INGHAM ANALYTICS
Equity Research and Advisory Services

Healthcare: Pharmaceuticals

Report catalyst: private placement and listing on the Johannesburg Stock Exchange

Ascendis Health

JSE short code: ASC

A wealth of possibilities

Ascendis Health represents a unique new medicinal and wellness products investment for small- to mid-cap investors. The constituent businesses cover human, animal and plant wellbeing requirements and there is a compatible theme spanning the portfolio. A combination of proven track records, established routes to market, consumer brand recognition, use of premium raw materials in product composition and the need for government chemical registration results in challenging moats for would-be competitors to surmount and a fair degree of pricing advantage. There is a clear strategic purpose behind the targeted businesses methodically acquired since Ascendis was incorporated in 2008. Private placements have recently been concluded. As a precursor to a listing there is an institutional placement underway together with a secondary sell-down by majority owners Coast2Coast and management is invested too. Ascendis has been courted by private equity investors but a decision to seek a public listing satisfies the owners desire to raise the group profile, retain a majority stake as an anchor shareholder with long term wealth creation objectives, achieve optimum valuation over time, create acquisition currency and provide a transparent pricing environment for management incentive. Whether all this is sufficient for Ascendis to be a successfully performing group in future or have the differentiating characteristics to sustain a premium pharmaceutical rating remains to be seen. Ascendis is to be listed effective 22 November 2013 with a 40% free float.

The year ended June 2014 will be the first full financial year for Ascendis Health as a listed entity with three reporting segments - Consumer Brands, Pharma-Med and Phyto-Vet. Annualised turnover is projected to be R1.9 billion with profits before interest, tax, depreciation and amortisation at R259 million. There is now sufficient size to take advantage of economies of scale in procurement, shared services, treasury management, best practice know-how and leadership. Each business within the group has developed a known value proposition with customers and has an entrepreneurial business culture that should pair well with a small group-level management team. Organic and acquisitive growth in South Africa, the African continent and export markets is being sought. Profitability is likely to run ahead of turnover growth for the foreseeable future. Ascendis has already indicated that it is in advanced discussions with respect to the purchase of a medical devices business that could conceivably be included in the Pharma-Med division.

The investment case:

- Proven businesses with a wellness and medicinal focus underpin the group
- A combination of FMCG and Pharma characteristics
- Strategy to ratchet up organic growth and performance and add complementary businesses
- Substantially cash generating but rate of re-investment in operations could do to be substantially increased

Ascendis is valued as a growth stock with no dividends factored in. Fair value is 1400 cents, target price is 1600 cents.

June Year end Currency ZAR	Sales million	PBITDA million	PBIT million	Earnings Ex-amortisation million	EPS Cents	EPS ex amortisation Cents	Free Cash flow Cents	EV/ PBITDA (x)	P/E (x)
2014	1 913,7	259,0	233,2	165,2	67,0	71,9		9,8	15,3
2015	2 181,6	350,6	316,3	217,0	89,6	94,5	111,0	6,5	11,6
2016	2 469,5	415,8	376,2	265,1	110,5	115,4	98,2	5,0	9,5
2017	2 784,7	492,6	447,2	322,0	135,3	140,2	121,3	3,6	7,8
2018	3 116,9	577,1	525,7	385,0	162,7	167,6	147,8	2,5	6,6

Fair value of equity R3 216 million	ROE 18% 2015, ROCE 18%	Share price 1100c	PEG ratio 0,79
Fair value per share 1400 cents	F2014 shareholder equity R1 137 million	Market cap R2 527 million	Shares in issue 229 735 527
Target price 1600 cents	Forecast book value 495 cents	Company is retaining cash for reinvestment	No dividends assumed

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Pricing and estimates effective close of business 11 November 2013

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Company information

The Ascendis Health company website http://www.ascendis.co.za/ provides financial and operational information that will further assist investors in making an informed judgement call.

A pre-listing statement issued in compliance with the Listings Requirements of the JSE provides further useful commercial, financial, regulatory and other information.

Disclosure

Mark N Ingham (Ingham), director of Ingham Analytics Ltd, has partnered with Coast2Coast (C2C), the founder and controlling shareholder of Ascendis Health, as an independent equity research provider. The descriptions, opinions, financial forecasts, valuations and conclusions reached are entirely those of Ingham. The report conforms to best financial analysis practice and is fully compliant with relevant professional codes of conduct and legislative imperatives. Both C2C and Ascendis Health agreed to respect the independence of Ingham. In making an evaluation of the company Ingham may take into account material confidential information without necessarily making that information available in the investment report or to third parties. He may use material and immaterial public information and non-public immaterial information to arrive at a conclusion that has the equivalence of material non-public information and apply deductive logic/reasoning in arriving at a conclusion.

At time of issue of this report Ingham held no beneficial interest, direct or indirect, in the equity of C2C or Ascendis Health.

This report is confidential, issued for the information of clients of Ingham Analytics Ltd and potential investors in Ascendis Health and may not be disseminated other than by prior consent. Sources referenced are reliable and opinions are formulated in good faith based on professional judgment and thorough analysis. Use hereof or action taken is done so at own risk.

Stock appraisal checklist on Ascendis Health

Industry Positioning	**	Established businesses at varying stages of their business life cycles
Management	***	Experienced owner-managers, group executives, technical and operating staff
Transparency	**	Appropriate disclosure, open-door to interested investors or business vendors
Balance sheet	**	Well capitalised, adequate liquidity, able to fund growth and acquisitions
Sales Growth	*	Ahead of nominal GDP in South Africa, Pharma offers best upside, exports
Earnings Growth	***	Ahead of sales, economies of scale with group structure, management incentivised
Rating	**	EV/EBITDA and PE attractive; little value trap risk, growth stock rating
Upside	***	The stock has strong potential upside if there is confidence in the strategy and execution
Downside	*	Economic recession or competition permanently depressing earnings – deemed a low probability given historic resilience and new growth vectors
Volatility	**	Relatively defensive properties, affordable through to premium products
Stock liquidity	*	Constrained by majority stake of C2C and management interest in equity, 40% free float
Shareholder structure	**	C2C 54% post listing, management 15%, institutional and private 31%

*** Very Good ** Good * Satisfactory - Unsatisfactory -- Poor --- Very Poor

SWOT on Ascendis Health

Strengths

- Operating entities founded between 1960 and 2007
- Proven business models and brand acceptance
- Acquisitions strategically well-chosen
- Skilled and motivated entrepreneurial management
- Financial position robust on listing

Weaknesses

- Generic pharmaceutical market subject to stiff regulatory and market pressures
- Exchange rate exposure is high
- The strategic rationale is appealing but only time will tell if it will be sustainably value enhancing
- Capex, investment in R&D and innovation seems light

Opportunities

- Optimising margin through integration and procurement
- Scope for further complementary bolt-ons
- Foreign markets, exports to offset exchange rate risk
- Group treasury management systems to mitigate risks
- Pharmaceuticals has barely tapped the market potential

Threats

- Price taker in Pharma
- Maintaining active ingredient integrity
- Government health policy and implementation
- Relative customer concentration – only in a few areas
- Failure to reinvest would undermine investment case

Exhibit 1

Ascendis Health company roadmap and strategic forces

Company road map

Past

March 2008: Nutrivest (Ascendis 2011)
2009 thru 2010: strategy formulated, deal team created, companies identified
June 2011: Efekto acquired
July 2011: Sportron and Regal acquired
February 2012: Avima acquired
April 2012: Chempure acquired
September 2012: Nimue Int. acquired
May thru October 2013: SSN, Nimue SA, Solal, Pharmachem, Marltons, Bolus, Evox, Swissgarde acquired

Present

Capital raising, pre-listing roadshow

Listing on JSE 22 November 2013 R1bn in equity, R500m debt consolidation

Establishment of corporate office with support services infrastructure

Integration of businesses into three-pillars of Consumer Brands, Pharma-Med, Phyto-Vet

Financial and IT systems commonality

Future

Three divisions a platform for an ambitious growth agenda

Exploiting library of dossiers, substantially increased government drug tender business + private market

Medium term opportunities in select African countries and internationally

Capacity to fund acqusitions, cash flow appears predictable

Strategic forces analysis

Substitutes

Product substitutes

Wellness products are available at different price points

Pharma generics is commoditised on pricing and heavily regulated - government business is tendered

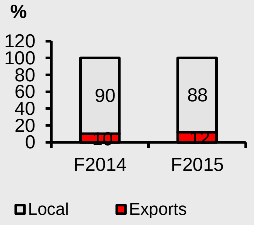
Healthcare equipment is available from distributors or direct
Plant and animal care products are available, regulation, ingredient sourcing

Some direct competitors to Ascendis
Aspen, Adcock Ingram, Cipla Medpro etc
Pharmacy and chainstore housebrands
Warren Chem, Dermalogica, RegimA
USN, Biogen, AMWAY, Herbalife, Vital
Starke Ayers, Green Cross, AVI

Customers

Variety of regional and national customers, small export presence as yet
Customer concentration is not particularly high
Dis-Chem is an important channel in Consumer Brands
Government tender business accounts for lion's share of Pharma-Med for now but expected to decrease

Customer mix



Suppliers

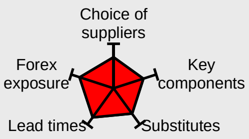
Specialist ingredients sourced from best in class worldwide

Food-grade and pharma specification

Lead times can be lengthy - working capital investment

Forex exposure

Supplier matrix



A smaller area denotes less pressure from

Competition – USP

Established routes to market, known value propositions, recurring business and brand recognition

Balance sheet capacity, anchor shareholder with long view, proven management, entrepreneurship

Good base for international expansion
Harnessing of efficiency opportunities through group procurement and key support services

New entrants

Regulated Pharma industry and hurdles to access limits players

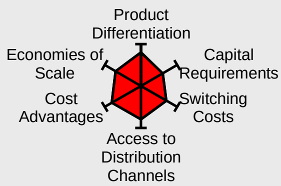
State drug tender qualification

Market presence, shelf space and relationships with national stockists

Chain stores could compete in certain areas but scale makes it unattractive

Premium quality ingredients a prerequisite

New entrant matrix



Larger area = higher barriers to entry

Financial and operational forecasts perspective

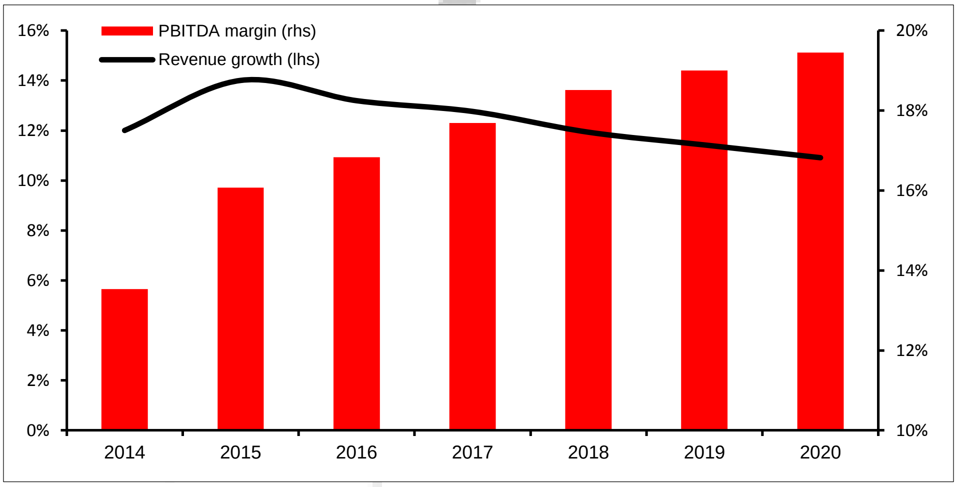
Apropos of Ingham Analytics group financial and operating segment forecasts for Ascendis Health, the following salient factors influencing the outcomes merit mention.

