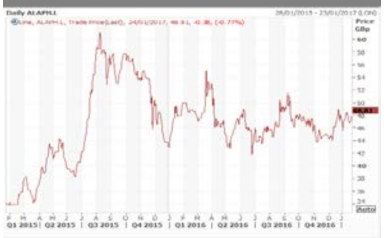
25th January 2017

hardman&co

Pharmaceuticals & Biotechnology



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	APH
Price (p)	48.6
12m High (p)	55.4
12m Low (p)	40.5
Shares (m)	472.6
Mkt Cap (£m)	229.7
EV (£m)	305.8
Free Float*	76%
Market	AIM

**As defined by AIM Rule 26*

Description

Alliance Pharma acquires, markets and distributes medical and healthcare brands in the UK and Europe (direct sales) and the RoW (via distributor network), through a buy and build strategy, generating relatively predictable strong cash flows.

Company information

CEO	John Dawson
CFO	Andrew Franklin
Chairman	Andrew Smith

+44 1249 466 966
www. alliancepharmaceuticals.com

Key shareholders

Directors	12.5%
MVM Life Sciences	11.8%
Aviva	9.2%
Fidelity	8.9%
Artemis	8.0%
Nigel Wray	7.7%

Diary

29 March	Finals
25 May	AGM
Mid-17	Diclectin UK approval

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Alliance Pharma

Potential of Diclectin

Alliance Pharma's buy-and-build strategy to evolve into a profitable, cash generative, specialty pharma business is clearly bearing fruit. Acquisition of the dermatology and woundcare products from Sinclair Pharma was transformational, doubling the size of the company and providing a more internationally-oriented business. The enlarged group is also a more attractive and credible partner for attracting in–licensing and M&A opportunities. 2017 looks set to be an exciting year for the group. Not only is there solid growth potential in the re-focused group, but approval of Diclectin in the UK also offers significant growth potential.

- **Strategy:** Since inauguration, APH has adopted a buy-and-build model thereby establishing a strong track record of 32 deals over 18 years to assemble a portfolio of >90 products. It is investing to accelerate growth through three multi-market brands, with infrastructure supported by its passive products.

- **Diclectin:** The 'unknown entity' for the future is the potential of Diclectin, which has been in-licensed for the UK and nine European countries, to achieve its commercial opportunity in morning sickness. For APH territories, this represents an estimated £40m market penetration, equivalent to 40% current group sales.

- **Forecasts:** Early evidence of success for the multi-market growth brand strategy was evident in the 2016 sales: Kelo-cote (+18%) is APH's first £10m sales product and MacuShield is up +40%. Sales forecasts have increased, but near-term investment in marketing/infrastructure will temper the profit growth rate.

- **Forex:** Translation of overseas sales benefited reported numbers by +£4.2m in 2016. This has a knock-on effect in future years which are forecast on a CER basis to provide a true picture of underlying growth. The benefit is not so great at the profit level given the natural hedge with overseas COGS and marketing costs.

- **Investment summary:** APH is forecast to have a CAGR in EPS of 9% and DPS of 10% over the next three years. The shares are trading on a 2017 P/E of 11.3x and carry a dividend yield of 2.7%, covered 3.2x. Internationalisation of the business coupled with the accelerated growth strategy augurs well and underpins forecasts. Management intends to invest in Diclectin, initially in the UK in 2017 and 2018, given its potential to transform medium-term prospects.

Financial summary and valuation

Year end Dec (£m)	2014	2015	2016E	2017E	2018E	2019
Sales	43.5	48.3	97.5	103.0	112.0	121.0
Operating profit	12.4	13.1	26.2	28.4	31.0	36.0
Reported pre-tax profit	10.2	15.2	22.3	24.0	26.8	32.0
Underlying EPS (p)	3.3	3.9	4.1	4.3	4.8	5.7
Reported EPS (p)	3.2	4.7	3.9	4.0	4.4	5.3
DPS (p)	1.0	1.1	1.2	1.3	1.5	1.6
Net (debt)/cash	-21.1	-71.5	-76.1	-63.9	-47.4	-27.4
Net debt/EBITDA (x)	1.6	5.3	2.8	2.2	1.5	0.7
P/E (x)	14.8	12.4	11.9	11.3	10.1	8.5
EV/sales (x)	7.0	6.3	3.1	3.0	2.7	2.5
EV/EBITDA (x)	23.2	22.5	11.4	10.5	9.4	8.1
Dividend Yield (%)	2.1	2.3	2.5	2.7	3.0	3.3

Source: Hardman & Co Life Sciences Research

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Executive summary

2016 Trading update

Underlying sales growth £2m above expectations

Alliance Pharma has provided the market with a trading update for 2016 ahead of its close period. The preliminary results announcement for full year 2016 results will be published on 29th March 2017. Underlying sales were ahead of market expectations, boosted by strong performances from products receiving marketing support. At the reported level, sales were enhanced by £4.2m by the weakness of sterling.

Key headlines

- Underlying sales growth +7.4% to £97.5m (£86.9m *pro forma*) was nearly £2m above expectations
- Kelo-cote (scar prevention) was the star performer, rising +18% to become APH's largest product at £10.1m (£7.7m *pro forma*)
- Currency benefitted reported sales by £4.2m highlighting the internationalisation of the business over the last 12 months
- APH has a natural hedge against currency with significant USD and EUR costs within COGS and SG&A, so the benefit of forex to sales is offset at the profit level
- Although net debt increased from -£71.5m to -£76.1m over the year. This was £1.6m better than forecast. Moreover, an estimated -£6m of this change was due to the retranslation of US$ & EUR denominated debt. In the second half of 2016, excluding forex, the group generated £10.0m of free cash

Alliance Pharma 2016 – actual vs expectations

Year to December (£m)	2015 Actual/pf	2016 actual	CER growth %	2016 forecast	Delta
Kelo-cote	7.7	10.1	+18%	8.4	+1.7
Hydromol	6.6	7.0	+6%	7.3	-0.3
MacuShield	3.8	5.3	+40%	4.8	+0.5
Ashton & Parsons	1.5	1.9	+27%	2.1	-0.2
Group sales		**97.5**	**+7%**	**95.8**	**+1.7**
Net cash/(debt)	-71.5	-76.1		-77.7	+1.6

PF = pro forma

Source: Alliance Pharma; Hardman & Co Life Sciences Research

Transformed Alliance

Acquisitions in…

…ophthalmology…

…nausea and vomiting…

…Sinclair Pharma healthcare

Although APH has maintained its core group strategy, the last two years has seen a period of considerable change. First, it bought the rights to an ophthalmology product which, with better targeted marketing support, offered a higher rate of growth coupled with a higher margin. Secondly, it acquired the UK and European rights to an unlicensed nausea and vomiting drug which would represent a totally new growth opportunity. Thirdly, it acquired a portfolio of healthcare products from Sinclair Pharma, which internationalised the group and provided overseas infrastructure. Integration of these products/businesses has been largely completed, although some investment in business systems will be needed to maximise growth opportunities of the enlarged entity in the future.

- **Internationalisation:** Headquartered in the UK, direct presence in five European countries, and direct presence in China and SE Asia (via Singapore)
- **Improved balance to portfolio:** Not only prescription products but some over-the-counter and consumer products has diminished reliance on reimbursed medicines in the UK
- **Multi-centre growth products:** Focus on certain brands that have higher margins, better growth prospects, and can be cross-sold into other territories within the APH network

Notwithstanding this progression, certain aspects within the strategy have remained the same – the company still outsources all manufacturing, warehousing and logistics; it does not perform any R&D; whilst marketing strategy is maintained in-house, execution via field forces is still contracted out in most territories.

Changing perceptions

Increasing internationalisation

Perceptions about APH within the industry have also changed. This was exemplified by the in-licensing of Diclectin (nausea & vomiting of pregnancy). Initially, rights owner Duchesnay Inc would only license the UK rights to this drug to APH. However, with the improved infrastructure and internationalisation of the business, Duchesnay was open to out-licensing rights to nine EU countries to APH. This would not have occurred with the legacy business.

