



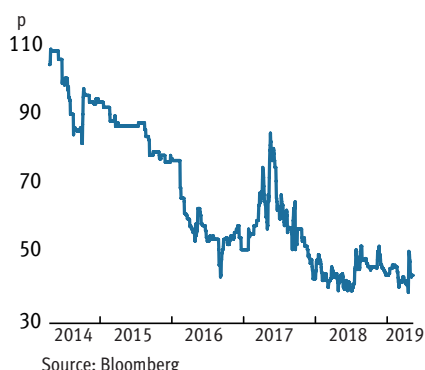
Venture Life: A profitable venture for accelerated earnings growth

This specialist in healthcare products is backed by fund managers to deliver a step change in profitability in the next few years

Venture Life (VLG)

Ticker	VLG
Current offer price (p)	45
Target price (p)	66
Market cap (£m)	36.8
52-week high (p)	55
52-week low (p)	36.75
Net cash (£m)	£5.8m (reported at 31 Mar)
Shares in issue (m)	83.7
Financial year-end	31 Dec
Next event	Annual general meeting on 3 Jun 2019
Company website	venture-life.com

Venture Life share price



Analyst: Simon Thompson
simon.thompson@ft.com

Alpha Production Editor: Sameera Hai Baig

Simon Thompson's view:

When a company with a relatively fixed cost base has capacity to increase sales, the impact on margins can be dramatic as a higher proportion of incremental revenue is converted into operating profit. This is exactly what's on offer at Venture Life as its manufacturing business scales up production from both third-party contract work and brings production in-house from the earnings accretive acquisitions the company is making. Moreover, a cashed-up balance sheet is set to be deployed on further acquisitions, offering the prospect of significant earnings upgrades. Trading on a 2020 forward cash-adjusted price/earnings (PE) ratio of 12, and rated on a material ratings discount to rivals, the shares are primed for a sharp re-rating over the next 12 months.

Bull points

- Ageing population supportive of self-care market.
- Scalable overseas manufacturing capacity to support growing pharmaceutical and healthcare customer base.
- Capital-light distribution model with partners funding marketing.
- Strong organic revenue growth from own brands.
- Operating leverage: operating margins on a strong upward trend after move into profitability.
- International expansion of distribution network.
- Capital raise has transformed balance sheet and slashed interest costs to mitigate financial risk.
- Cashed-up to make earnings-accretive acquisitions.
- Supportive and wider institutional shareholder base post last summer's placing.
- Directors have significant shareholdings.
- Accumulated UK tax losses to offset corporation tax charge.
- Access to low-cost debt facilities.
- Natural currency hedge to mitigate currency fluctuations post-Brexit.

Bear points

- Liquidity.
- Supply chain risk in event of Brexit.
- Customer specific risk.
- Adverse foreign exchange movements could impact profitability.
- Regulatory approval risk.

“An equity raise last summer has transformed the company’s finances”

Venture Life, a Bracknell-based company that develops, manufactures and distributes products for the self-care market, listed its shares on London’s junior stock market five years ago. It has been well under the radar of investors ever since, lacking the requisite scale for the operational gearing of the business to really kick in.

However, that has all changed following two acquisitions in the past few years and an equity raise last summer that has transformed the company’s finances and provided the board with the firepower to make earnings enhancing acquisitions.

Background to acquisitions

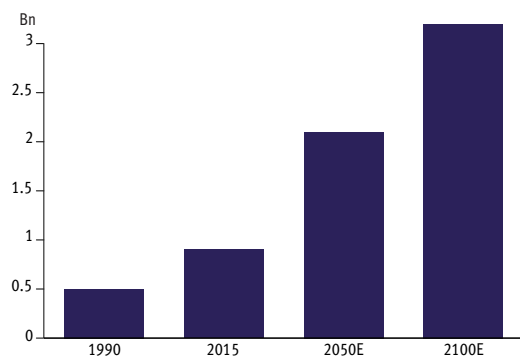
Established in 2010, Venture Life is an integrated UK-based consumer healthcare company that develops, manufactures and commercialises branded products addressing the needs of the ageing population.

This market benefits from a number of attractive growth drivers, including shifts in demography with people living longer, government organisations actively promoting self-care due to increasing constraints on public sector healthcare budgets, and lifestyle factors such as difficulties faced by elderly consumers in changing dietary habits. As a result, consumers are expected to take more responsibility and seek treatment for many non-critical ailments. This is usually through pharmacy and grocery multiples.

Self-care is where a patient will select and pay for the product (although this may be on the advice of a healthcare practitioner), and take it home to treat themselves. It does not require the intervention of a healthcare practitioner and is not reimbursed or dispensed on a prescription. Therefore, pricing is controlled by the pharmacy and is not subject to the price reductions that reimbursed products are regularly seeing from bodies such as the National Institute for Clinical Excellence (NICE) in the UK.

The over 50s comprise a significant proportion of this self-care audience. They generally have much higher disposable income and own a higher proportion of financial assets, and hence can afford to pay for healthcare. However, an increasing awareness globally of the need for each of us to take personal responsibility for our own healthcare is bringing many younger people into this market. Dermatology and oral care are significant sectors in this space, and Venture Life has strong expertise in both.

The world population is ageing and growing rapidly



Source: United Nations World Population Prospects (2017)

The population is ageing and growing rapidly

Year	Population aged 60 plus
1990	0.5bn
2015	0.9bn
2050E	2.1bn
2100E	3.2bn

...at the same time as healthcare budgets are under pressure

Net deficit of NHS bodies and NHS trusts in 2015/16	£4.3bn
Percentage of NHS trusts in deficit in 2015/16	66%
Savings the NHS needs to make by 2020-21	£14.9bn

Source: United Nations World Population Prospects (2017); and UK National Audit Office – Financial sustainability of NHS

So, while Venture continues to target the ageing population with its products, the directors see a significant opportunity in the wider self-care space, where the company's technical expertise in development, manufacturing and regulation compliance combined with its commercial expertise in the pharmacy channel can deliver self-care products around the world for all ages. Venture's objective is to capitalise on these favourable growth dynamics, building its business through organic expansion and by acquisition to leverage its existing operating infrastructure.

The product portfolio principally targets the regulated over-the-counter (OTC) segment of the consumer healthcare market, concentrating on the market segment between prescription pharmaceuticals and unregulated health foods. The OTC market was worth US\$133bn in global sales in 2017 and is forecast to grow at 6.5 per cent per annum between 2018 and 2023, according to analysts at Mordor Intelligence.

