# Top line growth and US market share up again

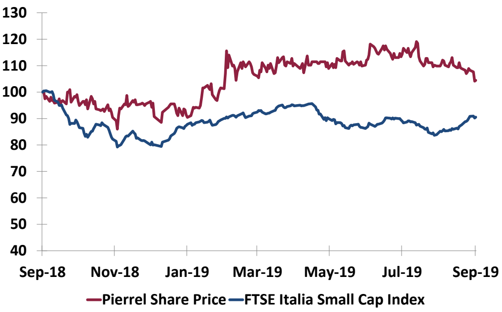
PIERREL

## OUTPERFORM

**Current Share Price (€): 0.164**

**Target Price (€): 0.271**

### Pierrel - 1Y Performance




Source: S&P Capital IQ - Note: 18/09/2018=100

### Company data

| | |
|---|---|
| ISIN number | IT0004007560 |
| Bloomberg code | PRL IM |
| Reuters code | PRL.MI |
| Sector | Pharma & Healthcare |
| Stock market | MTA (Italy) |
| Share Price (€) | 0.164 |
| Date of Price | 18/09/2019 |
| Shares Outstanding (m) | 228.9 |
| Market Cap (€m) | 37.5 |
| Market Float (%) | 28.6% |
| Daily Volume | 148,601 |
| Avg Daily Volume YTD | 390,877 |
| Target Price (€) | 0.271 |
| Upside (%) | 65% |
| Recommendation | OUTPERFORM |

### Share price performance

| | 1M | 3M | 1Y |
|---|---|---|---|
| Pierrel - Absolute (%) | -4.9% | -8.4% | 4.5% |
| FTSE Italia Small Cap (%) | 6.2% | 2.6% | -9.5% |
| 1Y Range H/L (€) | | 0.187 | 0.135 |
| YTD Change (€)/% | | 0.02 | 13.1% |

Source: S&P Capital IQ

### Top line keeps growing

Pierrel revenues in H1 2019 were €9.4m, +8% from H1 2018. EBITDA was €0.9m, +42% vs H1 2018 with increased margin at 9% vs 7% in H1 2018. EBIT at €0.3m and breakeven bottom line (€0.1m loss). Net debt as of June 2019 €4.7m vs. €3.7m as of December 2018, after use of around €2m cash beginning planned investments.

### Pierrel's Orabloc® towards 25% market share in the USA

Pierrel keeps expanding its presence in North America, with Orabloc® sales 15% up in H1 2019 compared to H1 2018. We see the management target of Pierrel Orabloc® 25% market share by 2020 in the USA closer after H1 2019 performance.

### Confidence on a favorable outlook

Pierrel is expanding its presence in North America and EurAsia, with international sales on the rise thanks to the contribution of the expanded international network. The global industry growth rates also help and long-term agreements with leading European and US dental care distributors provide high visibility of projections.

### Target Price €0.271 per share, OUTPERFORM rating

Reported H1 2019 results are overall in line with our projections, thus our earnings forecasts and valuation assumptions keep being reliable. We have rolled forward our DCF model (G 3%; WACC 8%), which ends at a target price of €0.271 per share (€0.267 in our prior note), with a potential upside of 65% on the current share price. As a consequence, we confirm the OUTPERFORM recommendation on the stock.

### Key financials and estimates

| €m | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|
| **Revenues** | **20.4** | **22.2** | **23.7** | **27.8** | **33.3** |
| *YoY %* | *17.7%* | *9.0%* | *6.8%* | *17.2%* | *20.0%* |
| **EBITDA** | **3.4** | **3.7** | **4.1** | **5.0** | **6.5** |
| *Margin* | *16.5%* | *16.6%* | *17.4%* | *18.0%* | *19.6%* |
| **EBIT** | **2.3** | **2.3** | **2.5** | **3.3** | **4.7** |
| *Margin* | *11.3%* | *10.5%* | *10.5%* | *11.7%* | *14.0%* |
| **Net Income (Loss)** | **0.8** | **1.6** | **1.7** | **2.3** | **3.4** |
| **Trade Working Capital** | **2.6** | **3.1** | **3.5** | **4.0** | **4.7** |
| **Net (Debt) Cash** | **(3.7)** | **(3.1)** | **(1.5)** | **0.7** | **4.0** |
| **Equity** | **11.3** | **12.9** | **14.6** | **16.9** | **20.3** |