- ✓ Ascendis will report a maiden half year result for the period ended 31 December 2013 in the early part of calendar 2014 and the first full year result will be for the year ended 30 June 2014.
- ✓ Individual businesses have had differing year ends and not all companies will have been included as part of Ascendis for a full twelve months – notably Pharmachem, Marltons, Bolus, Evox and Swissgarde. Published reviewed or audited results for the 2014 fiscal will thus not be a true reflection of operating performance of the group in the future.
- ✓ The forecast for the year ended 30 June 2014 is provided by management and included in the road show presentation. The figures are done on a consolidated basis and there is an annualised adjustment to give a reasonably accurate measure of what all business would contribute as if they were included for a full twelve months.
- ✓ The annualised forecast for the year ended 30 June 2014 is the starting point from which future Ingham estimates are derived through to F2020.
- ✓ The Ascendis F2014 forecast is normalised to exclude one-off listing costs of R16 million but includes usual corporate office expenses, largely payroll. In the Ingham forecasts the group share services expense is off a base of R15 million in F2014 and then growing at 5% per annum.
- ✓ The individual businesses have been privately owned and managed. Historical accounts would not provide the best gauge of how Ascendis Health as a new listed group could perform in future. But if the group had hypothetically existed as an aggregation of the component pieces from 2008 as a base year then compound annual growth in revenue of 13% would have been achieved over a five year period to June 2013.
- ✓ In the modelling assumptions, cost of sales is assumed to gain a small but worthwhile benefit from group-wide buying power. Cost of sales in F2014 is estimated to be R1.1 billion and growing to exceed R1.5 billion within three years. A modest 1% saving in current procurement costs adds 4 cents to earnings per share after tax or 5%.
- ✓ At the time of writing rand exchange rate is in one of its periodic very weak phases. The dollar, euro and sterling are the three currencies that most affect Ascendis and the rand is currently exchanging at approximately R10.00, R13.50 and R16.00 respectively. Whilst strengthening cannot be ruled out, with some benefits to cost of raw material inputs, the assumption is that the rate of exchange will show a steady but modest deprecation in line with inflation differentials between South Africa and advanced economies. An average inflation rate of around 5% would correspond to the average of the past fifteen years.
- ✓ No dividends are assumed with cash retained for growth in the foreseeable future. The directors have suggested a 3x to 5x cover ratio subject to caveats.
- ✓ Ascendis would appear to have a so-called lazy balance sheet going forward, with substantial cash building up in the absence of dividend payments or if there is no material reinvestment. For modelling purposes this may be so but in reality I would expect cash to be put to work and at some point dividends are likely to be commenced.

Forecasts for fiscal years ended June - graphical

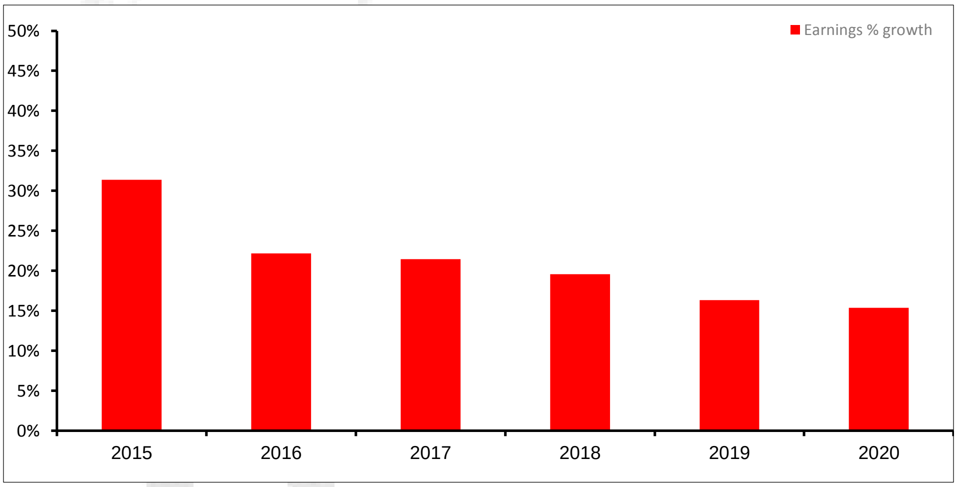
Revenue growth and PBITDA margin

Profit before interest, tax depreciation and amortisation margins have scope to improve within the divisions



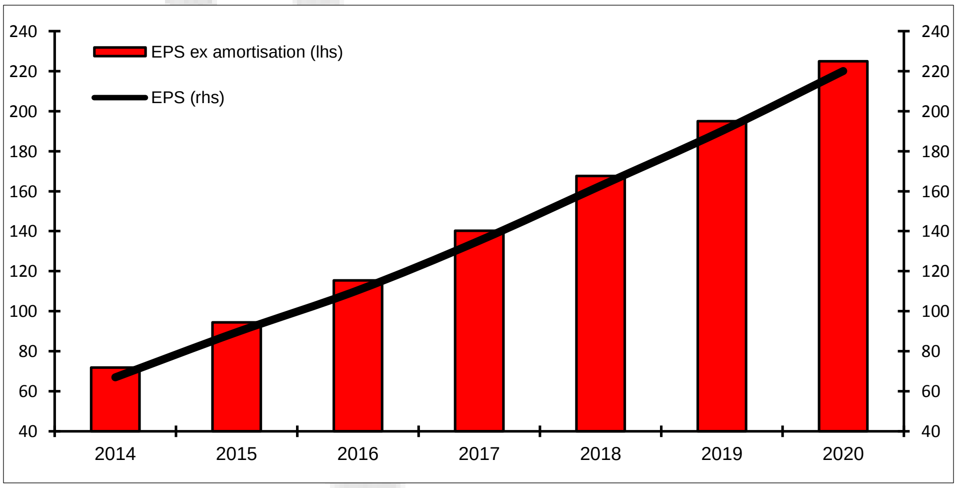
Earnings growth from F2014 base

Ascendis will report a maiden half year result for the period ended 31 December 2013 in the early part of calendar 2014 and the first full year result will be for the year ended 30 June 2014



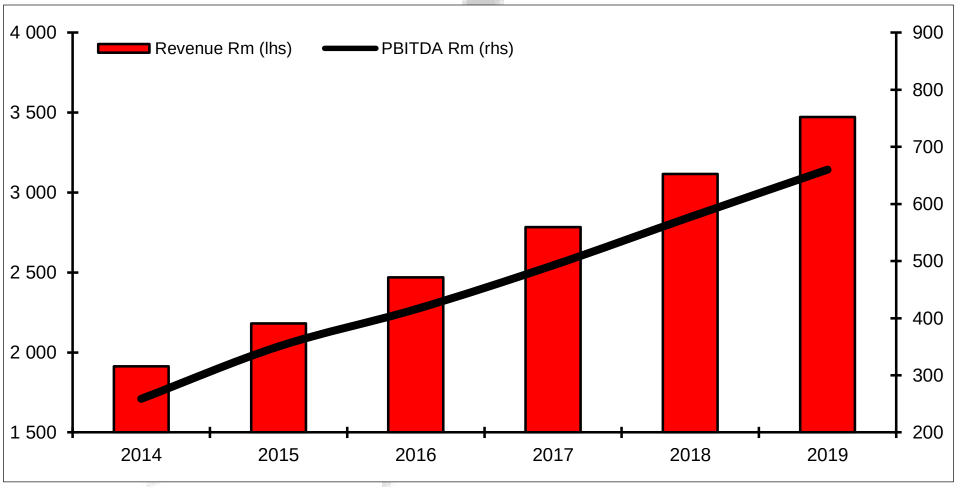
EPS and EPS excluding amortisation

Compound growth rate of 21% indicated in possible future EPS excluding amortisation



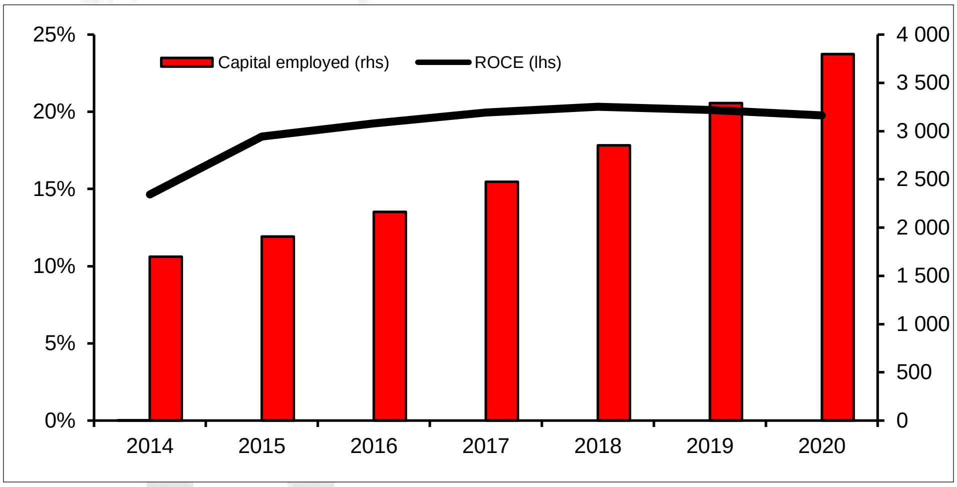
Revenue of over R1.9 billion and PBITDA of R259 million in F2014 on an annualised, normalised basis

Revenue and PBITDA in ZAR million



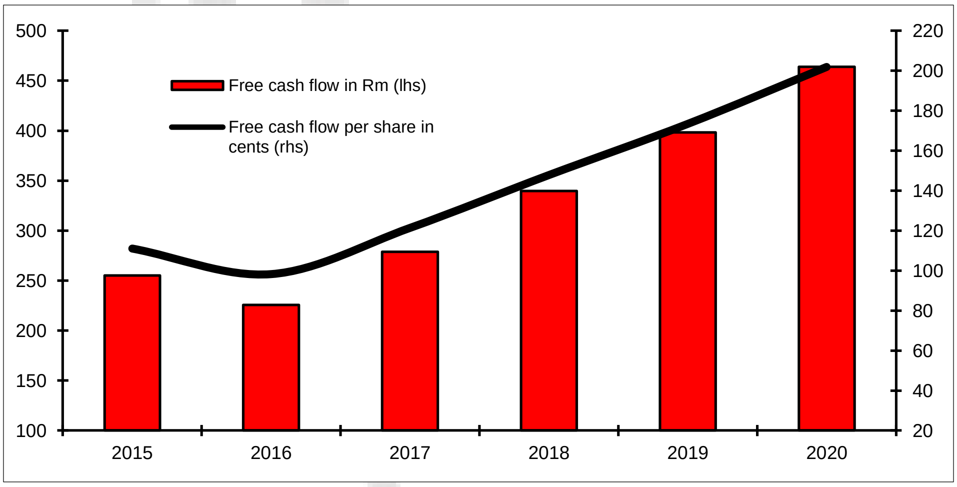
A well capitalised balance sheet, ROCE is likely to be at a higher level in future than modelling indicates as cash gets put to work better

Capital employed and ROCE %



Strong and reasonably predictable cash flows are possible

Free cash flow in ZAR million and cents per share



Segment forecasts

Exhibit 2 Segment estimates

Source: Ascendis, MN Ingham calculations

ZAR	F2014	F2015	% ch.	F2016	% ch.	F2017	% ch.	F2018	% ch.	F2019	% ch.	F2020	% ch.	CAGR
Revenue														
Pharma-Med	440 625 027	568 891 172	29,1	689 506 811	21,2	817 548 213	18,6	950 971 833	16,3	1 095 519 552	15,2	1 242 319 172	13,4	18,9%
Phyto-Vet	615 167 173	649 874 937	5,6	703 948 846	8,3	770 315 692	9,4	833 787 951	8,2	901 840 569	8,2	974 068 229	8,0	8,0%
Consumer	857 914 456	962 887 845	12,2	1 076 069 921	11,8	1 196 862 215	11,2	1 332 157 383	11,3	1 475 707 942	10,8	1 635 864 000	10,9	11,4%
Net total	1 913 706 656	2 181 653 954	14,0	2 469 525 578	13,2	2 784 726 120	12,8	3 116 917 167	11,9	3 473 068 063	11,4	3 852 251 401	10,9	12,4%
PBITDA														
Pharma-Med	48 441 604	86 690 053	79,0	115 317 501	33,0	148 159 872	28,5	184 521 421	24,5	215 834 639	17,0	247 669 759	14,7	31,3%
Phyto-Vet	79 170 988	96 393 244	21,8	107 362 144	11,4	121 950 631	13,6	136 389 172	11,8	152 333 718	11,7	169 073 928	11,0	13,5%
Consumer	146 406 011	182 986 158	25,0	209 354 523	14,4	239 533 343	14,4	274 171 923	14,5	310 675 616	13,3	352 285 910	13,4	15,8%
Sub-total	274 018 603	366 069 455	33,6	432 034 169	18,0	509 643 846	18,0	595 082 516	16,8	678 843 973	14,1	769 029 597	13,3	18,8%
Shared services	15 041 056	15 500 000	3,1	16 275 000	5,0	17 088 750	5,0	17 943 188	5,0	18 840 347	5,0	19 782 364	5,0	4,7%
Net total	258 977 547	350 569 455	35,4	415 759 169	18,6	492 555 096	18,5	577 139 329	17,2	660 003 626	14,4	749 247 233	13,5	19,4%
Revenue share														
Pharma-Med	23%	26%		28%		29%		31%		32%		32%		
Phyto-Vet	32%	30%		29%		28%		27%		26%		25%		
Consumer	45%	44%		44%		43%		43%		42%		42%		
Net total	100%	100%		100%		100%		100%		100%		100%		
PBITDA share														
Pharma-Med	18%	24%		27%		29%		31%		32%		32%		
Phyto-Vet	29%	26%		25%		24%		23%		22%		22%		
Consumer	53%	50%		48%		47%		46%		46%		46%		
Net total	100%	100%		100%		100%		100%		100%		100%		
PBITDA margin														
Pharma-Med	11,0%	15,2%		16,7%		18,1%		19,4%		19,7%		19,9%		
Phyto-Vet	12,9%	14,8%		15,3%		15,8%		16,4%		16,9%		17,4%		
Consumer	17,1%	19,0%		19,5%		20,0%		20,6%		21,1%		21,5%		
Net total	13,5%	16,1%		16,8%		17,7%		18,5%		19,0%		19,4%		