The company's portfolio includes medical devices, food supplements and dermo-cosmetics which address issues associated with ageing such as cognitive function, sleep disorders, cholesterol, joint and muscle ache, proctology (the branch of medicine concerned with the anus and the rectum) and health of skin and hair, all of which are sold in compliance with European Union (EU) regulations. Other key areas identified by the directors where future growth opportunities exist include diabetes, obesity, gastroenterology and oral health.

The existing products are typically sold into pharmacies through Venture's growing international network of over 100 distribution partners in 44 countries worldwide. The products are generally protected by intellectual property rights such as patents, trademarks, and formulations. The medical device and cosmetic products are manufactured from a facility in Italy by Biokosmes, a company that was acquired by Venture at the time of the company's IPO in March 2014.

As well as having an extensive library of proprietary formulations, Biokosmes provides development and manufacturing capabilities, and a significant operational gearing opportunity (see below). Biokosmes also provided Venture with the platform to leverage its expertise in areas such as new product development, brand management and commercialisation. To do so, however, Venture needed to scale up its activities significantly, which is why it moved into the oral health care market three years ago by acquiring Periproducts, a UK-based oral care products company. Periproducts owns a premium range under the UltraDEX® brand, including alcohol-free mouthwashes and toothpastes.

Venture Life (VLG)

Ord Price: 45p Market Value: £36.8m

Touch: 43-45p 12-Month High: 55p Low: 36.75p

Dividend Yield: nil PE Ratio: 14

Net Asset Value: 38p* Net Cash: £5.8m

Year to 31 Dec	Revenue (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2014	7.2	-1.54	-6.01	nil
2015	9.1	-1.64	-5.12	nil
2016	14.3	-1.11	-3.76	nil
2017	16.1	0.06	-1.00	nil
2018	18.8	0.71	0.42	nil
2019**	21.9	2.40	2.27	nil
2020**	23.7	3.17	3.12	nil
% change	8%	32%	37%	–

Normal market size: 3,000 SETSqx

*Includes intangibles assets of £20.5m, or 24p a share

**Cenkos Securities forecasts. Pre-tax profits and EPS stated after exceptional items and goodwill amortisation

Source: Venture Life annual report, London Stock Exchange

UltraDEX®-branded products

Products in the range are used to treat bad breath, remineralise and whiten teeth, and kill bacteria which cause plaque and can lead to tooth decay and gum disease. Incorporating patent protected and licensed intellectual property, Periproducts' UltraDEX®-branded products, including UltraDEX Recalcifying & Whitening range, are regarded as being particularly effective at managing bad breath (eliminating it for 12 hours by neutralising the sulphur compounds that cause bad breath), as supported by clinical data evidencing efficacy. Launched in the UK through retail pharmacies 20 years ago, the products also come recommended by dental professionals. The brand has become well-established in the UK and enjoys high levels of customer loyalty.

At the time of the Periproducts acquisition in March 2016, the products were manufactured by third parties and sold primarily through leading UK retailers with whom Periproducts had long-standing relationships, in-



The UltraDEX brand is well-established in the UK

cluding Boots, Tesco, Sainsbury's, Waitrose and Amazon. Sales through Boots accounted for 45 per cent of Periproducts' turnover prior to acquisition and over 95 per cent of sales were made in the UK with the balance originating from eight other EU territories.

However, Periproducts' was barely profitable, turning in annual operating profits of £200,000 on revenue of £2.8m prior to Venture's acquisition, thus offering the opportunity for Venture to boost profits by:

- Revitalising UltraDEX's UK marketing strategy with clearer advertising, branding and messaging.
- Extending the UK retail distribution into more stores with existing UK retailers, and expanding the number of different UK retailers.
- Leveraging the company's business development infrastructure, including relationships with its key overseas distribution partners in the short-term, to internationalise Periproducts' brand and achieve meaningful commercial roll-out in Europe.
- Leveraging Venture's operating infrastructure, existing manufacturing capacity and expertise in oral care product manufacturing, to bring functions such as product development, regulatory compliance and quality assurance in-house.
- Registering UltraDEX in other overseas markets to enable products to be launched in territories including North America, Latin America and Asia. The global market for medicated mouthwashes is worth over €500m per annum, so is a huge global market to target.
- Developing new oral care products to complement Periproducts' existing range, and identifying additional product cross-selling opportunities across both Venture Life's and Periproducts' respective customer bases.

Venture's management has been very successful in executing this strategy, having increased UltraDEX's revenues by a quarter to more than £3.3m in both 2017 and 2018 to generate trading profit of £1.1m from the brand. That's more than four times higher than at the time of the acquisition in March 2016, justifying the £5.6m cash consideration Venture paid for the business.

The dramatic turnaround in UltraDEX's financial performance has been achieved by:

- Increasing the number of store listings markedly. For instance, Tesco has increased the distribution of UltraDEX Low-Abrasion Toothpaste from 234 to 403 stores, resulting in the highest level of sales of UltraDEX toothpaste in Tesco since the start of 2015.

“The performance of UltraDEX was the key driver in Venture reporting a maiden pre-tax profit in 2017”

- Appointing long-term distribution partners overseas. The brand is now represented in 20 countries, including four of the five largest EU countries, with nine new partners signed up in new markets in 2018.
- Launching into new UK retail outlets including Sainsbury's. The direct route into UK retailers earns the company higher revenue per unit which it can then reinvest in consumer marketing to support a product's life cycle.
- Introducing larger pack sizes to offer more value for money to loyal consumers of the brand.

The performance of UltraDEX was the key driver in Venture reporting a maiden pre-tax profit of £63,000 in 2017 on revenues up 12 per cent to £16m, and reversing the hefty losses made in prior financial years.

The major issue being that £518,000 of Venture's operating profit in 2017 was used to service the interest payments on gross borrowings of £11.4m that included £3.7m of convertible loan notes and £0.4m of vendor loan notes, a hefty sum in relation to shareholders funds of £10.9m. Net debt of £10m at the end of 2017 implied a gearing ratio above 90 per cent. Venture's balance sheet needed an injection of fresh equity to free the company from its financial constraints, and to enable its senior management team to scale up the business by targeting similar bolt-on acquisitions. And that's why last summer's £18.75m placing at 40p a share (net proceeds of £17.5m after expenses) has transformed Venture's prospects.

