



Growing and investing

AFT Pharmaceuticals (ASX: AFT) recorded a strong result for the 12 months to 31 March 2022 (FY22). It made \$130.3m in annual operating revenue (up 15.2%), a \$20.4m operating profit (up 91%) and a \$19.8m net profit (up 154%). The company credited the easing of pandemic restrictions and the ongoing commercialisation of Maxigesic. It also announced it would be paying its inaugural dividend to shareholders in FY23 – in the range of 20-30% of its normalised net profit after tax on an ongoing basis. It is expecting an operating profit for FY23 between \$27m and \$32m.

Expanding Maxigesic reach in new markets

Maxigesic tablet has been a key driver of AFT's growth in recent quarters. The company continues to expand its global footprint of Maxigesic (in the tablet and IV form) either by offering new products or by tapping into new markets. The tablet is now registered in 52 countries and sold in 46 countries while Maxigesic IV is now registered in 37 countries and sold in 7. Although the company has not indicated how much it intends these figures to grow, it does anticipate adding the world's largest healthcare market, the USA, onto its list among other countries. It anticipates FDA approval and the commencement of sales later this financial year.

AFT's strategy going forward

With the success of Maxigesic, the company is confident that its IP program can continue to bring new products to market. The most exciting prospect is its dermatology treatment Pascomer D which is currently amidst a clinical study set to report in mid-2022. It will also continue to roll out Maxigesic into new forms (including IV as well as a hot drink sachet) and into new markets. Although it does not appear that the company is specifically targeting the USA at expense of other markets, we think its rollout will nonetheless be important given the USA is home to the world's largest healthcare market and most stringent healthcare regulator in the FDA.

Valuation of NZ\$6.92 per share

In our research initiation on AFT from November 2021, available [here](#), we valued the company at NZ\$6.09 per share in the base case and NZ\$9.29 per share in the bull case, using the discounted cash flow model. Following the recent developments, we update our valuation to NZ\$6.92-\$9.59 per share.

Please refer to pages 5 & 6 for details on share price catalysts and risks.

Share Price: NZ\$4.09

NZX: AFT, ASX: AFP

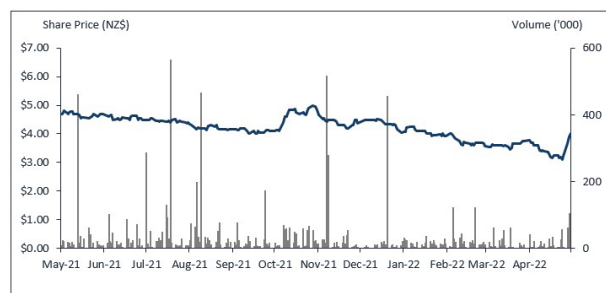
Sector: Health Care

27 May 2022

Market Cap. (NZ\$ m)	428.2
# of shares outstanding (m)	104.7
# of shares fully diluted (m)	104.7
Market Cap Ful. Dil. (NZ\$ m)	428.2
Free Float	26.7%
52-week high/low (NZ\$)	5.01/3.54
Average NZX daily volume (k)	34.5
Website	aftpharm.com

Source: Company, Pitt Street Research

Share price (NZ\$) and avg. daily volume (m, r.h.s.)



Source: Refinitiv, Pitt Street Research

Valuation metrics	
Valuation per share (NZ\$)	6.92-9.59

Source: Pitt Street Research

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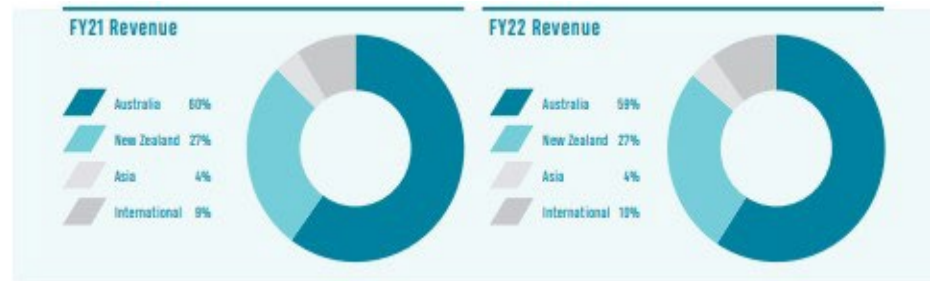
The key driver of AFT's growth was increased sales of its pharmaceutical products in Australia and New Zealand.