Source: Company data 2018A, EnVent Research 2019-22E

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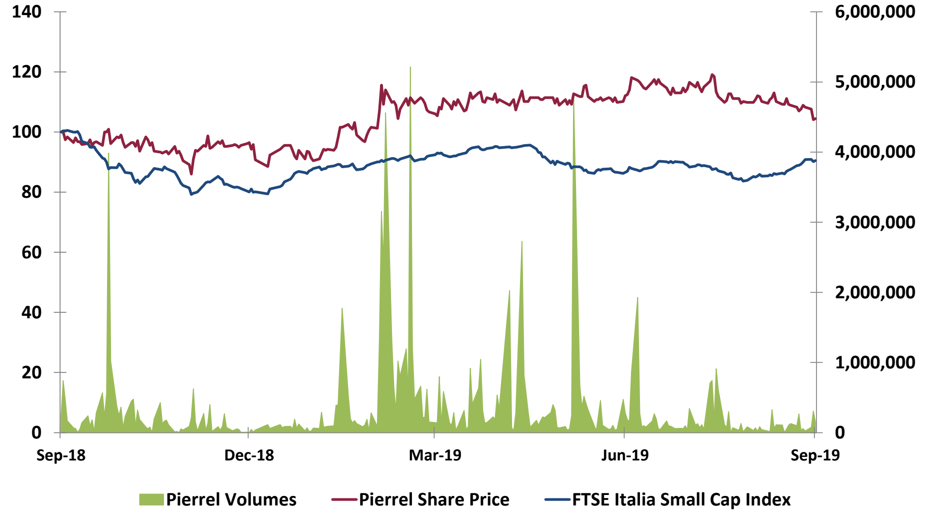
## Market update

**Outperforming Small Cap index**

**Pierrel's shares in the last 12 months traded in the range €0.135-0.187, with beginning price at €0.157 and ending at €0.164, up 4%**

**In the same period, the FTSE Small Cap decreased by 9%**

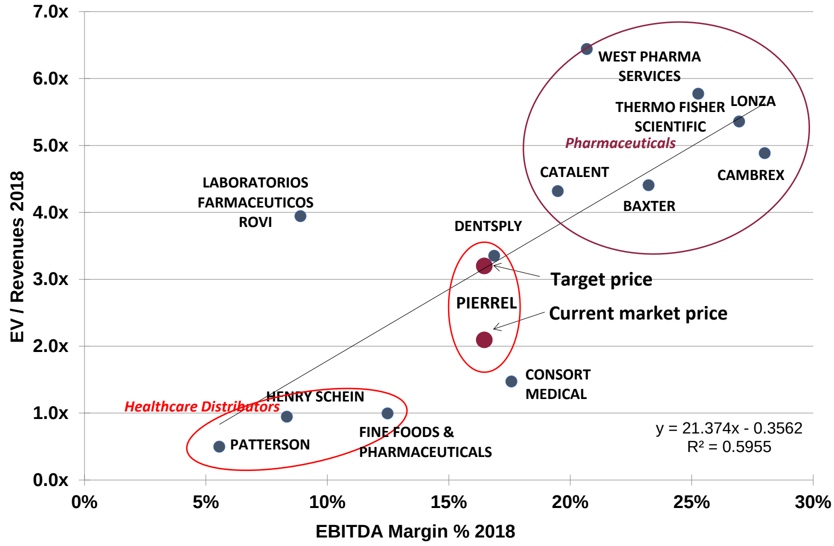
**Pierrel - 1Y Share price performance and trading volumes**




Source: EnVent Research on S&P Capital IQ - Note: 18/09/2018=100

**Forward industry multiples**

**Pierrel Peer group - Regression analysis and Pierrel target positioning**




Source: EnVent Research on S&P Capital IQ, September 2019

## H1 2019 revenues keep increasing, improved EBITDA compared to H1 2018 (+42%), €2m cash used for investments

**Rewarding performance consistently with 2018 trend**

**Personnel up to meet growing volumes**

In H1 2019, Pierrel consolidated revenues were €9.4m, +8% on H1 2018, driven by Orabloc® sales in North America and in new Eurasian markets. Operating costs remained mostly stable, apart for personnel which increased by 16% to €3.3m. EBITDA reached €0.9m, +42% on H1 2018, 9% margin, from €0.6m in H1 2018 (7% margin). EBIT was €0.3m, vs. €0.1m in H1 2018. Breakeven bottom line (€0.1m loss).

