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Apiam Animal Health (AHX)

Costs hitting the bottom line

Recommendation
Hold (Buy)
Price
$0.79
Target (12 months)
$0.87 (previously $1.44)

GICS Sector

Food Beverage and Tobacco

Expected Return	
Capital growth	10.1%
Dividend yield	2.0%
Total expected return	12.1%

Company Data & Ratios	
Enterprise value	$101.2m
Market cap	$89.9m
Issued capital	101.2
Free float	72%
Avg. daily val. (52wk)	$102,861
12 month price range	$0.79-1.88

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.13	1.15	1.40
Absolute (%)	-29.20	-30.43	-42.86
Rel market (%)	-27.15	-29.60	-50.76

Higher costs and lower margins drive a softer 2H17

AHX has provided a FY17e trading update with revenues expected to be in a range of $96-98m, a level consistent with our forecast of $97.4m. However, underlying EBITDA guidance of $7.2-8.5m is materially below our $10.5m forecast and implies a material contraction in EBITDA margins from levels reported in 2Q17 (from 11.0% to 7.9-8.6%). The revised guidance range implies a 30-40% YOY decline in EBITDA (from ProForma FY16 EBITDA of $12.1m) despite the benefit of the QVC (in Sep'16) and Allstock (Dec'16) acquisitions in 2H17e. Investment in developing internal capabilities to execute on its growth by acquisition strategy and an unfavourable mix shift are the main drivers of the shortfall.

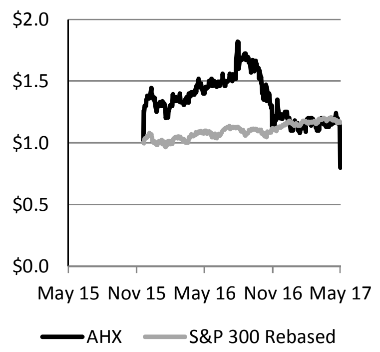
Changes to estimates

We have materially downwardly revised our estimates for AHX, downgrading NPAT by 27% in FY17e, 30% in FY18e and 28% in FY19e. The major driver of the downgrade has been the assumption of higher operating costs. We have also downgraded our target price to $0.87ps (from $1.44ps) with this driven by: (1) a materially lower ProForma (annualised for QVC and Allstock) FY17e ROIC assumption in our EVA based approach; and (2) a higher level of net debt at year end.

Investment view: downgrade to Hold

While some of the seasonal factors (lower dairy production and lower feedlot utilisation) in 1Q17 should reverse in FY18e, the elevated cost structure is likely to persist. While we remain favourably disposed to the theme of a rising production animal base in Australia and AHX's exposure to a consolidating vet and vetchem market, we note an earnings base now 30-40% below ProForma FY16 levels with a higher debt balance from recent acquisitions. On downwardly revised forecasts, AHX does not look compelling value relative to other production animal exposures in the sector and we downgrade our rating from Buy to Hold.

Absolute Price



SOURCE: IRESS

Earnings Forecast

Year end June	2016	2017e	2018e	2019e
Sales ($m)	54.1	97.4	109.7	117.0
EBITDA ($m)	5.5	7.9	10.1	11.4
NPAT (reported) ($m)	0.0	4.1	5.0	6.0
NPAT (adjusted) ($m)	3.3	4.7	5.0	6.0
EPS (adjusted) (cps)	3.3	4.0	4.9	5.8
EPS growth (%)		20.7	23.3	18.3
PER (x)	23.8	19.7	16.0	13.5
FCF Yield (%)	1.2	3.5	2.3	3.9
Adj. EV/EBITDA (x)	18.4	12.8	10.1	8.9
Dividend (¢ps)	0.0	1.6	2.0	2.5
Franking (%)	0.0	100.0	100.0	100.0
Yield (%)	0.0	2.0	2.5	3.2
ROE (%)	17.4	7.7	9.0	10.1

SOURCE: BELL POTTER SECURITIES ESTIMATES

AHX Company overview

COMPANY DESCRIPTION

Apiam Animal Health (AHX) is a vertically integrated animal health business providing a range of services (veterinary services and associated product sales) to production animals (~90% of the business). AHX currently owns 12 leading veterinary practices (across 25 locations) and a wholesaling & logistics business in animal health products with market leading positions in the dairy, beef feedlot and pig sectors.

