |
| Underlying EBIT | -2.98 | -4.04 | -3.13 | -3.38 | -4.05 | -4.58 |
| Reported EBIT | -3.03 | -3.99 | -3.13 | -4.37 | -4.05 | -4.58 |
| Underlying PBT | -2.98 | -4.38 | -3.57 | -3.39 | -4.11 | -4.84 |
| Statutory PBT | -2.57 | -5.57 | -3.55 | -4.83 | -4.11 | -4.84 |
| Underlying EPS (p) | -7.96 | -6.16 | -2.01 | -0.62 | -0.46 | -0.47 |
| Statutory EPS (p) | -6.66 | -8.22 | -2.00 | -0.94 | -0.46 | -0.47 |
| Net cash/(debt) | 0.23 | -0.73 | 0.31 | 0.06 | -2.17 | -6.56 |
| Capital increase | 2.68 | 2.61 | 3.60 | 3.43 | 0.50 | 0.00 |

*Source: Hardman & Co Life Sciences Research*

# VOLTA FINANCE

## Financials



*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | VTA .NA, VTA.LN VTAS LN* |
| Price (€) | 7.00/6.96/612p |
| 12m High (€) | 7.32/7.28/655p |
| 12m Low (€) | 6.44/6.52/585p |
| Shares (m) | 36.6 |
| Mkt Cap (€m) | 256 |
| Trail 12-mth. yield | 8.9% |
| Free Float | 70% |
| Market | AEX, LSE |

**Listing 03 September 2018*

## Description

Volta Finance is a closed-ended, limited liability investment company that pursues a diversified investment strategy across structured finance assets (primarily CLOs). It aims to provide a stable stream of income through quarterly dividends.

## Company information

| | |
|---|---|
| Independent Chairman | Paul Meader |
| Independent Non-Executive Directors | Graham Harrison<br>Stephen Le Page<br>Atosa Moini<br>Paul Varotsis |
| Fund Managers AXA IM Paris | Serge Demay<br>A Martin-Min<br>François Touati |
| Co. sec. /Administrator | BNP Paribas Securities Services SCA, Guernsey Branch |

BNP: +44 1481 750853

www.voltafinance.com

## Key shareholders

| | |
|---|---|
| Axa Group | 30.4% |

## Diary

## Analyst

Mark Thomas 020 7194 7622

mt@hardmanandco.com

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**Volta is a closed-ended, limited liability company registered in Guernsey. Its investment objectives are to seek to preserve capital across the credit cycle and to provide a stable stream of income to its shareholders through dividends that it expects to distribute on a quarterly basis. The rolling 12-month dividend is €0.62 per share (with €0.15/€0.16 per share paid quarterly). The assets in which Volta may invest, either directly or indirectly, include, but are not limited to, corporate credits, sovereign and quasi-sovereign debt, residential mortgage loans, commercial mortgage loans, automobile loans, student loans, credit card receivables, leases, and debt and equity interests in infrastructure projects. The current underlying portfolio risk is virtually all to corporate credits. The investment manager for Volta's assets is AXA Investment Managers Paris, which has a team of experts concentrating on the structured finance markets.**

On 11 December 2018, Volta announced that, after due enquiry, it was the opinion of the Board that the company's shares qualified as an "excluded security" under the rules; the company is therefore excluded from the FCA's restrictions that apply to non-mainstream pooled investments (NMPIs). The Board believes, therefore, that independent financial advisers can recommend the company's shares to retail investors, although financial advisers should seek their own advice on this issue.

Given the regulatory restrictions on distributing research on this company, the monthly book entry for Volta Finance can be accessed through our website (*Volta Finance Ltd Research*). Our initiation report, published on 5 September 2018, can be found on the same site, as can our recent note on the manager's March presentation.

## Personal Products


*Source: Refinitiv*

## Market data

| | |
|---|---|
| EPIC/TKR | **W7L** |
| Price (p) | 105.5 |
| 12m High (p) | 267.5 |
| 12m Low (p) | 72.0 |
| Shares (m) | 76.7 |
| Mkt Cap (£m) | 81.0 |
| EV (£m) | 79.7 |
| Free Float* | 36.1% |
| Market | AIM |

**As defined by AIM Rule 26*

## Description

Warpaint is a UK-based colour cosmetics specialist that sells creative, design-focused and high-quality cosmetics at affordable prices. The company comprises of two divisions: own-brand (W7, Retra and others) and close-out. It has a presence in more than 67 countries.