Funded for accelerated profit growth

The equity raise more than doubled Venture's issued share capital and enabled the company to pay off the expensive convertible bonds (principle value of £1.9m and coupon rate of 9 per cent) that had been issued to part fund the acquisition of UltraDEX oral care products, and redeem a further €2m (£1.75m) of loan notes which part funded acquisition of its manufacturing business, Biokosmes, and were due to be repaid in July 2020. Including the interest payable on £400,000 of vendor loan notes that have also been redeemed, Venture immediately cut its annual interest costs by £280,000.

Venture also used £4.2m of the £17.5m net cash raised from the placing last summer to make the acquisition of the Dentyl Dual action mouthwash and BB Mints businesses. This still left the directors with gross cash of £9.6m and net funds of £5.8m (after taking into account low-cost debt facilities) at the end of last year to target further earnings enhancing acquisitions in order to try and replicate the success they have enjoyed at UltraDEX.

Specifically, the company is targeting the acquisition

of unloved and under commercialised brands that it can grow internationally using its operating leverage and distribution channels with more than 100 partners across 44 countries to deliver incremental profit growth in addition to organic growth from its existing businesses. Vendors are predominantly larger companies that are often rationalising their brand portfolios to focus on bigger assets, so are offloading sub-scale non-core brands as a result.

So, by targeting bolt-on acquisitions in this way, Venture's management can acquire profitable, cash generative brands that it can integrate into the company's operating structure in an efficient manner and then grow brand revenue through rapid geographic expansion and new product development. Venture's management team are already enjoying early success at reinvigorating Dentyl's sales.

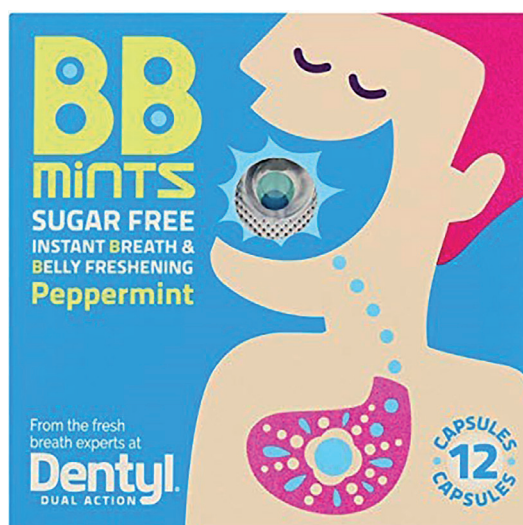
Earnings-accretive strategic acquisition

Dentyl is a prominent brand in the UK mouthwash market. It is activated by shaking, with the two phases interacting to create an electrostatic charge, which removes bacteria. The formulation consists of an aqueous phase, which contains an anti-bacterial agent, and an oil phase, which contains mint oil and it is packaged in a distinctive triangular bottle. The product is sold in 500 ml, 250 ml and 100 ml bottles and comes in two main flavours, Smooth Mint and Fresh Clove. The BB Mints product is a sugar-free dual action breath and belly freshness capsule.

Prior to acquisition, Dentyl derived 95 per cent of its revenues from the UK where it has been sold for the past 22 years and had listings in many of the major UK grocery and pharmacy outlets with its top five customers by sales being Tesco, Morrisons, Sainsburys, Asda and Wilkinsons. South Africa was the largest overseas market, representing less than 3 per cent of Dentyl's revenues and the only other significant international distribution partner was in China.

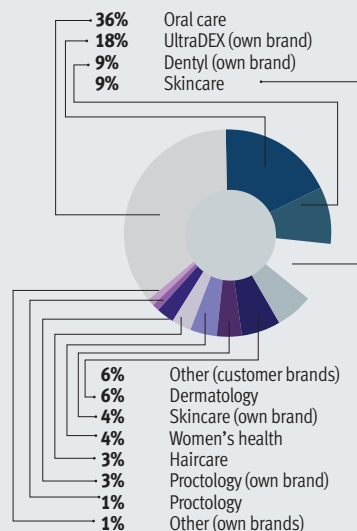
However, Dentyl's sales had been in decline, partly because the business was not a core holding of the vendor, but also due to under investment. This offered Venture the opportunity to expand Dentyl's UK listings and internationalise the brand by partnering in overseas markets using Venture's network of marketing partners; improve marketing and product innovation; bolster sales through cross-selling across the complementary retailer channel of both UltraDEX and Dentyl which target different markets; and make cost savings.

In the first five months under Venture's ownership Dentyl contributed £1.6m of revenues, split 50:50 between the UK and international markets. On a proforma basis, revenues for the brand increased by a third to £3.9m in 2018, a significant rise on sales of £2.9m reported in 2017 prior



Dentyl contributed £1.6m of revenues

Venture Life 2018 revenues by main therapeutic area



Source: Venture Life corporate presentation, 18 April 2019

to Venture acquiring the business. The performance more than justified an acquisition price of 3.5 times Dentyl's 2017 pre-tax profit of £1.17m.

In the UK, Lloyds Pharmacy, Amazon and Ocado are now stocking Dentyl mouthwash, and Venture has obtained new listings for the Dentyl BB Mints in Morrisons, WH Smith Travel, Amazon and Ocado. Amazon and Ocado launched both Dentyl mouthwashes and BB Mints in the UK at the end of the 2018 financial year, and given these online retailers have been important partners for UltraDEX in the UK, then one would expect similar benefits to be reaped for the Dentyl range too.

Internationally, Venture's business development team has started to work with the brand and has signed new long-term distribution partners in Ireland, Malta and Finland. Discussions are ongoing with potential distribution partners across different countries - expect further news to be announced later this year.

The improved sales contribution from Dentyl meant that Venture's revenues from its branded products increased by almost 50 per cent to £6.6m in 2018, and led to a 17 per cent rise in the company's total revenues to £18.8m, the balance of sales being from manufacturing activities on behalf of third parties from Biokosmes' facility in Italy. It also meant that Venture posted a maiden full-year post-tax profit of £0.4m, a significant milestone in its move towards sustainable profitability and cash generation.

Venture Life 2018 revenues by main therapeutic area

Dentyl (own brand)	9%
UltraDEX (own brand)	18%
Skincare (own brand)	4%
Proctology (own brand)	3%
Other (own brands)	1%
Oral care	36%
Women's health	4%
Skincare	9%
Proctology	1%
Dermatology	6%
Hair care	3%
Other (customer brands)	6%

Source: Venture Life corporate presentation 18 April 2019

Boosting sales at both UltraDEX and Dentyl, and targeting similar bolt on acquisitions will play a part in delivering the step change in Venture's profits this year and next, but there is also decent organic growth and useful contributions coming through from other products in its branded portfolio, as the box on the next page shows.

