Group Chief Financial Officer's review



Sean Capazorio
Group Chief Financial Officer

Key features of 2022

Double-digit organic growth in normalised EBITDA

Normalised EBITDA increased 11% (+13% CER) to R11,0 billion largely due to the leverage provided by lower operating expenses.

Solid earnings growth

NHEPS, at the highest level ever, increased 24% (+26% CER) to 1 627,6 cents, bolstered by reduced net financing costs.

Leverage ratio comfortably below target levels

Net borrowings of R16,1 billion at the lowest level in five years, creating significant headroom and providing capacity for value enhancing investments.

Increased dividend declared as well as share buy-back

Dividends of 326,0 cents (gross) per ordinary share declared, up 24% from 262,0 cents per share in the prior year. Share buy-back of R1,8 billion equating to 2,2% of issued shares.

Purpose-driven growth

In this my first report since being appointed to the position of Group Chief Financial Officer, I am pleased to be able to present a strong set of results for the year ended 30 June 2022, despite the challenging trading environment. These results are testament to the ongoing efforts of our employees across Aspen, who are dedicated to maintaining a reliable supply of our high quality medicines and products to patients globally. Supported by robust financial discipline, the Aspen business model has proven to be resilient against the unprecedented challenges presented during the COVID-19 pandemic period, followed by further business and economic impacts in the wake of the Russia/Ukraine conflict. As a global pharmaceutical company, we play an important role in contributing to the health and well-being of people while creating economic value for our key stakeholders. While the provision of high quality, affordable medicines and products benefits patients and consumers directly, a focus on building a profitable and sustainable business model generates economic value for our varied stakeholder groups. Our activities this year have created R18 617 million in wealth, distributed to our employees (43%), the providers of capital (10%) and to the fiscus (8%), with the remainder (39%) reinvested to sustain the business (refer to page 95).

The Group has delivered double-digit organic growth in normalised EBITDA, operating profit and earnings, demonstrating the Group's resilience against the backdrop of a challenging trading environment and inflationary cost pressures. As we deliver on our strategic plan, we continue to improve our return metrics and are making good progress in delivering on our medium-term financial targets.

Group Chief Financial Officer's review continued

Financial performance highlights

Revenue increased by 2% (+5% CER) to R38,6 billion and normalised EBITDA increased 11% (+13% CER) to R11,0 billion. Commercial Pharmaceuticals revenue declined 1% (+1% CER) to R27,7 billion, reflecting the difficult trading conditions. A strong performance from Manufacturing with revenue growth of 11% (+18% CER) was boosted by the fill and finish production of the Johnson & Johnson COVID-19 vaccine. NHEPS increased by 24% (+26% CER) to 1 627,6 cents, favourably impacted by lower financing costs.

Operating cash flow was impacted as a consequence of increased inventory investment by the Manufacturing segment in key input materials to mitigate future supply constraint risks which may arise from continued global supply chain disruptions. The cash conversion rate dropped to below our targeted level of 100% to 81%. Net borrowings declined R0,3 billion to R16,1 billion. The leverage ratio of 1,91 times was well below the covenant threshold of 3,5 times and is inclusive of funding a share buy-back of R1,8 billion and dividend payments of R1,2 billion.

Our reported results are impacted by the rate of exchange prevailing during the period. The table which follows compares performance in the prior comparable period at previously reported exchange rates and then at CER. The CER results for the 12 months ended 30 June 2021 restate the performance for that period using the average exchange rates for the 12 months ended 30 June 2022. While fluctuations in exchange rates have been experienced over the reporting period, the overall strengthening of the ZAR against the majority of the currencies in which Aspen trades has had a slightly unfavourable impact on our reported results.

