

RUA Medical now a done deal

31 March 2020

Following the EGM on the shareholder vote for AorTech's acquisition of RUA Medical, we have taken the opportunity to review the new expanded management team and the sensitivities around our valuation. The latter remains unchanged despite the recent market turmoil as the key valuation drivers remain acquisitions of the vascular and heart valve products which are based on historical transactions.

A bigger company, in revenues and expertise

AorTech's £2.45m mainly stock, and cash acquisition of RUA Medical Devices Limited was approved by shareholders at the EGM on March 31. The transaction brings 'in house' AorTech's partner in the development of its vascular products. The acquisition of RUA Medical also brings increased revenues for the combined company (which we now estimate at £2.2m for FY 2021) plus an enlarged management team with extensive medical device experience.

Cash component partly deferred

In another positive RNS announcement, AorTech and David Richmond, sole RUA Medical shareholder, AorTech board member and its new CEO, have agreed to defer 45% of the cash component for up to two years from completion. A payment in April 2021 is contingent on the financial performance of RUA and, while both companies are operating during the coronavirus pandemic, we have deferred the contingent payment until FY 2022. Our revenue estimates have been adjusted to assume flat FY 2021 revenues.

Valuation sensitivities

In our note on the announcement of the proposed acquisition of RUA Medical, our valuation barely changed. This was because the increased revenues soften the expected cash burn associated with increased development costs of AorTech's heart valve and vascular products as they progress.

We have taken the opportunity to run sensitivity analyses on the key valuation variables (which are predominantly the exit valuations of the vascular and heart valve products on acquisition). That suggests **the stock-market is assigning very low probabilities of success** for both products and/or extended timelines for their acquisition or licensing.

Our fair value for the combined entity is unchanged at £101.2m or 689 pence per share, despite the recent market turmoil.

EPIC	AOR
Price (last close)	70p
52week Hi/Lo	114p/40p
Market cap	£10.3m
ED value / share	£101.2m/689p
Estimated net cash, Mar '20	£1.9m
Avg. daily volume	28,152

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. In early 2020, AorTech announced the acquisition of RUA Medical to retain the Vascular business in the combined company

AorTech's shares are listed on the UK London Stock Exchange's Alternative Investment Market and will change its name to RUA Life Sciences plc.

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Summary Financials

£'000s, y/e 31 March	2017A	2018A	2019A	2020E	2021E
Revenues	614	404	463	500	2164
Reported EBIT	-237	-34	-631	-579	-958
Basic EPS (US c / UK p)	-4.26c	-0.61c	-4.72p	-3.94p	-5.30p
Net Assets	1318	1016	3000	2421	3579
Net Cash	114	422	2412	1870	590

Source: Company historic data, ED estimates

New company name and supplemented team

AorTech's acquisition of RUA Medical was approved at its EGM on March 31. We expect the next news will be AorTech's FY 2020 financial results announcement followed by its interim results. It is intended to change the name of the combined company to RUA Life Sciences plc, but this is subject to Company's House commencing normal operations again after the coronavirus pandemic.

The acquisition of RUA Medical brings with it not just the revenues from a profitable designer and developer of medical devices, its manufacturing facilities, but also a proven management team. Their expertise comes from having worked on medical devices such as those in AorTech's Vascular division and Lombard Medical's approved Aorfix endovascular stent graft.

The AorTech side of the business retains the staff responsible for collecting the licensing and royalty revenues on ElastEon in AorTech Royalty (to be called RUA Biomaterials) and the heart valve product in AorTech Heart (to be called RUA Structural Heart). The addition of RUA Medical bolsters the senior executive team with the appointment of a CEO, a COO and Directors of Operations and R&D. The existing RUA Medical business will become RUA Medical Device Innovations and the combined Vascular business – RUA Vascular – will contain resources from both progenitor businesses. The Director of Clinical Marketing, CFO and Executive Chairman come from the AorTech side and brief biographies of the leadership team are provided below:

RUA Life Sciences – new Management team

Bill Brown, Executive Chairman

Bill joined the board of AorTech in 2011 and became Chairman in 2012. Bill is a chartered accountant with over 30 years of advising and investing in high growth smaller companies. He has floated several companies and had significant experience in fund-raising, transactions and restructurings. Since 2011, Bill has been instrumental in the realignment of AorTech to monetise its core technology.

David Richmond, CEO

David founded RUA Medical Ltd in 2004. David built RUA Medical using his background in fabric manufacturing and design into a fully-integrated medical device contract design, development, manufacture and packaging company. David was previously CTO at Lombard Medical and has been a non-executive director of AorTech since June 2018.

Kate Full, CFO

Kate was AorTech's Company Secretary and CFO. Kate is a qualified accountant whose experience includes professional practice at PwC and Tenon, venture capital and financial leadership. Kate is part-time CFO for other medical device companies – Vascular Flow Technologies Ltd and Sirakoss Ltd.