Profit & Loss forecasts

Exhibit 3 Profit & Loss Account

Source: Ascendis, MN Ingham calculations

Year end June ZAR	2014	2015	2016	2017	2018	2019	2020	CAGR
Number of months	12	12	12	12	12	12	12	
Revenue	1 913 706 656	2 181 653 954	2 469 525 578	2 784 726 120	3 116 917 167	3 473 068 063	3 852 251 401	12,4%
% annual change		14,0	13,2	12,8	11,9	11,4	10,9	
Cost of sales	1 132 022 543	1 265 727 091	1 438 945 095	1 623 392 652	1 815 821 032	2 030 549 481	2 258 186 832	
% annual change		11,8	13,7	12,8	11,9	11,8	11,2	
Gross profit	781 684 113	915 926 863	1 030 580 483	1 161 333 468	1 301 096 135	1 442 518 582	1 594 064 569	
% annual change		17,2	12,5	12,7	12,0	10,9	10,5	
Expenses	537 810 112	584 276 541	637 021 804	694 380 235	753 171 329	815 638 513	882 001 041	
% annual change		8,6	9,0	9,0	8,5	8,3	8,1	
Sundry income	15 103 545	18 919 134	22 200 490	25 601 863	29 214 523	33 123 556	37 183 705	
% annual change		25,3	17,3	15,3	14,1	13,4	12,3	
PBITDA	258 977 547	350 569 455	415 759 169	492 555 096	577 139 329	660 003 626	749 247 233	19,4%
% annual change		35,4	18,6	18,5	17,2	14,4	13,5	
Dep/amort	25 818 668	34 239 153	39 588 336	45 374 968	51 424 433	57 893 725	64 601 419	
% annual change		32,6	15,6	14,6	13,3	12,6	11,6	
PBIT	233 158 879	316 330 302	376 170 833	447 180 128	525 714 895	602 109 901	684 645 813	19,7%
% annual change		35,7	18,9	18,9	17,6	14,5	13,7	
Interest earned/(paid)	-19 254 249	-30 500 000	-23 500 000	-15 500 000	-6 500 000	4 500 000	17 500 000	
Profit before tax	213 904 630	285 830 302	352 670 833	431 680 128	519 214 895	606 609 901	702 145 813	
Taxation	59 893 296	80 032 485	98 747 833	120 870 436	145 380 171	169 850 772	196 600 828	
PAT	154 011 334	205 797 818	253 923 000	310 809 692	373 834 725	436 759 128	505 544 986	
Attributable earnings	154 011 334	205 797 818	253 923 000	310 809 692	373 834 725	436 759 128	505 544 986	21,9%
Earnings ex amort.	165 198 929	216 985 413	265 110 595	321 997 287	385 022 320	447 946 724	516 732 581	20,9%
% annual change		31,3	22,2	21,5	19,6	16,3	15,4	
Retained surplus	154 011 334	205 797 818	253 923 000	310 809 692	373 834 725	436 759 128	505 544 986	
EPS	67,0	89,6	110,5	135,3	162,7	190,1	220,1	21,9%
% annual change		33,6	23,4	22,4	20,3	16,8	15,7	
EPS ex amortisation	71,9	94,5	115,4	140,2	167,6	195,0	224,9	20,9%
% change		31,3	22,2	21,5	19,6	16,3	15,4	
Shares in issue	229 735 527	229 735 527	229 735 527	229 735 527	229 735 527	229 735 527	229 735 527	
Cost of sales%	59,2%	58,0%	58,3%	58,3%	58,3%	58,5%	58,6%	
Expenses %	28,1%	26,8%	25,8%	24,9%	24,2%	23,5%	22,9%	
GP margin %	40,8%	42,0%	41,7%	41,7%	41,7%	41,5%	41,4%	
Dep/amort to sales %	1,3%	1,6%	1,6%	1,6%	1,6%	1,7%	1,7%	
PBITDA margin %	13,5%	16,1%	16,8%	17,7%	18,5%	19,0%	19,4%	
Trading margin %	12,2%	14,5%	15,2%	16,1%	16,9%	17,3%	17,8%	
Ordinary tax rate %	28%	28%	28%	28%	28%	28%	28%	

Balance Sheet forecasts

Exhibit 4 Balance Sheet

Source: Ascendis, MN Ingham calculations

Year end June ZAR	2014	2015	2016	2017	2018	2019	2020
Ordinary share capital	994 559 074	1 137 262 007	1 345 014 824	1 600 892 824	1 913 657 516	2 289 447 241	2 728 161 369
Revaluation	1 955 000	1 955 000	1 955 000	1 955 000	1 955 000	1 955 000	1 955 000
Retained income	140 747 933	205 797 818	253 923 000	310 809 692	373 834 725	436 759 128	505 544 986
Ordinary shareholders interest	1 137 262 007	1 345 014 824	1 600 892 824	1 913 657 516	2 289 447 241	2 728 161 369	3 235 661 355
Total shareholders funds	**1 137 262 007**	**1 345 014 824**	**1 600 892 824**	**1 913 657 516**	**2 289 447 241**	**2 728 161 369**	**3 235 661 355**
Long-term Borrowings	561 931 080	561 931 080	561 931 080	561 931 080	561 931 080	561 931 080	561 931 080
Total non-current liabilities	**561 931 080**	**561 931 080**	**561 931 080**	**561 931 080**	**561 931 080**	**561 931 080**	**561 931 080**
Fixed assets	88 392 862	107 093 687	131 143 696	160 980 337	196 866 443	239 221 842	288 284 934
Accumulated Depreciation	0	18 700 826	42 750 835	72 587 476	108 473 582	150 828 980	199 892 072
Total Fixed Assets	88 392 862	88 392 862	88 392 862	88 392 862	88 392 862	88 392 862	88 392 862
Goodwill	521 454 400	521 454 400	521 454 400	521 454 400	521 454 400	521 454 400	521 454 400
Intangibles	174 113 422	158 575 095	143 036 768	127 498 441	111 960 114	96 421 787	80 883 460
Deferred tax asset	8 016 044	8 016 044	8 016 044	8 016 044	8 016 044	8 016 044	8 016 044
Total other long term assets	703 583 866	688 045 539	672 507 212	656 968 885	641 430 558	625 892 231	610 353 904
Total non-current assets	**791 976 727**	**776 438 400**	**760 900 073**	**745 361 746**	**729 823 419**	**714 285 092**	**698 746 765**
Net Current Assets	907 216 359	1 130 507 504	1 401 923 831	1 730 226 850	2 121 554 901	2 575 807 357	3 098 845 670
Stock	319 267 082	370 881 172	419 819 348	473 403 440	529 875 918	590 421 571	654 882 738
Trade debtors	314 393 054	370 881 172	419 819 348	473 403 440	529 875 918	590 421 571	654 882 738
Cash	543 753 807	800 683 897	1 028 215 192	1 308 907 221	1 650 380 423	2 050 694 289	2 516 493 949
Total Current Assets	**1 177 413 943**	**1 542 446 241**	**1 867 853 889**	**2 255 714 102**	**2 710 132 260**	**3 231 537 430**	**3 826 259 425**
Creditors	235 777 259	370 881 172	419 819 348	473 403 440	529 875 918	590 421 571	654 882 738
Short term borrowings	0	0	0	0	0	0	0
Tax	14 971 531	21 608 771	26 661 915	32 635 018	39 252 646	45 859 708	53 082 223
Provisions	18 444 536	18 444 536	18 444 536	18 444 536	18 444 536	18 444 536	18 444 536
Finance lease	1 004 258	1 004 258	1 004 258	1 004 258	1 004 258	1 004 258	1 004 258
Total Current Liabilities	**270 197 584**	**411 938 737**	**465 930 057**	**525 487 252**	**588 577 358**	**655 730 073**	**727 413 756**
Total assets	1 969 390 670	2 318 884 641	2 628 753 962	3 001 075 848	3 439 955 679	3 945 822 523	4 525 006 190
Total equity & liabilities	1 969 390 670	2 318 884 641	2 628 753 961	3 001 075 848	3 439 955 679	3 945 822 522	4 525 006 190
Balance check	0	0	0	0	0	0	0
Employment of capital	1 699 193 086	1 906 945 904	2 162 823 904	2 475 588 596	2 851 378 320	3 290 092 449	3 797 592 435
NAV	1 137 262 007	1 345 014 824	1 600 892 824	1 913 657 516	2 289 447 241	2 728 161 369	3 235 661 355
Number of shares	229 735 527,09	229 735 527,09	229 735 527,09	229 735 527,09	229 735 527,09	229 735 527,09	229 735 527,09
NAV per share cents	495	585	697	833	997	1 188	1 408
Net cash/(Net debt)	-18 177 273	238 752 817	466 284 112	746 976 141	1 088 449 343	1 488 763 209	1 954 562 869
ROE	14%	18%	19%	19%	20%	19%	19%
ROCE	15%	18%	19%	20%	20%	20%	20%
Stock	0,37	0,33	0,33	0,33	0,33	0,33	0,33
Debtors	0,36	0,33	0,33	0,33	0,33	0,33	0,33
Creditors	0,27	0,33	0,33	0,33	0,33	0,33	0,33
	1,00	1,00	1,00	1,00	1,00	1,00	1,00

Cash flow forecasts

Exhibit 5 Cash Flow

Source: Ascendis, MN Ingham calculations

Year end June ZAR	2015	2016	2017	2018	2019	2020
PBITDA	350 569 455	415 759 169	492 555 096	577 139 329	660 003 626	749 247 233
Working capital (Increase)/Decrease	27 001 705	-48 938 176	-53 584 092	-56 472 478	-60 545 652	-64 461 167
Cash generated from operations	377 571 160	366 820 993	438 971 003	520 666 851	599 457 973	684 786 065
Net Interest	-30 500 000	-23 500 000	-15 500 000	-6 500 000	4 500 000	17 500 000
Taxation paid	-73 395 245	-93 694 689	-114 897 333	-138 762 542	-163 243 710	-189 378 313
Cash available from operations	273 675 915	249 626 304	308 573 670	375 404 308	440 714 264	512 907 752
Purchase of property, plant, equipment	-18 700 826	-24 050 009	-29 836 641	-35 886 106	-42 355 398	-49 063 092
Net cash inflow/(outflow)	254 975 089	225 576 295	278 737 030	339 518 202	398 358 865	463 844 660
Cash at beginning	543 753 807	800 683 897	1 028 215 192	1 308 907 221	1 650 380 423	2 050 694 289
Cash at year end	800 683 897	1 028 215 192	1 308 907 221	1 650 380 423	2 050 694 289	2 516 493 949
Opening net (borrowings/cash	-18 177 273	238 752 817	466 284 112	746 976 141	1 088 449 343	1 488 763 209
Closing net borrowings	238 752 817	466 284 112	746 976 141	1 088 449 343	1 488 763 209	1 954 562 869
Reduction/(increase) in net borrowings	256 930 090	227 531 295	280 692 029	341 473 202	400 313 866	465 799 660
Free cash flow	254 975 089	225 576 295	278 737 030	339 518 202	398 358 865	463 844 660
Cash flow per share	111,0	98,2	121,3	147,8	173,4	201,9

Valuing Ascendis

Ascendis Health is raising fresh equity and listing at a price of 1100 cents

Ascendis Health is raising fresh equity and listing at a price of 1100 cents. The question, therefore, is what does this translate to on conventional valuation metrics?

The table below includes relevant forecast data for 2014, 2015 and 2016. The year ended June 2014 is normalised to reflect Ascendis as if it had traded in its new form for a full twelve months with all acquisitions contributing.

Exhibit 6 Listing valuation at 1100 cents per share

Source: Ascendis, MN Ingham calculations

Year ended June - normalised result	2014	2015	2016
	Rm	Rm	Rm
Forecast PBITDA	259,0	350,6	415,8
Forecast adjusted earnings	165,2	217,0	265,1
EPS - cents	71,9	94,5	115,4
Net (debt)/cash	-18	239	466
Shares in issue (m)	229,74	229,74	229,74
Equity value	2 527	2 527	2 527
Enterprise value	2 545	2 288	2 061
EV/PBITDA	9,8	6,5	5,0
Price earnings ratio	15,3	11,6	9,5
Fair value and target price per Ingham - cents	1100	1100	1100

Ascendis is thus listing at a 15.3x earnings multiple and an EV/PBITDA ratio of 9.8x. In view of the anticipated acceleration in earnings and significantly cash-rich balance sheet at the outset, the respective multiples fall to 11.6x and 6.5x

Ascendis is thus listing at a 15.3x multiple and an EV/PBITDA ratio of 9.8x. In view of the anticipated acceleration in earnings and significantly cash-rich balance sheet at the outset, the respective multiples fall to 11.6x and 6.5x.

