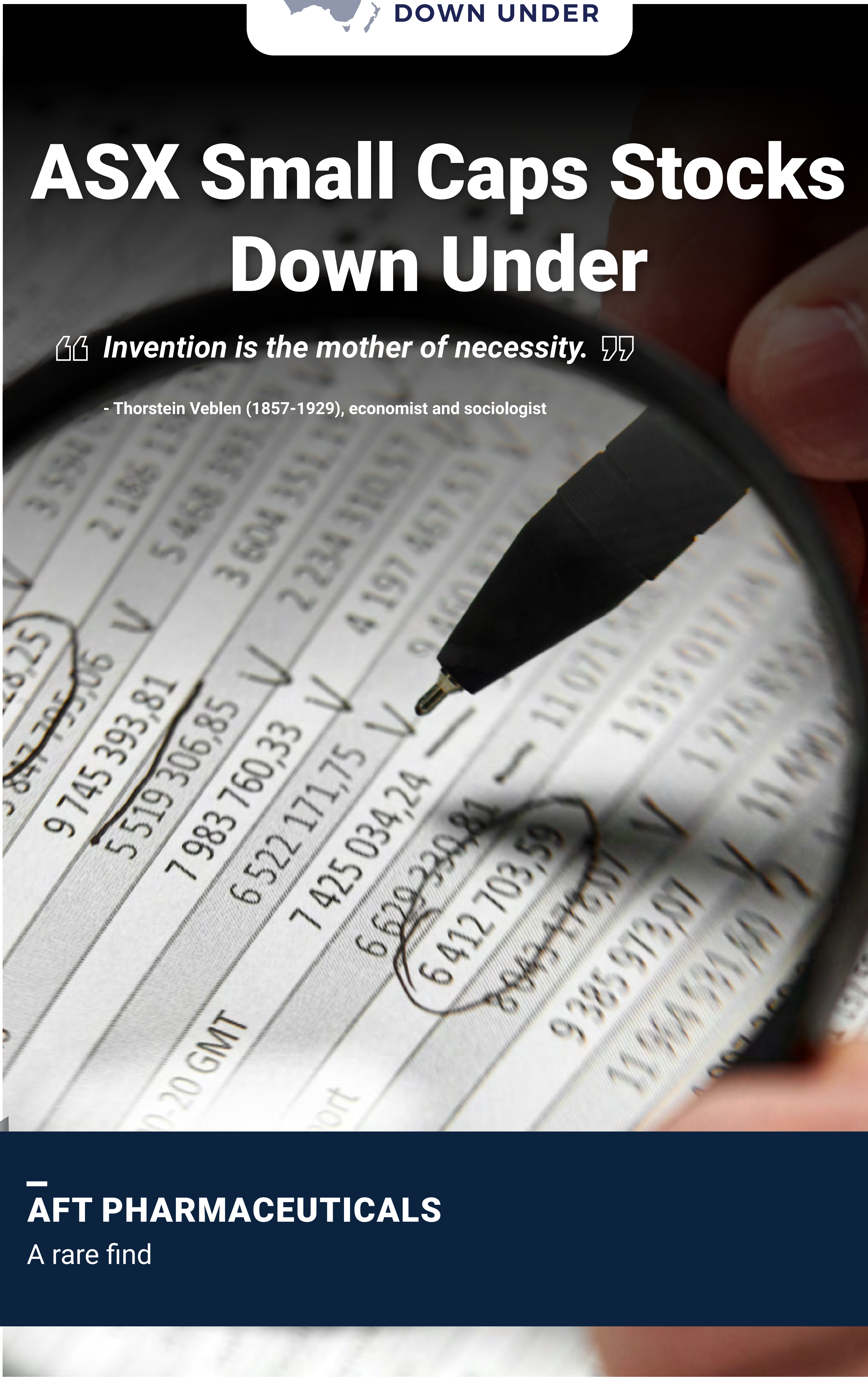
STOCKS DOWN UNDER

1 JULY 2022



ASX Small Caps Stocks Down Under

"Invention is the mother of necessity."

- Thorstein Veblen (1857-1929), economist and sociologist

AFT PHARMACEUTICALS

A rare find

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Stocks Down Under rating: ★★★★

ASX: AFP
Market cap: A$381.7M

52-week range: A$2.91 / A$4.80
Share price: A$3.35

There are over 50 New Zealand companies on the Australian bourse and AFT Pharmaceuticals is one of them. It has not been as prominent as Xero (ASX: XRO), but it has a similar long term growth story. It began in 1998 as an importer and distributor of medicines, but gradually developed its first breakthrough product (Maxigesic) and now sells it in over four dozen countries. It also in-licenses and distributes over 130 other pharmaceutical products. We think there's more growth to come from Maxigesic and other products the company is developing and distributing.