VALUATION

In deriving a target price for AHX we have utilised an ROIC based approach which looks at the existing asset base on a ProForma basis with an assumption around the incremental earnings uplift we can see emerging over the next three years as AHX takes over recently acquired practices as well as the incremental upside we can see being generated on a fully utilised balance sheet. Major assumptions in this model include and Adjusted (post synergy) ProFroma FY17e ROIC on the base business of 13.6% and a WACC of 9.8%We derive a value of $0.87ps for the existing business.

RISKS

AHX is a stock with high reliance on the outlook of agricultural markets, particularly volumes in the pig, feedlot cattle and dairy sectors. Key risks to an investment in AHX include but are not limited to:

Commodity price risk: Customer production and stocking decisions are typically made based upon commodity prices for end products such as milk, beef, pig, and poultry. Deterioration in farmgate profitability can reduce the size of herds on farms.

Seasonal factors: Adverse weather conditions can diminish the availability of food and reduce water allocations inhibiting the profitability of farms and reducing herd volumes.

Disease: While any outbreak of disease could increase the demand for veterinary services, it can also have long-term impact on the production and customer perceptions of the industry.

Acquisitions risks: AHX has undertaken a large amount of acquisitions, and intends to in part continue with this strategy. There is a risk that these acquisitions may not fully integrate with the business or may not be as profitable as due diligence suggested.

Key supplier/customer risk: AHX procures key pharmaceuticals from key suppliers, and also provides services to key customers. Any loss or interruption of service of a large customer or supplier could adversely affect the company’s operations and performance.

Technology: AHX’s sales are managed through its proprietary IT platform. Any disruption of service could adversely affect performance. In addition, any advances from competitors could supersede the company’s current product offering.

Competition: Any new entrants or developments with existing veterinarians in the market could result in a material reduction in market share or margins.