On the balance sheet side, trade working capital decreased to €1.7m from €2.6m in 2018, with a major drop in receivables by 55%, followed by payables by 25%, inventory was almost stable.

**TWC down by 36%**

Net debt of €4.7m as of June 2019 includes:

- €7.9m cash

**€2m cash used for investments**

- €0.8m bank debt
- €11.9m other financial debt, of which €5.6m scheduled to be reimbursed within 2026 to a supplier

## Business update

### Sales progress as expected in North America

In H1 2019, Orabloc® sales in North America went 15% up compared to H1 2018, and, according to management, are projected to reach a 25% market share by 2020.

## Financial projections

We deem H1 2019 results as overall consistent with our year-end 2019 projections and with management guidance (revenues €22.4m; EBITDA €3.7m). We recall that H1 revenues are historically lower than H2, based on a backward comparison of H1 and H2 revenues, being production facilities' maintenance cycles concentrated in the first part of the year. As such, we consider the target figures at reach and we confirm our 2020-22E estimates, remaining conservative with respect to management guidelines.

**Consolidated Profit and Loss**

| €m | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| **Revenues** | **17.3** | **20.4** | **22.2** | **23.7** | **27.8** | **33.3** |
| *YoY %* | *19%* | *18%* | *9%* | *7%* | *17%* | *20%* |
| COGS | (6.0) | (7.4) | (8.1) | (8.7) | (10.2) | (12.2) |
| **Gross profit** | **11.3** | **12.9** | **14.1** | **15.0** | **17.6** | **21.2** |
| *Margin* | *65.2%* | *63.5%* | *63.5%* | *63.5%* | *63.5%* | *63.5%* |
| Personnel | (5.0) | (5.8) | (6.0) | (6.2) | (6.7) | (7.3) |
| G&A | (3.2) | (2.6) | (2.6) | (2.7) | (2.9) | (3.2) |
| Marketing & Sales | (0.4) | (0.5) | (0.5) | (0.6) | (1.4) | (1.7) |
| Other operating costs | (0.6) | (0.7) | (1.3) | (1.5) | (1.6) | (2.5) |
| **EBITDA** | **2.1** | **3.4** | **3.7** | **4.1** | **5.0** | **6.5** |
| *Margin* | *12.3%* | *16.5%* | *16.6%* | *17.4%* | *18.0%* | *19.6%* |
| D&A | (1.1) | (1.0) | (1.4) | (1.6) | (1.8) | (1.9) |
| **EBIT** | **1.0** | **2.3** | **2.3** | **2.5** | **3.3** | **4.7** |
| *Margin* | *5.9%* | *11.3%* | *10.5%* | *10.5%* | *11.7%* | *14.0%* |
| Interest | (1.2) | (0.9) | (0.1) | (0.1) | (0.0) | 0.1 |
| Exchange gain (loss) | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-recurring items | (3.1) | (0.3) | 0.0 | 0.0 | 0.0 | 0.0 |
| **EBT** | **(2.3)** | **1.1** | **2.2** | **2.4** | **3.2** | **4.7** |
| *Margin* | *-13.1%* | *5.5%* | *10.0%* | *10.1%* | *11.6%* | *14.2%* |
| Income taxes | (0.2) | (0.3) | (0.6) | (0.7) | (0.9) | (1.4) |
| **Net Income (Loss)** | **(2.5)** | **0.8** | **1.6** | **1.7** | **2.3** | **3.4** |