APH has also developed a very strong track record on buy-and-build acquisitions, having completed 32 deals in 18 years. Consequently, the business development team has deep industry understanding and an established network of contacts. These characteristics, coupled with APH's improved infrastructure across many territories, is attractive to all the major pharmaceutical companies looking to realise value from some of their non-core assets. There is trust that if the right deal is on the table for appropriate assets, then the transaction will reach a satisfactory conclusion for both parties.

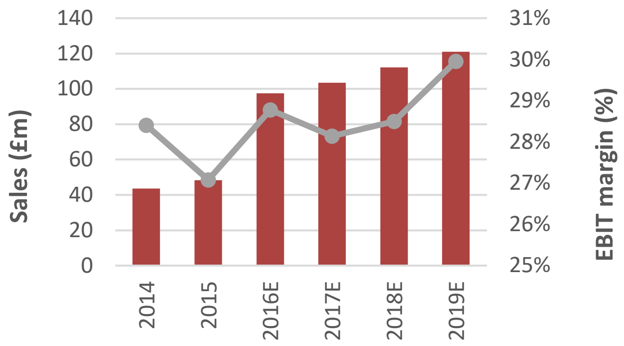
Investment conclusion

Diclectin large commercial opportunity

This report takes an in-depth look at the enlarged entity. Particular emphasis has been placed on the three multi-market growth brands that are receiving about half of APH's entire annual marketing spend and how they might shape the future business and growth prospects. There were very clear early signs in the 2016 sales that the two commercially available products have responded to APH's nurturing. For the future, Diclectin has very large, although not guaranteed, potential, with rights in the UK and Europe representing a commercial opportunity equivalent to 40% of current group sales. While some short-term investment is required to support and launch these growth opportunities, which will temper the profit and earnings growth rate, APH is still expected to grow and pay a rising dividend.

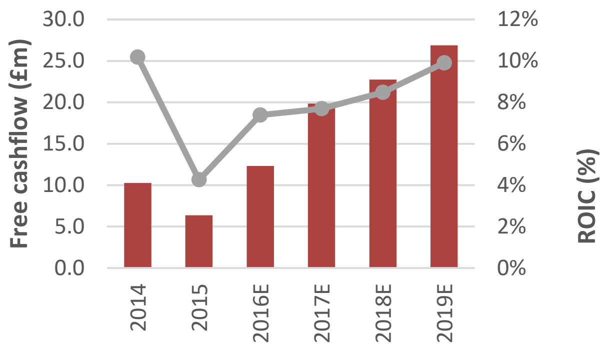
APH is trading on a prospective PE multiple of 11.3x 2017, falling to 10.1x in 2018, despite considerable investment in marketing and infrastructure in both years, the benefits of which show through in the multiple for 2019. During this period, the underlying EPS CAGR is +12%. Moreover, the company is expected to retain its progressive dividend policy, with DPS growth of 10% per annum over the same period, which has adequate cover. In the event that Diclectin develops market share faster than expected, the leverage effect of forecast upgrades would be substantial. APH looks set for an exciting period of growth.

Sales & margin



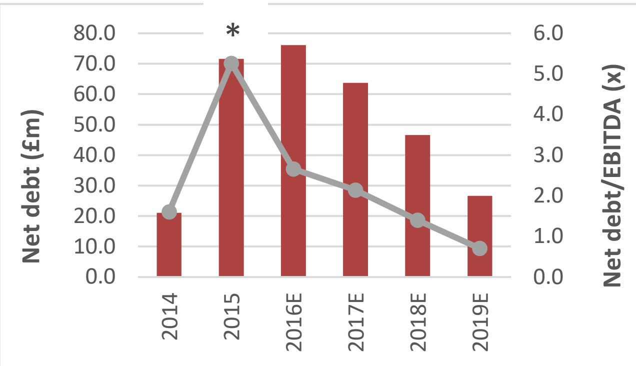
- Sales growth has returned to a stable mid-single digit level over the forecast period with scope for acceleration
- Alliance Pharma now operates a multi-location international operation
- EBIT margin is underlying margin, before share-based payments
- Target margin is 25-30%

Free cashflow & ROIC



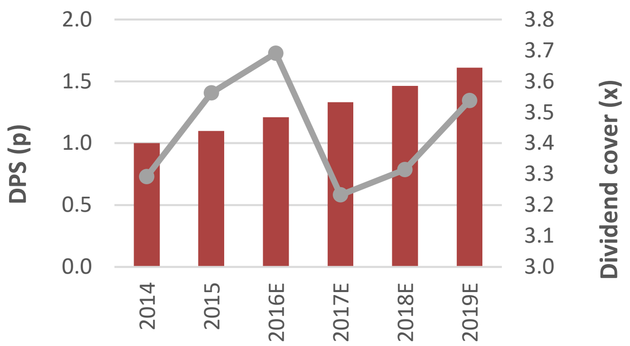
- Investment and integration limited the generation of free cash in 2016, but is expected to accelerate over the forecast period
- Operating cashflow conversion is typically ca.100% of EBIT
- Free cashflow in 2016 reflects working capital requirements for the enlarged group and the costs of integration, reverting to normal levels in 2017
- 2015 ROIC impacted by year end acquisition of Sinclair IS portfolio, returning to normal in 2016 after which it should return to ca.10% in 2019

Net debt



- Net debt at 31st December 2016 was £76.1m, slightly better than expectations
- Financial covenants are well within the specified range, with net debt/EBITDA of 2.8x at the end of 2016, falling in 2.2x in 2017 (*in 2015 it was unusually high because of the timing of the Sinclair acquisition)
- Minimum interest cover (EBITDA/interest cost) of 4.0x. This is expected to be 9.0x in 2016
- In the absence of significant acquisitions, free cashflow will be used to pay down debt

Valuation & Dividends



- Progressive dividend policy since dividend commenced in 2009
- 2016 dividend of 1.21p, +10%; rising to 1.33p in 2017
- Dividend cover of ca.3.4x in 2016 and 3.2x in 2017
- Scope to increase dividend

Source: Company data; Hardman & Co Life Sciences Research

Transformed group

Strategy

A 'buy-and-build' strategy

Since inception in 1998, the company has adopted a buy-and-build strategy, acquiring established products and supporting this with in-licensed products for launch and marketing in selected markets. The company is headquartered in the UK, with marketing offices covering direct sales in Europe and the Far East, but overall the group runs an asset light model, with all manufacturing, warehousing and logistics outsourced. 2016 has been a transformative year for Alliance Pharma following acquisition of the medical products business of Sinclair Pharma (SPH.L) at the end of 2015 which doubled the sales, moving the business from being UK-centric to one more internationally oriented that can exploit growth opportunities.

Transformation of Alliance Pharma

@31st December	2009	2012	2016
Reimbursed Rx medicines	38	67	73
Consumer brands/OTx	2	11	29
International distributors	12	13	127
Commercial team	8	17	40
Promoted products	2	7	24
International growth brands	0	0	3
Commercial footprint	UK	UK, RoI, F, DACH	UK, RoI, F, DACH, I, E, Singapore, China

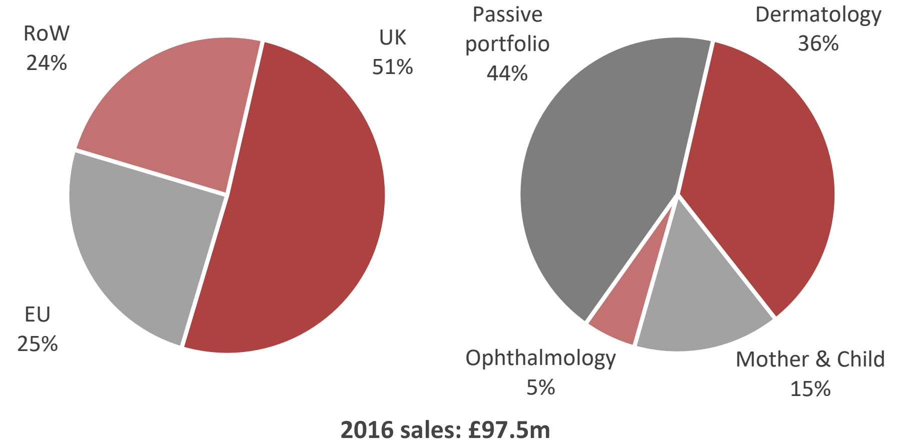
Source: Alliance Pharma; Hardman & Co Life Sciences Research

Geographical and organisational split

Sales currency benefit £4.2m

The trading statement indicated how the business has become far more internationalised. In 2015, around 80% of sales were derived from the UK with most of the remainder from Republic of Ireland (RoI). In contrast, in 2016 APH derived 51% of sales from the UK, 25% from its EU affiliates and the remainder from its international distributors. Reported sales benefited +£4.2m in 2016 from the weakness of sterling with underlying growth of +7%, about 2pp ahead of expectations. All forecasts are based on constant currency, therefore, the benefit is carried through into future years.