	2022 R'million	2021 R'million	Change %	2021 (CER) R'million	Change (CER) %
Revenue	**38 606**	37 766	2	36 724	5
Normalised EBITDA	**11 012**	9 945	11	9 767	13
NHEPS (cents)	**1 627,6**	1 309,7	24	1 296,4	26

Business segment performance

Product and geographic diversification sustain Commercial Pharmaceuticals performance while a strong performance from Manufacturing contributes to an increase in revenue

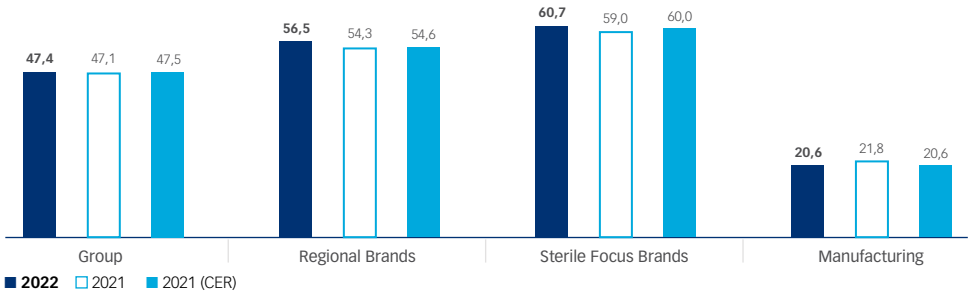
Revenue increased by 2% (+5% CER) to R38,6 billion. The revenue generated by the Commercial Pharmaceuticals business, comprising Regional Brands and Sterile Focus Brands, decreased by 1% (+1% CER) to R27,7 billion. Regional Brands delivered a sound performance, increasing revenue by 1% (+3% CER) to R17,4 billion, notwithstanding the divestment of certain products and supply constraints in Africa Middle East. The Sterile Focus Brands segment posted a decline in revenue of 4% (2% CER) to R10,3 billion, affected by challenges faced in our Chinese business, including volume-based procurement and COVID-19-related lockdowns, as well as the impact of the geopolitical situation on our businesses in Russia and Ukraine. Manufacturing delivered a strong performance, increasing revenue by 11% (+18% CER) to R10,9 billion, supported mainly by the production of the FDF Johnson & Johnson COVID-19 vaccines.

	2022 R'million	2021 R'million	Change %	2021 (CER) R'million	Change (CER) %
Commercial Pharmaceuticals	**27 658**	27 874	(1)	27 407	1
Regional Brands	**17 405**	17 183	1	16 895	3
Sterile Focus Brands	**10 253**	10 691	(4)	10 512	(2)
Manufacturing	**10 948**	9 892	11	9 317	18
API (Chemicals)	**4 737**	5 154	(8)	4 849	(2)
API (Biochemicals)	**778**	1 243	(37)	1 161	(33)
FDF	**5 433**	3 495	55	3 307	64
Group revenue	**38 606**	37 766	2	36 724	5

Improvements in gross profit offset by increase in Manufacturing revenue mix

Gross profit growth of 3% (+5% CER) slightly exceeded revenue growth with the underlying segmental margins all showing improvement. The increased contribution from the lower margin Manufacturing segment diluted the overall gross margin performance resulting in a gross profit margin of 47,4% compared to the prior year of 47,5% (CER). Commercial Pharmaceuticals achieved a 3% increase in gross profit to R16,1 billion (58,0% gross profit margin), supported by improved margins in both Regional and Sterile Focus Brands, despite the inflationary and freight cost headwinds experienced, particularly in the second half of the financial year. Manufacturing gross profit at 20,6% was consistent with the prior year (CER).

Gross profit by business segment (%)



Group Chief Financial Officer's review continued

Reduction in operating expenses levers growth in normalised EBITDA and a higher normalised EBITDA margin percentage

Normalised EBITDA rose 11% (+13% CER) to R11,0 billion, achieved through strict management of our operating expenses. Normalised EBITDA margin increased by 2,2 percentage points to 28,5%.

