

## Resetting expectations

We retain a BUY rating with a revised 12-month price target of \$3.21 p/sh. We assess market conditions to imply a more gradual ramp up in narcotic raw material production and sales volumes for TPI, relative to our previous expectations. We lower our NRM sales volumes by 28% - 36%, implying a more gradual ramp up to TPI's target of 100t, which we now assume is achieved in FY20. This translates to more significant EPS adjustments, given the operating and financial leverage. Despite the material earnings reductions, TPI offers patient investors exposure to an attractive business with high barriers to entry and sustainable growth prospects.

### Key points

**The path to 100 tonnes.** We assess market conditions to imply a more gradual ramp up in NRM production and sales volumes for TPI, relative to our previous expectations. In the current year, we are mindful of TPI still requiring an import permit for the raw material equivalent of ~10t of NRM, which is being sourced from a third party supplier in Europe. This permit is expected within weeks. For the 2016/17 cropping year (ie. FY17 sales volumes), we are encouraged by recent media comments indicating an expected reduction in Tasmanian plantings contracted to TPI's two competitors, which should enable TPI to materially increase its contracted area in that region.

**Balance sheet.** TPI recently increased its debt facility with Washington H. Soul Pattinson Company Ltd, also a substantial shareholder, from \$8.0M to \$20M. The facility matures 31 March 2017 and was drawn to \$5.5M at the end of FY15. We expect TPI's working capital requirements will exceed the current facility limit during 1H17, meaning TPI will need to establish a bank debt facility or expand and extend the existing facility within the next ~9 months.

**Forecasts.** We lower our NRM sales volumes by 28% - 36%, implying a more gradual ramp up to TPI's target of 100t, which we now assume is achieved in FY20. This translates to more significant EPS adjustments, given the operating and financial leverage.

**Valuation.** Our revised 12-month target of \$3.21 p/share is set at a 20% discount to our DCF valuation (\$4.01 p/sh) to account for execution risk in the ramp-up of NRM production.

### Risks and catalysts

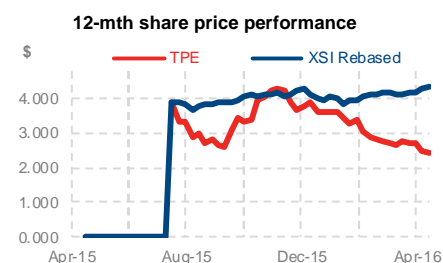
**Risks.** Reduction in raw material supply; changes to international and/or foreign government conventions; loss of licences; FX movements. **Catalysts.** Crop updates; ramp-up of NRM production and sales (towards 100t); confirmation of new debt facility; commissioning of API processing capability.

Year-end December (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep (\$m)	-9.0	-25.9	-5.7	-1.9	6.8
NPAT norm (\$m)	-4.0	-13.5	-5.7	-1.9	6.8
Consensus NPAT (\$m)			1.2	12.3	21.6
EPS norm (cps)	-9.2	-27.3	-11.1	-3.8	13.3
EPS growth (%)		-197.3	59.5	65.9	453.2
P/E norm (x)	-26.2	-8.8	-21.7	-63.7	18.0
EV/EBITDA (x)	-46.4	-13.6	-115.7	27.3	9.0
FCF yield (%)	0.0	-21.4	-9.8	-15.6	-4.8
DPS (cps)	0.0	0.0	0.0	0.0	4.0
Dividend yield (%)	0.0	0.0	0.0	0.0	1.7
Franking (%)	0	0	0	0	0

Source: Company data, WHTM estimates, S&P Capital IQ

12-mth target price (AUD)	\$3.21
Share price @ 12-May-16 (AUD)	\$2.40
Forecast 12-mth capital return	33.8%
Forecast 12-mth dividend yield	0.0%
<b>12-mth total shareholder return</b>	<b>33.8%</b>
Market cap	\$109m
Enterprise value	\$125m
Shares on issue	45m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.0m

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	1-mth	6-mth
Abs return (%)	-7.7	-39.2
Rel return (%)	-14.5	-46.4

KEY CHANGES	01-Mar	After	Var %
<b>NPAT: FY16F</b>	1.2	-5.7	<-99%
<b>norm FY17F</b>	12.3	-1.9	<-99%
<b>(\$m) FY18F</b>	21.6	6.8	-68.3%
<b>EPS: FY16F</b>	2.4	-11.1	<-99%
<b>norm FY17F</b>	23.9	-3.8	<-99%
<b>(cps) FY18F</b>	42.0	13.3	-68.3%
<b>DPS: FY16F</b>	0.0	0.0	0.0%
<b>(cps) FY17F</b>	0.0	0.0	0.0%
<b>FY18F</b>	12.6	4.0	-68.3%
<b>Price target:</b>	4.55	3.21	-29.4%
<b>Rating:</b>	<b>BUY</b>	<b>BUY</b>	