Alliance Pharma



Source: Hardman & Co Life Sciences Research

Dermatology

- Biggest growth segment representing 36% of sales
- Kelo-cote (scar reduction) is APH's largest product with sales of £10.1m versus £7.7m *pro forma* – representing underlying growth of +18%
- Hydromol (emollient) still seeing solid +6% growth to £7.0m

APH's biggest growth segment is dermatology…

Skin conditions are common and often poorly managed. Because skin problems vary in different parts of the world, coupled to the fact that products are usually applied locally – topical formulations such as creams and ointments – dermatology is not a field of medicine that is attractive to the major pharmaceutical companies. Moreover, many companies operating in this space often have one or two specialty products only. APH has a portfolio of about six key dermatology products that cover a wide range of skin conditions – although some are used for some non-dermatological conditions. There is a significant opportunity to cross-sell and expand products that are strong in one territory into other countries. Dermatology is also a medical field that does not particularly interest the majors, which offers the potential for bolt-on acquisitions.

Mother & Child

- Strong growth from Ashton & Parsons to £1.9m (£1.5m)
- Good growth in Oxyplastine (eczema) to £2.8m (£2.3m)
- Diclectin (nausea & vomiting of pregnancy) launch in 2017 in the UK and in 2018 in Europe

Major opportunities in mother and child…

As with Dermatology, APH has a range of products in the Mother & Child segment which cover a wide range of conditions targeted at pregnant/new mothers and their offspring. This segment represented 15% of group sales in 2016, and grew over 15%. This business segment is considered to be an important area going forward, with the likely launch of Diclectin in the UK in 2017, a major growth opportunity for the group.

Ophthalmology

- MacuShield is the only product in this segment – with sales of £5.3m versus £3.8m *pro forma* – representing underlying growth of +40%

Geographical expansion opportunities for ophthalmology…

At present, APH only has one product within its ophthalmology portfolio – MacuShield for the treatment and prevention of age-related macular degeneration. In 2016, sales were particularly strong at £5.3m, up 40% on an annualised basis – APH reported sales of £3.5m for the 11-month period of its ownership in 2015. Currently, most sales are generated in the UK and Republic of Ireland, but there is considerable opportunity to expand this product into overseas territories.

Bedrock

- Established, mostly branded, products
- Not only in UK, but also in EU5
- Commercially managed and support for the supply chain

This passive portfolio of products is by far the largest business segment, representing 44% of group sales in 2016. Growth is only expected to be very modest from these established products, which have an important role to play in supporting the operations both in the UK and overseas.

Kelo-cote

- 2016 sales £10.1m versus £7.7m *pro forma* – underlying growth of +18%
- Silicone gel to improve the appearance of scars
- For the prevention and treatment of hypertrophic and keloid scars

Kelo-Cote

Source: Alliance Pharma

Scar formation

Scar formation is a natural part of the healing process that occurs when skin is injured by accident, surgery or disease. The time taken for this biological process to produce a natural repair is dependent on the degree of damage. In general, the longer that it takes to repair, the greater the chance that the end result is a noticeable scar. All scarring is composed of the same protein (collagen) as the tissue that it replaces, but it is in a different form to normal tissue and lacks the elasticity of the original tissue. Following tissue damage, a normal scar will start to develop within 48 hours of wound closure and will generally disappear in about three months, however, abnormal scars can develop over a long period of time and persist for life.

The two most common types of scar are termed hypertrophic and keloid scarring, situations where excessive amounts of stiff collagen are produced which over-extends the tissue and blocks off normal regeneration.

Hypertrophic scars

Typical hypertrophic scar

Source: Colorado Skin & Vein

These occur when the body overproduces collagen, causing the scar to be raised above the level of surrounding skin. Hypertrophic scars take the form of a red raised lump on the skin. They usually occur within 4 to 8 weeks following wound infection or wound closure and/or other traumatic skin injuries. They are differentiated from keloid scars by their lack of growth outside the area of the original wound. Hypotrophic scars are commonly associated with, but not limited to, small areas of surgery. Treatment can reduce the size and appearance of such scars.

Keloid scars

Keloid scars are a much more serious form of excessive scarring, because they can grow indefinitely into large, tumour-like (although benign) growths. Although they can occur in anyone, they are more commonly found in dark-skinned people, particularly Asian, African and Latinos. As with hypertrophic scars, they occur following surgery, accidents, etc but are also the result of body piercings and tattoos.

Typical keloid scar

Source: Your Health Encyclopaedia

While keloid scars are only an excessive mass of inert collagen and completely harmless, they are much more unsightly, and often cause itching, potentially becoming painful. The temptation to have them removed surgically risks exacerbating the condition, resulting in an even larger unsightly area.

Social impact

Scars are often considered trivial, but they can be quite distressing if they are on exposed parts of the body, especially the face, or if they are disfiguring. People with visible scars can be shy or withdrawn, self-conscious, and anxious in social situations. Therefore, treatments that can proactively treat scars can help to restore a person's self-confidence.

Treatment

Gel and spray formulations for gas permeable, waterproof sheet

Kelo-cote is a topical silicone gel approved for the prevention and treatment of hypertrophic and keloid scars. After application – gel or spray formulations – it dries rapidly to form a silicone sheet that is gas permeable, flexible and waterproof which are particularly attractive characteristics. Together with the outer layer of skin cells, this layer provides a protective barrier against chemical, physical and microbial invasion of the scar site, allowing the scar to mature through normal collagen synthesis. Over time, Kelo-cote improves both the physiological and cosmetic appearance of the scar.

Competitive landscape

Competition from other silicone or vegetable extract products

Competition to Kelo-cote falls into two categories. There is either direct competition with a different silicone formulation (e.g. Dermatix (Meda)) or alternative products based on formulations of vegetable extracts. In our opinion, the products shown in the following table provide the greatest competition to Kelo-cote. Products are available in a range of sizes so, for comparative purposes, the recommended retail price has been divided by the product size to give a price per gram. The silicone based products are clearly far more expensive than those based on vegetable extracts.

Competitive landscape

Product	Manufacturer	Content	Size	£/g
Contractubex	Merz Pharma	Onion extract/heparin/allantoin	20g	£0.43
Dermatix	Meda	Silicones	15g	£2.39
Kelo-cote	**Alliance Pharma**	**Silicones**	**15g**	**£2.00**
Mederma	Merz Pharma	Onion extract/allantoin	50g	£0.50
Scar Gel	InstaNatural	Sea kelp bioextraxt	30ml	£0.67
Sodermix	Life Sciences Invest	Green tomato extract	30g	£0.70

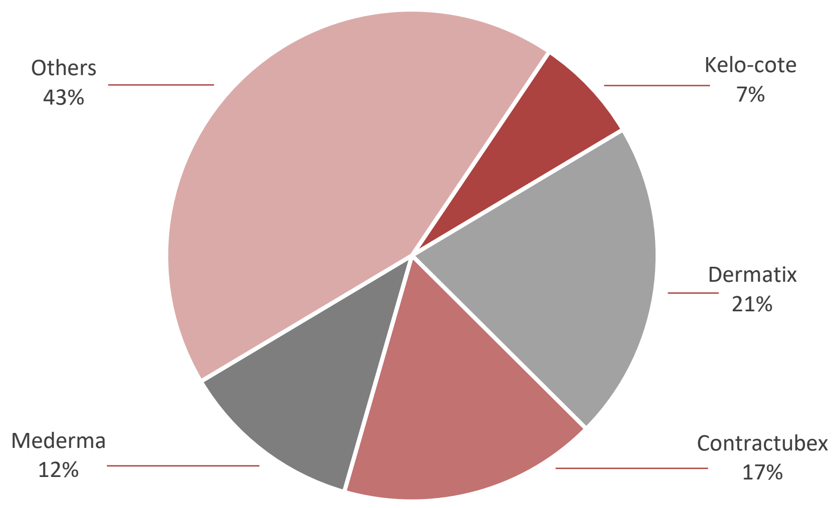
Prices taken from Chemist & Druggist
Source: Hardman & Co Life Sciences Research

Commercial market

Targeting an $800m market

The global market for scar treatments was estimated at $800m in 2015. Although Kelo-cote faces some strong competition from larger companies, we are forecasting CAGR of 13% over the next five years, making it a £25m opportunity.