Share price chart

Source: Tradingview

A long-term success story, with more growth to come

Maxigesic is a repurposed pain-relief drug that combines two popular OTC analgesics, namely paracetamol and ibuprofen, into a unique patented formulation. Maxigesic was commercially launched back in 2009 and has gradually expanded into new markets over time. It is available in tablet and IV forms and is registered in 52 countries and sold in 46 in the tablet format, while the IV version is registered in 37 countries and sold in 7. Recently, AFT also began offering Maxigesic in an oral dose format (hot drinks) in the Australian market and sales to date are exceeding the company's expectations.

Although the USA is not a country Maxigesic is distributed in, it hopes to obtain FDA approval in the current financial year (which, for AFT being a Kiwi company, is the 12 months to 31 March 2023). It also has a licensee and distributor at the ready in US medicine supplier Hikma Pharmaceuticals. Launching Maxigesic into the US will be significant for AFT, being the world's largest healthcare market, but it will continue to seek new markets. Our friends at Pitt Street Research have estimated that by FY28, Maxigesic could reach 99-114 countries. The company itself estimates there is a US$59.5bn global market for Maxigesic.

Still, the company also hopes to grow its presence in market it is already in, including Australia and New Zealand, with a number of product launches planned along with growth in its existing business. The most exciting future product is its dermatology treatment Pascomer D, which targets rare skin conditions, including facial angiofibromas in Tuberous Sclerosis Complex (TSC). Pascomer D is currently in a clinical study, set to report in the middle of this year. Even before it has passed the pivotal clinical study, AFT has already secured licensing agreements. These include arrangements with Timber Pharmaceuticals in North America and Desitin Arzneimittel GmbH in Europe. It is worth noting however that the orphan market is no longer avaliable, with competitor Nobel Pharmaceuticals obtaining it.

AFT also in-licenses and distributes over 130 other pharmaceutical products. These include products for pain relief, eye care, skin care, allergy and digestive health. Some are among the top selling in the market, one example being its HYLO-FORTE eye lubricant, which is the top selling product in its category.

Solid financials and ownership

AFT released its financial results for FY22 just under six weeks ago. It made NZ$130.3m in annual operating revenue (up 15.2%), a NZ$20.4m operating profit (up 91%) and a NZ$19.8m net profit (up 154%). The company credited the ongoing roll out of Maxigesic (which accounted for NZ$13.1m in revenue) and the easing of pandemic restrictions. It experienced its fair share of challenges during the pandemic, including a drop off in general OTC pharmaceutical sales and GP visits as well as travel restrictions, which made it difficult for the company to market its products abroad.

Looking to FY23, the company anticipates an operating profit of NZ$27m to $32m and expects to pay its inaugural dividend to shareholders. It expects to pay 20-30% of its normalised net profit after tax, starting in FY23 and then on an ongoing basis.

Its valuation multiples are reasonable too, at 13.8x EV/EBITDA and 16.5x P/E for FY23. Consensus estimates forecast NZ$156.4m in revenue and NZ$30.4m in EBITDA for FY23, up 20% and 42% from FY22 (We note AFT recorded $21.4m in EBITDA in FY22, according to S&P CapitalIQ, but the company doesn't emphasise EBITDA as a key metric). In FY24, consensus estimates forecast $179.4m in revenue and $38.5m in EBITDA, up 15% and 27% from FY23.

We also observe that the company is still managed and 70%-owned by its founders, the Atkinson family. We like founder-led businesses, especially when they have been around in the long term. There is additional incentive for management to deliver in the longer term, because other shareholders' success will be their own. The flipside of such a large holding by a company's founders is that the free float of shares is limited, in this case it's just 30%. This can deter certain investors, including institutional investors, from buying the stock as this lack of liquidity means that it's hard to get into the stock without moving the share price too much and most likely even harder to get out of it when the time comes. Ideally, a company's free float exceeds 50% of the shares outstanding.

You'll have to cross the Ditch for it

Notwithstanding that we like this company (it's four stars from us), there are a couple of things investors should be aware of. Most notably, the stock's liquidity in Australia is far lower than in New Zealand. This means investors would be best investing in AFT through the NZX and this will bring the typical issues associated with investing in foreign shares, particularly tax, forex and repatriation of funds. Even though New Zealanders and Australians have more in common than New Yorkers and Californians, the stock exchanges differ in many respects, including listing rules and trading hours.

Investors should also be wary of the typical issues that can impact drug development, without it being an individual company's fault. Examples include delayed regulatory approval and supply chain issues. However, we think this is less likely to happen with Maxigesic given how advanced its market roll out is. We would observe that AFT's patent for Maxigesic expires in FY28, which isn't too far away, and it remains to be seen if AFT will seek an extension or will be exposed to market competition. Finally, as good as it is that the company will be paying a dividend, it remains to be seen if it will be at the expense of its R&D to any extent. It has historically invested ~10% of its sales into R&D.

But don't forget, it has over 130 established products already and such companies are a rare species, before you even consider that it'll be paying its inaugural dividend this financial year. That's why this one is four stars for us.

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