Possible acquisitions of privately owned businesses in the near term would be executed at a rather lower multiple than public listed companies are rated at and compared to Ascendis on listing.

Possible acquisitions of privately owned businesses in the near term, such as a medical devices business, would be executed at a rather lower multiple than public listed companies are rated at and compared to Ascendis on listing.

Private equity transactions on quality small companies are typically achieving earnings multiples of approximately 7.5x and EV/PBITDA multiples of 5x, sometimes up to 7x. On becoming part of a listed entity an acquired business would achieve a value uplift commensurate to that of the listed acquirer.

To test the reasonableness of the listing price of 1100 cents, I have also taken a share buy-back model and assumed a 10% share buy-back at a cost of borrowing of 8% pre-tax. Should Ascendis purchase its own shares with surplus cash or borrowed money the effect would be as follows.

Exhibit 7 Share buy-back at listing valuation of 1100 cents per share

Source: Ascendis, MN Ingham calculations

Current	Buy back	New					
shares m	shares (10%)	shares m					
229,74	23,0	206,8					
Forecast 2014	Buy back	Cost of	Interest	Tax relief	After tax cost of		
earnings Rm	price cents	buy back Rm	cost Rm	on interest Rm	interest Rm		
165,20	1100	252,7	20,2	5,7	14,6		
Earnings less interest	EPS before	EPS after	% difference	P/E before	P/E after		
cost Rm	cents	cents					
150,6	71,9	72,9	1,3	15,3	15,1		
	Equity	Equity			Gearing before	Gearing after	
	before Rm	after Rm	ROE before %	ROE after %	Rm	Rm	
	1 137,3	884,6	14,5	17,0	-18,2	-270,9	PBITDA
					Gearing %	Gearing %	Interest cover
					1,6%	30,6%	12,0

Buying back its own shares would be marginally EPS accretive

Buying back its own shares would be marginally EPS accretive for Ascendis, gearing would rise from a negligible amount to 30% and ROE would improve. The listing price of 1100 cents, based current fiscal year performance, thus satisfies the reasonableness test.

On a Du Pont ROE model, the flowing outcomes are evident.

The assumption is a 20% ROE, real profits growth of 12% in the higher growth years, possibly over a decade before descending to be in line with GDP and a 14% cost of capital.

Du Pont ROE model indicates listing price fair

The implied exit PE is 13.3x giving a future price on F2015 EPS of 1260 cents and which discounted to the present day at 14% derives a present value of 1018 cents. This is thus in line with the listing price.

Exhibit 8 Du Pont ROE valuation in line with listing price

Source: Ascendis, MN Ingham calculations

DuPont ROE

Forecast ROE in F2015 = 20%
Real stable state growth rate = 12%
Cost of capital = 14%
Implied exit P/E = 13.3x
Diluted EPS F2015 = 94.5 cps
Implied future price on exit P/E = 1260 cents
Discounted present value at 14% WACC = 1018 cents

On a discounted cash flows basis Ascendis offers value

On a discounted cash flows basis I have taken free cash flow forecasts from F2015 through to F2020. F2015 is the first practical year to assume representative cash flows for Ascendis. I have then assumed nominal growth in perpetuity of 5% per annum. The costs of capital is 14%, no gearing is assumed.

Exhibit 9 Discounted cash flows

Source: Ascendis, MN Ingham calculations

Discounted Cash Flows

Risk free rate = 8%
Equity risk premium = 5%
Beta = 1.0
WACC = 14%
No gearing assumed
Perpetual nominal growth rate = 5%
PV of free cash flows = R3.6 billion
Firm value per share F2015 = 1569 cents
Firm value per share as at 11 November 2013 discounted at 14% = 1267 cents

The future value indicated, discounted at 14%, is 1569 cents per share. If I discount this at 14% to the time of writing it is 1267 cents.

Given that this is a growth stock and shall be retaining cash for growth, a dividend discount model or a Gordon growth model would not be helpful.

Ingham Analytics suggested valuation:

Stock market investors may factor in anticipated growth to the post-listing price

From a stock market point of view, with investors factoring in future growth and potential acquisitions in advance, it is feasible for post-listing stock price to be at least 1100 cents or higher.

There is no exact science to valuation, it is as much intuition, knowledge of the people and processes involved and the external forces at play as it is about the mathematics. Ultimately, an asset is worth what people are prepared to pay for it.

Demand for scrip ahead of listing, investors voting with their wallets at 1100 cents

The demand for scrip ahead of listing was oversubscribed. Enough investors have voted with their wallets to pay 1100 cents for that to be a decent indicator of what investors think the assets are worth, even before a public listing and the future newsflow on performance and corporate activity.

Ingham fair value of 1400 cents with an intermediate target price on a twelve month view of 1600 cents

I ascribe a fair value of 1400 cents with an intermediate target price on a twelve month view of 1600 cents. Simply plugging in these figures gives the following outcomes in Exhibit 11 for illustrative purposes.

Book value at listing of 495 cents per share, price to book on listing price is 2.2x

With book value in F2014 estimated at 495 cents per share, price to book on the listing price of 1100 cents is 2.2x and on a 1400 cents fair value it is 2.8x.

Exhibit 11 Ingham fair value and target price indicators

Source: Ascendis, MN Ingham calculations

Year ended June - normalised result	2014	2015
	Rm	Rm
Forecast PBITDA	259,0	350,6
Forecast adjusted earnings	165,2	217,0
EPS - cents	71,9	94,5
Net (debt)/cash	-18	239
Shares in issue (m)	229,74	229,74
Equity value	3 216	3 676
Enterprise value	3 234	3 437
EV/PBITDA	12,5	9,8
Price earnings ratio	19,5	16,9
Fair value and target price per Ingham - cents	1400	1600

Comparative earnings metrics of FMCG stocks are indicated below.

It should be noted that Aspen pays a minimal dividend and is a fully fledged growth stock, retaining for growth. AVI on the other hand is a generous dividend payer, reducing dividend cover this past year to 1.25x. Tiger Brands has a 2x cover. Adcock Ingram is priced for corporate action at present because of the CFR cash and share offer. Pepkor is part-owned by Brait and my sum of the parts value derives an implied EV/PBITDA multiple of 12x.

Exhibit 12 Comparative companies

Source: MN Ingham calculations

Comparative metrics indicate Ascendis is pitched fairly

	Share price cents	EV/PBITDA	Rolling exit PE	Forward PE
Aspen	27 500	19,0	30,0	26,7
Adcock Ingram	6 800	8,8	16,3	16,5
AVI	5 700	10,0	17,0	15,8
Tiger Brands	30 000	12,4	18,2	16,9
Implied multiples	Part of Brait			
Pepkor		12,0		

Key Ascendis Health people

The following individuals, inter alia, will play important operational roles in the business in future.

Capable and experienced leadership team

CEO: Karsten Wellner joined Ascendis in 2011 as CEO following a two decade career with Fresenius AG internationally and independently in the healthcare and nutrition field. Wellner has a key role in guiding the strategic evolution of the business and has become increasingly recognised as the public face of Ascendis Health.

CFO: Robbie Taylor brings experience in agribusiness to Ascendis, more recently as the CFO of a JSE listed poultry and stock feed group. Taylor is well equipped to handle the disciplines associated with Ascendis assuming a main board listing and has been instrumental in facilitating the process.

COO: Richard Crouse spent a number of years in the mobile telephony industry before joining the family business of Chempure as MD. With the acquisition of Chempure by Ascendis in 2012, Crouse was the natural choice to take on the new position of COO of the rapidly evolving group and he is well versed in all aspects of the businesses.

MD Consumer Brands: Marion Burgess brings substantial international managerial experience with multinational healthcare groups to her role as MD of the largest division at Ascendis.

MD Pharma-Med: Immy Mohamed is co-founder of Pharmachem and an established entrepreneur. Having vended in his business to Ascendis he has a crucial role to play in the future growth of this fast-developing pharmaceutical and devices division.

MD Phyto-Vet: Jayen Pather brings a logistics and FMCG background to Ascendis, more recently in the branded health, beauty and wellness sector, and is tasked with leading the growth of this plant and animal part of Ascendis.

Ascendis Health has a strong board of non-executives with requisite industry experience and international perspectives

Original C2C founders have been pivotal in bringing Ascendis about but will have a non-executive role

Gary Shane is the quiet but significant influence behind Coast2Coast and has played a pivotal role in the conception and realisation of Ascendis Health, in which he is the largest shareholder. A successful entrepreneur in his own right he will be an important sounding board and strategic thinker, bringing a long term view on what is best for the business.

Cris Dillon is a co-founder of Coast2Coast and also a shareholder in Ascendis Health. He has had prior experience in investment banking. Dillon has played an energetic, hands on role in the creation of Ascendis and like Shayne is a firm believer in long term investment thinking.

John Bester is non-executive Chairman, bringing experience in the accounting profession and in business, including finance directorships and other non-executive directorships, to the role of steering the Board.

Philip Cunningham is an established entrepreneur. He is currently MD of his own motion picture business specialising in animation technology and has had particular success with various media initiatives.

Bharti Harie is a practicing attorney and holds board directorships. She previously served in various roles over fourteen years at the Industrial Development Corporation.

Background to listing

There are three reporting segments - Consumer Brands, Pharma-Med and Phyto-Vet

Three component pieces

The Ascendis Health group businesses cover human, animal and plant wellbeing requirements. There are three reporting segments - Consumer Brands, Pharma-Med and Phyto-Vet.

The group's origins date to 2008 with financial and strategic backing from the original Coast2Coast founders. Since then the group has taken shape through a series of methodically planned corporate actions.

The constituent businesses have proven track records in their respective fields.

Substantial equity and debt capital secured

To introduce additional shareholders, a private placement was carried out in October 2012 and R30 million was secured.

Subsequently, senior executives subscribed for shares.

Additional equity in the amount of R350 million was secured in June 2013, with R250 million invested by Coast2Coast Investments and the balance by a number of individuals.

A debt package worth R500 million was also secured which reduced the effective annual interest rate to 9%.

A pre-listing capital raise of R50 million was done in September 2013.

Approximately R1 billion in equity will have been injected to Ascendis Health

Assuming a R400 million pre-listing private placement is secured from institutional investors then some R1 billion in equity will have been injected in to Ascendis Health, resulting in a well-capitalised financial position.

On listing date, 17.6 million shares worth R193.5 million will be issued to vendors of various group companies. Post-listing, company management will hold 15% of the equity.

At listing, 229 735 527 shares will be in issue

At listing, 229 735 527 shares will be in issue.

A pre-listing statement will be issued but this is for public information purposes only and is not an invitation to the public to subscribe for shares or an offer to the public to purchase shares in Ascendis.

In the private placement to institutions, there is a minimum of 18,181,818 new subscription shares and a maximum of 36,363,636 new subscription shares together with a maximum of 4,545,455 existing sale shares.

Ascendis is listing at 1100 cents per share on Friday the 22nd of November 2013

Ascendis is listing at 1100 cents per share.

Listing is scheduled for 09H00 on Friday the 22nd of November 2013.

Segment companies

The following companies and brands are included in the portfolio with year of founding indicated in parenthesis.

Within Consumer Brands division, the following companies and brands are included:

- Chempure (1994) – importer and distributor of speciality chemicals of food-grade and pharma specification predominantly from DSM and Hilmar Ingredients
- Solal (2000)– a nutritional supplements and enriched foods business that are sold via retail pharmacy accompanied by professional diagnostics and treatments and medicine formulation
- Nimue (1994) – premium skincare products sold via salons
- Evox (1996) – nutritional supplements for body building, toning or endurance sport
- Scientific Sports Nutrition (SSN) (2008) – body building supplements
- Bolus Distribution (1997) – importation of US sourced branded body building and fitness supplements such as Muscletech
- Sportron (1992) – network marketed nutritional and allied ranges
- Regal (2005) – exclusive licence holder for Foodstate products in South Africa
- Swissgarde (1991) – network marketed herbal health and beauty predominantly in Southern Africa, Nigeria and selected other African markets
- Reviva (2007) – exclusive distributor to retailers of the British ultra-comfort footwear range called Fitflop

Within Pharma-Med division, the following companies and brands are included:

- Pharmachem Pharmaceuticals (2006) is the umbrella brand
- Pharmachem – a Medicines Control Council licensed wholesaler for marketing and distribution of branded generic drugs and over the counter medications
- Dezzo Trading - a Medicines Control Council licensed generic pharmaceutical manufacturer predominantly in the government tender market
- Pharmadyne - a Medicines Control Council licensed manufacturer predominantly in the multivitamin government tender market
- MDI – applicant for registration of all Pharmachem group dossiers

Within Phyto-Vet division, the following companies and brands are included:

- Efekto (1973) – plant fertiliser, nutrition and pest control, seeds and allied accessories sold via retailers
- Avima (1961) – manufacturer of crop pesticides, malaria and tsetse protection, stored grains pesticides and allied phytosanitary formulations
- Marltons (1989) – domestic animal wellbeing products sold via retailers, pet and vet shops

Competitive positioning overview

The target markets are not as clear cut as may appear at a casual glance.