Global scar treatment market – 2015 est $800m



Source: Alliance Pharma; Hardman & Co Life Sciences Research

MacuShield

- 2016 sales £5.3m, +40% versus £3.8m *pro forma*
- Only product on market containing a combination of three carotenoid pigments – meso-zeaxanthin (M), zeaxanthin (Z) and lutein (L)
- To prevent degeneration of the macula

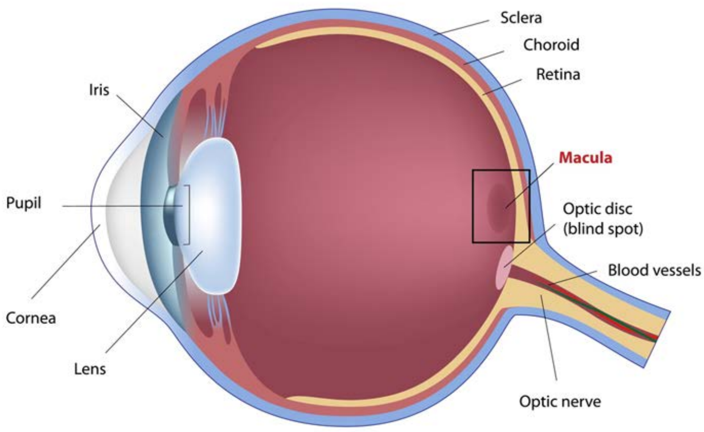
MacuShield

Source: Alliance Pharma

Macular degeneration

Macular degeneration is a common eye condition that leads to loss of vision among people over 50 years of age, it is sometimes referred to as age-related macular degeneration (AMD). The macula is a small area near the centre of the retina at the back of the eye and is required for sharp, central vision that allows us to visualise objects that are straight ahead. This region constitutes millions of light-sensing cells, making it the most sensitive part of the retina.

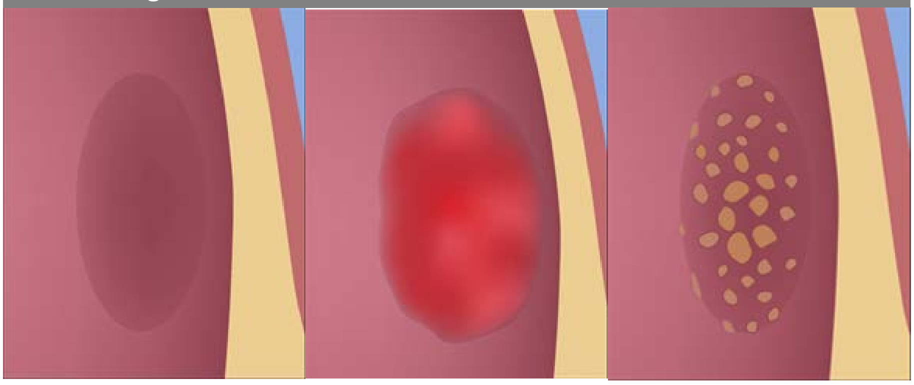
Diagram of the eye



Source: La Palma Eye Care Center

When the macula is damaged, the centre of your field of vision becomes blurry, distorted or dark. Although AMD does not cause blindness itself, loss of central vision can interfere with everyday life.

Macular degeneration



Normal	Wet macular degeneration	Dry macular degeneration

Source: La Palma Eye Care Center (http://lapalmaeye.com/macular-degeneration)

While age is the most common risk factor, other risk factors include:

- **Diet:** diet deficiency
- **Smoking:** doubles the risk
- **Race:** more common in Caucasians than African-Americans or Hispanics/Latinos
- **Family history/genetics:** people with family history of AMD carry a higher risk

Although AMD is a difficult to treat disease, steps can be taken to prevent it occurring. Keeping the macula well nourished is important, therefore AMD occurs less frequently in people who exercise, avoid smoking, and eat nutritious foods including green vegetables and fish. In addition, taking dietary supplements has been shown to be beneficial.

MacuShield endorsed by professionals…

The macula contains three carotenoid pigments – meso-zeaxanthin, zeaxanthin and lutein. As your age increases these macular pigments are reduced and require supplements to ensure adequate levels remain in the retina. Using carotenoids harvested from the marigold flower, MacuShield has been tested at leading research institutes (Waterford Institute of Technology, Institute of Vision Research, Whitfield Clinic), is endorsed by eye care professionals and has been investigated as part of an episode by Dr Michael Mosley for the BBC series "Trust me I'm a Doctor".

Competitive landscape

…and competitively priced

There are many nutritional supplements available from health food shops and on the internet, some of which claim to help with the preservation of vision. In addition, some specifically have carotenoid pigments added and, supported by marketing campaigns, are specifically targeted at the prevention of macular degeneration. However, MacuShield is the only product on the market which contains a blend of all three carotenoid nutrients to help prevent degeneration of the macula. In addition, it is priced very competitively compared to products considered to be direct competitors of MacuShield, as shown in the following table.

Competitive landscape

Product	Manufacturer	Content	Per day	Month
I·Caps Plus	Alcon (Novartis)	Vitamins + L + Z	2	£12.99
MacuShield	**Alliance Pharma**	**M + L + Z**	**1**	**£9.49**
Ocuvite	Bausch & Lomb (Valeant)	Vitamins + L + Z	2	£15.61
PreserVision AREDS 2	Bausch & Lomb (Valeant)	Vitamins + L + Z	2	£16.66
Visionace	Vitabiotics	Vitamins + L	1	£7.10

M = meso-zeaxanthin, Z = zeaxanthin, L = lutein
Prices taken from Amazon
Source: Hardman & Co Life Sciences Research

MacuShield is not only the only product with all three carotenoid supplements, but also the quantities of each are clearly defined on the label. In contrast, the precise quantities of carotenoid in the formulation of competitor's products are, in some cases, very difficult to ascertain.

Daily intake of carotenoids

Product	Meso-zeaxanthin	Lutein	Zeaxanthin
I·Caps Plus	-	4mg in total (undefined)	
MacuShield	**10mg**	**10mg**	**2mg**
Ocuvite	-	5mg	1mg
PreserVision AREDS 2	-	10mg	2mg
Visionace	-	4mg	-

Source: Hardman & Co Life Sciences Research

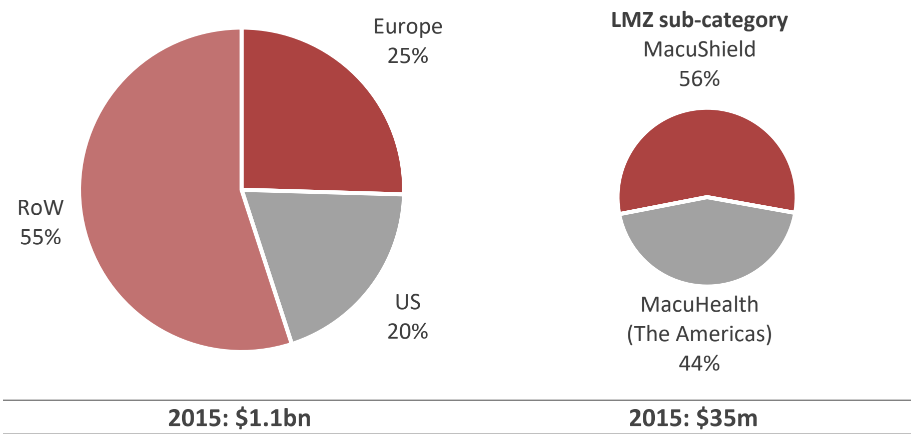
Commercial opportunity

MacuShield is available primarily in two stock-keeping units (SKUs) of different formulations, but the carotenoid pigments are the same in each – MacuShield (original) and MacuShield Gold (added vitamins consistent with AREDS2). With extensive scientific support for the product for MacuShield, APH has the strategy of targeting key opinion leaders via the hospital ophthalmologists, and the specialist retail market via opticians and optometrists.