Lubatti

Venture's Lubatti skincare range was launched in China in January 2016 through a long-term partnership with Gialen and by the end of 2017 was being distributed in 2,000 Gialen stores. The products contain a combination of fruit, plant and flower extracts and have a rich history and heritage. Sales are growing fast, doubling from £0.4m in 2016 to £0.8m in 2018, and in the process achieving record monthly sales in November 2018. Expect revenues for the brand to grow further driven by the on-going opening of new Gialen stores in China, and expansion of the product range.

Venture's smaller brands

Venture's product portfolio encompasses 10 brands in total including:

■ **Myco Clear®:** There are two products, a solution to treat and prevent nail fungal infections and a cleanser for the hands and feet to guard against further infections. Myco Clear® has been signed up in France with a new distribution partner, the launch is planned for the current quarter.

■ **Rosacalma:** A range of products developed to control the signs and symptoms related to rosacea, a chronic, inflammatory skin condition that most often affects the face. Products include a cleansing foam, a cream to reduce the appearance of redness, and a serum to reduce the symptoms caused by the condition.

■ **Vonalei:** A range of women's intimate healthcare products including a gel for the prevention and management of bacterial vaginosis and vaginal atrophy, and a cream-gel for the prevention and management of thrush.

■ **NeuroAge:** A food supplement product to support cognitive function and mental alertness. Ingredients have been tested and show an improvement in short-term memory loss and other cognitive disorders. Venture entered into new distribution partnerships in Greece last year.

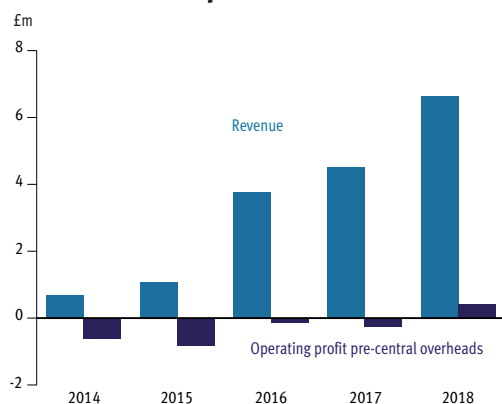
■ **Procto-eze:** Key products in the Procto-eze range are a cleanser and a cream to relieve the discomfort of haemorrhoids and a range of Procto-eze Wipes. In 2018, Venture signed up new partners in Austria, Romania and Poland.

■ **Benecol:** The brand is owned by Raisio, a Finnish company, which licenses the brand to Venture and sells the active ingredient to the company. Venture has a license to develop Benecol as a food supplement that can be sold in pharmacies, but not as a spread or yoghurt drink. The company has developed capsule and sachet forms of Benecol, which it intends to partner through its international distribution network. As a food supplement, Benecol offers a two-year shelf life and has no need for refrigeration.

■ **Bioscalin:** A treatment to help control hair loss, promote new hair growth and enhance the overall condition of hair. The range includes hair elixir, shampoo, lotion and foam, and a food supplement product too.

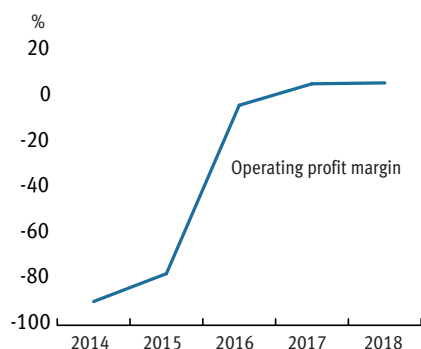
In total, these smaller brands contributed £0.9m, up from £0.5m in 2017, of Venture's total revenues of £18.8m in 2018, a useful and growing contribution.

Venture Life brands move into sustainable profit



Source: Venture Life annual report

Venture Life's brand margins



Source: Venture Life annual report

Venture Life brands division moves into sustainable profit

Year	Revenue	Operating profit pre-central overheads	Operating profit margin
2014	£0.68m	-£0.60m	-89.6%
2015	£1.07m	-£0.83m	-77.4%
2016	£3.76m	-£0.14m	-3.7%
2017	£4.50m	£0.26m	5.7%
2018	£6.63m	£0.40m	6.1%

Source: Venture Life annual report

A scalable manufacturing operation

Employing 62 staff, and with an average tenure of 10 years per employee, Venture's manufacturing facility in Lecco, Italy covers 5,500 sq metres of space and has capacity to produce 27m units a year across 10 filling and packaging lines. It's a key differentiating factor for the company versus peers as it enables Venture to develop and make both its own branded goods and those for third party customers. Goods are shipped to over 40 countries worldwide.

The plant has generated 25 per cent revenue growth since 2015, and last year produced 23m units, up from 21m in 2017. It's scalable as the directors believe that with £1m additional annual capital expenditure, representing 2 per cent of manufacturing revenue per year for the next three years, that capacity can be increased to 40m units per year. Additional capital expenditure of £2m per year for two years would increase capacity to 70m, or three times 2018 production levels. The point being that Venture can boost its output markedly without requiring high levels of investment.

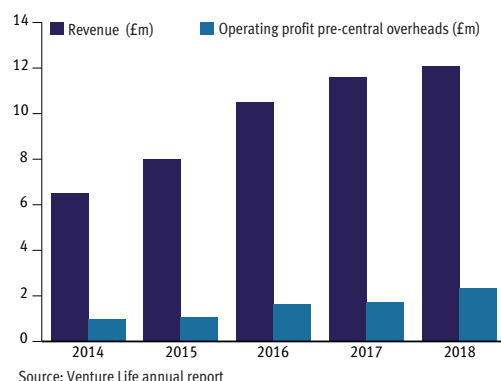
Venture Life's top 10 manufacturing customers by revenue

Customers	Activity
Alliance Pharma	Aim-listed international pharma company
Sunstar SA	Operates mainly in oral care and health & beauty
Giuliani SPA	Italian pharmaceutical company
Polichem SA	Swiss pharmaceutical company in dermatology, dermo-cosmetics, and gynaecology
Helsinn Healthcare SA	Swiss pharmaceutical group focused on building quality cancer care products
BMG Pharma SRL	Italian pharmaceutical company
Menarini	Italian pharmaceutical company
Farmaka SRL	Independent R&D and licensing healthcare compa-ny
APR SA	Swiss pharmaceutical company focused on innova-tive patient centric healthcare products
ESI SPA	Specialized in creating herbal products, nutraceuti-cals, dietary and nutritional supplements