	2022 R'million	% of revenue	2021 R'million	% of revenue	Change %	2021 (CER) R'million	% of revenue	Change (CER) %
Revenue	**38 606**	100,0	37 766	100,0	2	36 724	100,0	5
Gross profit*	**18 306**	47,4	17 789	47,1	3	17 462	47,5	5
Operating expenses	**(8 539)**	(22,1)	(9 124)	(24,2)	(6)	(8 931)	(24,3)	(4)
Net other operating income	**78**	0,2	237	0,6	(67)	225	0,6	(65)
Depreciation	**1 167**	3,0	1 043	2,8	12	1 011	2,8	15
Normalised EBITDA	**11 012**	28,5	9 945	26,3	11	9 767	26,6	13

* *Gross profit is after the deduction of depreciation.*

Earnings growth positively impacted by growth in EBITDA and reduction in net funding costs

Normalised headline earnings, which adjusts for specific non-trade items as set out in our accounting policies, is the primary measure management uses to assess our underlying financial performance. Normalised headline earnings of R7,4 billion was 23% (+25% CER) higher than the R6,0 billion achieved in the prior year, positively impacted by the increase in EBITDA and a further reduction in normalised net funding costs.

With the reduction in share capital following the share buy-back effected during the year, NHEPS increased by 24% (+26% CER) to 1 627,6 cents per share.

Set out below is a reconciliation of earnings per share at the basic, headline and normalised headline levels (continued operations).

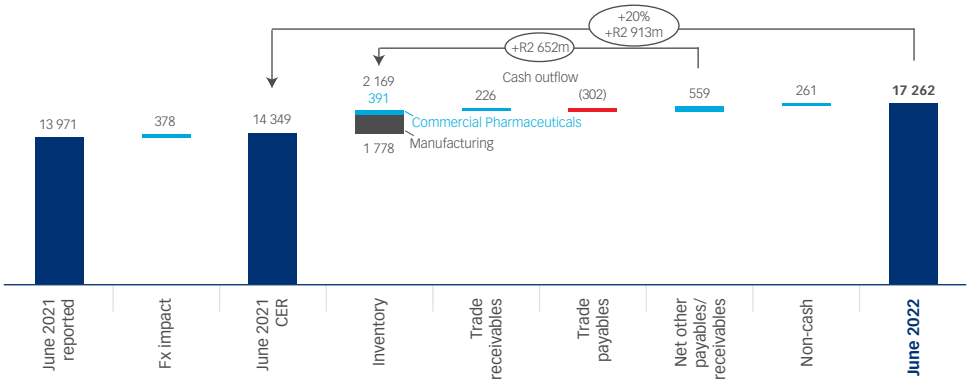
	2022 Cents	2021 Cents	Change %	2021 (CER) Cents	Change (CER) %
Basic earnings per share (EPS)	**1 432,3**	1 051,1	36	1 050,0	36
Impairment of PPE	**1,9**	29,1		28,2	
Impairment of right-of-use assets	**3,2**	—		—	
Impairment of intangible assets	**327,3**	274,8		257,6	
Impairment of goodwill	**2,4**	27,8		26,2	
Reversal of impairment of intangible assets	**(79,6)**	(90,2)		(84,2)	
Reversal of impairment of PPE	**(2,5)**	(59,5)		(55,6)	
Profit on sale of assets classified as held-for-sale	**(252,6)**	—		—	
Loss/(profit) on sale of tangible and intangible assets	**39,8**	(28,8)		(28,7)	
Insurance compensation on assets	**(11,0)**	—		—	
Headline earnings per share (HEPS)	**1 461,2**	1 204,3	21	1 193,5	22
Restructuring costs	**29,7**	63,7		62,7	
Transactions costs	**124,1**	49,2		47,2	
Product litigation costs	**16,6**	9,1		8,5	
Reversal of deferred consideration no longer payable	**(3,3)**	—		—	
Foreign exchange gain relating to transactions	**(0,7)**	(16,6)		(15,5)	—
Normalised HEPS	**1 627,6**	1 309,7	24	1 296,4	26

Group Chief Financial Officer's review continued

Strategic investment in inventory to mitigate supply risks elevates net working capital investment

A strategic investment in Manufacturing inventory to mitigate the risk of stock-outs, following global supply disruptions, and inflation risk has negatively impacted our efforts to reduce our investment in net working capital. Net working capital levels increased by +20% CER over the prior year, increasing the investment in working capital to 45% of revenue from 37% reported in the prior year. Our working capital levels are influenced by the long working capital cycle associated with our Oss API business, and excluding this business, working capital reduces to 38% of revenue compared to 31% in June 2021.