- **Evidence-based** – More scientific data and publications than for any competitive product
- **Endorsement** – Key opinion leaders; Most recommended eyecare supplement in the UK and Republic of Ireland
- **Global rights** – APH owns the commercial rights and trade mark in all markets except the Americas
- **Global footprint** – Currently available in 16 markets with the potential for wider geographical expansion
- **Route to market** – Strategy to sell as an OTC medicine provides greater commercial support, particularly via opticians and optometrists, and reduces pricing pressure compared to the route of nutritional supplement

MacuShield is one of the three APH products currently receiving strong marketing support in order to accelerate growth. The global market for nutritional supplements for eyecare was estimated to be worth $1.1bn in 2015. At present, the segment for products targeting health of the macula is relatively small at just $35m. However, with greater knowledge and education through ophthalmologists and optometrists, this segment is forecast to have strong growth, with MacuShield leading the way with CAGR of +20% over the next five years to give potential annual sales of £12m.

Global eyecare health supplement market



From EuroMonitor Global Eye Health Supplement
Source: Alliance Pharma

Diclectin

Diclectin tablet – Canada

Source: Duchesnay

In January 2015, Alliance Pharma announced that it had in-licensed Diclectin – a combination of doxylamine (10mg, anti-histamine) and pyridoxine (10mg; vitamin B6) – for the treatment for nausea and vomiting of pregnancy (NVP) for the UK market from Duchesnay Inc of Canada, for a payment of up to £1.5m. This was followed in September 2016, with the announcement that APH and Duchesnay had signed a further licensing and distribution agreement to secure additional rights in a further nine countries in the EU, for a further payment of £1.0m.

For the UK rights, APH paid a licensing fee of £1.0m on regulatory submission, which is refundable if not approved, with the balance of £0.5m payable on UK registration. For the subsequent European rights, APH paid a further £1.0m. Under both agreements, Duchesnay will manufacture Diclectin for APH and will also receive royalties on net sales.

Well established

The active ingredients of Diclectin have been used for many years and are well characterised. The formulation is film-coated to prevent the actives being broken down by acid in the stomach. It is also a delayed release formulation so that it can be taken at night to produce the maximum effect in the morning. Doxylamine has been demonstrated to be effective in preventing nausea and vomiting of pregnancy.

Diclectin used by 35m women in Canada since launch…

…and given category A safety rating by FDA

Even though the individual components were effective and had been well characterised, after thalidomide, it was understandable that there were the obvious concerns that this combination drug might cause fetal defects if used by pregnant women. Despite several attempts to obtain compensation for fetal defects, with no credible evidence of any causality, all legal cases were rejected by the courts and Duchesnay started selling the product in 1984. Since then, Diclectin has been widely prescribed for the prevention of nausea and vomiting after the Canadian Obstetrics Society recommended it as first line use, and this combination treatment has been being used by 35 million pregnant women in Canada. In 2013, the FDA approved the drug, branded as Diclegis, with a category A safety rating for the US market.

Incidence of NVP

Morning sickness is very common in pregnancy. Indeed, it is often the first sign that a woman is pregnant. However, the severity of the condition is extremely variable. In an extensive review of 26 publications involving 39,710 expectant mothers, the incidence of NVP was 73.4%[1] and the symptoms lasted a median of 41 days.

The severity of the condition determines the likelihood of seeking treatment and the number of tablets that are likely to be taken. There are four well-defined classifications regarding the frequency and severity of NPV:

- Hyperemesis gravidarum (HG) – occurs in about 3% and patients need to be hospitalised
- Severe – occurs in about 11%
- Moderate – occurs in about 30%
- Mild – occurs in about 26%

[1] https://www.pregnancysicknesssupport.org.uk/resources/literature-review/incidence-of-nausea-and-vomiting-in-pregnancy-nvp/

Commercial opportunity

In order for the model to be robust, Hardman uses data sources that are reliable and consistently updated each year. Therefore, we start the model with 'live births' which is from government sources. We recognise that there are many more pregnancies than live births, but this is an impossible number to ascertain. To counter this, the number of patients seeking help from their general practitioner is likely to be less than the 70% used in the model, but the net effect of these two is considered to be quite accurate. Based on the actual sales outcomes for Diclectin in Canada and Diclegis in the US, our model has been built to provide an implied utilisation rate.

Diclectin – Market shares in Canada and the US

	2014	2015	2016
Canada			
Live births	388,517	391,408	395,322
NVP patients	271,962	273,986	276,725
Net sales (CN$m)	26.60	27.30	28.20
Gross sales (CN$m)	31.29	32.12	33.18
Price for 5-6 weeks (CN$)	143.40	146.36	147.84
Implied utilisation	80.2%	80.1%	81.1%
United States	**(Year 1)**	**(Year 2)**	**(Year 3)**
Live births	3,988,076	3,977,745	3,997,634
NVP patients	2,791,653	2,784,422	2,798,344
Net sales (US$m)	56.00	130.00	135.50
Gross sales (US$m)	80.00	185.71	193.57
Price for 5-6 weeks (US$)	593.46	593.46	565.20
Implied utilisation	**4.8%**	**11.2%**	**12.2%**

Live birth statistics taken from Statistics Canada; CDC&P
Source: Hardman & Co Life Sciences Research

Market share in Canada, where very well established, is ca.80%

In Canada, Diclectin has been available and used extensively for over 30 years. On the one hand, this provides long-standing and accurate information about the incidence of side effects; on the other hand, it means that the product is used extensively and generates a market share/implied utilisation figure (ca.80%) that cannot be achieved in early years following launch in a new territory.

Three years after launch, Diclectin has achieved 12.1% market share

In the US, where the product was launched only three years ago, the implied utilisation rate shows the development of market share since launch which can then been used to calculate the market opportunity for Diclectin in territories where APH has the commercial rights – UK and nine countries in Europe.

Diclectin – market potential in UK and Europe

In building up the market opportunity, there are a number of variables that need to be taken into consideration:

- Number of patients – Live births versus total pregnancies
- Severity of the condition
- Percentage of pregnant women seeking help – Average 70%
- How long the medication is likely to be taken for – average 5-6 weeks
- Frequency of administration – 2-3 times a day
- End selling price – Modelled using £1 per tablet in UK and €1.25 for Europe
- Wholesaler discounts – 12.5% in UK; 18.5% in Europe

Diclectin – UK market opportunity based on 2016 data	Example 2016 data
United Kingdom	
Live births	779,499
NVP patients	545,649
Price for 5-6 weeks (GBP)	168.0
Utilisation	**12.2%**
Gross sales (GB£m)	11.2
Opportunity: net sales (GB£m)	**9.8**
Top 9 Europe	
Live births	2,558,540
NVP patients	1,790,978
Price for 5-6 weeks (EUR)	193.2
Utilisation rate (year 3 from US)	**12.2%**
Gross sales (EURm)	42.3
Net sales (EURm)	**34.5**
Opportunity: net sales (GBPm)	**30.0**

Live birth statistics taken from Eurostat
Source: Hardman & Co Life Sciences Research

Diclectin is a £40m market opportunity

Applying the market share figure derived from the US to APH's markets in Europe suggests that Diclectin will potentially be a ca.£40m opportunity for the group about five years after launch. This is comprised as follows:

- Ex-factory sales of ca.£10m in the UK five years from end-2017
- Ex-factory sales of ca.€35m/£30m from Europe on a staggered launch strategy over five years expected to start at the end 2018

Irrespective of timing, this would be a significant boost to a company currently generating group sales in the order of £100m p.a.

Regulatory update

Diclectin under review at the MHRA…

APH submitted its filing to the MHRA in June 2015. The company has received and replied to the first set of questions from the regulator and is not anticipating further material questions to be raised. No safety issues were raised. Approval is simply a matter of time. The company's best estimate for completion of the regulatory review is mid-2017. While not wishing to pre-empt the machinations of the regulators, APH has recruited a market access team, set in motion advisory panels, market research, and undertaken other pre-launch activities. Investment in marketing in 2017 and 2018 will more than offset any sales achieved.

