EDISON

aap Implantate AG

Financial results

Loqteq on track and pipeline progressing

Healthcare equipment & services

aap's initial 2014 outlook underlines its aim to grow profits faster than sales. The key driver remains Loqteq. Clinical data from the ongoing post-marketing study and a decision on a US partner are both anticipated during 2014. The pipeline, including silver-coated plates and resorbable magnesium implants, continues to progress as planned. Our forecasts are unchanged and our valuation remains €3.3/share based on a DCF.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/11	29.2	2.7	0.08	0.0	25.0	N/A
12/12	36.4	4.9	0.14	0.0	14.3	N/A
12/13e	40.1	6.0	0.17	0.0	11.8	N/A
12/14e	44.5	6.7	0.20	0.0	10.0	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Loqteq on track; data and US decision in H114

Loqteq sales grew +83% to €1.1m in Q3 and +182% to €3.1m ytd. Data from the ongoing post-marketing study are expected during Q114, and a decision on US partnering is anticipated during 2014. aap already has a two-year, non-exclusive agreement with an undisclosed partner, which expires at the end of 2014.

Promising pipeline potential

Beyond Loqteq, aap is working on a number of pipeline opportunities, including silver-coated trauma plates to reduce infection and biodegradable magnesium implants for small bone fractures. The ongoing initial preclinical trials with the silver-coated products are progressing positively, with data expected in Q114 before moving to the proof-of-concept clinical phase. The JV with eontec Co for resorbable magnesium implants is progressing as planned.

Aiming to grow profits faster than sales

aap is on track to deliver on its reiterated 2013 guidance of 10% sales growth to around €40m and 15% EBITDA growth to around €7m. It has also provided a first outlook for 2014 and remains focused on growing profits faster than sales. Sales growth of around 10% and EBITDA growth of around 15% are anticipated in 2014, both of which represent minimum targets. Based on 2013 guidance, this implies sales of €44m and EBITDA of €8m, both in line with our unchanged forecasts.

Valuation: €100m based on DCF

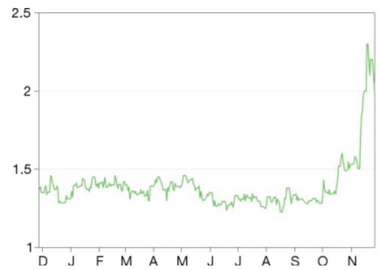
Our €100m or €3.3/share DCF valuation is unchanged. We forecast 10% 2012-15 revenue CAGR and a doubling of current sales to around €80m by 2020, driven by Loqteq. In addition we assume EBITDA margins can expand around 200 basis points over the next two to three years. In the longer term we expect operating margins to reach around 25% from 14% today.

27 November 2013

Price	**€2.00**
Market cap	**€61m**

Net cash (€m) as at end September 2013	3.0
Shares in issue	30.7m
Free float	34%
Code	AAQ
Primary exchange	Xetra
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	36.4	47.4	45.2
Rel (local)	31.9	33.8	14.0
52-week high/low		€2.3	€1.2

Business description

aap Implantate is a German medical technology company focused on developing, manufacturing and selling products for bone fractures. These include the recently launched Loqteq trauma plating system, in addition to bone cements.

Next events

Loqteq post-marketing study data	Q114
Loqteq US partnership decision	H114

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Loqteq on track; data and US decision in H114e

The key growth driver for aap in the near and medium term remains Loqteq, aap's internally developed and recently launched trauma plating system. Data from the ongoing post-marketing study anticipated in Q114 could provide the first clinical evidence of Loqteq's potential cold-welding advantage. Cold-welding causes problems during explantation (plate removal). In the US, a two-year beta launch with an undisclosed, non-exclusive partner is underway to understand Loqteq's acceptance. Management reported that initial feedback is encouraging, with Loqteq being well received by surgeons. The next step is to determine the optimal partnering strategy for this key market. A number of potential options are being considered.

