aap Implantate AG

Q2 update

US LOQTEQ launch poised to drive H2 recovery

Healthcare equipment & services

As aap gears up for a US launch of LOQTEQ in H2, its FY15 guidance looks attainable. As expected, Q2 trading was soft, reflecting the lumpy orders in Biomaterials. Taking into account the combined effect of €5m lower net cash and rolling forward, we trim our valuation from €3.05 to €2.96/share.

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	26.7	N/A
12/17e	43.2	6.3	17.9	0.0	12.0	N/A

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

FY15 growth on track as Q2 softness was expected

As anticipated, aap's Q2 trading was affected by weak orders in the high-margin Biomaterials business, which has grown strongly during several recent quarters. Group revenues shrank by 20% to €6.5m, driven by a 34% decline in Biomaterials to €3.2m, partly offset by LOQTEQ revenues rising 15% to €2.0m. LOQTEQ's recent cannibalisation of other Trauma revenues stabilised, resulting in a 9% rebound in other revenues to €1.2m. Both group revenues and EBITDA of -€0.8m (including €1.5m non-recurring costs due to the planned sale of Biomaterials) exceeded company guidance for Q2 of €5.0-6.5m and -€1.0-1.5m, respectively.

Preparations for US LOQTEQ launch well underway

Appointed distributors are due to launch LOQTEQ in six US states in Q3 with more significant sales expected in Q4. aap is building stock (+€2.1m y-o-y in Q2 also in anticipation of a strong Q3 in Biomaterials) and is hosting product training courses for the employees of the new distributors. Moreover, management is strengthening in a targeted manner the US product management and distribution teams.

Progress with product launches and developments

aap expanded its LOQTEQ portfolio in Q2 to include a radius system with variable locking technology and plates with polyaxial locking technology. Further, it is developing a foot and ankle joint plate system and aims to launch a periprosthetic femoral plate in H2. It intends to submit its antimicrobial silver coating technology for CE-marking by the end of FY15. While still opportunistic about a divestment, it has identified new expansion opportunities within high-margin Biomaterials.

Valuation: Attractive upside remains

Based on a DCF, we reduce our valuation from €94m to €91m or €2.96 per share. The change reflects the €5m reduction in net cash since the start of the year, partly offset by rolling forward our valuation. An eventual sale of Biomaterials may crystallise €3.26 per share (reduction from €3.42 due to lower net cash), based on assumed net divestment proceeds of €35m.

24 August 2015

Price	**€2.15**
Market cap	**€66m**

Net cash (€m) at end H115	2.8
Shares in issue	30.7m
Free float	34%
Code	AAQ
Primary exchange	Xetra
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.9)	(5.3)	(22.0)
Rel (local)	5.6	11.0	(27.6)
52-week high/low		€2.85	€2.18

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

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Financials: Full-year outlook unchanged

Despite the soft Q2, we expect aap to meet its financial guidance of €33-35m revenue and €2.5-3.5m EBITDA in FY15e. Having delivered 27% growth in H1 (€5.6m revenues) aap expects LOQTEQ to grow by c 25% in FY15e to over €10m, with the decisive factors being the Chinese market and LOQTEQ's planned launch in the US and possibly Brazil in H2. Key to achieving the EBITDA target will also be delivery on several projects. We forecast group revenues of €34.2m (+12%) and EBITDA of €3.0m (+34%) in FY15e and a further 13% and 64% growth in revenues and EBITDA, respectively, in FY16e. We note the fast internationalisation of aap's business with sales outside Europe increasing from €3.3m (23% of group revenues) in H114 to €5.3m (+39% of group revenues) in H115.

Since H214, aap has been working on raising production capacity of its trauma products, enabling the production of 20,000 anatomical plates per quarter. In the next phase of the plan, aap expects to further raise output but also, importantly, reduce its dependency on costly third-party production. This should prompt an improvement in gross margins, consistent with our forecasts of a 5 percentage point improvement FY14-18e.

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: Healthy upside despite slight downgrade

We value aap at €91m or €2.96 per share, based on DCF. The change reflects the €5m reduction in net cash caused by the working capital build up in anticipation of LOQTEQ's US launch and €1.5m extraordinary expenses relating to the planned sale of Biomaterials, in addition to the temporary operating losses in Q2. The negative impact on the valuation from the net cash reduction is partly offset by rolling forward our valuation. 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%).