…with approval expected towards middle of 2017

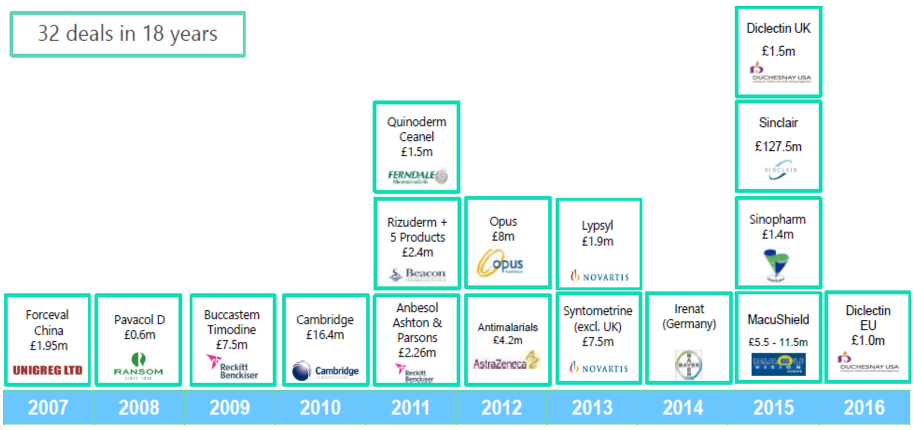
Launch in Europe likely to follow in late 2018

For Europe, the UK will act as the reference country and drive the process through the European Medicines Agency (EMA). Once approved – expected mid-2018 – APH is likely to stagger its launches, starting with Germany and the RoI and then expanding out on a country-by-country basis.

Buy-and-build strategy

- 32 deals in 18 years
- Cumulative investment in the region of £200m
- On average 30 opportunities considered to derive each deal closure

Deal graphic – last 10 years



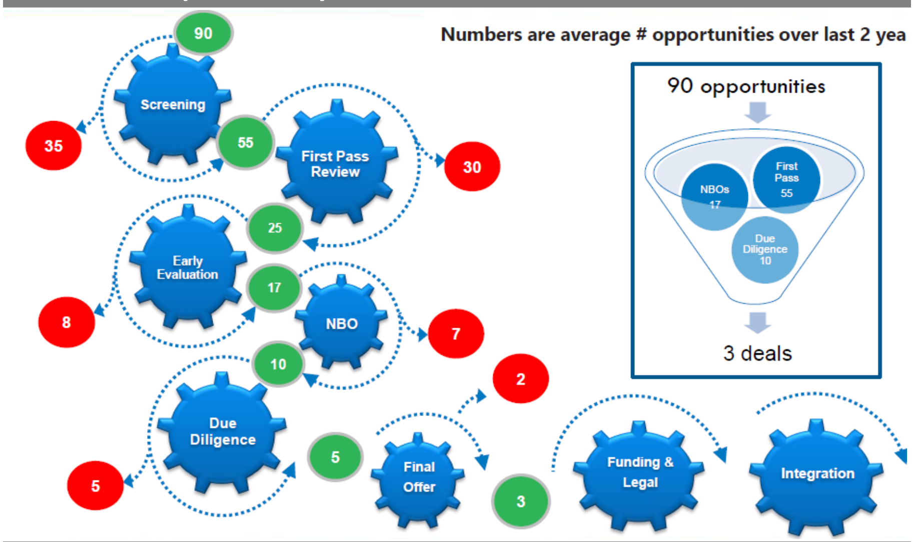
Source: Alliance Pharma

Finding deals

- Networking and relationships are key
- Deep business knowledge and analysis

APH has had a stable corporate development team for a number of years. Its ability to identify, analyse and conclude deals is important and the track-record that has been established provides considerable comfort to the selling party.

Deal machine productivity



Source: Alliance Pharma

Over the last two years about 90 opportunities were assessed from which three deals were concluded. Numbers do vary from year to year, but the increased size and international capability of APH today has increased its attractiveness to companies looking to unlock value from some of their assets.

Types of deal

APH has reviewed the key growth drivers of the enlarged business and the company is clearly looking to add to these areas, thereby leveraging on its enhanced commercial and geographical infrastructure.

Deal approach

Deal type	Benefits
Bolt-on acquisitions	Many opportunities exist in the marketplace Strength and expertise to execute Track-record
In-licensing	Opportunity to leverage infrastructure platform Opportunity to prove brand building can deliver organic growth Therapeutic focus – can complement add-ons
Transformational deals	Possibilities do exist Scarcity value of enlarged enterprise
Innovative transactions & development	Limited risk Small-scale developments & partnering structures Helps to move enterprise further along the value chain

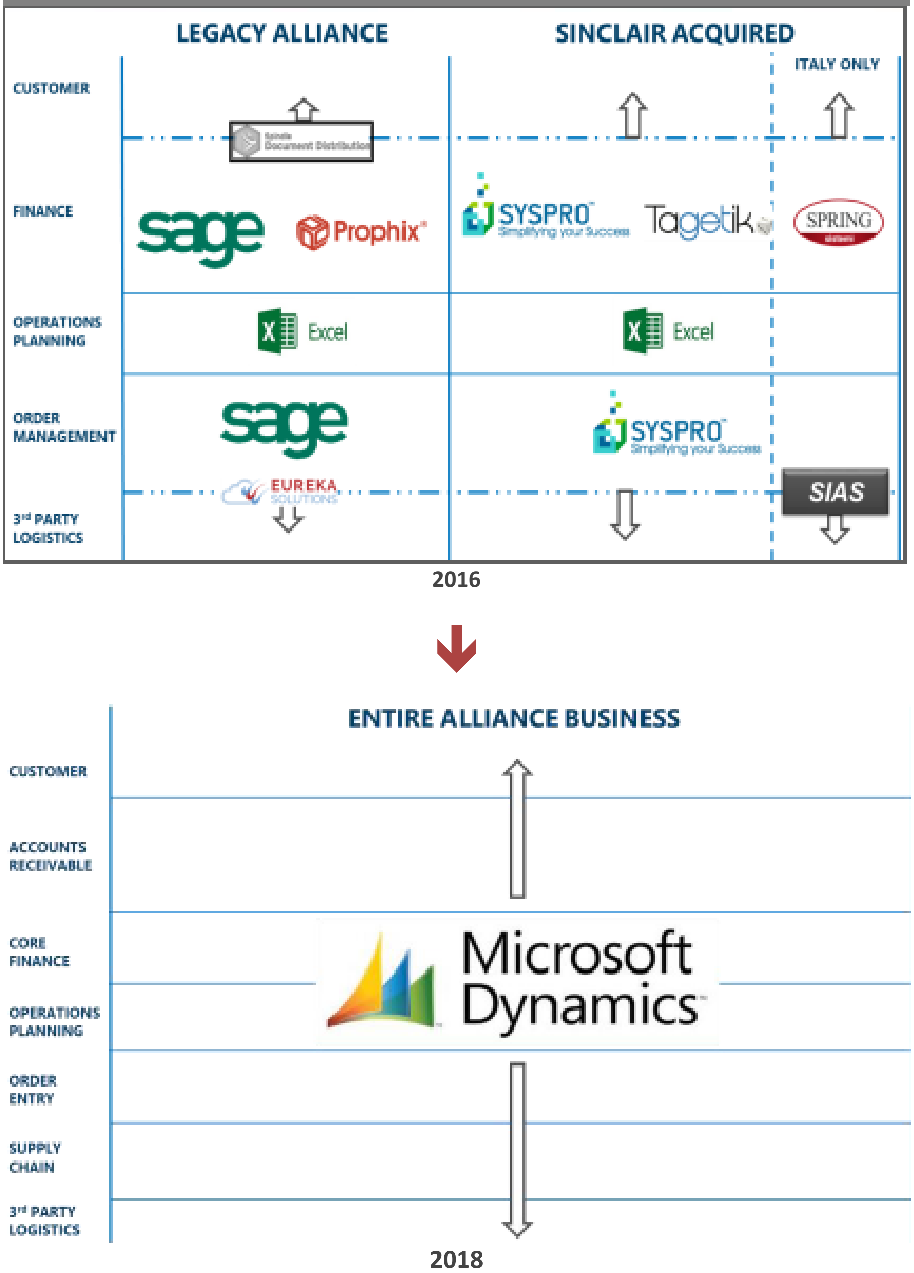
Source: Alliance Pharma; Hardman & Co Life Sciences Research

Financials & investment case

Investing in business systems

APH is a very different business today compared to 12 months ago. This change has been accompanied by the need to manage a more complex multi-location operation, encompassing planning, accounting, controlling and reporting. Systems employed by Sinclair were totally different to those used by Alliance Pharma. The question was whether either system could support properly the needs of the enlarged entity in the future. Following an extensive review, the Board concluded that an entirely new system was required, based on Microsoft Dynamics.

