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Please refer to our full report before making any investment decisions.

Paragon Care Limited

Well equipped

August 2017

Recommendation: BUY

- **Realisation of critical mass can foster organic growth opportunities**
- **Business model lends itself to further bolt-on M&A**
- **Healthcare industry dynamics offer attractive, long-term growth**

ASX: PGC

Share Price: \$0.90

Target Price: \$1.20

M/Cap.: \$149M

Valuation: \$200M

Shares/options: 165M

Monthly T/over: \$4.6M



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Petra Capital Pty Ltd



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August 2017

Paragon Care Limited (PGC)

BUY

Share Price: A\$0.90

Well equipped

Target Price: A\$1.20

Following the appointment of Mark Simari (MD) in 2007, Paragon Care Limited (PGC) embarked on a period of significant acquisitions. Undertaking 13 to date, including two sizeable acquisitions in 2016, PGC has reached a point of critical mass and now has the scale and distribution capabilities to be a major player in the Australian and New Zealand medical supplies and services markets. From here, the Company has aspirations to more than double revenues over the medium term, to around \$250m, through a combination of organic and acquisitive growth. We initiate with a BUY recommendation and target price of \$1.20 p/sh.

Company Data

Shares – ordinary (M)	165.0
Dilution (M)	0.0
Total (fully diluted) (M)	165.0
Market capitalisation (\$M)	132.0
12 month low/high (\$)	\$0.69 - \$0.91
Average monthly turnover (\$M)	4.6
Index	All Ordinaries
GICS Industry	Health Care Equip. & Services

Financial Summary (fully diluted/normalised)

Year end Jun	2016A	2017A	2018E	2019E	2020E
Revenue (\$M)	93.3	117.2	124.9	136.9	152.4
Costs (\$M)	(81.2)	(100.1)	(106.1)	(115.9)	(128.6)
EBITDA (\$M)	12.1	17.1	18.8	21.0	23.8
NPAT (\$M)	7.5	10.2	11.1	12.6	14.6
EPS (¢ps)	5.5	6.2	6.7	7.6	8.9
EPS Growth (%)	74.5	13.1	8.0	13.6	16.2
PER (x)	16.4	14.5	13.4	11.8	10.2
Free Cashflow (\$M)	5.5	10.9	10.4	11.3	12.9
FCFPS (¢ps)	4.0	6.7	6.3	6.9	7.8
PFCFPS (x)	22.3	13.5	14.3	13.1	11.5
Enterprise Value (\$M)	167.6	167.2	171.9	173.6	167.1
EV / EBITDA (x)	13.9	9.8	9.2	8.3	7.0
Payout ratio (%)	40.0	48.3	48.3	48.3	48.3
Dividends (¢ps)	2.2	3.0	3.2	3.7	4.3
Yield (%)	2.4	3.3	3.6	4.1	4.8

Industry trends favouring PGC

- PGC is a diversified medical supplies and services business, offering almost 50,000 SKUs and services across clients in the acute hospital, aged care and primary care markets.
- A growing and ageing Australian population; an increasing rate of chronic illnesses; greater access to healthcare treatments; and higher patient expectations, are increasing the need for greater resourcing within the health and aged care sectors.
- Centralised procurement, reduced supplier numbers, and increasing compliance requirements will benefit larger suppliers with national distribution capabilities, and better resourcing.

Scale breeds growth opportunities

- We expect organic growth to come from a combination of product extensions, through new exclusive distribution agreements; cross-sell opportunities across business units; increased presence in under-represented territories; and new client wins.
- PGC will explore further acquisitions which complement the existing businesses. The focus will be on earnings and cashflow accretive businesses, with funding through internal cashflows, whenever possible.

MIDAS Software Solutions – a possible sleeper

- In July 2016 PGC purchased a small, fully automated interpretative software business, still in development.
- While we do not ascribe any earnings to the business at this point in time, it has the potential to revolutionise the reporting function of a medical examination. If productivity improvements can be substantiated, and the product commercialised, this product may offer substantial value.

Valuation

- Our DCF valuation and target price is \$1.20 per share.
- Our valuation does not assume any further acquisitions.