#### PRICE TARGET

	Valuation	Price target
WACC post tax (%)	10.5	
PV of FCF forecast (\$m)	82.4	
<b>PV of terminal value (\$m)</b>	<b>140.0</b>	
Enterprise value (\$m)	222.5	
<b>Net debt/(cash) (\$m)</b>	<b>16.0</b>	
Equity value (\$m)	206.5	
<b>Equity value p/sh (\$)</b>	<b>4.01</b>	

<b>Earnings cap (\$)</b>	<b>3.21</b>
FY18 EV/EBITDA (x)	14.4
FY18 PER (x)	24.1

**12-mth target (\$)** **3.21**

#### INTERIMS (\$m)

Half-year (AUD)	Jun 15	Dec 15	Jun 16	Dec 16
	1HA	2HA	1HE	2HE
Sales revenue	1.1	1.0	4.7	13.7
EBITDA	-3.6	-5.6	-2.4	1.3
EBIT	-5.2	-7.5	-3.8	-0.2
<b>Net profit</b>	<b>-5.8</b>	<b>-7.7</b>	<b>-4.5</b>	<b>-1.2</b>
<b>Norm EPS</b>	<b>-12.2</b>	<b>-15.0</b>	<b>-8.7</b>	<b>-2.4</b>
EBIT/sales (%)	-486.6	-757.7	-82.0	-1.6
Dividend (c)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

#### FINANCIAL STABILITY

Year-end December	FY15A	FY16F	FY17F
Net debt	5.3	16.0	33.0
Net debt/equity (%)	25.7	106.9	253.9
<b>Net debt/EV (%)</b>	<b>4.2</b>	<b>12.8</b>	<b>26.4</b>
Current ratio (x)	6.1	2.4	1.7
Interest cover (x)	<0	<0	0.4
<b>Adj cash int cover (x)</b>	<b>&lt;0</b>	<b>&lt;0</b>	<b>&lt;0</b>
Debt/cash flow (x)	<0	<0	<0
Net debt (cash)/share (\$)	0.1	0.3	0.6
NTA/share (\$)	0.4	0.3	0.3
Book value/share (\$)	0.4	0.3	0.3
Payout ratio (%)	0	0	0
Adj payout ratio (%)	0	0	0

#### EPS RECONCILIATION (\$m)

	FY15A		FY16F	
	Rep	Norm	Rep	Norm
Sales revenue	2	2	18	18
EBIT	-25.1	-12.7	-4.1	-4.1
<b>Net profit</b>	<b>-25.9</b>	<b>-13.5</b>	<b>-5.7</b>	<b>-5.7</b>
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
<b>Profit for EPS</b>	<b>-25.9</b>	<b>-13.5</b>	<b>-5.7</b>	<b>-5.7</b>
Diluted shrs (m)	50	50	51	51
<b>Diluted EPS (c)</b>	<b>-52.3</b>	<b>-27.3</b>	<b>-11.1</b>	<b>-11.1</b>

#### RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	-84	-32	-14	43
ROIC (%)	-33	-10	2	14
Incremental ROE	-92	469	-98	437
Incremental ROIC	-43	525	36	47

#### KEY ASSUMPTIONS

Year-end December (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Revenue growth (%)	48.0	-46.2	-72.7	791.1	90.2	42.9
EBIT growth (%)	-77.8	118.0	171.6	-68.2	-128.9	772.1
<b>EPS growth (%)</b>			<b>197.3</b>	<b>-59.5</b>	<b>-65.9</b>	<b>-453.2</b>
Tax rate (%)	30.0	30.0	0.0	0.0	0.0	0.0
ROA (%)		-11.7	-30.7	-8.3	1.7	11.9
<b>ROE (%)</b>		<b>-34.7</b>	<b>-65.6</b>	<b>-38.1</b>	<b>-14.9</b>	<b>36.1</b>
Pharma revenue (\$m)	10.1	4.7	1.7	15.9	30.6	43.7
Poppy seed revenue (\$m)	3.8	2.9	0.4	2.5	4.4	6.3
Gross profit (\$m)	1.8	2.0	0.5	8.3	14.9	24.6
Gross profit margin (%)	13.1	26.1	22.9	44.9	42.7	49.2