Changing business systems



Source: Hardman & Co Life Sciences Research

Microsoft Dynamics fully phased in in 2018

The project to implement the new system will start in 1Q 2017, with the first implementation scheduled for 1Q 2018, and will be fully rolled-out by the summer of 2018. The total cost is estimated to be around £1.5m based on £1.2m capital cost and £0.3m in staff training and education programmes. The capital costs will come within capital expenditure in the cashflow statement. There will be ca.£0.3m in SG&A on an annual basis, and the depreciation costs will rise.

Investing in growth brands

Multi-market growth next two years

The group's core strategy has not changed. However, in 2016 and for the next two years, management sees the future in a small number of multi-market growth brands which will be supported by investment, particularly marketing, in the early years. APH is spending ca.50% of its total marketing spend on Kelo-cote, MacuShield and Diclectin. The consequence of this is that operating profits will not rise at the same rate as sales. However, once established, the leverage effect of sales increases will be visible in the margin improvement.

Share-based costs

Employees can earn share options

Management adopts a very progressive approach to rewarding staff and all employees have the opportunity to receive share options in the company. Given the enlargement of the group over the last year, coupled to the investment in people to manage the accelerated growth strategy, the share-based costs are expected to rise significantly in the short term, from ca.£0.7m p.a. to £1.4m plus over the next three years. Being a non-cash item, this does not change the Hardman estimates of underlying operating profit. However, it will impact the company's statutory numbers.

Tax

Positive impact from UK corporation tax rate

In recent years, the effective tax rate of APH has been positively impacted by the reduction in the corporation tax rate introduced by the UK government. In 2016, along with the interim announcement, management indicated to the market that the tax rate for the full year for 2016 would be around 18.5%. Given that the UK government is not forecasting any further reduction in the rate of UK tax rate, no further benefits are expected to arise. Even though the company is expected to report growth in sales, EBIT and pre-tax, this will be tempered at the EPS level by a rise in the tax rate to an estimated 22% in fiscal 2017 and beyond, due to the international nature of the enlarged business.

Forex

Natural currency hedge

The benefit to sales in 2016 was £4.2m. All forecasts are made on a constant currency basis to provide a true picture of underlying growth expectations. Therefore, there is a knock-on effect on future years of moving forecasts to the actual average exchange rates for 2016. However, as mentioned earlier, the company has considerable overseas costs, so the effect on profit is much less.

About 50% of group debt is in USD and EUR. Correcting for period end currencies also has an effect on net debt.

Profit & Loss

- **Forex:** Forecasts are based on constant currency using the actual rates for fiscal 2016, clearly shown in the P&L account
- **Diclectin:** Forecasts have been adjusted to account for sales and launch costs in the UK at the end of 2017 and through 2018. Further launch costs might be expected in fiscal 2018 once the marketing strategy in Europe becomes clearer
- **SG&A:** The percentage increase is likely to be higher than sales growth over the next two years as management is planning to invest in the growth products
- **Tax:** Group tax rate is expected to rise in 2017 based on current forecasts due to overseas rates influencing the mix

Profit & Loss account

Year end Dec (£m)	2014	2015	2016E	2017E	2018E	2019E
GBP:USD	-	1.432	1.354	1.354	1.354	1.354
GBP:EUR	-	1.284	1.223	1.223	1.223	1.223
Sales	**43.5**	**48.3**	**97.5**	**103.0**	**112.0**	**121.0**
Cost of goods	-18.5	-19.6	-42.9	-45.0	-48.6	-51.9
Gross profit	25.0	28.7	54.6	58.0	63.4	69.1
Admin & marketing	-12.5	-15.6	-28.6	-29.9	-32.7	-33.4
Underlying EBITDA	**13.2**	**13.6**	**26.8**	**29.1**	**32.4**	**37.7**
EBITDA margin	30.2%	28.1%	27.5%	28.3%	28.9%	31.1%
Depreciation	-0.3	-0.3	-0.4	-0.5	-1.2	-1.5
Amortisation	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2
Other income	0.0	0.0	0.0	0.0	0.0	0.0
Share of JV profits/(loss)	0.3	0.2	0.2	0.3	0.3	0.3
Underlying EBIT	**12.4**	**13.1**	**26.2**	**28.4**	**31.0**	**36.0**
Share based costs	-0.6	-0.6	-0.7	-1.4	-1.5	-1.6
Exceptional items	-0.6	4.5	0.0	0.0	0.0	0.0
Statutory EBIT	11.2	17.0	25.3	26.8	29.3	34.2
Net financials	-1.0	-1.8	-3.0	-2.8	-2.5	-2.2
U/lying pre-tax profit	**10.7**	**12.1**	**23.2**	**25.4**	**28.5**	**33.8**
Exceptional items	0.0	0.0	0.0	0.0	0.0	0.0
Reported pre-tax	**10.2**	**15.2**	**22.3**	**24.0**	**26.8**	**32.0**
Underlying tax	-2.0	-1.4	-4.1	-5.3	-6.0	-7.1
Exceptional tax	0.3	-1.1	0.0	0.0	0.0	0.0
Tax payable/credit	-1.8	-2.5	-4.1	-5.3	-6.0	-7.1
Tax rate	17%	16%	19%	22%	22%	22%
Underlying net income	**8.7**	**10.7**	**19.1**	**20.1**	**22.5**	**26.6**
Statutory net income	8.4	12.7	18.2	18.7	20.8	24.8
Ordinary shares:						
Period-end (m)	264.1	468.2	468.2	468.2	468.2	468.2
Weighted average (m)	264.1	272.7	468.2	468.2	468.2	468.2
Fully diluted (m)	265.6	279.1	474.5	474.5	474.5	474.5
U/lying basic EPS (p)	**3.29**	**3.92**	**4.07**	**4.29**	**4.81**	**5.69**
Statutory basic EPS (p)	3.17	4.65	3.88	3.99	4.45	5.31
U/lying fully-dil. EPS (p)	**3.27**	**3.83**	**4.02**	**4.23**	**4.75**	**5.62**
Stat. fully-dil. EPS (p)	3.16	4.55	3.83	3.94	4.39	5.24
DPS (p)	**1.00**	**1.10**	**1.21**	**1.33**	**1.46**	**1.61**

Source: Hardman & Co Life Sciences Research

Balance sheet

- **Net debt:** At 31st December, the net debt was £76.1m. About 50% of debt is denominated in USD and EUR, which was adversely affected by the weakness of sterling
- **Banking covenants:** APH remains well within it banking covenants taken on at the time of the Sinclair acquisition. At the end of 2016, net debt/EBITDA ratio was 2.8x, which is expected to fall to 2.2x by the end of fiscal 2017
- **Cash:** The model works on the basis that free cashflow is used to drive down debt and leave cash constant. In reality, we expect the enlarged group to hold a slightly higher level of cash on its balance sheet