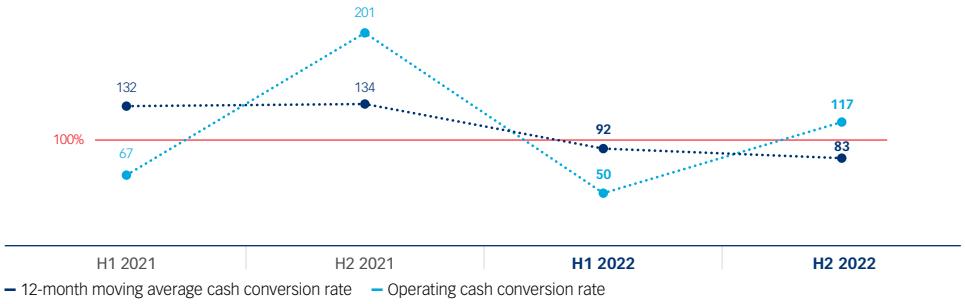
Net working capital bridge (R'million)



Operating cash flow and cash conversion rate falls below target but necessary to protect supply

Operating cash flows were negatively impacted by the increase in working capital offsetting the benefits of lower net finance costs. Cash generated from operating activities of R5,4 billion represents operating cash flow per share of 1 186,2 and an 81% conversion of headline earnings to cash.

Operating cash conversion cycle (%)



Non-current asset optimisation

Strategic investment in our manufacturing capabilities underpins our growth strategy

The capital expenditure programmes at our Gqeberha and Notre Dame de Bondeville sites for the in-house production of our Anaesthetic portfolio have continued, with the restrictions imposed by COVID-19 resulting in some unavoidable delays. We have continued to invest in the expansion of our sterile manufacturing capacity in Gqeberha to be used for vaccines and other steriles including biological products. The expansion project value of R2 billion will be spread over the financial years 2022 to 2024, with R0,5 billion being expended in the June 2022 financial year. Commercial manufacture for certain products at our Gqeberha and Bad Oldesloe sites will continue to ramp up over the next two years. We have also incurred capital expenditure in the rehabilitation of the Alphamed site in India which was damaged in a fire in June 2021. Total PPE capex for FY2022 was R2,0 billion.

Based on our approved capital expenditure projects, including the sterile expansion projects, expenditure on PPE is expected to increase to approximately R2,3 billion in FY2023 and R2,4 billion in the following year.

Acquisitions and disposals enhance our product portfolio offering

Aligned to our strategic intent to continually reshape and focus our product portfolio, two significant transactions were effected during the year. In the first, a basket of six products was sold by the South African business to Acino Pharma AG for a consideration of R1,8 billion, plus cost of the related inventory effective 1 March 2022. The second was the acquisition of 100% of ENTT by the Australian business for a consideration of R386 million. This business has a portfolio of market-leading products that treat a range of common ear, nose and throat problems, and present an opportunity to further strengthen the Australian business' product offering. After taking into account transactions relating to prior period business transactions, net proceeds on acquisition and divestment activity amounted to R371 million.

	2022 R'million
Proceeds from sale to Acino	**1 800**
Proceeds on disposal of intangible assets	**325**
Proceeds on disposal of European Thrombosis business	**146**
Net payment of deferred consideration in relation to prior year business acquisitions	**(1 539)**
Acquisition of ENTT	**(361)**
Net inflow from bolt-on disposals and acquisitions	**371**

Impairment to intangible assets and goodwill

We classify certain of our intangible assets as being of indefinite life. Each year, the carrying values of the intangible assets and goodwill are rigorously tested for impairment and carrying values are written down where there has been a reduction in value. Intangible assets which are no longer assessed as indefinite life are reclassified as definite life assets. This year, net impairments of intangible assets and goodwill were R1,2 billion on a total combined net book value of R58,7 billion at financial year-end.