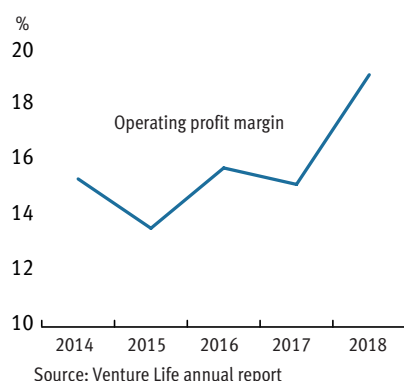
Source: Venture Life

Bearing this in mind, one of Venture's largest customers, **Alliance Pharma (APH)**, has extended its manufacturing contract by a further seven years to 2026, and with a run-off period of three years thereafter if it is not further extended. Alliance is an international pharmaceutical company specialising in the acquisition and licensing of healthcare products. It sells its products in more than 100 countries worldwide via direct sales, joint ventures and a wide network of distributors. The company also has a

Venture Life's manufacturing division adds scale



Venture Life's manufacturing division adds scale to boost operating margin



strong track record of acquiring the rights to established niche products and owns or licenses the rights to 90 pharmaceutical and consumer healthcare products.

Venture Life manufacturing division adds scale

Year	Revenue	Operating profit pre-central overheads	Operating profit margin
2014	£6.5m	£1.00m	15.4%
2015	£8.0m	£1.09m	13.6%
2016	£10.5m	£1.68m	15.8%
2017	£11.6m	£1.76m	15.2%
2018	£12.1m	£2.33m	19.2%

Source: Venture Life annual report

Venture manufactures products for Alliance and the contract extension incorporates the manufacture of new products under Alliance's Atopiclair brand, to generate additional revenues of at least €1.6m annually from 2019 onwards. Atopiclair is a steroid free cream for the treatment of mild to moderate atopic dermatitis. It can provide relief against the most common signs and symptoms such as itching, redness, burning and pain in both adults and children. The agreement puts Venture at the forefront of Alliance's strategic suppliers, and secures continued future business from the company.

Moreover, another key partner, Menarini Group, launched its Relife range of products in Italy in 2018, which includes 21 products developed and manufactured at Venture's Biokosmes facility. The launch has gone well and contributed to revenue growth in 2018. These products are expected to be launched by Menarini into additional markets in 2019 and beyond, thus supporting further production.

Venture's management are also in discussions with other customers with a view to generate further meaningful revenue streams for the manufacturing business. Also, during 2018 the company took on a significant amount of work to help customers adapt and modify products for changed medical device regulations in Europe (effective May 2020). This work will continue throughout 2019 and is expected to deliver significant revenues to the manufacturing business.

With Venture's central administration costs relatively stable (and with spare capacity to be utilised at the Biokosmes facility), based on a gross margin of say 30 per cent for new contract work taken on, a high percentage of the incremental margin earned will be converted into cash profits and operating profit given the operational gearing of the business. Before central overheads, the manufacturing business reported an operating margin of 19 per cent in 2018 – up from 15 per cent in 2017 – and the upwards move in margins seen in recent years looks set to

continue. Indeed, extra work for Alliance Pharma could add almost £400,000 to Venture's trading profit in 2019.

Venture's operating leverage about to kick in

The contributions from the UltraDEX and Dentyl acquisitions, and the additional margin being earned from the manufacturing operation, should lead to another milestone in Venture's profitability as the operating leverage of the business really kicks in this year and next.

Venture Life's operating leverage set to kick in

Year	Revenue	Adjusted Ebitda	Ebitda margin
2015	£9.1m	-£0.6m	-6.6%
2016	£14.3m	£0.8m	5.6%
2017	£16.1m	£1.9m	11.8%
2018	£18.8m	£2.7m	14.4%
2019E	£21.9m	£3.7m	16.9%
2020E	£23.7m	£4.5m	19.0%

As cash profit margins rise, operating margins are set to double between 2018 to 2020 to drive operating profit up by 160 per cent

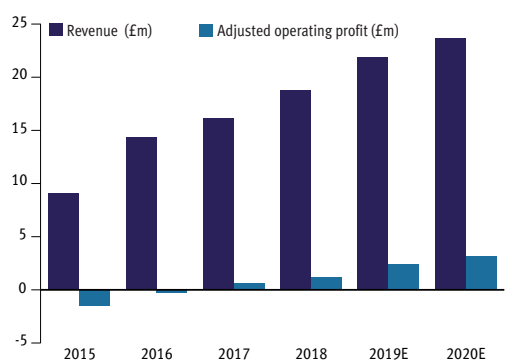
Year	Revenue	Adjusted operating profit	Operating margin
2015	£9.1m	-£1.45m	-15.9%
2016	£14.3m	-£0.29m	-2.0%
2017	£16.1m	£0.58m	3.6%
2018	£18.8m	£1.22m	6.5%
2019E	£21.9m	£2.40m	11.0%
2020E	£23.7m	£3.17m	13.4%

Source: Venture Life annual report; Cenkos Securities forecasts 18 April 2019

In fact, based on house broker Cenkos Securities forecasts, underlying operating profit before exceptional items (which doubled from £581,000 to £1.22m in 2018) is on course to double again to £2.4m in 2019, based on a £3.1m rise in revenues to £21.9m. These forecasts have real substance once additional work the manufacturing operation has been awarded is accounted for; and after a full 12-month's profit contribution from the Dentyl business, acquired in August 2018, is factored in.

The investment case gets even better still. That's because with a higher proportion of branded goods being sold (these enjoy gross margins of between 40 to 50 per cent), Venture's operating margin is getting a double boost from both rising sales and the higher profitability they are generating. This explains why analysts at Cenkos believe that an extra £1.8m of revenue generated in the 2020 financial year could produce incremental operating profit of over £750,000 and result in group operating margins doubling between 2018 and 2020 to produce operating profit of £3.17m next year, up from £1.22m in 2018.

Venture Life's operating profits surge



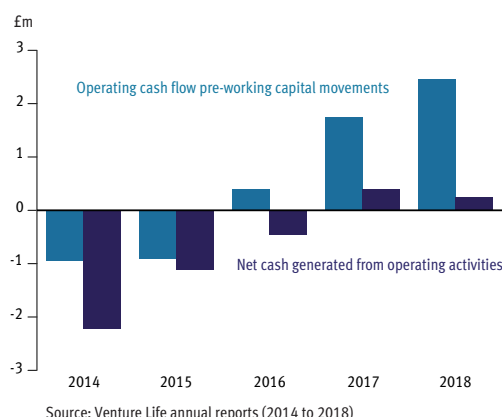
Source: Venture Life annual report; Cenkos Securities forecasts as at 18 April 2019

Rising sales, rising margins, and an increasing amount of recurring revenue are not the only clear positives for the business.