Strong FY22 results driven by core operations & commercialization of Maxigesic products

AFT Pharmaceuticals delivered strong FY22 results with significantly improved profitability. The company's net profit post-tax more than doubled from \$7.8m to \$19.8m while its operating profit nearly doubled from \$10.7m to \$20.4m. The company recorded revenue of \$130.3m - up 15.2%.

All regions posted strong growth but the key driver of its growth was increased sales of its pharmaceutical products in Australia and New Zealand. The pair were responsible for \$111.8m in revenue (roughly 85% of the company's total) and delivered double digit growth in spite of COVID-19 restrictions. Sales in Asia remained a relatively small proportion of revenue but nonetheless grew 24.7% to \$5.5m. OTC sales were flat but hospital and prescription channels grew 32% primarily due to strong anti-bacterial sales.

Figure 1: AFT's revenue mix in FY21 and FY22



Source: FY22 annual report

The sales of AFT's Maxigesic tablets were particularly important. These represent the most preferred ibuprofen-paracetamol combination used in Australia. These tablets have been key drivers of AFT's growth in recent quarters. Looking ahead, the company plans to expand its global footprint of Maxigesic either by offering new products or by tapping into new markets. It has been selling direct in most markets but increasingly it is following a model of out-licensing. In FY22, royalties from licensees in market sales grew 96.7% to \$0.5m from \$0.2m and licensing income grew from \$2.1m to \$6.7m - half of the \$13.1m in Maxigesic sales. Licensing income helped offset decreased overall sales due to partners exploiting stockpiling they had undertaken in prior year.

A strong performance achieved despite COVID-19

You may think that COVID-19 would benefit pharmaceutical companies such as AFT, but in reality COVID-19 has presented challenges. Lockdowns resulted in a drop off in general OTC sales of pharmaceuticals as well as GP visits. Although both regions OTC sales were hit by COVID restrictions throughout the year, sales returned as restrictions eased and COVID began to transition to endemic status. The lack of travel has also made it difficult for the company to promote new products in overseas markets but the easing of international travel restrictions will now make it easier for the company.

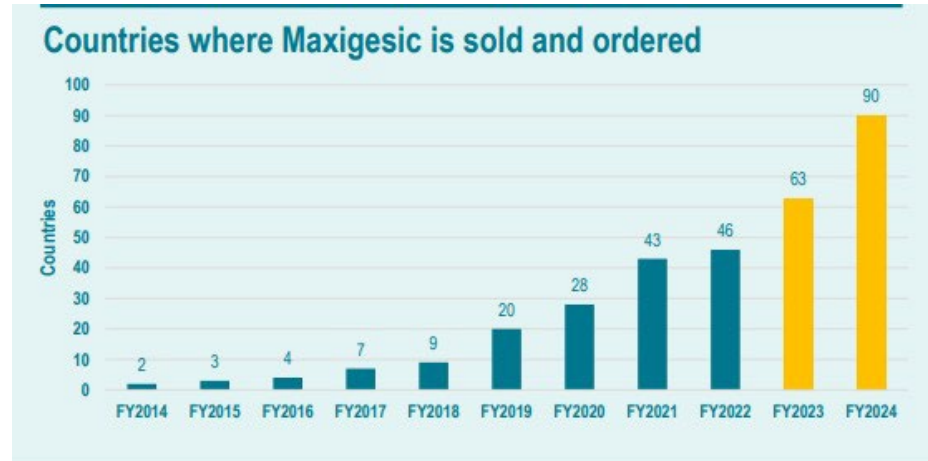
COVID restrictions posed challenges, but the company was helped by the easing of restrictions.



Maxigesic tablets now sold in 46 countries

At the end of FY22, AFT offered its Maxigesic tablets in 46 countries with 3 markets – Switzerland, Greece and Lithuania – adding during the year. It estimates there is a US\$59.5bn global market for Maxigesic.

Figure 2: Countries where Maxigesic is sold and ordered



Source: FY22 Investor Presentation

AFT's other products have helped its cause too. For instance, its eyecare range is the second best-selling lubricating eyecare product Australia and its own top selling product. The prescription channel delivered 12.9% growth with certain products such as penicillin oral liquid returning to more usual sales levels.

