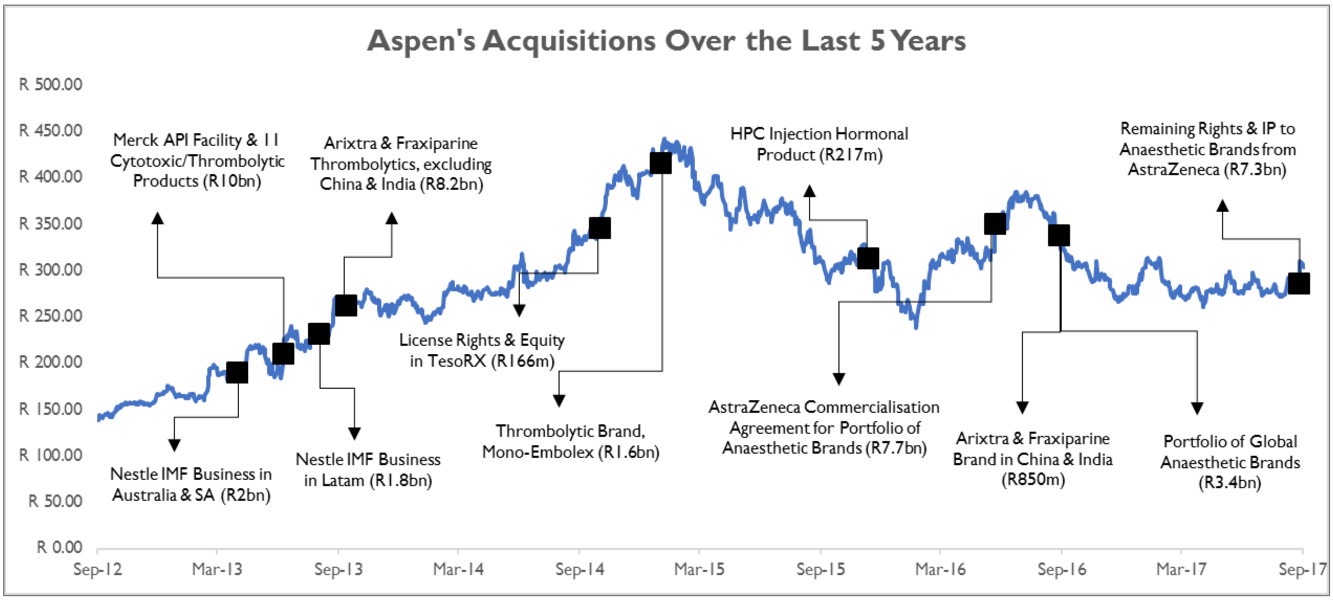
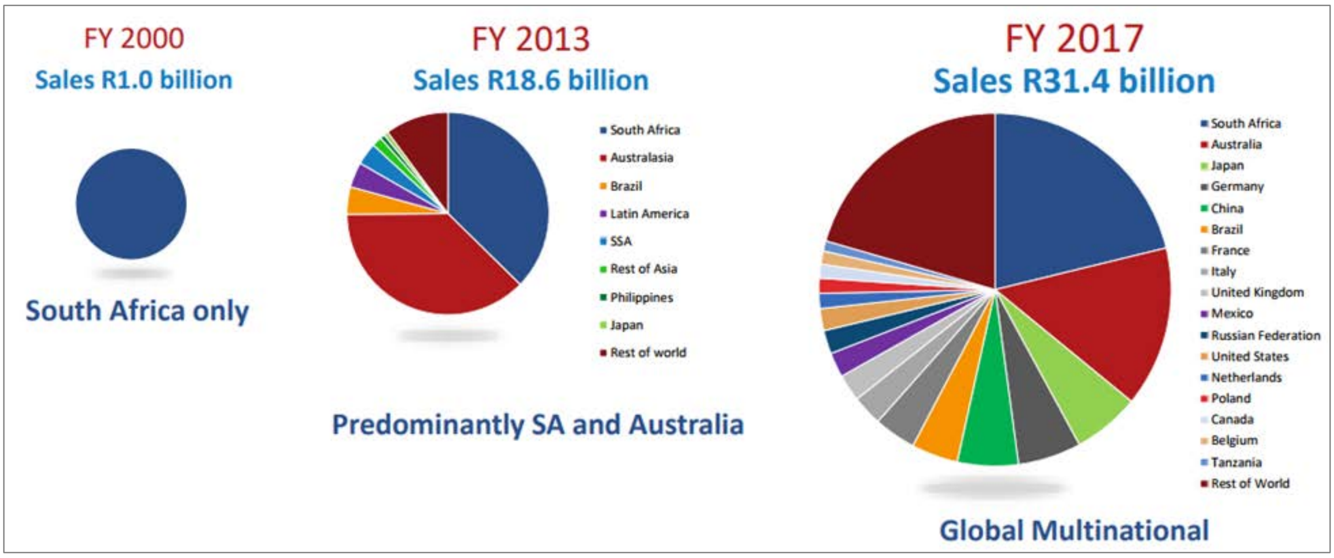
Aspen 2.0

