

# aap Implantate AG

## US LOQTEQ launch poised to drive H2 recovery

Q2 update

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.

Healthcare equipment  
& services

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



### 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 |

### Analysts

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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     |
| <b>PROFIT &amp; LOSS</b>                     |       |          |          |          |          |
| 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     |
| <b>BALANCE SHEET</b>                         |       |          |          |          |          |
| 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   |
| <b>CASH FLOW</b>                             |       |          |          |          |          |
| 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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