Balance sheet

@31st December (£m)	2014	2015	2016E	2017E	2018E	2019E
Shareholders' funds	70.8	162.4	174.9	187.4	201.4	218.7
Cumulated goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Total equity	74.4	188.5	201.0	213.4	227.4	244.7
Share capital	2.6	4.7	4.7	4.7	4.7	4.7
Reserves	68.1	157.8	170.3	182.7	196.7	214.0
Provisions/liabilities	0.4	1.5	1.5	1.5	1.5	1.5
Deferred tax	6.1	37.0	39.0	39.0	39.0	39.0
Long-term loans	19.2	59.0	57.5	45.3	28.8	18.8
Short-term debt	3.3	15.8	21.8	21.8	21.8	11.8
less: Cash	1.4	3.2	3.2	3.2	3.2	3.2
Invested capital	**98.4**	**272.5**	**291.5**	**291.8**	**289.3**	**286.6**
Fixed assets	0.4	1.0	1.5	3.0	3.3	2.8
Intangible assets	85.3	233.9	245.8	245.8	245.8	245.8
JV assets	2.7	2.9	3.8	3.8	3.8	3.8
Goodwill	3.6	26.0	26.0	26.0	26.0	26.0
Inventories	5.9	12.9	16.2	17.1	18.6	20.1
Trade debtors	*6.6*	*8.8*	*19.3*	*20.4*	*22.2*	*24.0*
Other debtors	*1.7*	*2.8*	*3.1*	*3.3*	*3.6*	*3.9*
Tax liability/credit	*-1.0*	*-2.1*	*-2.3*	*-2.0*	*-2.1*	*-2.2*
Trade creditors	*-1.7*	*-1.2*	*-10.0*	*-10.5*	*-11.3*	*-12.1*
Other creditors	*-5.2*	*-12.7*	*-11.9*	*-15.2*	*-20.6*	*-25.5*
Debtors less creditors	0.4	-4.3	-1.8	-3.9	-8.3	-12.0
Invested capital	**98.4**	**272.5**	**291.5**	**291.8**	**289.3**	**286.6**

Source: Hardman & Co Life Sciences Research

Key metrics

@31st December (£m)	2014	2015	2016E	2017E	2018E	2019E
Net cash/(debt)	-21.1	-71.5	-76.1	-63.9	-47.4	-27.4
Net debt/EBITDA (x)	1.6	5.3	2.8	2.2	1.5	0.7
Net debt/equity (%)	-28%	-38%	-38%	-30%	-21%	-11%
NAV/share (p)	27	35	37	40	43	47
Stock days	48	71	55	59	58	58
Debtor days	66	58	72	70	69	70
Creditor days	33	57	85	85	85	85
Interest cover (x)	11.4	10.8	7.7	10.2	12.2	16.4
Dividend cover (x)	3.3	3.6	3.4	3.2	3.3	3.5

Source: Hardman & Co Life Sciences Research

Cashflow

- Investment in business system infrastructure has been included in capital expenditure with an associated increased in subsequent depreciation

Cashflow						
Year end Dec (£m)	**2014**	**2015**	**2016**	**2017E**	**2018E**	**2019E**
Operating profit	12.4	13.1	26.2	28.4	31.0	36.0
Depreciation	0.3	0.2	0.4	0.5	1.2	1.5
Amortisation	1.1	0.2	0.2	0.2	0.2	0.2
Inventories	-0.4	-7.0	-3.3	-0.9	-1.5	-1.5
Receivables	*2.8*	*2.3*	*-10.5*	*1.1*	*1.8*	*1.8*
Payables	*-1.8*	*-3.3*	*8.8*	*-0.5*	*-0.8*	*-0.8*
Working capital	1.0	-1.0	-1.7	0.6	1.0	1.0
Exceptionals/provisions	0.0	4.5	0.0	0.0	0.0	0.0
Other	-1.0	-0.1	-2.0	0.0	0.0	0.0
Cashflow from ops.	**13.3**	**9.9**	**19.9**	**28.8**	**31.9**	**37.2**
Net interest	-0.9	-1.0	-3.0	-2.8	-2.5	-2.2
Tax paid/received	-2.0	-1.9	-3.5	-4.0	-5.0	-7.0
Operational cashflow	**10.5**	**7.0**	**13.3**	**22.0**	**24.3**	**28.0**
Capital expenditure	-0.1	-0.6	-0.9	-2.0	-1.5	-1.0
Capitalised R&D	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Free cashflow	**10.3**	**6.4**	**12.3**	**19.9**	**22.7**	**26.9**
Acquisitions	-3.3	-133.9	-7.0	-2.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	-2.4	-2.6	-4.4	-5.7	-6.2	-6.9
CF after investments	**4.1**	**-130.1**	**0.9**	**12.2**	**16.5**	**20.0**
Share repurchases	0.0	0.0	0.0	0.0	0.0	0.0
Share issues	0.0	79.8	0.0	0.0	0.0	0.0
Currency effect	0.0	-0.1	-5.5	0.0	0.0	0.0
Change in net debt	**4.1**	**-50.4**	**-4.6**	**12.2**	**16.5**	**20.0**
Opening net cash/(debt)	-25.2	-21.1	-71.5	-76.1	-63.9	-47.4
Closing net cash/(debt)	**-21.1**	**-71.5**	**-76.1**	**-63.9**	**-47.4**	**-27.4**
Hardman FCF/share (p)	3.9	2.3	2.6	4.2	4.9	5.7

Source: Hardman & Co Life Sciences Research

Changes to forecasts

Better underlying growth coupled with revised currency rates has led to an increase in sales as shown in the following table, which also reflects increased Diclectin costs.

Changes to forecasts					
Year end Dec (£m)		**2016E**	**2017E**	**2018E**	**2019E**
Sales	Old	95.8	101.3	106.0	112.0
	New	97.5	103.0	112.0	121.0
	Change	-	+2%	+6%	+8%
U/lying pre-tax	Old	22.8	25.5	29.7	32.0
	New	23.2	25.4	28.5	33.8
	Change	+2%	-0%	-7%	+6%
EPS (p)	Old	3.95	4.38	4.92	5.32
	New	4.07	4.29	4.81	5.69
	Change	+3%	-2%	+3%	+7%

Source: Hardman & Co Life Sciences Research

Company matters

Registration

Incorporated in England and Wales with company registration number: 04241478

UK Headquarters:

Avonbridge House
Bath Road
Chippenham
Wiltshire
SN15 2BB

+44 1249 466 966
www.alliancepharmaceuticals.com

Board of Directors

Board of Directors

Position	Name	Nominations	Remuneration	Audit
Chairman	Andrew Smith	C	C	M
Chief Executive Officer	John Dawson	M		
Chief Financial Officer	Andrew Franklin			
Deputy CEO	Peter Butterfield			
Non-executive director	Thomas Casdagli	M	M	
Non-executive director	Nigel Clifford	M	M	M
Non-executive director	David Cook	M	M	C

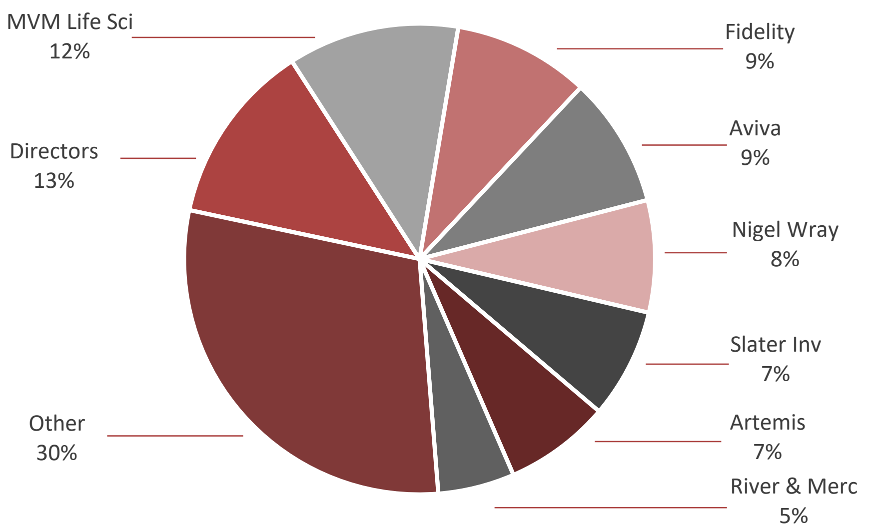
M = member; C = chair
Source: Company reports

Share capital

Number of Ordinary shares in issue at 23rd January 2017: 472,568,462

Number of options outstanding: 6.32 million

Key shareholders (@ 18th January 2017)



Source: Company website; Hardman & Co Life Sciences Research

Glossary

AREDS2	Age Related Eye Disease Study 2
OTx	A combination market in which products are promoted to doctors who then recommend that their patients purchase the products through the retail channels

ec.europa.eu/eurostat

www.cdc.gov/nchs

Kelo-cote® and MacuShield® are Registered Trade Marks of Alliance Pharma plc. Diclectin is a Registered Trade Mark of Duchesnay Inc.

Notes

Notes

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