Pipeline beyond Loqteq

aap continues to progress its pipeline of innovative medtech products. These include:

- **Silver-coated trauma products:** aap is working to develop silver-coated trauma implants in order to improve infection prevention. Current trauma implants are not coated and hence the application of certain coatings, such as silver, or controlled release of an antibiotic could prevent infections and improve healing. Animal trials are progressing positively, with data anticipated in Q114. First market entry could come from 2015.
- **Resorbable magnesium implants:** In March 2013 aap and eontec Co, a Chinese magnesium specialist, agreed to form a 50:50 JV for the development of resorbable magnesium implants. Such implants could be used in trauma applications, particularly for small implants in, for example, hands and feet, and would remove the need for later explantation of the implant. eontec develops and produces magnesium products for the electronics industry. Hence the JV combines aap's trauma expertise with eontec's magnesium knowledge. Human clinical trials are ongoing, with costs shared equally.

Temporary slowdowns should reverse in Q413

There has already been a recovery in bone cements in Q3, following a temporary slowdown earlier in the year; during H113 bone cements revenues had declined by €3.0m, with only a €0.4m decrease in Q313. New customers are coming on board and management expects strong sales in Q413, with orders already ahead of Q412. In addition, there was a one-off slight seasonal fluctuation in medical aesthetic products, but the overall business remains intact.

No changes to forecasts; valuation remains €3.3/share based on DCF

We value aap at €100m or €3.3/share based on a DCF valuation assuming a WACC of 12.5%, terminal growth of 2.0% and a long-term tax rate of 25%. Our key revenue growth assumptions are shown in Exhibit 1. We expect around a 200 basis point improvement in product gross margin owing to the changing product mix, and anticipate some cost efficiencies in the future, driving operating margin expansion to c 16% by 2015 from 14% in 2012. In the longer term as Loqteq grows, we believe operating margins could reach around 25% from 14% currently.

If we assume Loqteq peaks at sales of €5m, and that long-term operating margins remain at 16%, our DCF valuation is €44m or €1.4/share, providing downside protection.

Exhibit 1: Base case revenue assumptions

€m	2011	2012	2013e	2014e	2015e
Biomaterials	22.4	28.6	30.0	28.4	28.9
Trauma & Orthopaedics (ex-Loqteq)	6.4	5.8	5.0	5.6	6.1
Loqteq	0.4	2.1	5.0	10.5	14.0

