aap Implantate AG

Revised forecasts

LOQTEQ set for launch in the US in Q3

Healthcare equipment & services

aap should reach its FY15 guidance after a solid Q1 and distribution deals enabling a US launch of LOQTEQ in Q3. However, we trim our CAGR 2014-18e revenue from 15% to 12% and our valuation from €3.17 to €3.05 per share. An eventual sale of Biomaterials may prompt a re-rating of the fast-growing trauma business.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/14	30.6	0.7	0.9	0.0	N/A	N/A
12/15e	34.2	1.1	2.3	0.0	N/A	N/A
12/16e	38.1	3.0	8.0	0.0	30.0	N/A
12/17e	43.2	6.3	17.9	0.0	13.4	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments. 2013 and 2014 sales are for continuing operations only.

On track to meet FY15e financial guidance

aap's Q1 trading was solid: group revenues rose 16% to €7.1m, of which Biomaterials' portion grew 23% to €4.4m and LOQTEQ soared by 45% to €1.7m. This was balanced by LOQTEQ's cannibalisation of other Trauma revenues, which declined 27% to €0.8m. aap expects LOQTEQ to grow by c 25% in FY15, helped by the planned launch in the US and possibly Brazil in H2. Also, aap is working to raise delivery capacity and reduce production costs. This should enable it to meet its financial guidance of €33-35m revenue and €2.5-3.5m EBITDA in FY15e and to grow revenues and profits considerably in FY16e.

LOQTEQ's US market entry in the offing

aap has signed US distributor agreements, paving the way for launch of LOQTEQ in six states in Q3. In addition to these non-stocking distributors, it plans to engage stock-carrying intermediaries, which we believe will yield a more immediate sales contribution. Further, aap's position has been reinforced in recent months by intellectual property awards in Europe for LOQTEQ, the antimicrobial silver and the resorbable magnesium technologies, mirroring previous awards in the US.

Biomaterials sale could boost growth

While the sales process stalled in Q1, aap still aims to sell the Biomaterials division. We estimate a sale could raise €35-40m (8-9x EBITDA). The resulting cash could be deployed to bolster Trauma (acquisitions and organic growth) and to repurchase shares for up to €3m pa (10% of subscribed capital). Also, being focused on IP-protected trauma products may make aap a more attractive acquisition target.

Valuation: Attractive upside remains despite EPS cut

We have trimmed our sales estimates, due to a more paced roll-out of LOQTEQ and its stronger cannibalisation of other Trauma sales, and our profit forecasts as a result of expected higher depreciation charges in FY15e and FY16e. Based on a DCF, we reduce our valuation from €97m to €94m or €3.05 per share. An eventual sale of Biomaterials may crystallise €3.42 per share.

30 June 2015

Price	**€2.40**
Market cap	**€74m**

Net cash (€m) at end FY14e	7.7
Shares in issue	30.7m
Free float	34%
Code	AAQ
Primary exchange	Xetra
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	7.4	(5.3)	(20.9)
Rel (local)	10.6	1.4	(30.0)
52-week high/low		€3.40	€2.20

Business description

aap Implantate is a German medtech 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

H115 results	14 August 2015
Q315 results	13 November 2015

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Edison profile page

aap Implantate AG is a research client of Edison Investment Research Limited

Financial forecast changes

Our FY15 and FY16 revenue forecasts have been trimmed by 3% and 6%, respectively, reflecting a more paced international roll-out of LOQTEQ and its higher degree of cannibalisation on other Trauma product sales than previously forecast. Our new EBITDA forecasts reflect the lower revenue forecasts and fixed overhead costs. Additionally, we have raised our forecasts for depreciation and amortisation to reflect upgraded capex forecasts, which is the main additional factor affecting our new net income forecasts.

Exhibit 1: Financial forecast changes

€m	2015e			2016e		
	Old	New	Change	Old	New	Change
Revenue	35.2	34.2	-3%	40.5	38.1	-6%
Gross profit	22.5	21.7	-4%	25.9	24.3	-6%
EBITDA	3.4	3.0	-12%	6.3	5.0	-20%
Net income (normalised)	2.3	0.7	-70%	4.5	2.5	-45%

Source: Edison Investment Research

Valuation

We value aap at €94m or €3.05 per share, based on DCF. The key assumptions in our DCF valuation are a 10% discount rate and a 2% long-term growth rate after a two-stage forecast period: 2015-19e and 2020-29e (with growth phased down from 10% to 2%). The downgrade from €3.17 reflects rolling forward the model (positive) and a more conservative view on Trauma revenues, owing largely to LOQTEQ cannibalising to a higher degree than expected other Trauma revenues. However, we have also tweaked our assumptions for capitalisation on R&D (lower), working capital (lower) and capex (higher) which, taken together, largely compensate for the EBIT shortfall.