Aspen has transformed its business over the last 5 years, making over R42bn in acquisitions during the period. The journey hasn't been smooth-sailing, recent results however provided some much-needed clarity on the Aspen of today – *"Aspen 2.0."*



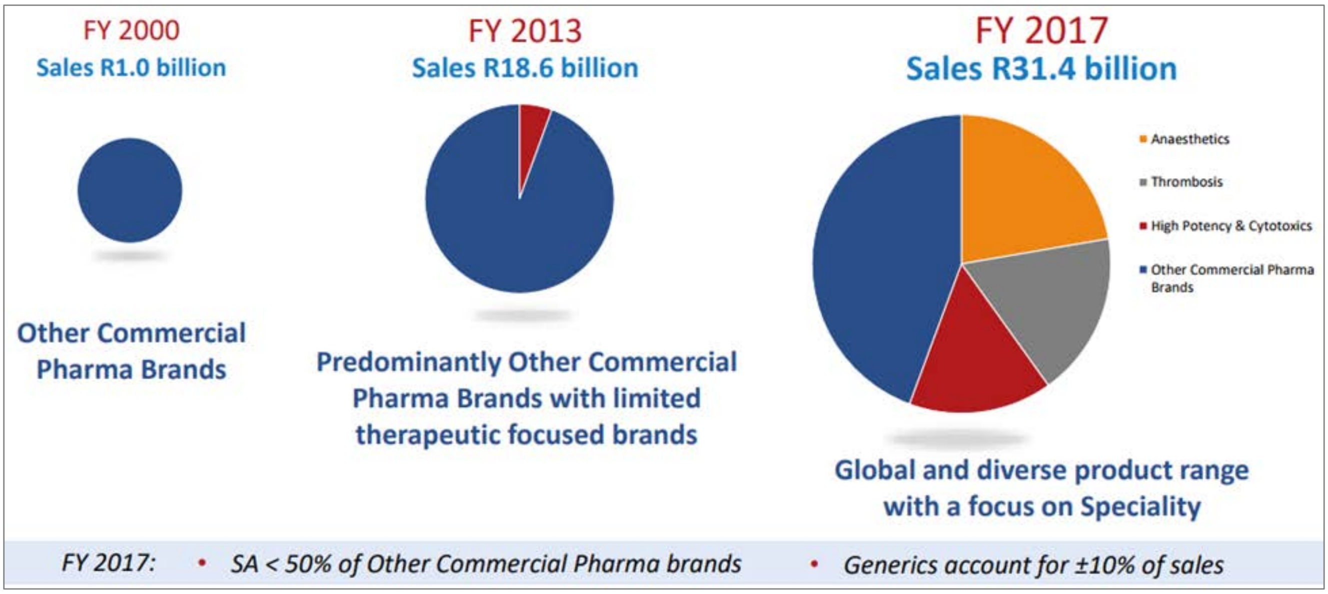
Aspen reported normalised headline earnings per share growth of 16% to R14.63 for the year ended June 2017, with 27% growth achieved in the second half of the year. Results were boosted by the acquisition of the anaesthetic brands from GSK and AstraZeneca, included in the results for 4 and 10 months, respectively. On releasing results, Aspen also announced the acquisition of the rights to the intellectual property (IP) of the anaesthetic brands being sold under the commercialisation agreement with AstraZeneca. The original agreement allowed Aspen to sell the respective anaesthetic products globally (excluding the US) with Aspen having to pay a double-digit percentage royalty on sales to AstraZeneca as it still held the rights and IP to the products. The latest agreement entails the transfer of the full rights and IP of the products to Aspen for $555m (~R7.3bn). Additionally, AstraZeneca will continue to manufacture and supply these products to Aspen for up to 5 years, providing Aspen with the necessary time to transition the manufacturing into its own facilities.



The acquisitions made over the last 6-years, including the acquisition of Sigma in Australia in early 2011, has transformed Aspen into a truly multinational pharmaceutical company. With 54% of Group revenue still being generated in Emerging Markets, Aspen provides a unique mix of geographical earnings relative to its competitors. In addition to the R31.4bn generated by its commercial pharma division as outlined above, Aspen generated a further R10bn from its Nutritionals and Manufacturing businesses.

Aspen 2.0 (Continued)

Within the Commercial Pharma division, Aspen now has three therapeutic focus areas – Anaesthetics, Thrombolytics and High Potency / Cytotoxics. From the Group's heritage as a predominantly generic, non-therapeutically focused business, generics now contribute just 10% of Commercial Pharma revenue. The significance of this transformation is better contextualised when one learns that Aspen is now the largest global anaesthetics company and second-largest thrombosis company, outside the US.