Source: Company data 2017-18A; EnVent Research 2019-22E

## Consolidated Balance Sheet

| €m | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| Inventory | 2.8 | 3.8 | 4.1 | 4.4 | 5.2 | 6.2 |
| Trade receivables | 3.3 | 3.3 | 3.6 | 3.8 | 4.5 | 5.4 |
| Trade payables | (4.9) | (4.5) | (4.6) | (4.8) | (5.7) | (7.0) |
| Trade Working Capital | 1.2 | 2.6 | 3.1 | 3.5 | 4.0 | 4.7 |
| Other assets (liabilities) | 1.2 | 1.2 | 1.4 | 1.6 | 1.8 | 1.8 |
| **Net Working Capital** | **2.5** | **3.8** | **4.5** | **5.1** | **5.7** | **6.4** |
| Intangible assets | 1.4 | 2.0 | 2.6 | 2.6 | 2.5 | 2.4 |
| Property, plant and equipment | 10.2 | 9.5 | 9.3 | 8.8 | 8.3 | 7.8 |
| Financial assets | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Non-current assets** | **11.8** | **11.5** | **11.9** | **11.4** | **10.9** | **10.2** |
| **Provisions** | **(0.5)** | **(0.4)** | **(0.4)** | **(0.4)** | **(0.4)** | **(0.4)** |
| **Net Invested Capital** | **13.7** | **15.0** | **16.0** | **16.1** | **16.2** | **16.3** |
| **Net Debt (Cash)** | **11.4** | **3.7** | **3.1** | **1.5** | **(0.7)** | **(4.0)** |
| **Equity** | **2.3** | **11.3** | **12.9** | **14.6** | **16.9** | **20.3** |
| **Sources** | **13.7** | **15.0** | **16.0** | **16.1** | **16.2** | **16.3** |

Source: Company data 2017-18A; EnVent Research 2019-22E

## Consolidated Cash Flow

| €m | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| **EBIT** | **1.0** | **2.3** | **2.3** | **2.5** | **3.3** | **4.7** |
| Current taxes | (0.2) | (0.3) | (0.6) | (0.7) | (0.9) | (1.4) |
| D&A | 1.1 | 1.0 | 1.4 | 1.6 | 1.8 | 1.9 |
| Provisions | (0.0) | (0.2) | 0.0 | 0.0 | 0.0 | 0.0 |
| **Cash flow from operations** | **1.8** | **2.9** | **3.0** | **3.4** | **4.1** | **5.2** |
| Trade Working Capital | (1.8) | (1.4) | (0.5) | (0.4) | (0.5) | (0.7) |
| Capex | (0.9) | (0.8) | (1.7) | (1.2) | (1.2) | (1.2) |
| Other assets and liabilities | 3.3 | (0.0) | (0.2) | (0.2) | (0.2) | 0.0 |
| **Free cash flow** | **2.4** | **0.7** | **0.7** | **1.7** | **2.2** | **3.3** |
| Interest | (1.2) | (0.9) | (0.1) | (0.1) | (0.0) | 0.1 |
| Exchange gain (loss) | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-recurring items | (3.1) | (0.3) | 0.0 | 0.0 | 0.0 | 0.0 |
| Capital increase (decrease) | 12.3 | 8.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Net cash flow** | **11.4** | **7.8** | **0.5** | **1.6** | **2.2** | **3.3** |
| Net (Debt) Cash - Beginning | (22.9) | (11.4) | (3.7) | (3.1) | (1.5) | 0.7 |
| Net (Debt) Cash - End | (11.4) | (3.7) | (3.1) | (1.5) | 0.7 | 4.0 |
| **Change in Net (Debt) Cash** | **11.4** | **7.8** | **0.5** | **1.6** | **2.2** | **3.3** |

Source: Company data 2017-18A; EnVent Research 2019-22E

## Ratio analysis

| KPIs | 2017 | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| ROE | -112% | 7% | 12% | 12% | 14% | 17% |
| ROS (EBIT/Revenues) | 6% | 11% | 11% | 10% | 12% | 14% |
| ROIC (NOPAT/Invested Capital) | 6% | 11% | 10% | 11% | 14% | 20% |
| DSO | 70 | 59 | 59 | 59 | 59 | 59 |
| DPO | 175 | 147 | 135 | 130 | 130 | 130 |
| DOI | 59 | 68 | 68 | 68 | 68 | 68 |
| TWC/Revenues | 7% | 13% | 14% | 15% | 14% | 14% |
| NWC/Revenues | 14% | 19% | 20% | 21% | 21% | 19% |
| Net Debt / EBITDA | 5.4x | 1.1x | 0.8x | 0.4x | cash | cash |
| Cash flow from P&L operations / EBITDA | 86% | 87% | 82% | 83% | 81% | 79% |
| FCF / EBITDA | 115% | 22% | 18% | 40% | 44% | 50% |

Source: Company data 2017-18A; EnVent Research 2019-22E

# Valuation

## Discounted Cash Flows

DCF assumptions updated:

- Risk free rate: 2.0% (Italian 10-year government bonds interest rate - 3Y average. Source: Bloomberg, September 2019)
- Market return: 13.6% (3Y average. Source: Bloomberg, September 2019)
- Market risk premium: 11.6%
- Beta: 1 (Median of core business peers. Source: Bloomberg, September 2019)
- Cost of equity: 13.9%
- Cost of debt: 3.5%
- Tax rate: 24% IRES
- 50% debt/(debt + equity) as target capital structure
- WACC calculated at 8.3%, according to above data
- Perpetual growth rate after explicit projections 3% (industry long-term trend)
- Terminal Value assumes an EBIT margin of 16%

### DCF Valuation

| €m | | 2018 | 2019E | 2020E | 2021E | 2022E | Perpetuity |
|---|---|---|---|---|---|---|---|
| **Revenues** | | **20.4** | **22.2** | **23.7** | **27.8** | **33.3** | **34.3** |
| **EBITDA** | | **3.4** | **3.7** | **4.1** | **5.0** | **6.5** | **6.7** |
| *Margin* | | *16.5%* | *16.6%* | *17.4%* | *18.0%* | *19.6%* | *19.6%* |
| **EBIT** | | **2.3** | **2.3** | **2.5** | **3.3** | **4.7** | **5.5** |
| *Margin* | | *11.3%* | *10.5%* | *10.5%* | *11.7%* | *14.0%* | *16.1%* |
| Taxes | | (0.7) | (0.7) | (0.7) | (0.9) | (1.3) | (1.6) |
| **NOPAT** | | **1.6** | **1.7** | **1.8** | **2.3** | **3.3** | **3.9** |
| D&A | | 1.0 | 1.4 | 1.6 | 1.8 | 1.9 | 1.2 |
| Provisions | | (0.2) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Cash flow from P&L operations** | | **2.5** | **3.0** | **3.4** | **4.1** | **5.2** | **5.1** |
| Trade Working Capital | | (1.4) | (0.5) | (0.4) | (0.5) | (0.7) | 0.0 |
| Capex | | (0.8) | (1.7) | (1.2) | (1.2) | (1.2) | (1.2) |
| Other assets and liabilities | | (0.0) | (0.2) | (0.2) | (0.2) | 0.0 | 0.0 |
| **Unlevered free cash flow** | | **0.3** | **0.6** | **1.6** | **2.2** | **3.3** | **3.9** |
| WACC | 8.3% | | | | | | |
| Long-term growth (G) | 3.0% | | | | | | |
| **Discounted Cash Flows** | | | **0.6** | **1.5** | **1.9** | **2.6** | |
| Sum of Discounted Cash Flows | 6.6 | | | | | | |
| **Terminal Value** | | | | | | | **74.6** |
| Discounted TV | 58.7 | | | | | | |
| **Enterprise Value** | **65.4** | | | | | | |
| Net Debt as of 30/06/19 | (4.7) | | | | | | |
| Short-term tax relief | 1.5 | | | | | | |
| **Equity Value** | **62.1** | | | | | | |

| **DCF - Implied multiples** | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|
| EV/Revenues | 3.2x | 2.9x | 2.8x | 2.4x | 2.0x |
| EV/EBITDA | 19.5x | 17.7x | 15.9x | 13.0x | 10.0x |
| EV/EBIT | 28.4x | 28.0x | 26.3x | 20.1x | 14.1x |
| P/E | 73.4x | 39.7x | 36.6x | 27.0x | 18.4x |

| **Current market price - Implied multiples** | | 2018 | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|
| EV/Revenues | | 2.1x | 1.9x | 1.8x | 1.5x | 1.3x |
| EV/EBITDA | | 12.6x | 11.5x | 10.3x | 8.4x | 6.5x |
| EV/EBIT | | 18.3x | 18.1x | 17.0x | 13.0x | 9.1x |
| P/E | | 44.4x | 24.0x | 22.1x | 16.3x | 11.1x |
| *Discount* | *35%* | | | | | |

Source: EnVent Research

## Target Price

We have rolled forward our model and updated DCF criteria. Our valuation of Pierrel is at €0.271 per share, from €0.267, with a potential upside of 65% on the current share price. As a consequence, we confirm the OUTPERFORM recommendation on the stock.