Corporate activity set to accentuate pre-tax profit surge

With Venture's balance sheet degeared, shareholders are set to benefit from the company's improving cash generation and a step change in operating profit and margins rather than funding hefty interest payments to debt holders. Indeed, the finance charge of £518,000 in 2017 was slashed to £341,000 last year and could be as little as £50,000 this year.

Venture Life's improving cash generation



Venture Life's improving cash generation

Year	Operating cash flow pre-working capital movements	Net cash generated from operating activities
2014	-£0.95m	-£2.22m
2015	-£0.90m	-£1.11m
2016	£0.40m	-£0.46m
2017	£1.74m	£0.40m
2018	£2.45m	£0.24m

Source: Venture Life annual reports (2014 to 2018)

It makes sense for Venture to still use its Italian debt facilities as they are keenly priced at around one per cent above three or six month Euribor. As these two Euribor rates are negative (minus 0.30 per cent and minus 0.25 per cent, respectively), effectively Venture is tapping debt facilities at interest rates of one per cent or less. The upshot being that although the company had gross cash of £9.6m and net funds of £5.8m at the end of 2018, it has around £8m of free cash plus untapped debt facilities to make further acquisitions.

Venture Life's Italian loan positions

Lender	Loan	Planned full repayment date	Finance terms
BNL	€0.3m	30/09/2020	1% plus 3 month Euribor
Unicredit	€0.8m	31/05/2023	1.05% plus 6 month Euribor
Intesa	€2.0m	30/11/2024	0.9% plus 6 month Euribor
RIBA	€1.4m	On demand	below 1% (HSBC invoice facility and Ricevuta Bancaria facility)

Source: Venture Life 2018 annual accounts; Venture Life corporate presentation

That's important because assuming Venture deploys the £8m free cash to purchase a business (or businesses) on 1.5 times sales, a multiple in line with what it paid for Denty, and the target company makes a gross margin in line with Venture's own gross margin of 39 per cent, then this could add upwards of £1m to Venture's operating profit. In other words, potential for corporate activity offers upside to Cenkos' current pre-tax profit forecasts that point towards Venture delivering pre-tax profit of £2.4m

“Venture has £9.27m of accumulated UK tax losses to offset against the UK corporation charge”

this year and £3.17m in 2020. Indeed, there could be scope for 30 per cent EPS upgrades to next year’s numbers if Venture finds the right target. The directors are on the active look out for the right deal.

Moreover, Venture has £9.27m of accumulated UK tax losses to offset against the UK corporation charge, so UK shareholders rather than HMRC will be the main beneficiary. The company’s Italian manufacturing business is still subject to Italy’s corporate tax rate but, by recycling around £8m of cash into the right acquisition, Venture could earn £1m a year of additional operating profit. Much of this profit could be tax free, which will give an accentuated boost to EPS.

Indeed, my models suggest that Cenkos’ basic earnings per share (EPS) estimates of 3.12p for 2020, which are based on a blended corporation tax rate of 16 per cent on group pre-tax profits of £3.12m, could be upgraded by 39 per cent to 4.3p if the right acquisition is made that generates £1m of annual operating profit, subject to UK corporation tax.

Significant re-rating potential

No matter which way you look at it Venture’s shares are underrated. The only real comparable left amongst UK listed entities is Alliance Pharma following last autumn’s £167m acquisition of Sinclair Pharma, an international specialty pharma business, by Huadong Medicine Company. That deal was priced on a bid premium of 75 per cent to Sinclair’s previous closing share price.

Peer group comparison

	Venture Life	Alliance Pharma
Share price	45p	80p
Market value	£37.7m	£414m
Enterprise valuation (EV)	£31.9m	£500m
EV/EBITDA 2019e	8.6	12.6
EV/EBITDA 2020e	7.1	11.1
EPS 2019E	2.27p	5.1p
EPS 2020E	3.12p	5.6p
2020 EPS forecast growth	37.4%	9.8%
2020 PE ratio (ex-cash)	12.2	14.3

Source: Cenkos Securities (Venture Life); Numis Securities (Alliance Pharma)

Admittedly, Alliance is a far larger company. It’s market capitalisation of £414m and enterprise valuation of £500m (after factoring in net debt of £86m at the end of 2018) dwarfs Venture’s market capitalisation of £37.7m and enterprise valuation of £31.9m. So, a liquidity discount needs to be applied. But there is still clear value on offer.

For instance, Venture is rated on an enterprise value to cash profit multiple of 8.6 times for the 2019 financial, a

thumping 31 per cent discount to that of Alliance Pharma. Cash profits are also referred to as Ebitda (earnings before interest, taxation, depreciation and amortisation charges) and give a more accurate idea of the overall cash profitability of the business. The valuation anomaly is even more skewed for the 2020 financial year when the implied discount on this basis widens to 36 per cent, even though Venture is set to deliver a step change in profitability by increasing its cash profit by two thirds between 2018 and 2020. Venture is also expected to deliver 37 per cent earnings per share (EPS) growth in 2020, outpacing the 10 per cent EPS growth of Alliance handsomely.

Although the discount narrows to 15 per cent based on the respective price/earnings (PE) ratios for the 2020 financial year, this ignores the potential for Venture to successfully execute an earnings accretive acquisition that could lift 2020 EPS estimates (currently 3.12p) by almost 40 per cent as I have demonstrated. If it does so, then Venture's 2020 PE ratio would fall to 10, or almost a third below that of Alliance. The respective multiples suggest that Venture's earnings growth is being undervalued, rather than Alliance being overvalued.

Meet the management

Of course, Venture's management team need to execute the acquisition strategy they outlined to the 18 new institutional investors who backed last summer's placing that raised £18.75m for the company. There are several positives on this score.

Venture is led by chief executive **Jerry Randall** who between 2000 and 2009 was the chief finance officer of Sinclair Pharma, having co-founded that company in 2000 when he completed a management buy-in. He was also on the board of Silence Therapeutics, an Aim-traded biotech development company, from 2008 to 2013. Prior to that he was a corporate financier and acted as an adviser to both private and publicly quoted companies with KPMG, with whom he qualified as a chartered accountant in 1990.