Board

Director	Position	Executive	Independent
Shane Tanner	Chairman	No	Yes
Mark Simari	MD	Yes	No
Geoffrey Sam	Director	No	Yes
Michael Newton	Director	No	Yes
Brett Cheong	Exec. Director	Yes	No

PGC – share price (A\$) performance over one year



Analysis

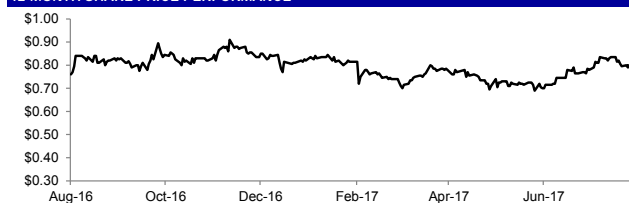
ParagonCare

Year end 30 June

MARKET DATA

Recommendation		BUY
Price	\$	0.90
Price target (12-month)	\$	1.20
52 week high / low	\$	\$0.69 - \$0.91
Market capitalisation	\$m	148.5
Shares on issue (basic)	no.	165.0
Options / rights	no.	0.0
Other equity	no.	0.0
Shares on issue (diluted)	no.	165.0

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

	FY16A	FY17A	FY18E	FY19E	FY20E
Reported NPAT	\$m 7.5	10.2	11.1	12.6	14.6
NPAT normalised	\$m 7.5	10.2	11.1	12.6	14.6
Reported EPS (diluted)	¢ 5.5	6.2	6.7	7.6	8.9
EPS normalised (diluted)	¢ 5.5	6.2	6.7	7.6	8.9
...Growth	%	13.1%	8.0%	13.6%	16.2%
PER normalised	x 16.4	14.5	13.4	11.8	10.2
Operating cash flow per share	¢ 5.7	7.3	6.9	7.5	8.5
Free cash flow per share	¢ 4.0	6.7	6.3	6.9	7.8
Price to free cash flow per share	x 22.3	13.5	14.3	13.1	11.5
FCF yield	% 4.5	7.4	7.0	7.6	8.7
Dividend	¢ 2.2	3.0	3.2	3.7	4.3
Payout	% 40.0	48.3	48.3	48.3	48.3
Yield	% 2.4	3.3	3.6	4.1	4.8
Franking	% 100	100	100	100	100
Enterprise value	\$m 167.6	167.2	171.9	173.6	167.1
EV/EBITDA	x 13.9	9.8	9.2	8.3	7.0
EV/EBIT	x 14.8	10.5	9.8	8.8	7.4
Price to book (NAV)	x 2.0	1.8	1.7	1.6	1.4
Price to NTA	x (18.0)	(9.4)	(15.4)	(53.1)	29.1

KEY RATIOS

	FY16A	FY17A	FY18E	FY19E	FY20E
EBITDA margin	% 12.9	14.6	15.0	15.3	15.6
EBIT margin	% 12.1	13.6	14.1	14.4	14.8
NPAT margin	% 8.1	8.7	8.9	9.2	9.6
ROE	% 10.3	12.3	12.5	13.3	14.3
ROA	% 8.8	10.3	11.4	12.5	13.7
Net tangible assets per share	¢ (5.1)	(9.5)	(5.8)	(1.7)	3.1
Net debt / (cash)	\$m 19.0	18.7	23.4	25.0	18.6
Interest cover (EBIT / net interest)	x 8.0	9.1	10.0	11.1	13.5
Gearing (net debt / EBITDA)	x 1.6	1.1	1.2	1.2	0.8
Leverage (net debt / (net debt + equity))	x 0.2	0.2	0.2	0.2	0.2

DUPONT ANALYSIS

	FY16A	FY17A	FY18E	FY19E	FY20E
Net Profit Margin	% 8.1	8.7	8.9	9.2	9.6
Asset Turnover	x 0.6	0.7	0.8	0.8	0.9
Return on Assets	% 5.1	6.1	6.8	7.5	8.4
Financial Leverage	x 2.0	2.0	1.9	1.8	1.7
Return on Equity	% 10.3	12.3	12.5	13.3	14.3

DIVISIONAL BREAKDOWN

	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	\$m 93.4	117.2	124.9	136.9	152.4
Cost of sales	\$m (56.9)	(71.1)	(74.1)	(81.2)	(89.9)
Gross Profit	\$m 36.5	46.1	50.8	55.7	62.5
Other income	\$m 0.0	0.4	0.0	0.0	0.0
Costs					
Operating expenses	\$m (5.7)	(7.8)	(7.9)	(8.2)	(9.1)
Corporate	\$m (0.4)	(0.3)	(0.3)	(0.4)	(0.4)
Selling and Admin	\$m (1.1)	(1.3)	(1.4)	(1.5)	(1.7)
Employee and consult (Incl directors)	\$m (17.2)	(21.0)	(22.5)	(24.6)	(27.4)
EBITDA	\$m 12.1	17.1	18.8	21.0	23.8
Gross profit margin	% 39.0%	39.3%	40.7%	40.7%	41.0%
EBITDA margin	% 13.0%	14.6%	15.0%	15.3%	15.6%

