

Strategically more than the sum of the parts

11 March 2020

AorTech have announced the proposed acquisition of the partner in their vascular business – RUA Medical Devices Ltd for £2.45m. RUA Medical is a stand-alone cash-generative, medical device and development company. The cash element of the acquisition is funded from existing resources and the stock element at £1 is a premium of 34% to the last close price. RUA's cost equates to 1.5x FY 2019 sales and 8.5 times EBITDA. Subject to shareholder approval, the deal should close post financial year-end, not affecting FY2020 estimates.

A strategically sensible move

AorTech continues its renaissance with the strategically sensible acquisition of RUA Medical Ltd. – already the partner in AorTech's Vascular business – for £2.45m. This transaction has a number of positive attributes:

- The acquisition transforms AorTech from a virtual business into a fully formed ISO-accredited, FDA authorised medical device manufacturer.
- RUA is **cash generative** in its own right, with revenues that have grown from £0.6m in 2013 to £1.6m in the year to April 2019.
- The full internalisation of the Vascular business will **double** AorTech's margin when the products are commercialised.
- The cash and mostly stock acquisition will be funded from AorTech's existing resources and **the combined business will be known as RUA Life Sciences**.
- As a transaction valued at just over 1.5X RUA's FY 2019 sales and one that brings new medical device competences and customers, AorTech seems to have ticked both boxes of **strategy and value**.

Our valuation of the proposed combined company includes RUA's revenues at the same 1.5 times multiple that AorTech are paying. This is lower than the 9.8X we have used for AorTech's royalty business because, as a manufacturer, RUA's profitability is lower than AorTech's royalty/licensing business although we expect RUA's recently added capacity to result in higher future manufacturing revenues.

Our fair value would change to £101.2m or 689p / share (previously £99.2m or 676p / share) on a pro forma basis that takes account of the additional shares issued. The largest components of our valuation remain AorTech's products which are valued on transaction multiples based on the historical acquisitions of similar products.

Summary Financials

£'000s, y/e 31 March	2017A	2018A	2019A	2020E	2021E
Revenues	614	404	463	2164	2297
Reported EBIT	-237	-34	-631	-476	-872
Basic EPS (US c / UK p)	-4.26c	-0.61c	-4.72p	-2.94p	-4.27p
Net Assets	1318	1016	3000	4240	3809
Net Cash	114	422	2412	1873	1412

Source: Company historic data, ED estimates (assuming deal completes on proposed terms)

EPIC	AOR
Price (last close)	74.5p
52week Hi/Lo	114p / 40p
Market cap	£10.9m
ED valuation/share * £101.2m / 689p	
Estimated net cash, Mar '20	£1.9m
Avg. daily volume	28,152

*assuming deal closure

Share Price, p



Source: ADVFN

Description

AorTech International PLC is incorporated in the UK and focused on the commercialization of its own world leading biostable co-polymer technology, Elast-Eon.

Elast-Eon is a basis for medical devices with improved clinical outcomes and durability. AorTech has three divisions, AorTech Royalty that receives the licensing and royalty fees on Elast-Eon, AorTech Vascular that is a collaboration with RUA Medical to develop biostable surgical patches and grafts, and the AorTech Heart valve.

AorTech's shares are listed on the UK London Stock Exchange's Alternative Investment Market.

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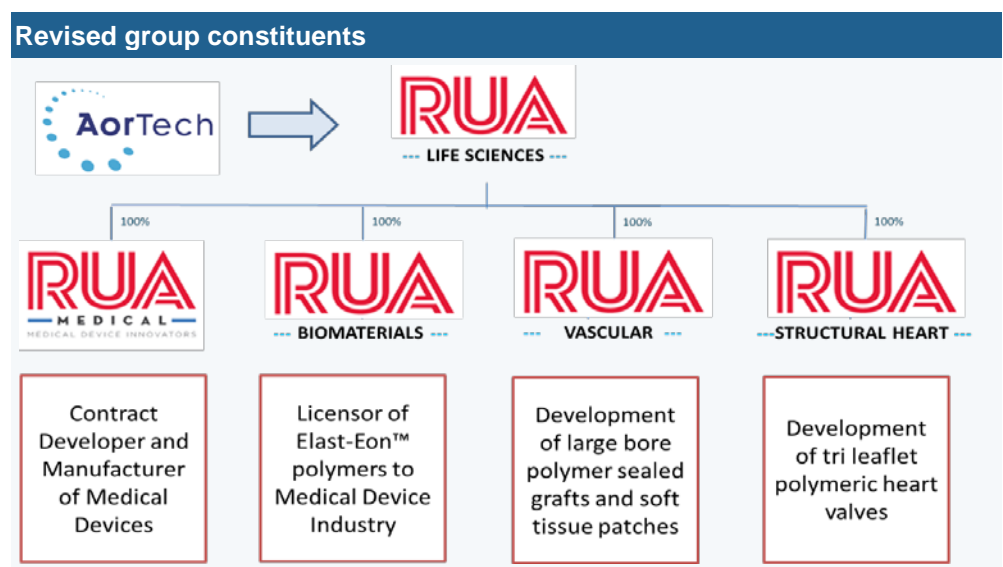
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The transaction