Mr Randall co-founded Venture in 2010 with **Sharon Daly**, the company's chief commercial officer. Ms Daly has over 20 years' experience within the healthcare industry, predominantly in marketing, sales and business development roles. She worked for a leading dental manufacturer for seven years and launched many products during this time. Their paths crossed at Sinclair Pharma where Ms Daly worked for five years within the International Business Development field where she completed more than 35 international out-licensing deals during a two-year period.

Gianluca Braguti is chief manufacturing officer, having founded Biokosmes, the company Venture acquired at the time of the IPO in March 2014. He began his career working in his father's pharmacy and then, after he graduated as a pharmacist, continued working for several years in the Milano University cosmetic research and development department researching cosmetic applications for raw materials used in different fields. In 1990 he started developing formulations for Italian cosmetic brands mainly in the perfumery and pharmacy area. He moved into contract manufacturing in 1999 when he founded Biokosmes.

The company's finance director, 52-year old **Andrew Waters** is an interesting recruit. Having previously worked at PWC and **GlaxoSmithKline (GSK)**, where he spent 16 years in various financial and business management positions, Mr Waters subsequently co-founded two businesses, Cubase Consulting and In-

first Healthcare, which he led through three successful funding rounds, raising in excess of £40m from private equity. Mr Waters joined Venture earlier this month to replace previous finance director Adrian Crockett who left the company in January this year to take up a role at Didcot-based **Thruvision (THRU)**, an Aim-traded provider of visually intelligent solutions to the global surveillance, security and safety markets.

Equally interesting was the appointment last autumn of 56-year old **Carl Dempsey** as a non-executive director. Mr Dempsey was previously the Global Vice President for Customer Management at Johnson & Johnson, the American multi-national medical devices, pharmaceutical and consumer packaged goods manufacturing company, where he was responsible for global sales of US\$3.6bn across 22 countries. During his 29-year career at the group, he had responsibility for developing the Health and Wellness Partnership strategy. He also led the successful integration of Pfizer Consumer Healthcare across Europe, Africa and the Middle East which included the Listerine mouthwash brand. His expertise could prove an invaluable asset at this stage of Venture's development. So could that of chairman, **Dr Lynn Drummond**, who spent 16 years at Rothschild in London, most recently within the investment banking division, with a focus on transactions within the healthcare sector. He holds a PhD in Biochemistry from the University of London.

Importantly, the directors have significant skin in the game and are incentivised by share options too. Mr Randall holds 3.9m shares (4.7 per cent of the issued share capital), Mr Braguti owns just over 7m shares (8.1 per cent) and Ms Daly owns 1.67m shares (2 per cent). In aggregate they hold 14.8 per cent of the shares in issue. Also, Mr Randall and Ms Daly both have share options over 1.35m shares at exercise prices of between 41p and 45p. The options are in three tranches and expire in August 2022 and November 2023.

Boardroom pay and pension contributions of £1m for the seven directors doesn't seem excessive if the company can deliver operating profit of £3.1m in 2020 and this could be significantly higher if an earnings-accretive acquisition is made.

Liquidity

It's worth noting that almost 80 per cent of the issued share capital of 83.7m shares is held by the top-12 shareholders. There are some shrewd fund managers on the list including Gresham House Asset Management, Livingbridge VC LLP, Ennismore, and River & Mercantile.

Venture Life major shareholders

Shareholders	Shares held	Percentage stake
JO Hambro Capital Management	9.04m	10.8%
BGF Investment Management	7.88m	9.4%
Gianluca Braguti and associated holdings	7.09m*	8.1%
Livingbridge VC LLP	6.57m	7.8%
Gresham House Asset Management	6.24m	7.5%
Ennismore Fund Management	6.25m	7.5%
Otus Capital Management LP	5.50m	6.6%
River & Mercantile Asset Management LLP	4.41m	5.3%
Jerry Randall (CEO) and associated holdings	3.93m	4.7%
Quilter	3.80m	4.5%
LGT Vestra LLP	3.18m	3.8%
Dr Michael Flynn and associated holdings	2.81m	3.3%
Total		79.3%

*Includes 300,000 shares owned by Mr Braguti's wife and 2m shares owned by his adult children. Mr Braguti retains control of the voting rights for these 2.3m shares whilst he remains a director of Venture Life.
Source: Venture Life 2018 annual report

Admittedly, this means that liquidity is below average. However, it's still possible to buy and sell the shares in bargain sizes upwards of 25,000 shares, and between the bid-offer spread, so well above the London Stock Exchange official normal market size (NMS) of 3,000 shares on the SETS order book. That is well worth considering if you are trying to build a large position through several share purchases.

It's also worth considering that share price moves are likely to be accentuated in both directions given that only 17.3m of the 83.7m shares are held by investors with holdings below the 3 per cent London Stock Exchange disclosure threshold. That's clearly not an issue if Venture delivers the anticipated good news on trading that I am anticipating, but clearly if the company disappoints at any stage then the share price could be hit that bit harder.

Having issued that cautionary note, the shares are only trading on a 2020 cash-adjusted forward PE ratio of 12, so the rating is hardly excessive to start with, which should limit downside risk. Also, the company's new shareholders who backed the August 2018 equity raise subscribed for 58 per cent of the enlarged share capital at 40p a share, so are unlikely sellers below this level unless Venture seriously disappoints.

Target price

Having taken all the risk factors into consideration (see below), and the execution risk of Venture successfully making another earnings accretive acquisition(s) to deploy around £8m of the company's cash pile, I feel the potential for Venture to deliver accelerated earnings growth over the next few years is being significantly underrated by the market.

Indeed, this is a business that could have an unencumbered balance sheet and make cash profits of around £5.8m and operating profit of £4.2m in 2020, if the surplus cash is deployed on the right acquisition. The current market capitalisation of £37.7m fails to reflect this step change in profitability. Even if you were to value the current 2020 cash profit estimates of £4.5m on an 11-times multiple, and add in Venture's existing net funds of £5.8m, this still implies a target market capitalisation of £55.3m and a target price of 66p, based on 83.7m shares in issue.

Offering almost 50 per cent share price upside, and with earnings upgrades firmly on the cards when Venture announces its next acquisition, the shares rate a compelling **buy**.

Risk assessment

Of course, there are risk factors to take into consideration before making any investment.