PROFIT AND LOSS

	FY16A	FY17A	FY18E	FY19E	FY20E
Total revenue	\$m 93.3	117.6	124.9	136.9	152.4
EBITDA	\$m 12.1	17.1	18.8	21.0	23.8
Depreciation & amortisation	\$m (0.8)	(1.1)	(1.2)	(1.2)	(1.2)
EBIT	\$m 11.3	16.0	17.6	19.8	22.6
Net interest	\$m (1.4)	(1.8)	(1.8)	(1.8)	(1.7)
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m 9.9	14.2	15.8	18.0	20.9
Tax expense	\$m (2.3)	(4.1)	(4.7)	(5.4)	(6.3)
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Operating NPAT	\$m 7.5	10.2	11.1	12.6	14.6
Significant items	\$m 0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m 7.5	10.2	11.1	12.6	14.6

GROWTH PROFILE

	FY16A	FY17A	FY18E	FY19E	FY20E
Operating revenue	% 381.6	26.0	6.2	9.6	11.3
EBITDA	% 467.7	42.1	9.5	11.8	13.5
EBIT	% 503.4	41.6	10.0	12.4	14.2
Operating NPAT	% 407.1	35.1	8.9	13.6	16.2
Normalised EPS	% 105.2	13.1	8.0	13.6	16.2
DPS	% 76.0	36.4	8.0	13.6	16.2

BALANCE SHEET

	FY16A	FY17A	FY18E	FY19E	FY20E
Cash	\$m 19.1	18.6	13.6	13.6	13.6
Receivables	\$m 19.4	20.8	22.1	24.3	27.0
Inventory	\$m 22.6	21.7	23.1	25.3	28.2
Other	\$m 0.0	0.0	0.0	0.0	0.0
Current	\$m 61.1	61.1	58.8	63.1	68.7
Prop, plant & equip	\$m 3.0	3.4	3.6	3.7	3.8
Goodwill	\$m 81.0	98.4	98.1	97.7	97.4
Other	\$m 2.6	3.2	3.4	3.7	4.1
Non current	\$m 86.7	105.0	105.0	105.1	105.3
Total assets	\$m 147.8	166.1	163.8	168.2	174.0
Accounts Payable	\$m 22.7	25.5	27.2	29.8	33.2
Borrowings	\$m 38.2	37.2	36.9	38.6	32.2
Other	\$m 14.2	20.6	11.2	4.9	6.2
Total liabilities	\$m 75.0	83.4	75.4	73.3	71.5
Net assets	\$m 72.8	82.7	88.4	94.9	102.5
Equity	\$m 72.8	82.7	88.4	94.9	102.5
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Shareholder's equity	\$m 72.8	82.7	88.4	94.9	102.5
Shares on issue	m 159.9	165.0	165.0	165.0	165.0

CASH FLOW

	FY16A	FY17A	FY18E	FY19E	FY20E
EBITDA	\$m 12.1	17.1	18.8	21.0	23.8
Dividends	\$m 0.0	0.0	0.0	0.0	0.0
Change in working capital	\$m (8.7)	2.2	(0.9)	(1.5)	(1.9)
Net interest	\$m (1.4)	(1.7)	(1.8)	(1.8)	(1.7)
Tax paid	\$m (3.4)	(4.2)	(4.7)	(5.4)	(6.3)
Other	\$m 9.3	(1.4)	0.0	0.0	0.0
Operating cash flow	\$m 7.8	12.0	11.4	12.3	13.9
Capital expenditure	\$m (2.2)	(1.1)	(1.0)	(1.0)	(1.0)
Acquisitions/divestment/other	\$m (55.0)	(6.9)	(9.6)	(7.3)	0.0
Investing cash flow	\$m (57.2)	(7.9)	(10.6)	(8.3)	(1.0)
Equity	\$m 39.3	0.0	0.0	0.0	0.0
Increase / (decrease) in borrowings	\$m 27.1	(1.1)	4.7	1.7	(6.4)
Dividend/other	\$m (1.6)	(3.5)	(5.5)	(5.7)	(6.5)
Net cash flow	\$m 15.4	(0.5)	0.0	0.0	0.0
Free cash flow	\$m 5.5	10.9	10.4	11.3	12.9

Source: Petra Capital

Executive summary

Under the leadership of Mark Simari, Managing Director (2007) PGC become a leading medical equipment and supplies and services company. In generating this achievement, PGC has successfully executed on thirteen acquisitions, with the most transformational occurring in FY16, when it acquired two substantial businesses with combined pro-forma revenue of \$65m. Along the way, the Company has grown EPS to 6.2¢ps in FY17 (from break-even in FY10) and substantially improved its return on assets from 0% in FY10 to c10% in FY17.