A strong FY23 anticipated

AFT is targeting an operating profit in the range of NZ\$27-\$32m for FY23

AFT has told shareholders it is targeting an operating profit in the range of NZ\$27-\$32m for FY23. This would represent 32-57% growth on its FY22 figures. The company has also announced intention to pay its inaugural dividend post FY23. It anticipates paying out 20-30% of its normalised net profit after tax.

The company intends to expand Maxigesic to further countries in the year ahead, in particular the USA. We think the company can reach over 60 by the start of FY24. While it is not targeting the USA as a particularly important market, we think when it is approved it will be pivotal. This is because the USA is the world's largest healthcare market and is the world's most stringent medical regulator.

If the company can obtain approval with the FDA, it will have confidence it will be able to roll out Maxigesic into further markets. This is not just from a psychological standpoint, but it could have confidence to re-use the same data into countries that enable data used to obtain approval in other markets to be "re-used" for approval in their jurisdiction. The company has indicated registration is being undertaken for multiple markets in Asia and South America.

The company is also rolling out Maxigesic IV, an intravenous formulation of Maxigesic. It has had its first launches in European markets, and it has made a filing application to register the medicine in the USA. It has also launched Maxigesic hot drink sachets in Australia and the company reports this has



been well received, hitting the shelves just in time for the winter cold and flu season.

Shareholders have responded well to its FY22 results and FY23 outlook sending shares up by over 10% this week. We believe the company's share price has suffered this year due to the weak equity market conditions. But with its 11% gain this week we think investors are finally realising the opportunity that the company presents.

Profitable but still setting itself up for the future

Despite being profitable and intending to share some of the spoils with shareholders in the next year it is still investing in its future. The company spent \$10.4m in R&D costs in the new year and expects it to remain at this level for the future reflecting its intention to continue to bring new products to market.

In particular, it wants to expand its Maxigesic family of medicines and commercialise current projects including Pascomer as well as a number of confidential trials for applications in dermatology, astro-intestinal health and medicinal CBD products. It has a program of at least 20 product launches planned for the coming year.

The company reduced its net debt from \$35.2m to \$29.3m in the past six months and has retained higher than normal inventory levels as a buffer against ongoing supply chain disruptions.

Strategic partnership with Farmaforce Limited

In February 2022, AFT signed a partnership with Farmaforce Limited to provide “best in class” representation to healthcare practitioners and professionals. Established in 2016, Farmaforce is a contract sales organization which helps pharmaceutical organizations in Australia to promote their product portfolio to healthcare practitioners and professionals and boost their sales. It holds more than 25 pharmaceutical organizational partnerships.

The partnership with Farmaforce will bolster AFT’s footprint in the Australian market while providing easy access to innovative products to practitioners, professionals and people in need. This partnership will be crucial in the implementation of AFT’s plans to launch more than 30 new products over the next 18 months.

Valuation

In our research initiation on AFT from November 2021, available [here](#), we valued the company at NZ\$6.09 per share in the base case and NZ\$9.29 per share in the bull case, using the discounted cash flow model. Factoring in the developments since November 2021, including AFT's FY22 results, the partnership with Farmaforce and easing of COVID restrictions, we update our model.

We have increased the risk-free rate of return from 1.9% to 3.3% in light of the rise in the Australian government 10-year bond. We have decreased the market risk premium to 6% but kept the beta unchanged at 1.1, leading to a WAAC of 9.9%. Our original model accounted for FY22 and extended to FY32 but with FY22 complete, we have excluded FY22 and included FY33 to maintain an 11-year horizon. We used a 0.72 USD/NZD conversion rate. We have not forecasted terminal growth because of the prospect of other products coming to market after the expiry of the company's patents.

The company wants to expand its Maxigesic family of medicines and it has a program of at least 20 product launches planned for the coming year.

Our valuation is driven by expected sales, earnings and cashflows from AFT's three lead assets.