A key element of Aspen's strategy is to acquire products within therapeutic areas that are both niche in nature and complementary to its existing manufacturing operations. Most of the products acquired within the Thrombolytics portfolio have a common active pharmaceutical ingredient (API) – Heparin. We've spoken about Heparin in previous newsletters, but a as a quick recap, Heparin is manufactured from the intestinal lining of pigs. Aspen acquired the facility that produces the Heparin API from Merck in 2013, and whilst in negotiating with Merck, it was also in the process of reaching agreement with GSK to acquire the Arixtra and Fraxiparine / Fraxodi thrombolytic brands. This acquisition provided the Group with the manufacturing facility to produce finished dosage forms of these products. Coupled with the Merck acquisition, this gave Aspen a unique, vertically integrated portfolio of thrombolytic brands.

The anaesthetics portfolios acquired from GSK and AstraZeneca also fit the strategy, as these products primarily involve sterile manufacturing, an area where Aspen now has significant expertise. Additionally, both anaesthetics and thrombolytics are dispensed primarily in hospitals and clinics, presenting the opportunity to leverage Aspen's existing hospital-focused sales force, currently promoting the thrombolytics brands. Over the 5 year manufacturing transition period granted by AstraZeneca, Aspen will incrementally move production of the anaesthetic brands into its existing facilities in the Netherlands, France and Cape Town. As AstraZeneca was receiving a royalty on the sales of the portfolio under the commercialisation agreement, Aspen's acquisition of these rights would have added ~$90m (~R1.2bn) to Group operating profit over the last year – *an almost 15% jump on what was already reported!* As Aspen takes over the manufacturing of these products, we should see ongoing upside in the margin of the acquired portfolio.

Aspen exercised the option granted to it by GSK to acquire the Fraxiparine and Arixtra brand rights in China, India and Pakistan, which were previously excluded in the original transaction. These brands generated ~£30m in revenue from China over the last year alone. Aspen also took the opportunity to acquire the brand rights following the commercialisation agreement with AstraZeneca, which has fully operational offices in Beijing, Shanghai and Guangzhou. The AstraZeneca infrastructure in China provided Aspen with a sizeable sales footprint with which to expand the thrombolytics portfolio in the country – *Its Chinese sales force is now its largest across the Group!*

Aspen 2.0 (Continued)

Not to be overlooked, over the last 5 years, Aspen has built a sizeable infant nutritional (IN) business, with operations in Southern Africa, Latin America and Australasia. The Australian base has provided Aspen with a strong platform from which to expand into China. There have been a number of scandals in China surrounding infant milk formula (IMF) over the last several years, with a plethora of unregulated local distributors selling into that market. Chinese authorities have increasingly clamped down on unregistered local distributors operating in the country and by December 2017, no unregistered producers are permitted to sell IMF products in the country. This has provided Aspen with an attractive opportunity to formally enter the market. Aspen already owns 50% of one of the limited number of approved IMF manufacturing facilities, based in New Zealand, acquired in 2014. This business will launch its own-branded IMF product, "alula", with a Hong Kong-based partner in October 2017, with the registration of the product expected by March 2018, but could be as early as December / January. China is expected to account for nearly half of global IMF sales by 2021, with global sales of ~$47bn estimated in 2015, according to Euromonitor. This provides a sizable opportunity, even at a low market share, for Aspen in China. To put the size of this opportunity into context – *a 1% market share for Aspen equates to an almost 15% increase in Group revenue!*

Aspen's prospects going into its fiscal 2018 year look bright. The Group was able to over deliver on its cost savings guidance in the last year, achieving R1.2bn in synergies from its acquisitions and is expecting at least another R500m to be extracted over the coming year. Much of the focus over the last several years has been around bedding down its thrombolytic acquisitions, and in particular, optimising the manufacturing supply chain and processes to produce the highly complex APIs and finished dosage products. This has required a disproportionate amount of senior management time and was prioritised ahead of the commercial aspects of the business. Aspen can now really turn its focus onto growing its distribution and sales channels for these products.

While the operational performance of the Group improved markedly over the second half of the year, it still has the European Commission investigation hanging over it. Aspen has been accused of abusing its dominant position in certain oncology products in Europe, which is in breach of the EU's antitrust rules. The Italian Court has dismissed Aspen's appeal against the Italian Competition Authority ruling relating to its portfolio of oncology products distributed in Italy and was fined €5.2m. Aspen has lodged a further appeal to the "Council of State" appeal court in Italy. While the accusations are not to be taken lightly, this tends to be par for the course for a multinational, branded pharmaceutical company in today's world. We continue to monitor for any new developments on the case.

We remain positive on the long-term outlook for Aspen and continue to rate the management team highly. Aspen is one of the few, large multinational companies where the CEO and CFO hold material stakes in the business. Steven Saad is Aspen's largest shareholder, with a 12% stake and Gus Attridge, the fourth-largest, holds a 4% stake in the business. Aspen hasn't fully completed its transition just yet, but we believe the worst is behind it and we remain confident of Aspen maintaining its 19-year run of consecutive annual growth in normalised headline earnings per share.