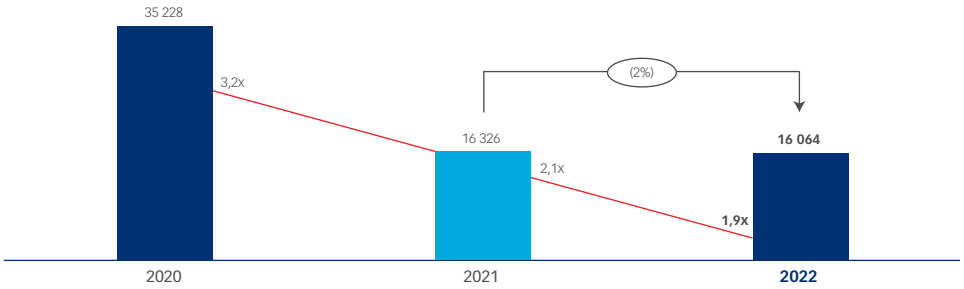
Group Chief Financial Officer's review continued

Funding and debt profile

Significant headroom on covenant leverage ratio

The cash flows from operating activities together with the net proceeds from business transactions have been substantially offset by capital outflows in respect of dividend payments, share buy-backs and capex. Further aided by favourable forex movement, the level of net borrowings has reduced R0,3 billion to R16,1 billion. The leverage ratio of 1,91 times is well within the covenant level of 3,5 times and below our internal limit of 3,0 times.

Net borrowings (R'million) **and leverage ratios** (x)*



* *Calculated based on the revised methodology per recent IFC and upcoming bank syndicate loan agreements expected to be finalised in the refinancing programme scheduled for completion in November 2022.*

Accolade

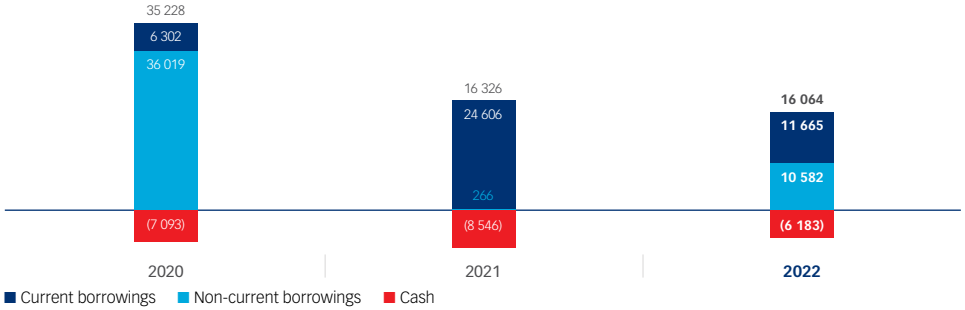
Aspen's 2021 loan from the International Finance Corporation ("IFC") (and consortium of other development finance institutions ("DFIs")) was selected by the Global Trade Review as one of their Best Deals for 2021.

Restructuring of debt maturity profile

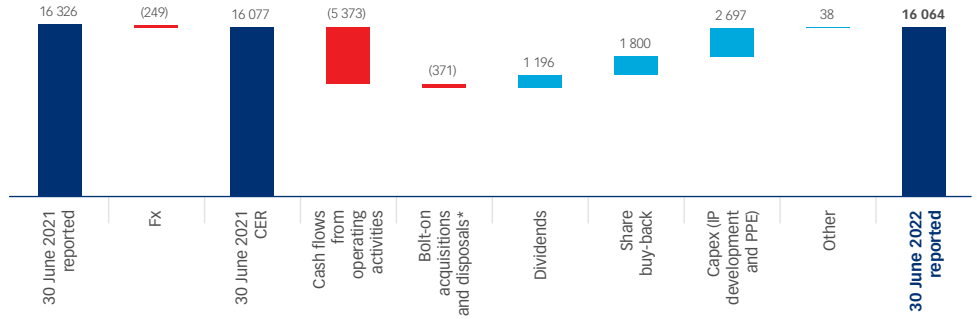
As reported in the prior year, we were successful in securing a joint refinancing package from the IFC and a consortium of DFIs related to the IFC. The debt financing package is for an aggregate of EUR600 million and is structured as an amortising loan, with a two-year grace period and with the final loan instalment being due up to seven years after its effective date. The further funding terms are substantially similar to our existing EUR-denominated syndicated debt facilities agreement. The proceeds from this funding were used to refinance a portion of our existing EUR-denominated syndicated debt facilities, thereby increasing our loan tenor and further diversifying our debt funder base. Repayment on this financing package will commence bi-annually from March 2024 onwards.

