



Biotech Daily

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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Probiotec

By TIM BOREHAM

ASX Code: PBP

Share price: 73 cents

Market cap: \$44.4 million

Shares on issue: 60,829,356

Managing-director: Wes Stringer

Board: Geoffrey Pearce (chairman), Wes Stringer, Greg Lan, Alexander Beard

Financials (year to June 30, 2017): sales \$62.5 million (down 4.7%), net profit after tax \$2.51 million (up 7.3%), earnings per share 5.1 cents (up 16%), dividend 2 cents (previously 1.5 cents), cash \$321,000 (down 36%).

Identifiable holders: Charles Wayne Stringer and Jane Stringer 16.4%, CVC 7.85%, Bath Road Pty Ltd (Tony Giam) 6.49%.

No matter how this contract drug manufacturer (and branded pharma owner in its own right) fares, at least investors know that its experienced key management is up to the task.

In 2014 chairman Geoffrey Pearce sold his business Beutiworx to a company that eventually became the listed BWX (which has a current \$660 million market cap).

Probiotec non-executive director Greg Lan was founding managing-director of Aspen Pharmacare Australia, while chief executive officer Wes Stringer was a tax and finance whiz at KPMG as well as Deutsche Bank and BNP Paribas.

Probiotec was founded in 1997 by accountant Wayne Stringer. Backed by private equity house CVC, the company listed on the ASX in November 2006 after raising \$17 million.

Wayne Stringer stepped down as chief executive officer in 2015 and was succeeded by his son Wes, who was chief operating officer. Younger son, Jared, is chief financial officer.

A bit too cosy? Crucible has never had a problem with nepotism, as long as it's kept in the family.

Three arms and lots of legs to the business

The Melbourne-based Probiotec has three divisions. Its biggest arm, contract manufacturing, manufactures and distributes a range of prescription up to S8 opiate standard and over-the-counter drugs, complimentary medicines and specialty ingredients. The plant has 15 to 20 full-time equivalent staff in research and development alone and operates three shifts a day, five days a week.

The company's branded pharma arm owns the well-known Gold Cross, David Craig and Skin Basics range.

Gold Cross is the house brand for the powerful Pharmacy Guild - a.k.a. the chemists' union - but Probiotec holds the intellectual property.

Probiotec's obesity management division owns the Impromy weight loss system (developed by the CSIRO) and the Celebrity Slim range.

Impromy, the company's "latest and greatest" weight loss program claims to be a tad more scientific than a lettuce-only diet, although we're not sure whether appearing on A Current Affair at least once commands praise or condemnation.

The Impromy program is exclusively offered through chemists, with candidates receiving a health check and customised weight loss diet.

In early October, the company lashed out between \$11.3 million and \$13.3 million for the privately-owned South Pack Laboratories, a contract pharmaceuticals packaging group.

The deal involved issuing 7.9 million Probiotec shares and \$8 million cash, \$2 million of which is deferred.

The debt-funded purchase is expected to be earnings per share accretive (in other words, it will make money) from day one.

The deal saw South Pack founder Tony Giam emerge with a chunky 6.5 percent Probiotec stake. CVC was also an investor in South Pack, so re-emerged as a substantial Probiotec holder having sold down its original stake after listing.

Picture of good health

Probiotec's recent AGM presented a picture of wellness that even its fat-burning protein shakes – the winner of ratings house Canstar Blue's customer satisfaction award for the category -- could not evoke.

The company's 2016-'17 earnings rose a creditable seven percent to \$2.51 million, despite revenue coming off a tad to \$62.5 million, mainly because of low-margin lines being rationalised. Adjusting for these dud lines, underlying sales grew five percent.

Management is upbeat about all three key divisions, citing new contracted work for the current year in manufacturing, several major distribution opportunities and new products in the second half of the year for obesity and health management.

"In the absence of any significant deterioration in economic conditions the board reasonably expects to deliver strong growth in both revenue and earnings in the 2017-'18 year," chairman Geoffrey Pearce chimed.

He added that the contract manufacturing arm - which accounted for two-thirds of sales in 2016-'17 - would influence things the most heavily.

But the branded pharmaceutical and obesity arms will be pulling their, er, weight as well.

With the branded lines it's more a case of modest growth as baked-on consumers continue to buy the trusted products.

In the first two months of ownership, South Pack (not to confused with Cartwright and buddies from South Park) is performing to plan as well. The only bum note is that a smaller European business is encountering "difficult economic conditions" in its key UK market.

Probiotec's performance has been helped along by a recent move to rationalise "low margin, capacity-hungry" product lines, which along with some good old fashioned cost cutting resulted in operating margins increasing significantly.

The company spends about \$1 million to \$1.5 million a year on research and development, mainly on lines such as extension formulations. Wes Stringer says that rather than "cold quoting" a potential contract manufacturing client, the company likes to present them with an opportunity to add value to their portfolio.

Probiotec's main facility at Laverton in Melbourne is operating at 60 percent capacity, which means it can win more work without more capital expenditure.

Dr Boreham's diagnosis:

Probiotec has the weighty advantage of operating in the "wellness" space, which is red hot as the ageing populace turn to anything from ginseng to kale to maintain their vim and verve.

Probiotec's high level of manufacturing certification means it competes more in the over-the-counter medicines and prescriptions sector than complementary medicines.

The alternative medicines sector has more than its share of snake oil merchants and out-and-out frauds, but consumers can't go wrong with lines such as Gold Cross Friars Balsam for nasal congestion and soothing calamine lotion.

In terms of listed peers, Probiotec shares traits with Blackmores (vitamins et al), BWX (chemist distribution) and IDT Australia (high-level contract drug manufacturing).

But none is a true rival, with Probiotec competing directly with South Africa's Aspen, US giant Catalent and the local Lipa Pharmaceuticals in the contract manufacturing sector.

In the weight-loss sector, Impromy competes with anything from Lite and Easy diets to Weight Watchers. But the most direct competitor is the Tony Ferguson weight loss program, which is also sold through chemists.

Probiotec is well backed, with original private equity firm backer CVC remaining on the register. It also has board representation in the guise of the well-known Alexander (Sandy) Beard, who has played a role in shaking up other biotechs including the drug developer Bionomics.

Our key objection with this one is that the company has been plodding for the last decade, given it made a net profit of \$4.97 million on sales of \$54 million in 2007.

Currently Probiotec shares are trading at seven year highs. But bear in mind they listed in 2006 at \$1 apiece, with the stock trading in a range of \$2.74 in October 2009 to 15 cents in May 2015.

"The past is the past," Wes Stringer says. "We think the best is certainly yet to come."

Probiotec's balance sheet is a picture of wellness and the 2 cents a share dividend (equating to a 2.8 percent yield) is nothing to sneeze at in biotech terms.

Because the company has a stockpile of franking credits as well as tax losses, it should be able to pay franked dividends for some years to come while not incurring income tax.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He's happy to give a free plug to Gold Cross's Glucojel jelly beans as they're the biggest, juiciest and most wholesome on the market.