Please refer to important disclosures at the end of this report.

| Pierrel Price per Share | |
|---|---|
| **Target Price** | **0.271** |
| Current Share Price (18/09/2019) | 0.164 |
| **Premium (Discount)** | **65%** |

Source: EnVent Research

# Annex

## Peer Group - Market Multiples

| Company | EV/REVENUES | | | EV/EBITDA | | | EV/EBIT | | | P/E | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | 2019E | 2020E | 2018 | 2019E | 2020E | 2018 | 2019E | 2020E | 2018 | 2019E | 2020E |
| **Pierrel** | 2.1x | 1.9x | 1.8x | 12.6x | 11.5x | 10.2x | 18.3x | 18.1x | 17.0x | 44.4x | 24.0x | 22.1x |
| **Core business peers** | | | | | | | | | | | | |
| **Lonza** | 5.3x | 4.8x | 4.5x | 19.6x | 17.9x | 16.2x | 28.7x | 23.7x | 21.5x | 46.2x | 25.8x | 23.5x |
| **Catalent** | 4.3x | 4.1x | 3.5x | 21.9x | 16.7x | 13.9x | 36.3x | 38.8x | 26.0x | 93.7x | 27.9x | 23.6x |
| **West Pharmaceutical Services** | 6.3x | 5.8x | 5.4x | 30.7x | 26.2x | 23.6x | 43.4x | 36.0x | 32.0x | 52.9x | 45.8x | 41.2x |
| **Cambrex** | 4.8x | 3.8x | 3.7x | 17.3x | 15.8x | 15.2x | 23.2x | 21.4x | 21.2x | 22.5x | 27.8x | 28.6x |
| **Consort Medical** | 1.5x | 1.5x | 1.6x | 8.7x | 8.3x | 9.8x | 11.4x | 11.0x | 13.2x | 23.4x | 11.8x | 15.5x |
| **Laboratorios Farmaceuticos ROVI** | 3.6x | 3.1x | 2.9x | 41.0x | 26.1x | 17.7x | 69.7x | 41.4x | 21.9x | 62.8x | 53.5x | 25.8x |
| **Baxter International** | 4.4x | 4.2x | 4.0x | 19.0x | 17.5x | 15.7x | 27.2x | 23.2x | 20.1x | 28.5x | 25.5x | 23.1x |
| **Thermo Fisher Scientific** | 5.7x | 5.3x | 5.0x | 22.6x | 20.5x | 18.9x | 35.7x | 22.4x | 20.7x | 41.3x | 23.7x | 21.7x |
| **Mean** | **4.5x** | **4.1x** | **3.8x** | **22.6x** | **18.6x** | **16.4x** | **34.5x** | **27.2x** | **22.1x** | **46.4x** | **30.2x** | **25.4x** |
| **Median** | **4.6x** | **4.1x** | **3.9x** | **20.8x** | **17.7x** | **15.9x** | **32.2x** | **23.5x** | **21.4x** | **43.7x** | **26.8x** | **23.6x** |
| **Customers/Distributors** | | | | | | | | | | | | |
| **Patterson** | 0.5x | 0.4x | 0.4x | 8.7x | 10.0x | 9.6x | 12.1x | 12.0x | 11.5x | 9.3x | 13.0x | 13.2x |
| **Henry Schein** | 0.9x | 1.2x | 1.1x | 10.8x | 12.7x | 12.3x | 13.4x | 16.0x | 15.2x | 18.0x | 18.0x | 17.0x |
| **Dentsply** | 3.3x | 3.2x | 3.1x | 19.8x | 14.9x | 13.6x | 39.0x | 17.7x | 16.0x | -11.8x | 21.4x | 19.2x |
| **Mean** | **1.6x** | **1.6x** | **1.6x** | **13.1x** | **12.5x** | **11.8x** | **21.5x** | **15.2x** | **14.2x** | **5.1x** | **17.5x** | **16.5x** |
| **Median** | **0.9x** | **1.2x** | **1.1x** | **10.8x** | **12.7x** | **12.3x** | **13.4x** | **16.0x** | **15.2x** | **9.3x** | **18.0x** | **17.0x** |

Source: S&P Capital IQ, September 2019

# Investment case

## Company

Pierrel SpA (PRL) is a global supplier of dental anesthetics and other products, specializing in CMO (Contract Manufacturing Organization) of injectable products under their proprietary brands or distributor-branded products. The CMO Business Unit provides a range of manufacturing services for injectable formulations for pharmaceutical companies that have chosen to outsource their production processes. The Pharma BU manages the registration and marketing of proprietary dental anesthetics branded Pierrel, entirely manufactured in-house, as well as the development and marketing of innovative medical devices and new drugs. Pierrel recently completed its operational and financial turnaround after the divestment of a loss-making non-core business.