Apiam Animal Health
as at 26 May 2017

Recommendation	Hold
Price	$0.79
Target (12 months)	$0.87

Table 1 - Financial summary

June Year end	2013	2014	2015	2016	2017e	2018e	2019e
Profit & Loss (A$m)							
Sales revenue	69.4	76.6	79.5	54.1	97.4	109.7	117.0
. . . Change		10.5%	3.7%	n.a.	80.1%	12.6%	6.7%
EBITDA	8.2	10.0	10.7	5.5	7.9	10.1	11.4
Deprec. & amort.				(0.6)	(1.4)	(1.6)	(1.6)
EBIT				4.9	6.5	8.5	9.8
Interest expense				(0.4)	(1.1)	(1.2)	(1.2)
Pre-tax profit				4.5	5.5	7.3	8.6
Tax expense				(1.1)	(1.3)	(2.2)	(2.6)
. . . tax rate				25%	25%	30%	30%
Minorities				(0.0)	(0.1)	(0.1)	(0.1)
Net Profit				**3.3**	**4.1**	**5.0**	**6.0**
Abs. & extras.				(3.2)	0.7	0.0	0.0
Reported Profit				**0.0**	**4.7**	**5.0**	**6.0**
Cashflow (A$m)							
EBITDA				5.5	7.9	10.1	11.4
Tax Paid				(1.3)	(2.2)	(1.8)	(2.4)
Net Interest Expense				(0.4)	(1.1)	(1.2)	(1.2)
Change in Wkg Capital				(3.0)	0.6	(1.9)	(1.1)
Other				0.5	(0.2)	0.0	0.0
Operating Cash Flow				**1.2**	**5.0**	**5.2**	**6.7**
Capex				(0.3)	(1.4)	(1.6)	(1.6)
Div Paid				0.0	(0.8)	(1.8)	(2.0)
Free Cash Flow				**0.9**	**2.8**	**1.8**	**3.1**
Acquisitions				(24.1)	(12.8)	0.0	0.0
Disposals				0.0	0.0	0.0	0.0
Share Issues (incl DRP)				20.0	4.1	0.0	0.0
Other				3.2	0.0	0.0	0.0
(Inc.) /dec. in net debt				**0.1**	**(5.9)**	**1.8**	**3.1**
Balance Sheet (A$m)							
Cash & near cash				2.12	2.12	2.12	8.62
Receivables				13.3	14.3	16.1	17.2
Inventories & WIP				10.2	11.0	12.4	13.2
Other Current assets				0.4	0.4	0.4	0.4
Current assets				**25.9**	**27.8**	**31.0**	**39.4**
Fixed assets				4.5	6.2	6.2	6.2
Investments				0.0	0.0	0.0	0.0
Goodwill				44.7	52.8	52.8	52.8
Other intangibles				0.0	0.0	0.0	0.0
Other assets				3.0	3.0	3.0	3.0
Non current assets				**52.2**	**62.0**	**62.0**	**62.0**
Total assets				**78.1**	**89.8**	**93.0**	**101.4**
Creditors				9.5	10.3	11.6	12.3
Current borrowings				4.1	4.1	4.1	4.1
Other current liabilities				6.1	3.9	4.6	5.4
Current liabilities				**19.7**	**18.4**	**20.3**	**21.9**
Non-current borrowings				11.9	17.8	15.9	19.3
Other liabilities				0.2	0.2	0.2	0.2
Non-current liabilities				**12.1**	**18.0**	**16.2**	**19.6**
Total liabilities				**31.8**	**36.3**	**36.5**	**41.5**
Net assets				**46.3**	**53.5**	**56.5**	**60.0**
Share capital				79.1	83.2	83.2	83.2
Reserves				(26.7)	(26.7)	(26.7)	(26.7)
Retained earnings				(6.8)	(3.6)	(0.6)	2.8
Outside equity Interests				0.6	0.6	0.6	0.6
S/holders' funds				**46.3**	**53.5**	**56.5**	**60.0**
Net Debt (Cash)				13.9	19.8	18.0	14.9

Share price ($ps)	$0.79
Target Price (A$ps)	$0.87
Recommendation	Hold
Issued shares (m)	101.2
Market cap ($m)	79.9
Enterprise Value ($m)	101.2

June Year end	2013	2014	2015	2016	2017e	2018e	2019e
Valuation Ratios							
Core EPS (¢ps)				3.3	4.0	4.9	5.8
Change (%)					20.7%	23.3%	18.3%
PE (x)				23.8	19.7	16.0	13.5
EV/EBITDA (x)				18.4	12.8	10.1	8.9
EV/EBIT (x)				20.7	15.5	11.9	10.3
NTA ($ps)				0.47	0.52	0.55	0.59
P/NTA (x)				1.70	1.51	1.43	1.35
Book Value ($ps)				0.47	0.53	0.56	0.59
Price/Book (x)				1.68	1.49	1.41	1.33
DPS (¢ps)					1.6	2.0	2.5
Payout (%)					40.0%	40.5%	42.8%
Yield (%)					2.0%	2.5%	3.2%
Franking (%)					100.0%	100.0%	100.0%
Performance Ratios							
EBITDA/sales (%)	11.9%	13.0%	13.5%	10.2%	8.1%	9.2%	9.7%
EBITA/sales (%)				9.0%	6.7%	7.8%	8.4%
OCF Realisation (%)				31.6%	92.1%	78.8%	88.7%
FCF Realisation (%)				28.6%	69.5%	36.2%	51.8%
ROE (%)				17.4%	7.7%	9.0%	10.1%
ROIC (%)				19.8%	9.8%	11.5%	13.2%
Asset turn (years)				8.9	5.7	6.5	7.3
Capex/Depn (x)				0.5	1.0	1.0	1.0
Interest cover (x)				12.7	7.4	8.4	9.7
Net debt/EBITDA				2.5	2.5	1.8	1.3
Net debt/equity (%)				30.0%	37.0%	31.8%	24.8%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

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

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

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

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

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

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