

## Production shaping up nicely

We retain a BUY rating with a revised 12-month price target of \$3.61 p/sh. TPI Enterprises has provided an encouraging market update, confirming positive outcomes on several customer audits of its manufacturing facility, while also suggesting near-term production will benefit from significant increases in area planted and sustained yield improvements. TPI offers patient investors exposure to an attractive business with high barriers to entry and sustainable growth prospects. Receipt of a permit to import poppy straw from Europe is the key near-term catalyst.

### Key points

**Market update.** TPI has received approval to supply narcotic raw material under European Directorate for the Quality of Medicines (EDQM) requirements. The qualification means TPI can now supply Morphine NRM into Europe under the new tightened regulatory regime. Several customer audits of TPI's Victorian site have now been completed with positive outcomes in all cases. The level of demand is such that TPI remains confident that it will deliver on its target of supplying 100t of NRM by 2019. TPI recently applied to import poppy straw (raw material) from Europe. A final decision is expected from the Australian federal government shortly. Imported raw material represents a significant component of TPI's production (we assume the equivalent of 10t of NRM in FY16 and 20t per annum thereafter). Based on strong demand for contracts in Tasmania, TPI has received approval to grow nearly double the quantity originally expected. TPI crop yields in 2015/16 improved 30% versus pcp. TPI expects this level of improvement to continue with the 2016/17 growing season off to a good start after well-timed rain in Victoria and Tasmania. TPI is on track to contract sufficient area to supply its expected needs for the 2017 production season.

**Forecasts.** We view TPI's update as broadly consistent with our forecasts, noting TPI is targeting 100t of NRM supply by 2019 (versus WHTMe: 90t in 2019).

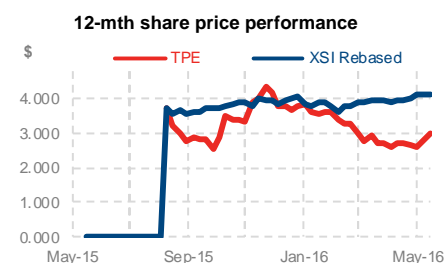
**Valuation.** Our revised 12-month target of \$3.61 p/share is set at a 10% discount (was 20%) to our DCF valuation (\$4.01 p/sh) to account for execution risk in the ramp-up of NRM production. We reduce the discount, given positive signs on production in TPI's market update.

### 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.

|  |              |
|--|--------------|
| 12-mth target price (AUD)              | \$3.61       |
| Share price @ 23-May-16 (AUD)          | \$3.00       |
| Forecast 12-mth capital return         | 20.4%        |
| Forecast 12-mth dividend yield         | 0.0%         |
| <b>12-mth total shareholder return</b> | <b>20.4%</b> |
| Market cap                             | \$136m       |
| Enterprise value                       | \$152m       |
| 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 (%) | 11.1  | -24.8 |
| Rel return (%) | 7.4   | -27.7 |

| 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)    |       |        | -5.7   | -1.9  | 6.8   |
| 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)            | -32.7 | -11.0  | -27.1  | -79.6 | 22.5  |
| EV/EBITDA (x)           | -56.5 | -16.6  | -140.9 | 33.3  | 10.9  |
| FCF yield (%)           | 0.0   | -17.1  | -7.8   | -12.5 | -3.8  |
| DPS (cps)               | 0.0   | 0.0    | 0.0    | 0.0   | 4.0   |
| Dividend yield (%)      | 0.0   | 0.0    | 0.0    | 0.0   | 1.3   |
| Franking (%)            | 0     | 0      | 0      | 0     | 0     |

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

| KEY CHANGES          | 13-May | After | Var % |
|----------------------|--------|-------|-------|
| <b>NPAT: FY16F</b>   | -5.7   | -5.7  | 0.0%  |
| <b>norm FY17F</b>    | -1.9   | -1.9  | 0.0%  |
| <b>(\$m) FY18F</b>   | 6.8    | 6.8   | 0.0%  |
| <b>EPS: FY16F</b>    | -11.1  | -11.1 | 0.0%  |
| <b>norm FY17F</b>    | -3.8   | -3.8  | 0.0%  |
| <b>(cps) FY18F</b>   | 13.3   | 13.3  | 0.0%  |
| <b>DPS: FY16F</b>    | 0.0    | 0.0   | 0.0%  |
| <b>(cps) FY17F</b>   | 0.0    | 0.0   | 0.0%  |
| <b>FY18F</b>         | 4.0    | 4.0   | 0.0%  |
| <b>Price target:</b> | 3.21   | 3.61  | 12.5% |
| <b>Rating:</b>       | BUY    | BUY   |       |



#### 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>3.61</b> |
| FY18 EV/EBITDA (x)       | 15.9        |
| FY18 PER (x)             | 27.1        |

**12-mth target (\$)** **3.61**

#### 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>3.5</b>   | <b>10.5</b>  | <b>21.7</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> |



## 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

TPI has provided an encouraging market update, confirming positive outcomes on several customer audits of its manufacturing facility, while also suggesting near-term production will benefit from significant increases in area planted and sustained yield improvements. TPI offers patient investors exposure to an attractive business with high barriers to entry and sustainable growth prospects. Receipt of a permit to import poppy straw from Europe is the key near-term catalyst.

### 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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