- Sales (2018): €20.4m, +18% YoY
- Geographical breakdown (2018): Europe 53%, North America 46%
- Market share of the own anesthetic brand Orabloc® for Articaine, its market segment in USA (2018): 21%
- Employees (December 2018): 91

## Revenue drivers

Pierrel, as one of the largest global producers of Articaine and Lidocaine and the only FDA authorized outside the USA, is a first choice supplier for North American and international dental products distributors which see room to rebalance market shares in a segment where the market leader has its own distribution and a market share higher than 50% in the US and even more internationally.

Pierrel's business model implies high visibility on the top line, which is driven by sales of large and well-established distributors to end customers. Major distribution contracts in this industry last several years, with an history of recurring and growing orders. Additional agreements with distributors are mid/long-term too. As such, a substantial portion of Pierrel's revenues over the years comes consistently from recurring major customers.

# Drivers

## Industry drivers

**Dental anesthesia market steadily growing.** The increasing dental health checkups, introduction of new products, new investments in dental research and increasing geriatric population are the key factors driving growth of the dental anesthesia market, expected to grow steadily at a moderate pace of around 2% globally.

**Dental anesthetics coverage shows room for growth.** The dental anesthesia market is segmented mainly into Articaine, Lidocaine, Mepivacaine, Prilocaine, Bupivacaine. In the USA the use of Lidocaine exceeds that of Articaine, because Lidocaine was introduced in 1970s, while Articaine in 2000s; in addition, Articaine is more expensive than Lidocaine. Articaine is the market leader in Europe, Russia, CIS countries. Articaine and Lidocaine share the market equally in the USA. Lidocaine is the market leader in emerging markets. Pierrel, as one of the largest global producers of Articaine and Lidocaine, is in the best position to enter new markets and benefit of the growing demand.

**On the tail of pharma trend, CMO on the rise.** Worldwide pharmaceutical market is estimated to reach \$1.5trn in 2021E, from \$1.1trn in 2015 (5.5% CAGR), according to Results Healthcare, a global corporate advisory firm. As incomes rise and populations age, drugs costs continue to rise and the growing demand for lower cost alternatives to novel therapies surges, due to time and investment necessary to bring complex drugs to market. Since many traditional pharma companies lack such expertise, they often turn to CMOs who have the expertise in developing and manufacturing generics and biologic drugs. The global market for CMO, estimated worth \$71.5bn in 2015, is expected to grow to \$105bn by 2021E, according to Results Healthcare (Source: Results Healthcare, *Pharma & Biotech*, 2017).

**Product and service quality driving demand for CMO.** CMO accelerates product development timeframes and go-to-market, reduces costs in order to better compete internationally and efficiently addresses regulatory and compliance issues. Key factors are product and service quality, while price is a second-tier selection criteria.

**Patent expiry.** The expirations of patents in the mid-term will affect several products made by originators, representing new growth opportunities for CMO players. As aging patents begin to expire and competition heats up, pharma firms are recognizing the urgency in leveraging novel, proprietary technologies to achieve product differentiation - expertise and resources provided by CMOs.

**Dental equipment market growing rapidly.** The global dental equipment market is expected to grow steadily in the upcoming years, at a 6.0% CAGR in 2019-24E, according to Mordor Intelligence, driven by the growing ageing population, increasing demand for cosmetic dentistry, increasing dental diseases, innovation in dental products, diagnostics and treatment-related technologies. North America is leading the global dental equipment market, Europe following closely. Asian countries, such as India, China, South Korea, Malaysia, Thailand, and Singapore are likely to provide a growing market due to their increasing per capita income and investments in healthcare (Source: Mordor Intelligence, *Dental Equipment Market 2019-2024*, 2018).

**Management of hedge risk and “gap capacity”.** Pharmaceutical companies often outsource to balance their risk and buy time until key milestones in clinical trials or market uptake are met and they can justify investing in-house. Also, outsourcing is a strategic option for large pharma companies switching over parts of their pipeline to biopharma and new market entrants and start-ups developing pharmaceuticals lacking existing manufacturing capabilities.