## Company information

| | |
|---|---|
| Joint CEO | Sam Bazini |
| Joint CEO | Eoin Macleod |
| CFO | Neil Rodol |
| Chairman | Clive Garston |

+44 1753 639 130
www.warpaintlondonplc.com

## Key shareholders

| | |
|---|---|
| Directors | 51.1% |
| Schroders | 12.0% |
| Blackrock | 4.8% |
| BI Asset Mgt. | 4.6% |
| Canaccord | 3.1% |

## Diary

| | |
|---|---|
| Sep'19 | Interim results |

## Analyst

Yingheng Chen 020 7194 7638
yc@hardmanandco.com

# WARPAINT LONDON PLC

## Encouraging international growth

**In the May AGM statement, Warpaint stated that the company continues to see an increase in brand awareness and encouraging growth in international sales, particularly in the EU and the US. However, trading conditions in the UK retail market remain challenging, particularly in the high street, with a reduction in footfall to bricks-and-mortar stores. Warpaint's management team is focusing on implementing its growth strategy and remains cautiously optimistic about the remainder of FY'19. Cash generation remains healthy.**

- **Strategy:** In the near term, Warpaint will continue to focus on developing the own brands, W7 and Technic, and on optimising operations in both Retra and LMS. The group believes that further synergies are still possible. It will also concentrate on increasing its product offerings and raising brand awareness across the globe.
- **LMS integration:** Since the acquisition of LMS in August 2018, Warpaint has opened a new showroom in Manhattan, which will showcase a full range of W7 and most Technic products. It has also opened a fulfilment centre in the US to shorten the lead time to customers in the Americas. The group saw an encouraging start in 1Q, with sales from LMS up 36%.
- **Valuation:** Warpaint remains profitable and cash-generative, despite a challenging trading environment in the UK. We estimate a 2019 P/E of 10.4x, falling to 8.7x in 2020 on an adjusted basis. Warpaint has never made a loss and has a healthy profit margin. The group also has a progressive dividend policy.
- **Risks:** The biggest short-term risk for Warpaint is the ongoing decline in the retail market, particularly in the bricks-and-mortar stores in the UK, given that the UK is the company's biggest market at present, with over 48.2% of sales in FY'18.
- **Investment summary:** The Warpaint story is quite simple. The group's flagship brand, W7, was created to fulfil the ever-increasing demand for creative, design-focused and high-quality cosmetics at affordable prices. The company deploys a similar strategy to its other own-brand products, with a quick product development time and on-trend products, meaning that Warpaint is well positioned for growth in a fast-growing colour cosmetics sector. Warpaint's RoE appears attractive.

### Financial summary and valuation

| Year-end Dec (£m) | 2016 | 2017 | 2018 | 2019E | 2020E | 2021E |
|---|---|---|---|---|---|---|
| Sales | 22.5 | 32.5 | 48.5 | 52.7 | 57.3 | 62.6 |
| EBITDA (adjusted) | 6.3 | 8.0 | 8.9 | 9.8 | 11.5 | 13.1 |
| Operating profit (adjusted) | 6.2 | 7.3 | 5.3 | 7.2 | 8.9 | 10.6 |
| PBT (adjusted)* | 6.1 | 7.7 | 8.2 | 9.0 | 10.9 | 12.7 |
| Basic EPS (adjusted, p)* | 7.9 | 9.6 | 9.1 | 10.1 | 12.1 | 13.9 |
| DPS (p) | 1.5 | 4.0 | 4.4 | 5.0 | 5.8 | 6.7 |
| P/E (x)* | 13.4 | 11.0 | 11.6 | 10.4 | 8.7 | 7.6 |
| EV/EBITDA (x) | 12.7 | 10.0 | 8.9 | 8.1 | 7.0 | 6.1 |
| Dividend yield | 1.4% | 3.8% | 4.2% | 4.7% | 5.5% | 6.4% |
| RoE | - | 20.0% | 8.8% | 13.0% | 15.5% | 17.2% |

**adjusted for amortisation relating to acquisitions, exceptional costs and acquisition-related impairments*

*Source: Hardman & Co Research*

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