#### PROFIT AND LOSS (\$m)

Year-end December (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Sales revenue	14.1	7.6	2.1	18.4	35.0	50.0
EBITDA	-0.8	-2.7	-9.2	-1.1	4.6	13.9
Deprn & amort	1.4	2.0	3.6	3.0	3.4	3.7
<b>EBIT</b>	<b>-2.2</b>	<b>-4.7</b>	<b>-12.7</b>	<b>-4.1</b>	<b>1.2</b>	<b>10.2</b>
Net interest expense	3.1	1.0	0.8	1.6	3.1	3.4
Tax	-1.6	-1.7	0.0	0.0	0.0	0.0
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net profit (pre-sig items)</b>	<b>-3.7</b>	<b>-4.0</b>	<b>-13.5</b>	<b>-5.7</b>	<b>-1.9</b>	<b>6.8</b>
Abns/exts/signif	-1.5	-5.0	-12.4	0.0	0.0	0.0
<b>Reported net profit</b>	<b>-5.2</b>	<b>-9.0</b>	<b>-25.9</b>	<b>-5.7</b>	<b>-1.9</b>	<b>6.8</b>

#### CASH FLOW (\$m)

Year-end December (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
EBITDA	-0.8	-2.7	-9.2	-1.1	4.6	13.9
Interest & tax	0.0	0.0	-1.3	-1.6	-3.1	-3.4
Working cap/other	0.8	2.7	-5.0	-6.0	-8.5	-5.8
<b>Operating cash flow</b>	<b>0.0</b>	<b>0.0</b>	<b>-15.5</b>	<b>-8.7</b>	<b>-7.0</b>	<b>4.8</b>
Maintenance capex	0.0	0.0	-7.8	-2.0	-10.0	-10.0
<b>Free cash flow</b>	<b>0.0</b>	<b>0.0</b>	<b>-23.3</b>	<b>-10.7</b>	<b>-17.0</b>	<b>-5.2</b>
Dividends paid	0.0	0.0	0.0	0.0	0.0	-0.9
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0
Invest/disposals	0.0	0.0	0.0	0.0	0.0	0.0
Other inv flows	0.0	0.0	0.0	0.0	0.0	0.0
<b>Cash flow pre-financing</b>	<b>0.0</b>	<b>0.0</b>	<b>-23.3</b>	<b>-10.7</b>	<b>-17.0</b>	<b>-6.1</b>
Funded by equity	0.0	0.0	28.0	0.0	0.0	0.0
Funded by debt	0.0	0.0	-4.8	13.0	15.0	8.0
Funded by cash	0.0	0.0	0.1	-2.3	2.0	-1.9

#### BALANCE SHEET SUMMARY (\$m)

Year-end December (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Cash	0.0	0.6	0.6	2.9	0.9	2.7
Current receivables	0.0	1.2	1.4	3.7	7.0	10.0
Current inventories	0.0	6.5	8.9	12.8	22.9	30.3
Net PPE	0.0	17.8	28.6	27.7	34.4	40.7
Investments	0.0	0.3	0.1	0.1	0.1	0.1
Intangibles/capitalised	0.0	3.1	2.0	1.9	1.9	1.8
Other	0.0	10.7	0.0	0.0	0.0	0.0
<b>Total assets</b>	<b>0.0</b>	<b>40.2</b>	<b>41.5</b>	<b>49.1</b>	<b>67.1</b>	<b>85.6</b>
Current payables	0.0	2.0	5.3	5.5	10.5	15.0
Total debt	0.0	17.6	5.9	18.9	33.9	41.9
Other liabilities	0.0	9.1	9.8	9.8	9.8	9.8
<b>Total liabilities</b>	<b>0.0</b>	<b>28.6</b>	<b>20.9</b>	<b>34.2</b>	<b>54.1</b>	<b>66.6</b>
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0
<b>Shareholder equity</b>	<b>0.0</b>	<b>11.6</b>	<b>20.6</b>	<b>14.9</b>	<b>13.0</b>	<b>19.0</b>
<b>Total funds employed</b>	<b>0.0</b>	<b>29.2</b>	<b>26.5</b>	<b>33.8</b>	<b>46.9</b>	<b>60.8</b>



## Earnings outlook

### Changes to earnings forecasts

A summary of the changes to our forecasts is provided in the table below.