## Company drivers

**Reliable manufacturing capabilities and high product quality combined with strong FDA and EMA record.** In the CMO business, state-of-the-art production plants and manufacturing of effective and quality products are key to obtain approvals from drugs associations. PRL leverages on this key competitive advantage as a fundamental requirement to enlarge customers portfolio and compete with the CMO leaders. Pierrel's production plant is authorized by AIFA (Italian Medicines Agency), EMA (European Medicines Agency) and FDA (US Food and Drug Administration) for the production of aseptic injectable drugs.

**One-stop full service provider.** Pierrel combines the development, registration and licensing of new drugs and medical devices with drug manufacturing in the dental anesthesia market, fully serving its customers. Offering a multitude of services creates the opportunity for PRL to sell more products to the same customer, as well as develop lock-in models through increased switching costs. In doing so, large and small customers are fully serviced improving time and costs efficiency.

**Long-term relationships with main industry distributors, leading to high revenue visibility**. Thanks to over 60 years of history, Pierrel relies on its well-established presence in Europe and North America. The nature of the business and Pierrel's track record give high visibility on the top-line, given that CMO contracts generally last a minimum of two years and Pharma contracts usually start from five years. In addition, both are often automatically renewed.

**Established presence in Europe and USA and potential expansion into countries with rapid growth.** Pierrel's flagship product, Orabloc®, dental anestethic based on Articaine, has a market share of around 20% in the USA. Exports to North America account for around 46% of 2018 total revenues.

**Technical know-how.** Pierrel has strong technical capabilities in drug development, process development and scale-up, and is well-suited to production process development, able to increase yields while reducing COGS. In fact, a CMO's technical know-how is one of the most important factors to consider when selecting an outsourcer, along with its track record of quality, compliance inspection and supply flexibility.

**Highly skilled and committed management team with a long track record in the pharmaceutical sector.** Pierrel management team has post-graduate degrees in pharmaceutical and chemical majors. Around 35% of employees have specializations or proven pharmaceutical, chemical and quality control technical know-how.

**Production capacity to double by 2020.** In order to sustain the future demand and especially its marketing program in the USA and other selected countries, Pierrel has planned to increase its production capacity up to doubling, adding a new production line for cartridges. The start-up of the new production line is currently scheduled for 2020. The investment over 2018-19E is estimated in €9m, including around €2m development and registration costs for the marketing authorization of a new molecule to be marketed in North America.

**Rationale of marketing strategy.** In the CMO BU growth in the volume of cartridges and new pharmaceutical specialties on the North American market. In the Pharma BU, growth in sales of Orabloc® through agreements with the largest global US and European dental care distributors; launch of products in new markets (Far East, Middle East, CIS regions, Africa) where marketing authorizations have been already obtained.

**Operational leverage.** Overheads reduction in 2017, still undergoing in 2018, together with the planned investment to double production capacity, should generate significant cost efficiencies in the coming years, leading to an improved operational leverage and increasing operating margins.

## Challenges

**Revenue concentration.** In 2018, Europe accounted for 53% of consolidated revenues, followed by USA (44%). The additional registrations and distributors in new geographies are going to decrease progressively customer concentration.

**Contract duration.** CMO and Pharma contracts, despite being long-term contracts generally lasting at least 2-5 years, are subject to renewal and in most cases do not require a minimum supply.

**Execution delivery risk.** Delivering products and services not in line with regulation and customer expectations due to cost/time overruns, and quality issues, may impact margins and reputation. Any unplanned interruption or limitation of the production capacity of the Capua plant could lead to delays or interruptions in the delivery of products.

**Reliance on key suppliers.** The choice of suppliers follows strict selection criteria that ensure adequate levels of service or that have particular skills or qualifications according to the GMP standards, as well as the necessary authorizations issued by AIFA and the Italian Ministry of Health. The authorization process for the selection of a qualified supplier or for its replacement can represent an issue as to time and charges and is subject to several authorizations.

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|---|---|---|---|
| 13/09/2018 | NOT RATED | n.a. | 0.154 |
| 11/06/2019 | OUTPERFORM | 0.267 | 0.175 |
| 18/09/2019 | OUTPERFORM | 0.271 | 0.164 |

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