Consumer Brands are discretionary, often nice-to-have products

As a general rule, and the nature of the businesses tells its own story, there is an indulgence or pampering or preventative factor to the Consumer Brands and much of the Phyto-Vet portfolios that hardly makes them cheap to buy.

Consumer Brands are discretionary, often nice-to-have products targeted largely at the mass affluent or the wealthy or the wannabes.

Low-income or no-income people on welfare, and that applies to most South Africans, don't buy Solal 'Naturally High' at R285 a pack together with 'Burnout' at R128 a bottle because they feel stressed.

Those same folks assuredly won't be laying out R700 at Pick n Pay for a 12kg bag of Fish4Dogs pet food, distributed in South Africa by Marltons.

The Pharma offering is largely directed to a less affluent consumer

But the poorer customer would be consumer of a generic drug either via a government hospital or through their dispensing medical doctor or they would be a purchaser of an affordable over the counter cough syrup such as a Bencough from Pharmachem.

And so the reality of Ascendis is that it actually spans the full spectrum of society. As this group develops, grows and bolts-on so in turn will the consumer demographic evolve.

Foreign markets a strategic imperative

And not just in South Africa. Foreign markets in Africa and internationally are a strategic imperative for the group in its new guise and this in turn will add investment appeal.

At around R100 million, most of which is through Avima into Africa and the balance through Nimue International, export business is small and would be an important factor in de-risking a high foreign exchange exposure in cost of sales through the group.

And if, as seems possible, the Pharma-Med segment demonstrates continued accelerating growth in the next few years then the socio-demographic customer profile will probably shift further to low income customers both indirectly through tender business or directly through own private market sales.

Lack of reliable disaggregated market detail

An important point to note is the lack of reliable disaggregated market detail in South Africa for many of the industry areas in which Ascendis companies compete. The old adage about lies, damned lies and statistics applies such is the inconsistency or outright paucity of data.

Brands historically have made it in the face of competition

Competitors are many and varied. There is no one area where Ascendis does not face competition and this is a positive factor as these brands historically have made it in the face of competition.

The Ascendis Consumer Brands companies do not have so-called pricing power, which would presuppose uniqueness, few, if any, rivals and an ability to charge pretty much what you like with little or no elasticity in demand.

Adcock Ingram, a company that Ascendis will be keeping company with in its JSE listing sector, has a solid category presence in curative, wellbeing and personal care yet has seen consistent margin erosion and flat nominal profits.

Pricing advantages

Ascendis has perhaps what is best described as pricing advantages, due maybe to the incumbency benefits that evolve from sticking around. As a listed group, Ascendis will come under increased scrutiny – from shareholders, customers, suppliers and particularly competitors.

Fast food industry success but the hidden price is nutritional

Price leadership can derive from perceived value and not the price level. In this regard, the experience of the fast food industry in South Africa is a noteworthy phenomenon.

Fast food has literally catered well to a seemingly contradictory combination of convenience, quality, affordability and choice.

By achieving these four elements on an industrial scale the fast food companies have in turn become the price leader in eating out. But in achieving this there has to be a sacrifice – and that is arguably nutritional value.

Which is partly why South Africa is increasingly a country populated by the vertically unwell. The efforts of medical insurers to incentivise healthier eating has minimal impact for the simple reason that few can afford comprehensive healthcare cover.

In difficult economic times consumers will migrate to the conveniently affordable even if it is at the cost of their wellbeing. Fast food companies are a primary beneficiary.

Ascendis plays to the wellness theme

Ascendis plays to the wellness theme. It'll have a job persuading a Steers customer to kick the habit but it is well positioned at a time of increasing consciousness about weight and healthiness and the costs benefits of prevention being better than cure.

Keeping up with competition let alone ahead of it will be a challenge.

Re-investment within Ascendis group companies is fairly modest at present

At the moment, re-investment within Ascendis group companies is fairly modest. Depreciation is estimated an annual basis to be running at just over R10 million or 0.5% of revenue. Capex is also estimated to be in line with depreciation for now. Amortisation is R15.4 million.

In F2015, I have depreciation and capex increasing R18.7 million, R24 million in F2016 and then R30 million in F2017. Either way this is still less than 1% of turnover spent on reinvestment.

In comparison, Adcock Ingram in F2012 spent R510 million or 11.5% of its South African revenue on replacement and expansion capex. In F2013 it will spend R260 million. The annual depreciation charge for F2013 I estimate at R150 million – 3% of revenue. Adcock Ingram is admittedly a rather more fixed asset intensive business with property, plant and equipment 50% of non-current assets versus 10% for Ascendis.

Upping of capex necessary in future

Ascendis is a grouping of previously owner-managed businesses that have probably been run for cash and less for return. The demands of being a public listed company are rather different and many of these acquired brands may need a rejuvenation for the next leg of growth and development. Some upping of the capex in both tangible and intangible assets would not be a bad idea and there is ample funding capacity to do so.

Strategic purpose to the acquisitions

Group has been assembled methodically and with strategic purpose

The constituent part of the group are important to understand as Ascendis as a group has been assembled methodically and with strategic purpose and not by happenstance acquisition.

Individually, these business would not merit a stock exchange listing but as constituted within three divisions in one group there is method in how the parts fit to form a whole.

Opportunity to begin rolling out a strategy of appropriate vertical and horizontal integration to capture the full benefit of a complementary value chain

Acquisition of a number of well-established businesses has created the opportunity to begin rolling out a strategy of appropriate vertical and horizontal integration to capture the full benefit of a complementary value chain - raw materials, manufacture, intellectual property and brand equity, and distribution and selling through retail, wholesale, export and direct selling routes to market.

Human capital key

The people factor is key. This is potentially the closest thing to a Bidvest that the market has seen in a long while if the majority owners and executives charged with day-to-day oversight can leave well alone where necessary and engage as needed, not least in steering strategic direction, encouraging sharing of best practice and harnessing collective financial muscle for growth and development.

Keen entrepreneurial trait in the managers

Without exception, there is keen entrepreneurial trait in the managers running these businesses. But crucially, this entrepreneurialism has been amply demonstrated by the creators of Ascendis who bring to the group a formidable wealth creation track record prior to setting up the Coast2Coast investment vehicle and thereafter.

Conceived with a clean sheet of paper and a fresh outlook

Unlike a conglomerate or a major corporate buying up bolt-ons, Ascendis has been conceived with a clean sheet of paper and a fresh outlook for possible opportunity from the start.

A combination of economic and legislative changes in the past twenty years has been beneficial for an opening up of South Africa to new opportunities but also competitive challenges. There has been corporatisation of pharmacy and development and growth of domestic pharma players, albeit not in the same breath as ethical majors, taking advantage of a plethora of patent expirations and a new pricing regime.

Innovation or imitation in South Africa?

And the one advantage of doing business in South Africa is we don't usually need to reinvent wheels – there is always someone from the northern hemisphere who has been there, done that, made the mistakes and created something. What passes for innovation down here is more often than not imitation.

There is a possibly a case for arguing that the whole is worth rather more than the sum of the parts. But Ascendis will need to demonstrate it can take co-shareholders along with it and build confidence.

Consumer orientation to portfolio

On listing, Consumer Brands is the largest contributor by revenue and profit, followed by Phyto-Vet and then Pharma-Med

Per the F2014 annualised forecast, Consumer Brands is the largest contributor by revenue and profit at 45% and 53% respectively. This is followed by Phyto-Vet at 32% of revenue and 29% of profit and then Pharma-Med at 23% and 18% respectively. These percentages are clean contributions excluding shared services costs.

Given the recent history of acquisition to create the Ascendis platform it is feasible that the respective contributions indicated for F2014 could change in the future.

Advanced discussions with respect to the purchase of a medical devices business

Ascendis has already indicated that it is in advanced discussions with respect to the purchase of a medical devices business that could conceivably be included in the Pharma-Med division.

Medical devices is predominantly a finished products import market in South Africa, typically on an agency basis. It is likely that Ascendis would be looking to target general surgical, gynaecology, urology, ear, nose and throat, cardiology and radiology among other specialities.

Although largely an import and distribution market in South Africa, worldwide medical devices is a manufacturing segment that commands premium profit margins - Johnson & Johnson, for example, returned 26% on sales in the 2012 fiscal, substantially higher than the normalised 14% it achieves on consumer products.

Consumer Brands in a broader sense is actually closer to 70% of both group revenue and profits

At this stage, one could argue that given the consumer orientation of Phyto-Vet, with the exception of Avima, that Consumer Brands in a broader sense is actually closer to 70% of both group revenue and profits.

In that broader context, Ascendis should also be viewed and valued more as a fast moving consumer goods play rather than a pure pharma group.

Ascendis may be listing in the Pharmaceutical sector of the JSE but that does not make it a predominantly pharmaceutical group – as yet.

Whilst over-the-counter and complementary alternative medicines feature in the Ascendis line up, the liberal use of phraseology such as ‘nutraceutical’ or ‘functional foods’ does not make these registered drugs, for all the squeaky clean image portrayed. In the United States, for example, such categories as dietary supplements are regulated by the Food & Drug Administration under authority of the Federal Food, Drug and Cosmetic Act but are not defined by law.

In a thematic sense, some comparison with AVI is perhaps more relevant than say a Aspen or Adcock Ingram.

AVI as a consumer products case study

AVI has a thematic resemblance to Ascendis

AVI, a branded consumer products group selling crisps, cosmetics and coffee together with processed fish and fancy footwear had a subtle but nonetheless significant shift in strategic orientation back in 2005.

Always a branded consumer products company with disparate interests, AVI had ditched glass making (Consol) and goods transport (Vector) to regroup around the supply and manufacture of branded, added-value consumer products within the categories of food, beverage, personal care & well-being, out-of-home, and branded semi-durables.

Similarly, much of the Ascendis portfolio has an aspirational aspect to it. Poorer, more unequal countries such as South Africa have consumers that tend to be more brand conscious and brand loyal than consumers in rich countries. It is no accident that house brands command a far smaller share of grocery than in advanced economies.

Aspiration and emulation plays a strong role in developing economies, which is combined with the fact that such purchases are a significant household budget item and quality and longevity matter.

Moreover, in countries such as South Africa brand premium in pricing is still achievable relative to cheap and cheerful mass-market merchandise. An emergent middle class adds fuel to this trend. A product such as Nimue is locally assembled with imported ingredients for the aspirational young female or male consumer.

For a company such as AVI, its consumers span breadth of LSM categories but it is innovation and brand extension that have been key aspects in AVI’s positioning in the market, with an orientation towards the mid and upper income segments. In the case of Spitz, the retail aspect in my view is incidental – the branding and market-positioning aspect is key.

Adcock Ingram compares on an income split

The closet comparison to Ascendis in revenue and profit segmental split is Adcock Ingram

The closet comparison to Ascendis in revenue and profit segmental split is Adcock Ingram which has a branded OTC business with household names such as Panado, Corenza and Bioplus. This segment I estimate will generate R1.85 billion in sales for the year ended September 2013 or some 39% of Southern Africa revenue. The OTC consumer contribution before Southern Africa operating expenses and R&D is 55%.

Adcock Ingram has a long established prescription medicine business that I estimate will generate R1.7 billion in F2013, just over 35% of the total Southern Africa revenue. The profit proportion I estimate at 29%, down from 35% two years ago and with the contribution margin at 20% some ten percentage points less.

Adcock Ingram has been particularly vulnerable to both single exit pricing controls and exchange rate weakness. Prices in F2012 actually decreased and there was a modest 2.1% single exit price adjustment following no adjustment the prior year. With raw materials and operating cost increasing margins are under downward pressure, falling in F2012 alone by five percentage points.

Investors will probably be wondering if Ascendis is a future Adcock Ingram or Aspen Pharmacare

Aspen leads the way

Investors taking a stake in Ascendis will probably be keeping an eye on a deceptively similar comparison between Adcock Ingram and Aspen Pharmacare. Both in the same sector but taking wildly differing paths and coming up with astonishingly divergent outcomes.

In the back of the mind is the thought – am I taking a punt on an AIP or a APN? Is this the next fire cracker that turned out to be a damp squib or an elevator to the stratosphere?