<b>Earnings revisions</b>		<b>FY16e</b>	<b>FY17e</b>	<b>FY18e</b>
<b>Y/E: 31 Dec</b>				
NRM sales volume - old	tonnes	39.9	67.0	94.4
<b>NRM sales volume - new</b>	<b>tonnes</b>	<b>25.4</b>	<b>49.5</b>	<b>67.8</b>
- % chg	%	(36.4%)	(26.1%)	(28.2%)
Sales - old	\$M	31.2	53.5	73.0
<b>Sales - new</b>	<b>\$M</b>	<b>18.4</b>	<b>35.0</b>	<b>50.0</b>
- % chg	%	(41.1%)	(34.6%)	(31.5%)
EBITDA - old	\$M	6.3	17.4	27.7
<b>EBITDA - new</b>	<b>\$M</b>	<b>(1.1)</b>	<b>4.6</b>	<b>13.9</b>
- % chg	%	n/a	(73.7%)	(49.6%)
EBIT - old	\$M	3.3	14.0	23.9
<b>EBIT - new</b>	<b>\$M</b>	<b>(4.1)</b>	<b>1.2</b>	<b>10.2</b>
- % chg	%	n/a	(91.6%)	(57.3%)
NPAT (normalised) - old	\$M	1.2	12.3	21.6
<b>NPAT (normalised) - new</b>	<b>\$M</b>	<b>(5.7)</b>	<b>(1.9)</b>	<b>6.8</b>
- % chg	%	n/a	n/a	(68.3%)
EPS - old	cents	2.4	23.9	42.0
<b>EPS - new</b>	<b>cents</b>	<b>(11.1)</b>	<b>(3.8)</b>	<b>13.3</b>
- % chg	%	n/a	n/a	(68.3%)
DPS - old	\$M	0.0	0.0	12.6
<b>DPS - new</b>	<b>\$M</b>	<b>0.0</b>	<b>0.0</b>	<b>4.0</b>
- % chg	%	n/a	n/a	(68.3%)

Source: Wilson HTM

#### Key points:

- We lower our NRM sales volumes by 28% - 36%, implying a more gradual ramp up to TPI's target of 100t, which we now assume is achieved in FY20 (refer overleaf).
- Sales forecasts are reduced by 32% - 41%, reflecting the lower volumes.
- EBITDA reductions reflect the operating leverage of fixed costs.



## Revised earnings forecasts

A summary of our revised forecasts and key assumptions are provided in the tables below.

<b>Earnings summary</b>										
Y/E: 31 Dec		<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16e</b>	<b>FY17e</b>	<b>FY18e</b>	<b>FY19e</b>	<b>FY20e</b>
<b>Sales revenue</b>	<b>\$M</b>	<b>9.5</b>	<b>14.0</b>	<b>7.6</b>	<b>2.1</b>	<b>18.4</b>	<b>35.0</b>	<b>50.0</b>	<b>65.7</b>	<b>77.7</b>
- growth	%	n/a	48%	(46%)	(73%)	796%	90%	43%	31%	18%
Gross margin	\$M	(3.6)	1.8	2.0	0.5	8.3	14.9	24.6	32.0	39.7
- growth	%	n/a	(151%)	9%	(76%)	nm	81%	65%	30%	24%
- margin	%	(37.6%)	13.1%	26.1%	22.9%	44.9%	42.7%	49.2%	48.8%	51.1%
<b>EBITDA</b>	<b>\$M</b>	<b>(8.1)</b>	<b>(0.8)</b>	<b>(2.9)</b>	<b>(9.2)</b>	<b>(1.1)</b>	<b>4.6</b>	<b>13.9</b>	<b>21.0</b>	<b>28.3</b>
- growth	%	n/a	(90%)	245%	215%	(88%)	(524%)	205%	51%	35%
- margin	%	(85.9%)	(6.1%)	(38.4%)	n/a	(5.9%)	13.1%	27.9%	32.1%	36.5%
Depreciation & Amortisation	\$M	(1.6)	(1.4)	(2.0)	(3.6)	(3.0)	(3.4)	(3.7)	(6.7)	(6.9)
EBIT	\$M	(9.7)	(2.2)	(4.7)	(12.7)	(4.1)	1.2	10.2	14.4	21.5
- growth	%	n/a	(78%)	118%	172%	(68%)	(129%)	772%	41%	49%
- margin	%	nm	(15.4%)	(61.7%)	n/a	(22.0%)	3.3%	20.4%	21.9%	27.6%
Net interest expense	\$M	(2.7)	(3.1)	(1.0)	(0.8)	(1.6)	(3.1)	(3.4)	(4.4)	(4.1)
Tax expense	\$M	3.7	1.6	1.7	0.0	0.0	0.0	0.0	0.0	0.0
<b>NPAT (normalised)</b>	<b>\$M</b>	<b>(8.7)</b>	<b>(3.7)</b>	<b>(4.0)</b>	<b>(13.5)</b>	<b>(5.7)</b>	<b>(1.9)</b>	<b>6.8</b>	<b>10.0</b>	<b>17.3</b>
- growth	%	n/a	(57%)	8%	236%	(58%)	(66%)	(453%)	46%	74%
NPAT (reported)	\$M	(8.7)	(5.2)	(9.0)	(25.9)	(5.7)	(1.9)	6.8	10.0	17.3
- growth	%	n/a	-40%	73%	188%	-78%	-66%	-453%	46%	74%

Source: TPE & WHTM.