Source: aap, Edison Investment Research

Exhibit 2: Financial summary

€000s	2008	2009	2010	2011	2012	2013e	2014e	2015e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	31,884	33,101	28,440	29,205	36,414	40,053	44,523	48,978
Total Output	36,476	34,788	32,560	33,003	39,337	42,806	47,210	51,653
Cost of Sales	(9,233)	(7,411)	(9,535)	(8,078)	(10,776)	(11,706)	(13,842)	(15,110)
Gross Profit	22,651	25,690	18,905	21,127	25,638	28,347	30,680	33,868
EBITDA	3,713	6,563	3,448	4,126	6,106	7,300	8,107	9,260
Operating Profit (before amort. and except.)	2,300	5,313	2,406	3,072	5,034	6,125	6,763	7,746
Intangible Amortisation	(6,935)	(1,719)	(1,687)	(1,907)	(2,837)	(2,095)	(2,136)	(2,240)
Exceptionals	0	0	0	0	1,015	0	0	0
Other	(6)	(306)	(174)	(220)	(316)	(300)	0	0
Operating Profit	(4,641)	3,288	545	945	2,896	3,730	4,628	5,506
Net Interest	(917)	(534)	(359)	(327)	(176)	(129)	(76)	(35)
Profit Before Tax (norm)	1,383	4,779	2,047	2,745	4,858	5,996	6,688	7,712
Profit Before Tax (FRS 3)	(5,558)	2,754	186	618	2,720	3,601	4,552	5,472
Tax	324	(816)	(135)	(223)	(310)	(500)	(600)	(675)
Profit After Tax (norm)	1,701	3,657	1,738	2,302	4,232	5,196	6,088	7,037
Profit After Tax (FRS 3)	(5,234)	1,938	51	395	2,410	3,101	3,952	4,797
Average Number of Shares Outstanding (m)	26.2	27.6	27.8	29.6	30.7	30.7	30.7	30.7
EPS - normalised (€)	0.07	0.13	0.06	0.08	0.14	0.17	0.20	0.23
EPS - normalised and fully diluted (€)	6.62	0.13	0.06	0.08	0.14	0.17	0.20	0.23
EPS - (IFRS) (€)	(0.20)	0.07	0.00	0.01	0.08	0.10	0.13	0.16
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)*	71.0	74.1	65.4	72.3	68.1	68.1	68.3	68.8
EBITDA Margin (%)	11.6	19.8	12.1	14.1	16.8	18.2	18.2	18.9
Operating Margin (before GW and except.) (%)	7.2	16.1	8.5	10.5	13.8	15.3	15.2	15.8
BALANCE SHEET								
Fixed Assets	44,493	41,066	42,597	43,675	44,921	45,797	48,306	50,588
Intangible Assets	34,506	35,528	37,000	38,248	39,403	36,549	37,063	37,430
Tangible Assets	7,309	5,055	5,200	5,071	5,107	7,337	9,333	11,248
Investments	2,678	483	397	356	411	1,911	1,911	1,911
Current Assets	22,537	21,589	21,035	22,476	23,669	24,085	25,922	28,824
Stocks	13,714	11,538	12,688	13,991	13,943	12,791	14,411	14,870
Debtors	6,795	6,007	6,204	5,508	4,226	6,487	6,099	6,709
Cash	96	2,406	909	2,152	3,698	3,005	3,610	5,442
Other	1,932	1,638	1,234	825	1,802	1,802	1,802	1,802
Current Liabilities	(16,334)	(13,596)	(14,986)	(15,126)	(13,018)	(9,139)	(9,446)	(9,755)
Creditors	(8,900)	(7,912)	(9,485)	(9,647)	(8,521)	(8,123)	(8,430)	(8,739)
Short term borrowings	(7,434)	(5,684)	(5,501)	(5,479)	(4,497)	(1,016)	(1,016)	(1,016)
Long Term Liabilities	(9,393)	(4,344)	(3,794)	(2,675)	(4,706)	(6,567)	(6,447)	(6,318)
Long term borrowings	(3,008)	(1,836)	(1,163)	(74)	(2,019)	(4,000)	(4,000)	(4,000)
Other long term liabilities	(6,385)	(2,508)	(2,631)	(2,601)	(2,687)	(2,567)	(2,447)	(2,318)
Net Assets	41,303	44,715	44,852	48,350	50,866	54,175	58,335	63,340
CASH FLOW								
Operating Cash Flow	544	4,761	2,654	3,213	7,088	6,164	7,364	8,679
Net Interest	0	0	0	0	0	(129)	(76)	(35)
Tax	0	0	0	0	0	(453)	(575)	(656)
Capex	(2,459)	(645)	(1,191)	(928)	(1,205)	(3,405)	(3,339)	(3,428)
Acquisitions/disposals	10	5,001	961	138	261	3,000	0	0
Financing	2,763	1,267	45	3,039	(101)	0	0	0
Dividends	0	0	0	(34)	0	0	0	0
Net Cash Flow	858	10,384	2,469	5,428	6,043	5,178	3,374	4,560
Opening net debt/(cash)	9,101	10,346	5,114	5,755	3,401	2,818	2,011	1,406
HP finance leases initiated	0	0	0	0	0	0	0	0
Other**	(2,103)	(5,152)	(3,110)	(3,074)	(5,460)	(4,371)	(2,769)	(2,727)
Closing net debt/(cash)	10,346	5,114	5,755	3,401	2,818	2,011	1,406	(426)

Source: aap accounts, Edison Investment Research. Note: Total output consists of revenues, capitalised development costs and inventory changes. aap's expenses are classified according to nature (material, personnel and other) rather than by function (R&D, sales and marketing etc), hence cost of sales refers to material costs. *Gross margin refers to underlying product gross margins, based on product sales and excluding licensing income. **Other in the cash flow includes capitalised development costs.

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