Exhibit 13 Adcock Ingram and Aspen in ZA cents from date of AIP listing 25 August 2008

Source: JSE, MN Ingham

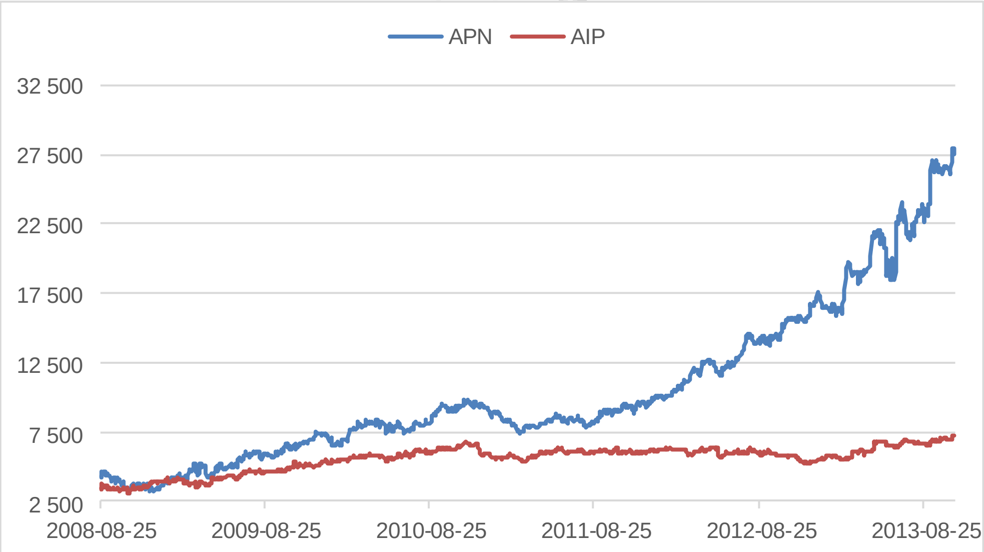
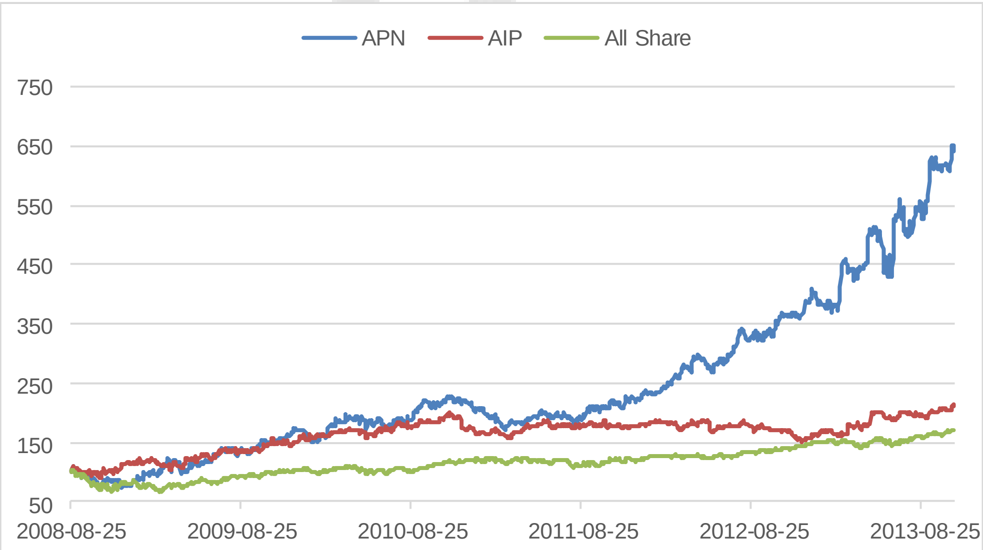


Exhibit 13 Adcock Ingram, Aspen and All Share Index based to 100 from date of AIP listing 25 August 2008

Source: JSE, MN Ingham



Aspen has grown international profit to 65% from 15% in 2008

As recently as F2008, South Africa accounted for 77% of Aspen revenue and 85% of its profit.

Possible Aspen lessons for Ascendis

For the year ended June 2013, South Africa contributed 35% to both revenue and profit. If my estimates hold any water, South Africa will contribute less than 30% within two years.

In the same five year period, annual group revenue and underlying profit has grown from R4.9 billion and R1.3 billion respectively to R19.3 billion and R5.3 billion. In five years, profits have grown to exceed starting revenue. The ten year EPS CAGR to 2013 is 27%. Aspen is now in the top ten globally in generic pharmaceutical sales.

The increase in non-South Africa profits last year accounted for three quarters of the total rise and it is probably fair to estimate recent acquisitions as having accounted for about half of the earnings rise.

Clear internationalisation theme with Aspen – but off a strong SA base

The integration of the Sigma business, completed 31 January 2011, accelerated this internationalisation trend at an investment value of R6.1 billion at the time. The acquisition of brands from GSK and cooperation with the drug giant has also played an important part.

Internationalisation is also reflected in shareholding. Glaxo, with which Aspen has developed a strategically and commercially important relationship since 2008, holds 18.6%. About half of institutional shareholders are from abroad.

But a key competitive advantage of Aspen is its South African manufacturing base.

The surge of internationalisation in group earnings does not imply the South African home base is less significant, quite the contrary.

It is a strong home base that has provided the launch pad for growth abroad and the South African operations are benefiting from the globalisation. Global ethical giants like GSK and MSD are comfortable partnering with Aspen because they implicitly know that Aspen in turn respects and protects their reputation.

Aspen is a good integrator, whole greater than the sum of the parts

I think it is also important to recognise that the lines between existing and acquisition are blurred. Aspen is a good integrator that operates in a joined up manner and as a result the whole then becomes greater than the sum of the parts.

Bidvest has similar characteristics

Bidvest has similar characteristics, a good acquirer and a brilliant integrator. Not because it expects portfolio companies to go along with group-think, quite the opposite.

Ascendis could learn a lesson from this.

For Aspen, it is this improving scale in capacity, reach, product and people that is reinforcing the growth and commercial success of the group when, ordinarily, a maturing phase would have seemed likely.

This is also important insofar as keeping a premium stock rating goes.

Acquisitions are well and good but acquisitions in multiple industries rarely eke out the benefits that Aspen has manifestly achieved and which rival Adcock Ingram has certainly failed to achieve.

But even as acquisitions may not be as readily doable in future there remains plenty of opportunity to exploit international markets in both developed and emerging countries.

Investment high at Aspen

Aspen has not been skint on capex, much of it in South Africa. Capex on tangibles was R470 million in F2012 and R670 million was spent in F2013 with expansion R505 million alone. Intangible capex was R3.7 billion in F2013, up from R2.2 billion.

Forex risk mitigation

Efficiency and procurement savings are bolstering margins in a price sensitive and regulated market. Rand weakness influences raw materials and with raw materials accounting for about 65% of cost of production manufacturing scale is essential to mitigate the price-down effects in this industry.

With foreign currency accounting for about two-thirds of cost of materials and the South African rand the balance, greater foreign sales have a very important benefit in managing foreign exchange exposure. There is ample capacity to fill, notably in Port Elizabeth, as international accounts for one sixth of volumes and growing. With foreign currency accounting for about two-thirds of cost of materials and the South African rand the balance greater foreign sales assist with managing forex exposure.

Lack of predictability in SEP drug pricing

With local pricing, predictability is desirable and a revised SEP adjustment formula that takes into account local inflation and exchange rate movements may provide that even if it could mean prices move up and down.

Aspen is in phase two of its life cycle, deepening its international exposure. It has an unambiguous growth agenda backed by tangible delivery and continues to bolster its competitive position.

Six or seven years back there was little difference between the earnings of Aspen and Adcock Ingram

Six or seven years back there was little difference between the earnings of Aspen and Adcock Ingram. This year Aspen trading profits are more than 5x that of Adcock Ingram and its enterprise value more than 10x that of Adcock Ingram, even with the CFR bid premium.

Adcock Ingram has a number of attributes, not least a good infrastructure and a world-class manufacturing operation at Wadeville.

But Adcock Ingram remains overwhelmingly reliant on the domestic South African market and in that it is not entirely in command of its own destiny given the regulatory situation and influence of state tenders.

I also struggle to get a clear sense of purpose for Adcock Ingram. And the rebuttal to the Bidvest approach was a case of protesting rather too much and appears to have been drafted by a cohort of barristers.

Significant intangible component of the Aspen balance sheet, cash generating capacity of the intellectual property

In valuing Aspen account must be taken of the significant intangible component of the balance sheet and thus confidence in the cash generating capacity of the intellectual property in particular. Many brands will be indefinite useful life intangible assets. The book value understates the extra value that derives from continuing investment in promotion of the brands.

Over 80% of Aspen’s long term assets are good will and intangibles. The cash generating potential of dossiers, product pipeline, brand recognition and positioning is very much tied up in the market cap of R125 billion at a share price of R277 which is 5.5x the NAV per share of R50.

It is quite feasible for Aspen to double, possibly treble, earnings over five years. Management is getting into their stride abroad and learning quickly and executing well. The decentralisation of teams within an Aspen business philosophy is working well too.

Vision to deliver value, not growth for the sale of growth

Aspen has no acquisition strategy per se. The group vision is to deliver value, be a responsible company and provide quality, affordable medicines and products globally. If Aspen was simply a land-grab outfit the chances are it would not have been half as successful and more than likely encountered financial and operational problems at some point.

Aspen’s growth is judiciously acquired

Growth does not come at any price. Aspen’s growth is judiciously acquired –which means it mixes wisdom, common sense, discretion and a bit of luck with the intention of building on what has been proven and avoiding unnecessary trouble or wastefulness. The surge of internationalisation in group earnings is not a product of acquisitive intent but a by-product of preparation meeting opportunity.

Symbiosis to process

Large-scale volume manufacturing in South Africa has been deepened through group rationalisation and consolidation internationally. There is a symbiosis to the growth and expansion process that the MBA buzz word synergy can’t even begin to describe. It is also important to recognise that the lines between existing and acquisition are blurred. And virtually all recent deals have been sealed by the excellence that Aspen brings to the table in quality pharma manufacturing.

Effective dual leadership structure at Aspen

The dual leadership structure of Stephen Saad and Gus Attridge is effective, with each playing to their strengths. This is partly by design and allows for seamless succession in the event of death of one. Both are clued up financially and demonstrate a clear sense of purpose and an eye for opportunity. Aspen has no greater key person risk than some other companies but in some respects is already better provided for and should give investor's confidence.

Moats across a diversified geography

Aspen is by no means comparable to the ethical majors in the pharmaceutical world. GSK, its key partner, is a mature, R&D intensive ethical producer. At some point Aspen will mature – when I do not know. But at that point it is still likely to be able to command a PE in the mid to late teens because of the moats its will have built around it across a diversified geography - the stuff of premium ratings.

Aspen is a great foreign investment – that just happens to be listed on the JSE.

Ascendis serves differing categories

Span of markets

Ascendis companies fall within differing fast moving consumer, specialist, and regulated healthcare categories and also within the public sector and private sector pharmaceutical markets.

Determining a market share is no simple task

Determining a market share is no simple task and can be misleading. Statistics in South Africa tend not to be as disaggregated, detailed and comprehensive as in certain advanced economies and moreover the quality of data collection and the scope thereof, particularly government statistics, leaves much to be desired.

OTC Pharmacy and OTC FMCG

The over-the-counter market is a case in point. If one defines it strictly as private pharma OTC, then industry turnover on a moving annual total basis is worth approximately R8.3 billion according to IMS. But that would be unlikely to include a number of the products that Ascendis sells – such as a Muscletech workout protein shake or a Nimue aftershave cream. The OTC market too is divided into pharmacy and FMCG. IMS estimates pharma FMCG at R3 billion in sales.

Simply taking an annualised F2014 segment turnover for Consumer Brands of R857.9 million over, say, R8 billion to get a market share of around 10% would be inaccurate.

Grocery too is a case in point. A few years back, when by its own admission today it was losing market share, Pick 'N Pay claimed (citing Nielsen) that it had a 33.4% market share versus Shoprite on 28.4%, Spar on 26.3% and Woolies on 11.9%. In turn, Shoprite claimed in its statistics that it had 29.8%, Spar reckoned 27.6%, whilst Woolies claimed 8.8% in its Food category.

In fact all of the grocery majors, who cover a huge proportion of FMCG, routinely claim either to be holding or increasing market share to the extent that market share percentages can be in excess of the total market.

Insofar as Ascendis is concerned, its sales are largely in a wholesale category and on-sold into retail.

What we do know from the official statistical services, caveats notwithstanding, is that total retail sales in pharmaceuticals and medical goods, cosmetics and toiletries will amount to R50 billion in calendar 2013. If that is a broadly defined benchmark within which group companies compete then even taking total group revenue Ascendis has very small share.

Lion's share of pharmaceuticals market is private by value but less so by volume

Data compiled by IMS further confirm that the total pharmaceutical market is currently worth approximately R32.5 billion. Of this, private is the lion's share at R28 billion with public sector at R4.5 billion.

Pharmachem is forecast to generate an annualised R440 million in revenue and so in the broad sense has a 1.3% share of the total market by value. For a business that started in 2006 that is not bad going.

Approximately half of Pharmachem revenue is from government tender

However, approximately half of Pharmachem revenue is from government tender and within the generic off-patent category and that is likely to remain the focus for the foreseeable future.