Exhibit 1: DCF

PV cash flows (€m)	6.6
PV intermediate term	40.7
PV residual	40.6
Enterprise value	88.0
Net debt/(cash)	(2.8)
Equity value	90.8
Shares in issue (m)	30.7
Share valuation (€)	2.96

Source: Company data, Edison Investment Research estimates

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 €2.8m at the end of H115 (previously €7.7m based on FY14). This would yield a pro forma enterprise value of €32m (current EV €67m), leaving the remaining fast-growing Trauma business trading at 2.16x Trauma sales of €14.8m in 2015e vs 3.3x for its global orthopaedic peers (Tornier, Wright Medical, Integra Lifesciences, Smith & Nephew, Stryker and Zimmer-Biomet). Weighing 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). On this multiple, the addition of €38m in cash gives a market cap of €100m and a valuation per share of €3.26. The downgrade from €3.42 per share of this illustrative valuation reflects the lowering of the net cash position from €7.7m at the previous valuation based on FY14.

Exhibit 2: Financial summary

€000s	2014	2015e	2016e	2017e
Year-end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	30,633	34,176	38,137	43,234
Total Output	32,846	36,731	40,706	45,819
Cost of Sales	(11,834)	(12,498)	(13,790)	(14,445)
Gross Profit	18,799	21,678	24,347	28,788
EBITDA	2,267	3,037	5,038	8,265
Operating Profit (before amort. and except.)	762	1,301	3,112	6,167
Intangible Amortisation	(816)	(2,182)	(2,263)	(2,345)
Exceptionals	0	0	0	0
Other	0	0	0	0
Operating Profit	(54)	(881)	849	3,822
Net Interest	(74)	(185)	(85)	134
Profit Before Tax (norm)	688	1,116	3,027	6,301
Profit Before Tax (FRS 3)	(177)	(1,066)	764	3,956
Tax	(361)	(405)	(560)	(800)
Profit After Tax (norm)	278	711	2,467	5,501
Profit After Tax (FRS 3)	(538)	(1,471)	204	3,156
Average Number of Shares Outstanding (m)	30.7	30.7	30.7	30.7
EPS - normalised (c)	0.91	2.32	8.04	17.94
EPS - (IFRS) (c)	(1.75)	(4.80)	0.66	10.29
Dividend per share (p)	0.0	0.0	0.0	0.0
Gross Margin (%)	61.4%	63.4%	63.8%	66.6%
EBITDA Margin (%)	7.4	8.9	13.2	19.1
Operating Margin (before GW and except.) (%)	2.5	3.8	8.2	14.3
BALANCE SHEET				
Fixed Assets	25,017	27,272	28,582	29,661
Intangible Assets	15,198	15,088	14,892	14,610
Tangible Assets	7,690	10,055	11,561	12,921
Investments	2,129	2,129	2,129	2,129
Current Assets	32,840	29,866	29,579	32,608
Stocks	9,400	9,930	10,957	11,477
Debtors	8,838	9,860	10,480	11,289
Cash	12,165	7,639	5,705	7,405
Other	2,437	2,437	2,437	2,437
Current Liabilities	(7,452)	(7,954)	(8,524)	(9,224)
Creditors	(5,455)	(5,957)	(6,527)	(7,227)
Short term borrowings	(1,997)	(1,997)	(1,997)	(1,997)
Long Term Liabilities	(5,189)	(5,107)	(4,855)	(4,855)
Long term borrowings	(2,466)	(2,384)	(2,258)	(2,258)
Other long term liabilities	(2,723)	(2,723)	(2,597)	(2,597)
Net Assets	45,216	44,077	44,783	48,189
CASH FLOW				
Operating Cash Flow	(2,683)	2,076	4,022	7,677
Net Interest	(125)	(35)	64	284
Tax	(136)	(394)	(521)	(740)
Capex	(5,133)	(6,173)	(5,500)	(5,521)
Acquisitions/disposals	18,291	0	0	0
Financing	0	0	0	0
Dividends	0	0	0	0
Net Cash Flow	10,213	(4,526)	(1,934)	1,700
Opening net debt/(cash)	3,436	(7,702)	(3,258)	(1,450)
HP finance leases initiated	0	0	0	0
Other	925	82	126	0
Closing net debt/(cash)	(7,702)	(3,258)	(1,450)	(3,150)

Source: aap Implantate, Edison Investment Research forecasts

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