For illustration, we estimate that a sale of the Biomaterials division could yield net sales proceeds of €35m after tax of €1.3-1.8m, which would be added to net cash of €7.7m at end 2014. This would yield a pro forma enterprise value of €31m (current EV €66m), leaving the remaining fast-growing Trauma business trading at 2.10x Trauma sales of €14.8m in 2015e (previously €17.5m) vs 3.13x for its global orthopaedic peers. Weighing both its superior growth but likely inferior profitability relative to its orthopaedic peers, we consider that aap without Biomaterials could be valued at 4.2x EV/Sales (€62m enterprise value), a premium to the broader orthopaedic peer group but in line with the smaller and more comparable Wright Medical and Tornier, which are soon to merge. On this multiple, the addition of €43m in cash gives a market cap of €105m and a valuation per share of €3.42. The downgrade from €3.8 per share of this illustrative valuation reflects the lowering of our FY15 Trauma revenue forecast.

Exhibit 2: Orthopaedic peer valuation

Company	P/E 2015e	P/E 2016e	EV/Sales 2015e
aap Implantate*	66.7	29.7	1.90
Integra LifeSciences	21.3	19.3	2.87
OrthoFix	74.6	43.3	1.53
Smith & Nephew	20.5	18.1	3.59
Stryker	19.2	17.6	3.61
Tornier	N/A	N/A	3.97
Wright Medical	N/A	N/A	4.53
Zimmer	16.8	14.4	3.06
Average	36.5	23.7	3.13

Source: Bloomberg consensus at 25 June 2015 and *Edison Investment Research

Exhibit 3: DCF

PV cash flows (€m)	6.4
PV intermediate term	39.7
PV residual	39.6
Enterprise value	85.8
Net debt/(cash)	(7.7)
Equity value	93.5
Shares in issue (m)	30.7
Share valuation (€)	3.05

Source: Company data and Edison Investment Research estimates

Exhibit 4: Financial summary

€000s	2013	2014	2015e	2016e	2017e
December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	28,573	30,633	34,176	38,137	43,234
Total Output	29,611	32,846	36,731	40,706	45,819
Cost of Sales	(8,282)	(11,834)	(12,498)	(13,790)	(14,445)
Gross Profit	20,291	18,799	21,678	24,347	28,788
EBITDA	5,081	2,267	3,037	5,038	8,265
Operating Profit (before amort. and except.)	3,848	762	1,301	3,112	6,167
Intangible Amortisation	(3,129)	(816)	(2,182)	(2,263)	(2,345)
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	719	(54)	(881)	849	3,822
Net Interest	(179)	(74)	(185)	(85)	134
Profit Before Tax (norm)	3,669	688	1,116	3,027	6,301
Profit Before Tax (FRS 3)	561	(177)	(1,066)	764	3,956
Tax	538	(361)	(405)	(560)	(800)
Profit After Tax (norm)	4,228	278	711	2,467	5,501
Profit After Tax (FRS 3)	1,099	(538)	(1,471)	204	3,156
Average Number of Shares Outstanding (m)	30.7	30.7	30.7	30.7	30.7
EPS - normalised (c)	13.79	0.91	2.32	8.04	17.94
EPS - normalised and fully diluted (c)	13.64	0.89	2.30	7.99	17.81
EPS - (IFRS) (c)	3.58	(1.75)	(4.80)	0.66	10.29
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	67.9	59.8	62.9	63.8	66.6
EBITDA Margin (%)	17.8	7.4	8.9	13.2	19.1
Operating Margin (before GW and except.) (%)	13.5	2.5	3.8	8.2	14.3
BALANCE SHEET					
Fixed Assets	22,394	25,017	27,272	28,582	29,661
Intangible Assets	14,502	15,198	15,088	14,892	14,610
Tangible Assets	5,906	7,690	10,055	11,561	12,921
Investments	1,986	2,129	2,129	2,129	2,129
Current Assets	42,843	32,840	29,866	29,579	32,608
Stocks	9,429	9,400	9,930	10,957	11,477
Debtors	6,866	8,838	9,860	10,480	11,289
Cash	1,580	12,165	7,639	5,705	7,405
Other	24,968	2,437	2,437	2,437	2,437
Current Liabilities	(13,671)	(7,452)	(7,954)	(8,524)	(9,224)
Creditors	(11,103)	(5,455)	(5,957)	(6,527)	(7,227)
Short term borrowings	(2,568)	(1,997)	(1,997)	(1,997)	(1,997)
Long Term Liabilities	(4,831)	(5,189)	(5,107)	(4,855)	(4,855)
Long term borrowings	(2,448)	(2,466)	(2,384)	(2,258)	(2,258)
Other long term liabilities	(2,383)	(2,723)	(2,723)	(2,597)	(2,597)
Net Assets	46,735	45,216	44,077	44,783	48,189
CASH FLOW					
Operating Cash Flow	3,383	(2,683)	2,076	4,022	7,677
Net Interest	(162)	(125)	(35)	64	284
Tax	326	(136)	(394)	(521)	(740)
Capex	(5,719)	(5,133)	(6,173)	(5,500)	(5,521)
Acquisitions/disposals	3,475	18,291	0	0	0
Financing	0	0	0	0	0
Dividends	0	0	0	0	0
Net Cash Flow	1,303	10,213	(4,526)	(1,934)	1,700
Opening net debt/(cash)	2,818	3,436	(7,702)	(3,258)	(1,450)
HP finance leases initiated	0	0	0	0	0
Other	(1,921)	925	82	126	0
Closing net debt/(cash)	3,436	(7,702)	(3,258)	(1,450)	(3,150)

Source: Company data and Edison Investment Research estimates