Of the R28 billion private market, R19.7 billion is prescription medicines (abbreviated to Rx in shorthand) and R8.3 billion over-the-counter.

Generics a growing share

Within the prescription category of drugs worth R19.7 billion, original R&D ethical products are worth R12.2 billion by value which is 62% of the market by value. Generics which are off patent are worth R7.6 billion and thus 38% by value. On counting units, ethical drugs account for 32% and generics and 68%.

In other words, of the total private sector 70% is prescription and 30% OTC by value.

Public sector has a small share by value

Of the total market for drugs, the public sector is a mere 13% by value with the private market 87%. Similarly, when the generics market is broken down, the private sector is valued at R6.6 billion or 87%.

By counting units, the difference between private and public narrows to the extent that the private sector has a 67% share of counting units and the public sector 33%.

Aspen largest share of private sector generics

In private sector generics, IMS data indicate that Aspen commands 33.3% market share, followed by Cipla Medpro on 16.5%, Adcock Ingram on 8.7%, Novartis on 7.9%, Sanofi on 5.3%, Daiichi on 3.5% and Pharmaplan on 3% with a long tail of far smaller players. The top three thus have 58.5% market share between them.

In OTC Pharmacy, Adcock Ingram leading player

In OTC Pharmacy, Adcock Ingram remains the leading player with a market share of 20% by value and 35% by volume. Aspen has 13% by value in this market and Johnson & Johnson 6.5%, with Cipla Medpro on 4.5%, Reckitt on 3.8% and then 50% of the market is fought over by many smaller players.

Pharma-Med is a relatively large portion of Ascendis Health revenue and a growth focus for the future. It will therefore be influenced by external macro industry factors together with own internal initiatives to win share.

Drivers for profits

Demand drivers of profitability for South African pharma manufactures include the number of consumers and how much money they have to spend, the number of people who have access to private medical care, and the generic product pipeline as ethical patents expire.

These are not exhaustive factors but neither are they mutually exclusive.

Ethical patent expiries

Globally, growth in the emerging middle class will be a driver of generics. The market for generic drugs is already estimated at $140 billion with emerging markets accounting for over half of demand by volume. Ethical patent expiries could expand the range with estimates varying from $50 billion to $100 billion in value worldwide.

Volume growth projected in South Africa

According to IMS, the total global market for all pharmaceuticals will be worth $1.2 trillion in 2016 and showing growth of between 1% and 4% in developed countries and 12% to 15% in emerging markets. South Africa demand is estimated to grow at 6% to 9% between 2012 and 2016.

IMS further estimate that ethical market share will have fallen from 60% in 2007 to 52% in 2016 with generics growing from 11% to 17%.

But growth will be driven by volumes, new product and range extension - not price.

Price/volume equation

This price/volume equation is seen in the value of scripts. The average price in the private market in 2013 is R70 per unit. This compares with R60 back in 2008, a total rise of 16.7%. In that five year period, scripts at schedule 3 or above have moved from R109 to R125, up 14.7%. OTC at schedules 0 to 2 have moved from R27.60 to

R35, up 27%. The share of OTC by volume has crept up to 61%. But the absolute price difference between scripted market and OTC is still wide, roughly 3.5x.

In the public sector, figures from IMS further show that generic medicines have a 75% share versus 60% in 2001. The average price of a generic medicine unit at R45 compared with R113 for an ethical alternative.

Retail pharmacy trends

In retail pharmacy, 34% of volumes at independent pharmacies was prescription with 66% OTC and the figures are similar for national chains such as Dis-Chem and Clicks. In supermarket pharmacies 74% of volume is OTC.

SEP challenge

The 2013 single exit price increase of 5.8% compares with only 2.1% in 2012 and should in fact have been 8% given the weakness of the currency and other rising costs. This poses further challenges for manufacturers and makes volume even more important in cost recovery.

NHI and international benchmarking

The introduction of a national health insurance and international price benchmarking add further to potential price-down pressures. There are also rumblings about a state-owned pharmaceutical parastatal. Detail on implementation of NHI through 2025 remains somewhat hazy and given the manifest failure of public health policy and execution in the past two decades there is little to get encouraged about. Embracing private sector management expertise would go a long way to restoring efficiencies in public health without creating unnecessary uncertainty and expense for no quantifiable benefit.

Mandatory generic substitution and growing availability of generics

Medicines in South Africa have got cheaper, in part due to mandatory generic substitution and the growing availability of generics. As a result, spending in this category has no correlation with overall household spending in the economy. Whilst this may suggest defensiveness and inelasticity there is substitution happening, not least between prescription and OTC. Substitution is also helping offset effects of single exit pricing for South African manufacturers. But further regulatory burdens are possible. The pharmacy sector has already had to cope with dispensing fee regulation and on the horizon there is logistics fee capping.

Private medical insurance looks set to stabilise

Private medical insurance looks set to stabilise after a strong growth in numbers in recent years, in part due to the government employees medical scheme. Private medical insurance covers 8.5 million lives or 15% of the population. GEMS alone has added 1.8 million lives.

All schemes, including the GEMS, have differing degrees of coverage though and it would be incorrect to assume that 8.5 million lives have fully comprehensive cover. In GEMS, with five benefit categories, less than 10% of the membership has access to comprehensive care with defined specialist access.

Hospital inflation contained

Hospital inflation in South Africa has been well contained in recent years and that trend is likely to continue as private sector efficiencies offset cost pressures. At Netcare and Life Healthcare, for example, revenue per patient day is running at 5%.

Tariffs charged by private hospitals are negotiated with medical scheme administrators every year and scale economies in treatment are passed through to members. Prescribed minimum benefits in terms of the Medical Schemes Act creates a further symbiosis between funder and service provider.

We need to ask the question - what differentiating factors does Ascendis have?

The question one has to ask is, what differentiating factors does Ascendis have versus other investment alternatives to warrant above average growth versus peers and possibly a premium rating?

An analysis of the individual businesses within the segments will provide further colour on this question.

Segment analysis

Consumer Brands

Consumer Brands preventative products are sold typically via retail outlets and fall into over the counters medicines and complimentary alternative medicines.

Chempure

Chempure potentially a critical building block for the group

Chempure supplies speciality ingredients and was acquired effective 30 June 2012. The business dates back to 1994 and has enjoyed long-standing supplier relationships.

The business will make up less than 10% of group revenue going forward but it is a potentially critical building block for the group as it has the potential to be the principal procurement channel for many group companies. Whilst sports nutrition orientated currently, active pharmaceutical ingredients could be a natural extension.

Chempure operates out of a bespoke facility near Pretoria.

Target markets are food, health-food, pharmaceutical and cosmetics. Technical expertise is provided to customers and there is backup support from foreign principals.

Chempure has a wide spread of customers, many of which are external to Ascendis and include multinational and domestic firms in FMCG and speciality nutrition. No single customer accounts for more than 10% of sales.

Being part of the Ascendis group though will provide Chempure with a framework within which to consolidate its position in chosen target markets and seek additional sourcing channels and customers.

High quality global suppliers

International suppliers include DSM and Hilmar Ingredients, collectively 70% of revenue on competitive terms and with good growth achieved in the sports nutrition market. Solae, a soy ingredient manufacturer owned by Du Pont, Purac, a natural food preservation producer, Berg & Schmid in lipids, Virginia Dare in flavour and extracts, Draco in botanicals, and American Casein Company are also well-known suppliers to Chempure. Capsules and miscellaneous items complete the line-up.

DSM, originally a Dutch state-owned coal mining business, has evolved into a leading life sciences and materials science company. Insofar as Chempure is concerned, nutrition and pharma is most relevant.

Life Sciences an important industry

Life Sciences is not some abstract biological field of study but a multi-billion dollar global industry encompassing food and beverage, animal feed, personal care, dietary supplements and pharmaceutical and biopharmaceutical industries.

Hilmar Ingredients is actually part of the Hilmar Cheese Company in California and as one would expect supplies whey protein concentrate, hydrolysate and isolate, and lactose. Whey is the largest single costs item, over 60%, in body building nutrition products.

Virtuous cycle thematic in Ascendis

This plays pretty much to the Ascendis virtuous cycle thematic. Urbanization drives consumption of processed foods which creates a need for a more efficient food chain. In turn, increasing incomes mean increased demand for proteins and thus the supply of protein. This creates a political imperative to improve food security. Ageing means higher healthcare spending but limited financial resources together with an understanding of prevention stimulates demand for healthy and active aging.

Chempure sales tend to coincide with the seasonality of FMCG with sales volumes tending higher from the middle of the calendar year through November. Management buys counter cyclically, taking advantage of the northern and southern hemisphere differences.

Working capital business, particularly stock and debtors

This is a working capital business, particularly stock and debtors. Long lead times on shipping are the norm, typically four months. Suppliers are settled promptly. Being in-stock is crucial for reliability and customer satisfaction. The differences in working capital between peak and low season months is around 30%. This pattern is unlikely to change and as the business grows further investment in working capital will be necessary.

Currency exposure

Currency is an important factor in gross profit, notably dollar and euro. Foreign exchange contracts are entered in to and matched to orders.

The weakness in the rand across a basket of leading currencies this past year could have margin erosion consequences if customers push back on pricing, which is a not uncommon feature in the South African market today, and mark-ups have to be reduced.

It is important to move pricing in tandem with currency movements in such a working capital business otherwise your ability to replenish in a depreciating currency cycle is impaired. Historically, Chempure has handled periods of extreme volatility fairly well and has taken a conservative forward view on pricing. The business is historically self-funding.

Safety-critical food-grade aspect to what customers require

An important differentiating factor for Chempure is the safety-critical food-grade aspect of what their customers require and which Chempure has always supplied.

Solal

Solal was purchased effective 1 July 2013. Half of the business was owned by private equity investor CAVI Brands. Restraints are in place with key vendors. A number of senior management are reinvesting.

Solal focus on preventative and healthy aging complementary medicines and supplements

The business was formed in 2000 with a focus on preventative and healthy aging complementary medicines and supplements.

The product range includes nutraceuticals, dermaceuticals, functional and functional super foods, hormone creams and there is an in-house published periodical called Health Intelligence widely distributed. There are over 150 nutraceutical supplements alone.

Health professionals, differing disciplines

An integrative medical centre provides consulting services by healthcare professionals of differing disciplines. The Compounding Pharmacy of South Africa is for customised preparations.

MCC approved facilities

The company is registered with the South African Pharmacy Council. Solal complementary medicines are made in MCC approved facilities with manufacture outsourced. It is possible that compulsory registration in this category could be introduced.

Chempure a key supplier

Chempure is a key supplier of quality active ingredients to Solal. Warren Chem Specialities is another supplier.

Available through physicians and from selected outlets

Products are stocked and prescribed by physicians and doctors and the branding is prominent in a number of selected stockists. UTI is the distributor nationally.

Dis-Chem is an important customer and as such it partly competes with the Dis-Chem own-brand Biogen. Dis-Chem has a powerful reach as a Walgreen’s type drug store in South Africa and the business philosophy dovetails well with Solal. Independent pharmacies, Clicks, Woolworths and the integrative medical centre are also important outlets.

Opportunities to be explored

Various other growth and innovation opportunities will be pursued. A number of new products are due for launch in Q1 of calendar 2014. There is complementary positioning with other Ascendis group companies.

Customer and prescriber perception of high quality

A differentiator in what is often seen as a crowded market is the customer and prescriber perception of high quality and the investment in key skills to underscore the efficacy of the product and the use of it.

Solal has a medical advisory board and there is a strong educative theme running through the marketing.

Solal has resisted increasing its penetration into grocery stores because of a desire to protect brand integrity, keep supply chain reliable and retain a drug store, chemist and prescription dispensing route to market.

No definable classification of what complementary alternative medicines are

The size of the market for vitamins and supplements is debatable, not least because there is no definable classification of what complementary alternative medicines are. Based on a study undertaken by The Health Products Association of Southern Africa a few years back a wholesale market of roughly R3 billion today would be a reasonable number. Other surveys suggest a number half that. Whatever the number is, Solal is a relatively small player overall but in the top three at the premium end of the market.

Nimue

Nimue comprises both Nimue International and Nimue South Africa and came into the Ascendis group via two separate owners although initially it was one company. Nimue South Africa owns the distribution rights for products in South Africa, distributing through salons, and is supplied via Nimue International.

Four clear treatment categories in skincare

Originated with a strong medical and scientific basis in South Africa back in 1994 the focus was initially on pre and post-operative application and skin rejuvenation. The product range has since expanded within four clear treatment categories.

Nimue has become well established as a brand internationally. International sales account for 60% of the sale of Nimue International with South Africa 40%.

Numerous products

Products number 150 and include cleansing gels, creams and lotions, conditioners, exfoliating enzymes, moisturisers, sun screen, eye serum, purifiers, phytogel washes and male after shave cream. Refills are available to customers, a popular cost effective option.