Our valuation is solely driven by expected sales, earnings and cashflows from AFT's three lead assets, being Maxigesic tablet, Maxigesic IV and Pascomer. Although Pascomer has not yet been commercialised, we have included it in our model because it is very close to that point. For Maxigesic Tablet we have calculated sales by assigning average sales per country, keeping the figure constant and assuming it rolls out into more countries over time. Our base and bull cases make different assumptions as to the pace of rollout. Our base case assumes 10 new countries a year to FY25 and 5 from FY26 to FY28. Our bull case assumes 15 per year until FY26 and 5 per year to FY28. By FY28, our base case forecasts 99 countries while our bull case forecasts 114 countries. However, we have not modelled beyond FY28 because the company's patent will expire

With Maxigesic IV, we have assumed a 30% market share in our base case and a 40% market share in our bull case, although full ramp up and AFT's reaching of the maximum market share only occurs in FY27. For Pascomer, our base case assumes a 50% market share and a 10% royalty payable while our bull case assumes a 60% market share and a 12% royalty. Again, we have assumed ramp up occurs gradually over the next few years, reaching 100% by FY23. For both Maxigesic IV and Pascomer, we have assumed a constant market size over the life of our model - US\$2.1bn for Maxigesic IV and US\$500m for Pascomer.

Our new base case is NZ\$6.92 per share (previously \$6.09) and our new bull case is \$9.59 per share (previously \$9.29).

Our new share price target range is NZ\$6.92-\$9.59 per share.

Figure 3: DCF valuation summary

Valuation	Base Case	Bull Case
Present value of FCF	759.4	1,038.4
Present value of Terminal FCF	-	-
Enterprise Value (NZ\$M)	759.4	1,038.4
Net debt (cash)	35.2	35.2
Equity value (NZ\$)	724.3	1,003.2
Share outstanding	104.7	104.7
Implied price (NZ\$)	6.92	9.59
Current price (NZ\$)	4.09	4.09
Upside (%)	69.2%	134.4%

Source: Pitt Street Research



Catalysts

We have identified the following near-term events as important facilitators of moving the current stock price towards our fair valuation range:

- Better-than-expected global uptake of the Maxigesic family of products;
- Obtaining regulatory approvals and registrations for new countries; and
- Positive results from clinical studies for Pascomer.

Risks

We see the following as key risks to our investment thesis:

- **Uptake risk:** There is a risk that AFT may not be able to gain traction in its target markets. There is no guarantee that AFT and/or its distributors will be able to secure a specific number of purchase orders for its existing and new products. In addition, the launch of new products may receive lower-than-expected uptake from customers. If this risk materializes, AFT will likely report financials below our forecasts. In turn, this will hamper our valuations.
- **Clinical risk:** The clinical studies for Pascomer could potentially produce unfavourable results, which would delay the commercialization timeline for the product.
- **Competition risk:** There is the “what if” scenario where new and/or existing competitors coming up with superior and cheaper products that seek to address the same market opportunity set as AFT. If this risk materializes, it can hamper AFT market share growth and margins.
- **Commercial risk:** To be able to distribute and/or sell its products in any country, AFT will first need to register its products in that country. There is a risk that AFT may not obtain entry in that market.
- **Currency risk:** AFT buys goods and services from offshore suppliers. This exposes AFT to foreign currency risk.



Appendix I – Analyst Certification

Nick Sundich, lead analyst on this report, is an equities research analyst at Pitt Street Research

- Nick obtained a Bachelor of Commerce/Bachelor of Arts from the University of Sydney in 2018. He has also completed the CFA Investment Foundations program.
- He joined Pitt Street Research in January 2022. Previously he worked for over three years as a financial journalist at Stockhead.
- While at university, he worked for a handful of corporate advisory firms.

Stuart Roberts has been an equities analyst since 2002.

- Stuart obtained a Master of Applied Finance and Investment from the Securities Institute of Australia in 2002. Previously, from the Securities Institute of Australia, he obtained a Certificate of Financial Markets (1994) and a Graduate Diploma in Finance and Investment (1999).
- Stuart joined Southern Cross Equities as an equities analyst in April 2001. From February 2002 to July 2013, his research speciality at Southern Cross Equities and its acquirer, Bell Potter Securities, was Healthcare and Biotechnology. During this time, he covered a variety of established healthcare companies, such as CSL, Cochlear and Resmed, as well as numerous emerging companies. Stuart was a Healthcare and Biotechnology analyst at Baillieu Holst from October 2013 to January 2015.
- After 15 months over 2015–2016 doing Investor Relations for two ASX-listed cancer drug developers, Stuart founded NDF Research in May 2016 to provide issuer-sponsored equity research on ASX-listed Life Sciences companies.
- In July 2016, with Marc Kennis, Stuart co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Life Sciences companies.
- Since 2018, Stuart has led Pitt Street Research's Resources Sector franchise, spearheading research on both mining and energy companies.

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