In our [recent initiation note](#) on AorTech, we included RUA Medical as AorTech's partner in its Vascular business segment. AorTech is now acquiring RUA Medical for £2.45m, or 1.5X RUA's FY 2019 revenues or 8.5X EBITDA. The divisional structure that we illustrated in our note, has been expanded to include RUA Medical (see below). Once the transaction has completed, the company will be renamed **RUA Life Sciences plc** and will be comprised of four divisions.

Two of these divisions will be **profitable** – RUA Biomaterials and RUA Medical. RUA Biomaterials is the division we termed AorTech Royalty in our previous note and collects royalty and license fees from the manufacture and use in medical devices of AorTech's proprietary biostable co-polymer, Elast-Eon. The new RUA Medical will be the existing contract medical device development business of RUA Medical.



Source: Company

RUA Life Sciences product divisions

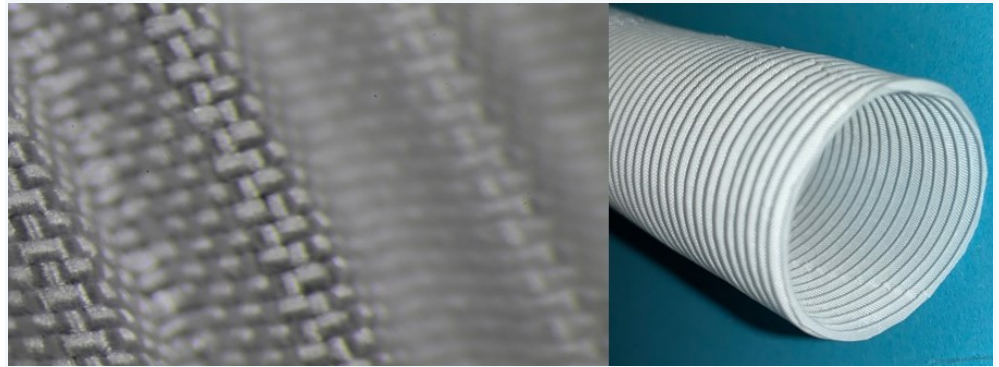
The two product divisions will be called RUA Structural Heart and RUA Vascular. Apart from the change of name from AorTech Heart Valve to RUA Structural Heart, the existing aortic heart valve division emerges from the transaction unchanged. The announcement of the transaction stated that the developments at both product divisions are progressing well.

AorTech Vascular, set to be known as RUA Vascular is a collaboration to develop medical devices constructed of medical grade fabric or textile-based products that can be coated with Elast-Eon to result in biostable implantable medical devices. While the simplest product for the collaboration to develop would be the implantable soft tissue surgical patch – which prevents the adhesion and scarring of internal organs to underlying tissue after surgery – the second product in the collaboration; the large bore surgical device, is being developed first.

This is because the formation of a cylindrical graft vessel, its sealing, shaping and Elast-Eon coating, are more complex than the development of the patch. Large-bore surgically implanted grafts are used to repair tears or pressure-induced distortions in arteries for example, that if not repaired, have a very high mortality rate.

Examples of the products under development in RUA Vascular division are shown below:

RUA Medical graft and patch products



Source: Company

It is expected that the large-bore graft (RHS in the diagram above) will start animal implantations in the next quarter with a US 510k regulatory submission in Q1 2021. The LHS in the diagram above is a close-up of an Elast-Eon-coated graft. The lower level of complexity and testing required for the patch product means that the timeframe for the regulatory submissions for both products within RUA Vascular will be similar. Our initiation note also discussed a combination product that includes an aortic graft and heart valve replacement which we expect to be the third product to be developed at RUA Vascular.

Advantages of the transaction

As a stand-alone company, we had estimated AorTech's FY 2020 royalty and licensing revenues to be about £0.5m growing by 8.0%. The addition of RUA Medical's revenues, which we estimate could double in the next five years as RUA's additional manufacturing capacity and new customers come on stream. For the moment, we have not included this higher revenue contribution from RUA Medical in the combined company and forecast that the combined FY 2021 revenues will be £2.3m. Our model only assumes that the historical revenue growth rates for RUA Biomaterials and RUA Medical will continue.

The transaction would bring RUA Medical's medical device capabilities and implantable medical device manufacturing capacity from its clean room facilities under the umbrella of the combined company. From a RUA Medical perspective, the combination of the two companies diversifies the revenue flows of the combined group as 90% of its revenues were from one customer.