Target market largely middle to upper income female

The target market is a middle to upper income female, and to a much lesser extent male, catering to all racial skin types. Distribution is largely through skin care salons as use needs guidance from a trained therapist. The company estimates a market share of 15% in its category but this is difficult to verify.

Typical local substitutes would include Dermalogica, Environ, RegimA and Lamelle and the major FMCG houses such as L'Oreal's Garnier brand.

Nimue has usually appointed distributors within a country and has an exclusive agreement determining growth and development of the brand in that country for a renewable three year period. In some countries with good market size and opportunity a wholly owned subsidiary would be considered.

Scope to be increasingly professionalised and grown internationally

There would appear to be scope for the business to be increasingly professionalised within the Ascendis umbrella and for the international component to be exploited and managed far more proactively.

Beautician feedback suggests this is a brand that has rested on past laurels rather too long with scant reinvestment and seemingly minimal R&D. Consumer choices have increased and the bar raised.

Sports Nutrition – Evox, SSN and Bolus

Recognised and trusted sports nutrition brands

The three brands of Evox, Scientific Sport Nutrition and Bolus (Muscletech, USP Labs, Gaspari, BPI, etc.) make up the sports nutrition component of Ascendis and are recent acquisitions. The brands are well known in their market and rank among the most recognised and trusted for the performance characteristics they impart.

Collective turnover is running at approximately R200 million in F2014. The size of the market is uncertain. Recent data out of Euromonitor indicates a total market value of R415 million. This alone would infer that the three Ascendis brands account for around 50% of the total market, which they certainly don't. Other data claims a wholesale market of in excess of R500 million.

Market data is suspect

Evox alone is ascribed a 1.2% market share by Euromonitor – even if we assume the collective turnover of R200 million is divided equally among the three, simple maths suggests an implied total market on that reckoning of R5.5 billion, which is rather more than R415 million. The Euromonitor numbers are thus highly questionable.

USN and Biogen market leaders although this could be matched by Ascendis

What we do know is that USN and Biogen, through Dis-Chem, are the two clear market leaders and at a rough estimate they probably have 30% and 25% each.

Collectively, Ascendis would probably have the largest market share going forward although what that means for future growth and development potential remains to be seen.

Suffice to say that in my forecasts I have assumed top line running in line with nominal GDP growth of around 8%. There is substantial scope to improve efficiencies through the Ascendis corporate structure.

Evox was founded in 1996. Products are marketed through Dis-Chem, Clicks, Game, Sportsmans Warehouse, Pick n Pay and independent pharmacies and health shops.

SSN is a more recent company, founded in 2008, with its products having a strong body building theme. It operates from a facility in Pinetown, Kwa-Zulu Natal. Chempure is an important supplier.

Stores such as Mr Price Sport and Dis-Chem stock the products and SSN has an online site for purchases. There is international distribution to India and Europe.

Bolus Distribution has exclusive representation in South Africa of known US brands and was set up originally in 1997 as a direct selling organisation. Distribution is through chains such as Dis-Chem, Clicks and Pick n Pay. In 2011, Bolus became the South African publisher of Inside Fitness magazine.

The sports nutrition market in South Africa is predominantly locally produced, possibly as much as 85%, and so Bolus represents a greater exchange rate sensitivity as a direct importer.

Network marketed products - Sportron and Regal (Foodstate), Swissgarde

Direct selling of wellness products locally and through Africa

Sportron is a direct selling business established in 1992 and was brought into Ascendis in August 2011. Sales exceed R100 million. The business uses Foodstate nutrients and herbs in formulations. Typical competitors would include AMWAY and Herbalife.

Foodstate products are retailed through Dis-Chem, Clicks, Pick n Pay, Shoprite and independent pharmacies and health stores. Competitors include Solal, Vital, Natrodale and the various house brands.

Swissgarde is similar to Sportron but it has an African and emerging markets focus with a notably strong following in Nigeria.

Reviva - Fitflop South Africa

Fitflop has a niche offering

Fitflop toning footwear is distributed by Reviva Technology based in Cape Town and it was the first company to be brought into the Ascendis fold. Fitflop is a British brand with a bit of a cult following. There is scope to add other premium niche footwear brands.

Green Cross, part of AVI, would be a typical alternative in this bracket.

Pharma-Med

Pharmachem

Platform for becoming a future player in generic and over-the-counter medicines in South Africa and regionally

This will be the Ascendis platform for becoming a future player in generic and over-the-counter medicines in South Africa and regionally. The business has been acquired effective October 2013 and the vendors are partly reinvesting in the Ascendis group.

For the most recent period pre-acquisition, the combined businesses generated a turnover of approximately R400 million, of which about half related to government tender revenue. Antibiotics are the largest single tender item at present.

Appealing proposition to be part of Ascendis

The founders of the Pharmachem business had no need to sell and so the Ascendis proposition had to be particularly appealing. There is the possibility now to realise a much bigger business over time together with the complementary nature of the other companies in the Ascendis stable.

Scope to ratchet up margins

This is a lower operating profit percentage margin business that with scale and increased reach could become a low to mid double digit operating margin business. Tender business is typically an early teens gross profit percentage with private sales at least twice that. Mix therefore is important in the final consolidated margin.

Certain risks

A risk to the model is expiring government tenders not being renewed.

New dossiers are also an important feature in sustaining revenue and contribute to diminishing concentration risk.

Imports are key and thus foreign exchange. Whether it is tender or private market Pharmachem is subject to pricing constraints and potential GP squeeze.

As with much of the Ascendis group, intangibles are the largest single balance sheet asset. A dossier can be valued at anything from R1 million upwards and much more for newer generation molecules.

This is a working capital intensive business too and will rise commensurate with the growth objectives. Government tender terms are 120 days.

Not an Aspen as yet but there is a lot to play for

Is this a Aspen? Perhaps not, at least not for a while and certainly not comparable 27% profit margins. But as Aspen grows ever larger locally and internationally so in turn will there be parts of the domestic market that it may wish to leave to smaller players, indeed that is what makes the GSK relationship so symbiotic. In fact Pharmachem is already experimenting with newer molecules for generic production.

Generics have reshaped pharma landscape

The state of healthcare in South Africa, and in particular the national disgrace that is public health mismanagement, goes beyond the scope of this note but suffice to say South Africa is an example of how generic drugs have reshaped the pharmaceutical landscape in both private and public sectors. In this regard, Ascendis has as good a chance as any to stake a claim.

Bulked up with acquisitions

Pharma-Med as a division, however, is likely to be bulked up and complementary acquisitions will go hand in hand with anticipated strong organic growth in revenue. Medical devices is seen as a business area with good potential.

Pharmachem develops, manufactures and sells prescription and selected over-the-counter preparations which are sold through dispensing doctors, wholesalers, pharmaceutical retailers and government and private hospitals.

Over 100 dossiers with a good number in the pipeline

Pharmachem has over 100 dossiers with a number in development and registration. As many as 50 new dossiers are targeted to be registered within the next three years. If that does materialise one could be looking at R75 million to R100 million in additional revenues.

Drugs are categorised as patented or generic

Drugs are categorised as patented by an originator, such as a Glaxo, with a certain period of protection and me-too generic drugs typically manufactured from older generation molecules. Prescription drugs are scheduled by the Medicines Control Council as three or higher with over-the-counter drugs at schedule two or lower.

Inefficiencies in registration process

The delayed South African Health Products Regulatory Agency is designed, if that is the word, to supplant the inefficient MCC and possibly include registration of complementary alternative medicines. The proposed amendments to the Medicines and Related Substances Act have recently been published. Nobody remotely familiar with this expects any meaningful improvements anytime soon. Registration can be a three year process. Electronic submission of dossiers has recently been approved in an attempt to accelerate the review process.

Public health failings has created its own opportunity

Nevertheless, public health failings creates its own opportunity and the entrepreneurs behind Pharmachem have grasped this. Pharmachem was started as recently as 2006 by two business partners to compete in the underserviced lower income or no-income market.

It is worthwhile recalling that of the 52 million people officially living in South Africa, and who knows how many illegally, 43.5 million have no medical aid cover and are reliant on either public facilities in their various forms or as first line of treatment a private GP, possibly in a rural area.

Routes to market

Pharmachem Pharmaceuticals markets and distributes its own branded generic pharmaceuticals and over-the-counter products to dispensing doctors and urban and rural independent pharmacies.

Government tender qualification

A related business, Dezzo, competes for government tender business on the same basis as Aspen or Cipla Medpro. It is a licenced importer and exporter of for pharmaceutical products and employs a well-qualified team.

Following the normal tender expiry, Dezzo has recently been awarded in excess of R400 million in the latest tender running over two years. There is potential upside well beyond that over the next few years.

API's sourced mainly from India

Much development is undertaken in India with active pharmaceutical ingredients sourced mainly from India.

Manufacture is outsourced. A license is issued in terms of Section 22c of the Medicines and Related Substances Control Act, specifying to a manufacturer, wholesaler or distributor of a medicine or medical device acceptable quality assurance principals and manufacturing and distribution practices.

Another sister company, Pharmadyne, focuses on vitamins and minerals with government tender the largest customer.

Potential to outperform

Estimates are predicated on this division potentially delivering faster earnings growth than Consumer Brands and Phyto-Vet.

Phyto-Vet

Efekto, Avima and Marltons

Important plant and animal component to Ascendis portfolio

Ascendis Phyto-Vet is the plant and animal part of the portfolio with Efekto the homes and gardens based business, Avima providing pesticides and related formulations for growing crops and Marltons the manufacturer and distributor of a comprehensive domestic pet care range. The largest of the three by revenue is Efekto which generates around half segment turnover.

Efekto

Efekto has built a leading presence in plant, home and garden protection (Efekto) and nutrition (Wonder) since 1973. Mayford Seeds are distributed through Efekto and there are numerous accessories available.

Department of Agriculture registration

Similar to human health, there is a Department of Agriculture registration requirement. Much of the portfolio will have an active chemical ingredient such as propiconazole, which would be composed of chemicals such as dichlorophenyl, or dimethoate, which would contain dimethyl, or the methylphenoxyacetic acid in a herbicide. Some of these things can kill you if ingested and a material safety data sheet is provided for use, toxicology and first aid.

Molecular ingredients are typically licensed for use in South Africa by chemical company principals

These molecular ingredients are typically licensed for use in South Africa by chemical company principals such as BASF, Dow or Beyer. Efekto buys the active ingredient and sub contracts formulation. The relationships are key for keeping up with latest developments.

There are around 800 products with a sales split dominated toward garden and with herbicides and insecticides the most profitable. There is a predictable seasonality to demand.

Distribution outlets

Distribution is through outlets such as Builders Warehouse and garden stores and there are sales agents on commission in the field. Marketing is typically in-store and in print. Builders Warehouse is today the largest stockist but there is little customer concentration risk and the category is very much a destination one with relative inelasticity. A house brand is produced for Massmart.

Leading market position

There is little accurate data on market size in South Africa but given that Efekto has the leading market position by some distance, with Starke Ayres the number two, a figure of R400 million for both chemicals and fertilisers seems reasonable.

Exports have been insignificant but offer promise regionally, including indirectly through chain stores such as Shoprite and Pick n Pay.

Avima

Avima is a scientific business with substantial sales outside of South Africa

Avima was formed in 1961 and today manufactures crop protection, public health and stored grain protection pesticides among other products. Half of revenue is exports, principally within Africa.

This is a scientific business and staffed appropriately. There are over 70 registrations in a number of countries and there is a pipeline of product improvement and range extension.

Strong relationships since 1961

Relationships have been established over many years with customers, formulators and toll manufacturers. Avima is a key supplier to Efekto and the two share R&D and warehousing and production.

Sales into Africa are often via agencies such as the African Development Bank or large agribusiness concerns or governments. Tsetse and malaria control feature prominently. Select distributors are also important.

Avima is a key component of the Ascendis Phyto-Vet division and brings a scientific, technical and customer relationship track record built over a half century.

Marltons

Owning the category in pet care, household name

A household name in South Africa, Marltons takes the name of the founder and is a complementary recent addition to Phyto-Vet. In a quarter century it has come to almost own the category in chain stores with some 4000 stock keeping units.

Dogs, birds, aquatic, cats and small animals are the largest contributor to sales in descending order. Tetra is an exclusive agency.

National distribution

Six key categories are catered for, from gold fish through to reptiles, with everything from feed, to toys, to treats and remedies. Distribution is through most chain stores such as Spar and Pick n Pay and through veterinary clinics and pet stores.

Local production is supplemented by imports. Registration is required in certain instances with the Department of Agriculture. Strong relationships have been

Extending reach and range

established internationally enabling the company to keep ranges fresh. The upmarket Fish4Dogs range was recently introduced and further range extension is quite feasible under new ownership

Satisfying stockists and customers for a quarter century

Whilst the possibility of greater chain store direct sales that bypass Marltons has always been a threat the business has continued to prosper and satisfy both stockist and customer requirements.

Ends