The maturity date for the major portion of the Group's syndicated term debt facilities was successfully extended to 30 June 2023 from June 2022. A refinancing programme for these facilities has commenced and is expected to be completed in November 2022. Included in current borrowings is syndicated debt to the value of R8,4 billion which will form part of the refinancing programme.

Net borrowings in (R'million)



Net borrowings bridge (R'million)



* *Bolt-on acquisitions are limited to a net transaction value of R1 billion per annum.*

Group Chief Financial Officer's review continued

A significant reduction in net financing costs contributes to NHEPS growth

The lower net borrowings and lower effective interest rates have contributed to a 50% reduction in net financing costs.

	2022 R million	2021 R million	Change %
Net interest paid	**(468)**	(854)	
Effective interest rate for the period*	**2,92%**	3,39%	
Foreign exchange gains/(losses)	**184**	(49)	
Notional interest on financial instruments	**(192)**	(211)	
Normalised net funding costs	**(476)**	(1 114)	(57)
Debt raising fees on acquisitions	**(64)**	(47)	
Foreign exchange gains on acquisitions	**3**	78	
Reported net financing costs	**(537)**	(1 083)	(50)

* *Excluding amortisation of capital raising fees.*

Capital returns to shareholders aligned to prioritisation model

In accordance with the Board-approval capital allocation prioritisation model and taking into account earnings and cash flow performance for FY2022 and the leverage ratio well below the limit of no more than 3,0 times, a share buy-back of R1,8 billion (2,2% of issued shares) was completed during the year. In addition, the Board declared a gross dividend of 326 cents per ordinary share which was paid to shareholders registered in the share register as at 23 September 2022. Refer to page 29 for more information on our capital allocation model.

Maintenance of financial health

To sustain our business model and to generate accretive value for investors, we have a fiduciary duty to our stakeholders to manage our financial capital in a responsible manner. Robust financial controls and treasury management systems are in place to mitigate currency, interest rate and credit risks as far as reasonably possible. The Audit & Risk Committee assists the Board in discharging its duties in respect of the safeguarding of assets, accounting systems and practices, internal control processes and the preparation of the Group and Company Annual Financial Statements.

Internal financial controls

The key internal financial controls in operation for all significant operating businesses within the Group are documented in formalised financial internal control frameworks, and these frameworks are maintained and updated by financial management during the course of the year or as part of the year-end process. The documented key internal financial controls are audited by Group Internal Audit on an annual basis. This process provides support for the positively worded statement corroborating that there are no material breakdowns in the internal controls underpinning the financial results.

The Group also undertakes a rigorous self-assessment process, with the scope including all subsidiaries. The self-assessment review is formally signed off by the financial head of each subsidiary and is also reviewed and approved by the Group finance team. The self-assessment includes financial and disclosure controls, internal financial and operating controls, business performance-related representations and a detailed fraud assessment review. The positive assurance outcome provides strong support for meeting the requirements of section 3.84(k) of the JSE Listings Requirements.

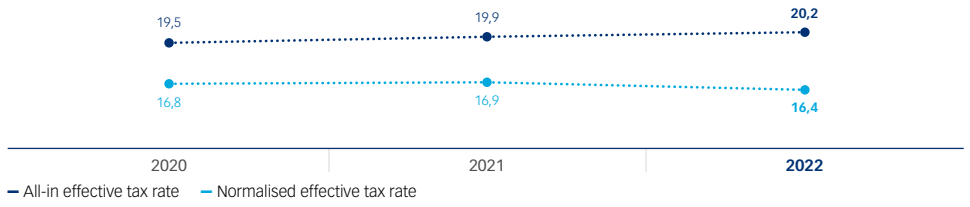
Funding and treasury risk management

The Group Treasury Committee is charged with monitoring the Group's performance in managing the risks (including liquidity, foreign exchange, covenant compliance, counterparty and interest rate) identified in the Group treasury policy. Local management is empowered, within the relevant approvals frameworks and the limitations set out in the Group treasury policy, to make decisions regarding how to manage these risks and to take ownership for implementation of any related actions. The Group Treasury Committee is also responsible for overseeing, reviewing and challenging the recommendations made and actions taken by Group Treasury in terms of its duties under the Group treasury policy, as well as with respect to centralisation, automation and optimisation of the Group's operational treasury activities and the appropriateness of the Group's debt funding portfolio (including related intra-group guarantees and funding arrangements).