Today, around 80-85% of PGC product range is under exclusive distribution arrangements with leading international manufacturers. Its products are also well diversified with around 70% in high turnover consumables and 30% in capital equipment. Customers are also diversified across the acute care (80%), aged care (10%) and primary care (10%) segments of the market, with new sub-markets such as optometry/ophthalmic, pharmacy and medical aesthetics more recently added.

Critical mass creates opportunities

Having reached critical mass in FY16, the business has proved its credentials and is now on the radars of international vendors/manufacturers looking for Australian/New Zealand distribution partners. Moreover, its size and diversity benefits those customers looking for a one-stop-shop to simplify their procurement process, in what is still a very fragmented industry. We estimate that this has created revenue synergies in excess of \$13m in the period between FY15 and FY17.

Within its existing products suite, we believe that PGC offers organic growth opportunities as it remains under-represented in many products and services, across clients and geographies.

In addition, we expect that new distribution agreements will proliferate, given PGC's scale. As an example, some recent exclusive distribution wins include Rubbermaid (a recognised leader in medical carts), Thermi products (minimal and non-invasive applications for the medical aesthetics market); and NeuroCom products (known worldwide for leading edge tools for the assessment and rehabilitation of balance and mobility disorders).

Market growth outlook remains strong

The Australian population continues to grow (1.5% p.a.) and age. According to the Australian Bureau of Statistics, the over 65's age group should approach 19% of the population by 2030, up from 15% in 2016, a growth rate of 2% p.a. and equivalent to an additional two million people.

With this ageing population come increasing requirements on health care and related services, including primary care, hospital care and aged care.

Industry remains fragmented

By our estimates, PGC has around 1-2% market share in a fragmented industry (including many private and family owned businesses) of around \$6.5bn-9.0bn in value.

PGC has indicated that it will continue to assess acquisition opportunities, which due to its scale can be internally funded (subject to the size of the deal). We note that the last bolt-on was announced in September 2016, which based on the historical cadence of news flow, suggests another acquisition announcement is due.

Valuation \$1.20/sh, based on DCF

Our valuation of \$1.20 per share is based on a discounted cashflow methodology, providing +c33% upside to the current share price. This valuation is based on key assumptions including WACC of 10%; revenue growth of 4% per annum; and EBITDA margins climbing to 15% by FY18.

While we believe that PGC will continue making acquisitions to complement its existing business, no such acquisitions are assumed in our modelling. Nonetheless, we expect these periodic earnings boosts to act as catalysts to an improving share price.

August 2017

Top 20 Shareholders

Figure 24: Top 20 Shareholders (dated 27 June 2017)

	Name	Amount	%
1	JP Morgan Nominees Australia Limited	23,710,337	15.08
2	Citigroup Nominees Pty Limited	10,530,115	6.70
3	JMT Investment Group VIC Pty Ltd	4,876,517	3.10
4	JMT Investment Group VIC Pty Ltd <John Turner Super Fund a/c>	4,785,489	3.04
5	DAK Drafting Services Pty Ltd	4,500,000	2.86
6	HSBC Custody Nominees (Australia) Limited – a/c 2	4,383,757	2.79
7	Posse Investment Holdings Pty Limited	4,000,000	2.54
8	HSBC Custody Nominees (Australia) Limited	4,000,000	2.54
9	AMCIL Limited	3,171,650	2.02
10	Brett Cheong & Lynn Cheong	2,642,640	1.88
11	Lora Falls Pty Ltd	2,594,006	1.68
12	BNP Paribas Nominees Pty Ltd	2,044,483	1.65
13	Peter John Diamond & Diana Elizabeth Diamond	1,900,000	1.30
14	Lionel Richards No 2 Pty Ltd	1,371,622	1.21
15	Brispot Nominees Pty Ltd	1,264,387	0.87
16	Shemozel Pty Ltd	1,257,862	0.80
17	Grills Investments Pty Ltd	1,257,862	0.80
18	Roman Lohyn Pty Ltd	1,230,000	0.78
19	Guerilla Nominees Pty Ltd	1,161,291	0.74
20	BNP Paribas Nominees Pty Ltd	1,055,122	0.67
	Total	84,693,640	53.84

Source: Company



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