Our pro forma valuation

In our initiation note on AorTech, we valued the product businesses using the value of very similar acquisitions of aortic heart valves or vascular products, discounted back to AorTech's stage of development and risk adjusted. Our valuations of these product divisions are unchanged as a result of the transaction completing.

We continue to value AorTech's royalty business (to be called RUA Biomaterials) on a 9.8X multiple of revenue, based on the comparative multiples of similar life science businesses.

The one minor change to our valuation would be the inclusion of RUA Medical's revenues to the combined business which we value at the same 1.5x multiple that AorTech has paid to acquire the business.

Taking into account the new shares issued, adding AorTech and RUA Medical's pro forma cash, we determine a valuation for the proposed combined business of £101.2m or 689 pence per share.

Valuation components (£m)		Valuation Summary (£m)	
Comparable exit valuation heart valve	214	Risk-adjusted heart valve valuation	35.6
Time to heart valve transaction (years)	5	Risk-adjusted vascular valuation	56.7
Target rate of return (preclinical)	12.5%	Intrinsic valuation	92.4
Lerner's VC heart valve valuation	118.8	Implied AorTech Royalty valuation	4.5
Risk adjustment	30%	Implied RUA Medical sales valuation	2.4
Risk-adjusted heart valve valuation	35.6	Estimated FY 2020 Cash	1.9
Comparable exit valuation vascular	227		
Time to exit vascular (years)	4		
Target rate of return (preclinical)	12.5%		
Lerner's VC vascular valuation	141.8		
Risk-adjustment	40%	Total valuation	101.2
Risk-adjusted vascular valuation	56.7	Per share valuation (p)	689

Source: Company historic data, ED estimates assuming deal completes, press reports on exits

Forecasts

Consolidated Income Statement & Forecasts					
£'000s, y/e 31 March	2017A	2018A	2019A	2020E	2021E
IFRS Income Statement					
Total revenue	614	404	463	500	2297
Administration expenses	-559	-474	-841	-994	-2517
Other income (expense)		255	7	7	7
Depreciation & amortisation	-292	-219	-218	-92	-144
Reported EBIT	-237	-34	-631	-597	-872
Reported profit before tax	-237	-34	-609	-597	-872
Taxation					100
Reported Net income	-237	-34	-609	-597	-772
Basic EPS (c before 2019, p after 2019)	-4.26	-0.61	-4.72	-3.94	-4.77
Diluted EPS (c before 2019, p after 2019)	-4.26	-0.61	-4.72	-3.94	-4.77

Source: Company historic data, ED estimates assuming deal completes, from 2020 onwards
pro forma numbers of the combined AorTech and RUA Medical business are shown

Consolidated Balance sheet & Forecasts					
£'000s, at y/e 31 March	2017A	2018A	2019A	2020E	2021E
Assets					
Non-current assets					
Tangible assets			1	2	1084
Goodwill					1275
Intangible assets	914	527	448	355	355
Total non-current assets	914	527	449	357	2714
Current assets					
Trade and other receivables	392	134	238	234	330
Cash and equivalents	114	422	2412	1870	251
Total current assets	506	556	2650	2104	638
Total assets	1420	1083	3099	2461	3352
Equity and liabilities					
Equity					
Ordinary shares	15189	12118	12574	12574	12649
Share Premium	3133	2500	4550	4550	5645
Retained earnings	-2511	-11599	-12208	-12787	-13138
Foreign exchange reserve	8752				
Other reserve	-23245	-2003	-1916	-1916	-1916
Equity attributable to the company	1318	1016	3000	2421	3240
Total equity	1318	1016	3000	2421	3240
Current liabilities					
Trade and other payables	-102	-67	-99	-40	-112
Total current liabilities	-102	-67	-99	-40	-112
Total non-current liabilities					
Total equity and liabilities	1216	949	2901	2381	3128

Source: Company historic data, ED estimates assuming deal completes, from 2020 onwards
pro forma numbers of the combined AorTech and RUA Medical business are shown

Consolidated Cash flow Statement & Forecasts

£'000s, y/e 31 March	2017A	2018A	2019A	2020E	2021E
Profit before taxation	-237	-34	-609	-1120	-1064
Adjustment for:					
Depreciation & amortisation	292	219	218	92	144
Movements in working capital	-212	162	-73	-56	-41
Net cash generated by operating activities	-200	347	-422	-543	-669
Investing activities					
Capital expenditure on tangibles					
Capital expenditure on intangibles		-16			
Acquisition of subsidiary			-139		
Net cash used in investing activities		-16	-139		
Financing activities					
Net proceeds from issue of shares			2552		
Net cash from financing activities			2552		
Net cash from discontinued operations					
Cash & equivalents at beginning of year	314	91	422	2413	1870
Cash & equivalents at end of year	91	422	2413	1870	251

Source: Company historic data, ED estimates assuming deal completes, from 2020 onwards pro forma numbers of the combined AorTech and RUA Medical business are shown



Investor Access

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