A responsible approach to taxation

As a Group that has a substantial presence in many countries, we understand our responsibility to pay an appropriate amount of tax. We comply with tax laws in the countries in which we operate and seek to maintain open and positive relationships with tax authorities. The Group Tax Committee oversees the Group's tax strategy and risk management and ensures that our tax affairs are proactively managed. Our approach to taxation is more fully explained on page 96.

Group effective tax rate (%)



Continued improvement in financial and tax reporting systems

During the year, we further progressed our digitalisation strategy and continued to invest in ERP systems and advanced technology. These projects remain integral to our objective of achieving significant improvement in the quality, timeliness and depth of financial and tax reporting available to the Group.

Group Chief Financial Officer's review continued

Looking ahead

Our performance for the year ended 30 June 2022 provides a solid foundation for future sustainable growth. In the context of an uncertain global environment, our focus remains firmly on pursuing our strategic plan and delivering on the FY2024 financial guidance provided.

The targeted reshaping of our Commercial business over the past few years, together with our ongoing focus on developing and evolving our product portfolio, is expected to continue to yield results, notwithstanding the challenging trading environment. Our Manufacturing performance in FY2023 will be impacted by the declining demand for COVID-19 vaccines from Johnson & Johnson, while replacement volumes from Aspenovax are uncertain. We expect to deliver organic CER revenue growth from between 3% and 7% (excluding potential Aspenovax orders), with sales heavily weighted towards the second half of the year.

Despite the benefit of ongoing cost of goods savings initiatives, the potential lower contribution from vaccines and ongoing inflationary pressures are expected to dilute our gross margin percentage. We will maintain strong control of our operating expenses, and expect these to continue to track below the percentage growth in revenue. The current upward trajectory in global interest rates is, however, expected to weigh on financing costs in the 2023 financial year. We will continue to focus on generating positive free cash flows and we anticipate achieving our operating cash conversion target of at least 100%, provided that the global supply chain landscape returns to normalised levels.

The signature of the long-term agreement with Serum Institute, coupled with the anticipated endorsements and grant funding to be received from each of the Bill & Melinda Gates Foundation and CEPI, provides a solid foundation for Aspen's sterile capacity fill strategy with sustainable benefits expected to be realised from FY2024 onwards.

Financial metrics on track to meet financial medium-term guidance to FY2024

Target		Achieved
Increase from rebased FY2020 EBITDA margin of 25,8%	→	28,5% EBITDA margin
EBITDA growth > Revenue growth	→	EBITDA growth of 13% > Revenue growth of 5%
NHEPS > EBITDA growth	→	NHEPS growth of 26% greater than EBITDA growth of 13%
Leverage ratio no greater than 3x	→	Significant headroom providing capacity for value-enhancing investments
Improving free cash flow	→	Lower FCF in FY2022 impacted by increased strategic inventory investment which should normalise in FY2023
Recommence dividends	→	Recommenced from FY2021 and declared for FY2022

Closing remarks

It has been both a challenging and deeply rewarding year for me as I have transitioned into the role of Group Chief Financial Officer. I am grateful for the support received from my colleagues at Aspen and the Board, and especially the continued guidance and mentorship from Gus Attridge, who I have worked with closely over my 26-year career at Aspen. I have been warmly received by our investors, funders and business partners and look forward to their continued support of Aspen. I would like to extend a sincere thanks to the finance team members across our operations who have worked diligently throughout the financial year to achieve strong financial discipline and meaningful financial reporting.

Sean Capazorio
Group Chief Financial Officer