■ **Customer specific risk:** A significant proportion of revenue from Venture's development and manufacturing business is derived from a relatively small number of customers. Its top five customers have accounted for over 50 per cent of group revenue in each of the past four financial years. The loss of any customer or group of customers which represents a significant proportion of revenue could have a negative impact on operating results and cash flow. That said, the company is winning additional work from customers as highlighted by the Alliance Pharma contract extension and it is trying to replicate this success across the manufacturing customer base, thus segmenting its existing strong relationships.

■ **Reduction in demand for products:** Venture's product distribution agreements generally give market exclusivity to its distribution partners for a period of five or ten years. While such agreements impose minimum annual purchase obligations, if any of the partners fail to meet minimum purchase obligations, then expected revenues and profits could be negatively affected. Such an adverse impact would continue until either the partner can meet minimum purchase obligations or until Venture finds an alternative commercial partner for that market. By adding new distribution partners to its network, and

extending the geographic footprint of the business, Venture is mitigating the risk of any one distribution partner failing to meet its purchase obligations.

Specifically, by adopting a business-to-business model in international markets, Venture targets reputable pharmaceutical and healthcare partners to ensure they have local expertise, and can fund all the sales and marketing costs.

■ **Delay in regulatory approval:** Products are primarily approved for use as food supplements, medical devices and functional cosmetics that in certain regions, including Europe, require pre-market notification but not pre-market authorisation or approval by the relevant authorities. In other regions of the world where Venture either has distribution agreements in place or is actively seeking to establish them, the procedure for registering and having products authorised may differ from that in Europe.

Other jurisdictions may require more lengthy registration and authorisation processes and Venture will be relying on its distribution partners to carry out this work in a timely manner. This in turn may lead to delays in product launches in certain territories. Venture works closely with its partners to support them through the process to mitigate this risk.

■ **Supply chain risk:** Venture relies extensively on third parties for many of its activities, including raw material supply, logistics, distribution and sales of its products. The company is therefore at risk of under-performance by third parties. To mitigate this risk, the company works with a variety of vendors and aims not to be over-reliant on one.

Venture is also reliant on its Italian manufacturing business for the supply of products and, although the company takes precautions against fire and flooding, there is a risk of supply chain interruption should such events occur.

■ **Adverse foreign exchange movements affecting profitability:** Venture's revenues are denominated in euros, Chinese renminbi and sterling. However, the company's financial accounts are reported in sterling, so reported revenues will depend on exchange rates prevailing during the relevant financial period.

Most cost of sales are denominated in euros, and 80 per cent of revenues are denominated in euros, thus providing a natural hedge. As a consequence, the company is not unduly exposed to adverse movements in the euro/sterling exchange rate in relation to its gross profit.

Administrative expenses arising in Italy represent a material component of the total administrative expenses. These expenses are denominated in euros and when reported on a consolidated basis, they will be reported in the presentational currency of sterling in Venture's accounts. Consequently, movements in the sterling/euro exchange rate can impact the sterling value of these expenses. Venture actively monitors the principal foreign exchange rates and will adopt hedging strategies when appropriate to mitigate this risk.

■ **Financial risk management:** The directors seek to minimise exposure to financial risk through issue of its own equity instruments and debt to fund operating and investing activities. Where it is necessary to utilise debt funding, the terms of the financing are reviewed against future cash flow expectations to ensure that there are sufficient resources for the company to meet its obligations under the financing arrangements. This is not a material risk now as interest rates on credit lines are one per cent or less per annum and the company's move into sustainable profitability should enhance operating cash flow.

■ **Financial risk factors:** Venture's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. Risk management is carried out under policies approved by the board. Management identifies and evaluates financial risks in close cooperation with the company's operating businesses. They also provide principles for overall risk management, as well as policies covering specific areas, such as interest rate risk, non-derivative financial instruments and investment of excess liquidity.

■ **Market risk:** Market risk is the risk of loss that may arise from changes in market factors such as interest rates and foreign exchange rates. The directors monitor market risk factors and regularly review business forecasts to assess the impact of changes in market conditions.

■ **Credit risk:** Credit risk arises from cash and receivables balances and is the risk of financial loss if a customer or counterparty to a financial instrument fails to meet its contractual obligation. Venture mitigates this risk by requiring upfront payments from new orders with new customers and monitoring the composition of its monthly debtor book. The company made a small provision of £20,000 on overdue trade receivables in the 2018 financial year, and only £12,000 in 2017, insignificant sums in relation to total receivables of £7m. This indicates good credit quality and credit control.

■ **Liquidity risk:** Management monitors rolling forecasts of liquidity and cash on the basis of expected cash flow to maintain sufficient cash reserves and to make sure the company is able to meet its financial obligations as they fall due.

■ **Capital risk management:** Venture's capital structure is comprised of shareholders' equity, invoice financing and unsecured commercial debt. The board's objective when managing capital is to maintain adequate financial flexibility to preserve its ability to meet financial obligations, both current and long term. The capital structure is managed and adjusted to reflect changes in economic conditions.

Venture funds its expenditures on commitments from existing cash balances, primarily received from issuances of shareholder equity and loan arrangements. There are no externally imposed capital requirements. Financing decisions are made by the directors based on forecasts of the expected timing and level of capital and operating expenditure required to meet Venture's commitments and development plans.

■ **Brexit:** Venture has operations in the UK and Italy. In the event of Brexit there may be some implications for the company. At the moment, there is limited clarity on the exact impact on UK-based businesses that trade internationally.

The significant proportion of Venture's operations is based in Italy so will not be affected by Brexit. In fact, with most operations based in the EU, Venture is more immune to the potential implications of Brexit compared to most UK businesses. The main issue that may affect the company could relate to import duties on products manufactured outside of the UK, but imported into the UK for sale. Approximately three quarters of revenues are invoiced or shipped out of Italy, in euros, and therefore do not come into the UK and would not be subject to any import tariffs.

The balance represents the sales of UltraDEX which are manufactured in Venture's plant in Italy, then imported to the UK and sold to customers. It is possible that these imports could be subject to import duties, which would increase the cost of these items sold in the UK, thus reducing gross margins on the product. As Venture manufactures these products, it already generates a high gross margin to absorb the impact of import duties. However, if import duties on these sales become particularly onerous, the company already has in place secondary suppliers in the UK that would be able to produce the goods at a better

price than that if import duties were imposed, thus maintaining the company's margins on these products.

Moreover, as part of its Brexit planning, Venture has already taken steps to make sure that there is additional inventory available in the UK to mitigate the risk of congestion issues arising for stocks being moved from Italy to the UK.

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