<b>Key forecast assumptions</b>										
Y/E: 31 Dec		<b>FY12</b>	<b>FY13</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16e</b>	<b>FY17e</b>	<b>FY18e</b>	<b>FY19e</b>	<b>FY20e</b>
<b>NRM production volume</b>	<b>tonnes</b>	<b>17.9</b>	<b>22.9</b>	<b>13.0</b>	<b>17.5</b>	<b>36.3</b>	<b>66.0</b>	<b>79.8</b>	<b>94.7</b>	<b>102.2</b>
- change (YoY)	%	n/a	27.8%	(43.3%)	35.2%	107.1%	81.9%	20.9%	18.7%	7.9%
<b>NRM sales volume</b>	<b>tonnes</b>	<b>17.9</b>	<b>22.9</b>	<b>10.1</b>	<b>3.0</b>	<b>25.4</b>	<b>49.5</b>	<b>67.8</b>	<b>90.0</b>	<b>100.2</b>
- change (YoY)	%	n/a	27.8%	(55.8%)	(70.5%)	752.7%	94.9%	37.0%	32.7%	11.3%
Seed sales volume	tonnes	1,094	1,398	792	214	1,606	2,810	3,653	4,567	5,023
- change (YoY)	%	n/a	27.8%	(43.3%)	(73.0%)	650.0%	75.0%	30.0%	25.0%	10.0%
<b>NRM price (p/kg)</b>	<b>AUD</b>	<b>414</b>	<b>443</b>	<b>468</b>	<b>563</b>	<b>625</b>	<b>600</b>	<b>612</b>	<b>585</b>	<b>597</b>
- change (YoY)	%	n/a	7.1%	5.6%	20.2%	11.1%	(4.0%)	2.0%	(4.4%)	2.0%
Seed price (p/t)	AUD	1,875	2,740	3,623	1,765	1,569	1,569	1,726	1,763	1,939
- change (YoY)	%	n/a	46.1%	32.2%	(51.3%)	(11.1%)	0.0%	10.0%	2.1%	10.0%
Raw material costs	\$ p/kg	n/a	202	316	198	186	205	194	198	202
NRM processing costs	\$ p/kg	n/a	200	200	275	151	136	123	116	111

Source: TPE & WHTM.



## TPI Enterprises Limited (TPE)

### BUSINESS DESCRIPTION

TPI Enterprises Limited (TPE) is one of nine licensed suppliers of licit narcotics (specifically morphine, oripavine, codeine and thebaine) to the global pharmaceutical sector. TPI has spent the past 10 years developing its water-based, solvent-free extraction process while acquiring multiple international, national, state and territory licences.

### INVESTMENT THESIS

We assess market conditions to imply a more gradual ramp up in narcotic raw material production and sales volumes for TPI, relative to our previous expectations. We lower our NRM sales volumes by 28% - 36%, implying a more gradual ramp up to TPI's target of 100t, which we now assume is achieved in FY20. This translates to more significant EPS adjustments, given the operating and financial leverage. Despite the material earnings reductions, TPI offers patient investors exposure to an attractive business with high barriers to entry and sustainable growth prospects.

### REVENUE DRIVERS

- NRM production (area, yield)
- NRM, API and poppy seed prices

### MARGIN DRIVERS

- Production volume
- Crop yields
- Processing costs

### KEY ISSUES/CATALYSTS

- Raw material supply updates
- Ramp-up of NRM production and sales (towards 100t)
- Confirmation of new working capital debt facility
- Commissioning of API processing capability

### RISK TO VIEW

- Reduction in raw material supply
- Changes to international and/or foreign government conventions
- Loss of licences
- FX movements

### BALANCE SHEET

- FY15 net debt: \$5.3M

### BOARD

- Peter Robinson – Non-Executive Chairman
- Jarrod Ritchie – Managing Director
- Todd Barlow – Non-Executive Director

### MANAGEMENT

- Jarrod Ritchie – MD
- Roger McPherson – CFO

### CONTACT DETAILS

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### Recommendation structure and other definitions

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