Caroline Stretton, COO

Caroline was RUA Medical's CEO having joined in 2018 from medical device manufacturer Touch Bionics where she was responsible for global manufacturing operations, quality and customer support. Touch Bionics was sold to the Icelandic medical device company Ossur. Prior to 2013, Caroline gained a broad range of experience at Teva Pharmaceuticals, Ocutec and Mpathy Medical – a medical device company that was sold to Denmark's Coloplast in 2010.

John McKenna, Director - Clinical Marketing

John is a leading expert in the field of cardiovascular medical devices with over 30 years' experience in cardiothoracic surgery. John has helped develop and launch a number of successful medical devices including heart valves, large vessel grafts and stents. John has established European distribution networks for medical devices and OEM supply agreements, particularly for heart valve related products. John has extensive contacts with both leading heart surgeons and medical device companies having worked at Pfizer, Vascutek (now Terumo) and CryoLife.

Source: Company

Sensitivity analyses on our valuation

In our initiation note, we deferred a sensitivity analysis until a later note for the sake of brevity. We considered a Monte Carlo analysis around our valuation but have narrowed our sensitivity analysis for two reasons:

- Firstly, stock returns are not normally distributed since they are based on human decision-making rather than natural processes. Stock returns are leptokurtic, having much higher peaks at the mean (most investors doing the same thing) and with fatter tails (more outliers at the extremes of the distribution) than the normal distribution. This would render a Monte Carlo valuation analysis based on a non-normal distribution invalidated.
- The second reason is that we have used two probability distributions in our valuation – those for the probabilities of success for the heart valve and vascular products (which are currently at the same preclinical stage) and those for the risk-adjustment of the transactions occurring and partially, the risk of the products (which are at different stages for the heart valve and vascular products). This would make for a very unwieldy analysis with separate probability distributions.

Instead, we have focussed our sensitivity analyses on one of the key valuation drivers in Lerner's VC valuation methodology – the number of years to the transaction – plus the risk-adjustment on the transaction occurring in that time.

In addition, we have also examined the effect that varying the multiples we apply to AorTech's and RUA's revenues has to our valuation. We had considered this variable to be a minor part of our original valuation of AorTech.

Cash component of the transaction deferred

In a positive RNS announcement just prior to the EGM, the AorTech directors and David Richmond, sole RUA Medical shareholder and new CEO, have agreed to defer 45% of the cash component for up to two years from the completion date. Potentially, the deferred cash payment could occur in April 2021 but would be contingent on the financial performance of RUA. We had previously included the full cash consideration payable in FY 2020. While both companies are operating during the coronavirus pandemic, we have prudently deferred the contingent payment until FY 2022. Despite both companies operating during this pandemic, the only other change to our financials is to forecast flat sales between FY 2020 and the end of FY2021.

Valuation sensitivity to time and probability of success

We have used a sensitivity table to examine the effect of changing the time to an exit transaction for both AorTech's products. In our valuation we have assumed that the time to exit for the vascular and heart valve products are four and five years, respectively. The left-hand column in the sensitivity below includes decreases in this time by one and two years (which results in a higher per share valuation). We have also modelled a much wider range of delays to the transaction (which result in lower per share valuations), up to an additional 41 years to each exit to illustrate investors' implied expectations of the transactions as reflected in AorTech's share price.

The boxed columns and rows represent our base case valuation which cross to give our valuation of 689p per share. Increasing the number of years for an exit to both products *decreases* the per share valuation and we have extended this to 41 years which results in a valuation close to the current share price.

It would appear from the 0% change in risk-adjustment column alone that investors' expectations for time taken for a transaction in both products is considerably longer than our assumptions. In these uncertain times during the global coronavirus pandemic, it is understandable that a 'risk-off' strategy applies for most equity investors. **But to almost exclude the possibility of either transaction occurring seems to us an over-reaction.**

£ / share value sensitivity to changes in risk-adjustment and years to exit

		Change in the risk-adjustment (for both products)						
		-35%	-30%	-20%	-10%	0%	+10%	+20%
Change in the number of years to exit	+41	0.60	0.61	0.62	0.64	0.65	0.66	0.72
	+20	0.61	0.69	0.86	1.03	1.20	1.36	2.04
	+10	0.62	0.90	1.44	1.99	2.54	3.08	5.27
	+4	0.65	1.20	2.31	3.42	4.53	5.63	10.06
	+1	0.67	1.46	3.04	4.61	6.19	7.77	14.08
	0	0.68	1.57	3.34	5.11	6.89	8.66	15.76
	-1	0.69	1.69	3.68	5.68	7.67	9.67	17.66
	-2	0.70	1.82	4.07	6.31	8.56	10.81	19.79

Source: ED estimates

By the same token, the change in the risk-adjustment row adds or subtracts additional or reduced risks to the likelihood of a transaction in both products. Our base case assumes these risk-adjustments to be 30% and 40% for the heart valve and vascular products, respectively. In the boxed row that reflects our current expectations for the number of years to exit (0 meaning no additional or no reduction in time), the 35% column results in a share price valuation close to the market price for AorTech. This implies investors' expectations that a transaction in either product is unlikely to occur.

With the recent falls in global equity markets, it is not unexpected to see investors raising the company-specific risk for loss-making life science companies but in these cases the market often over-reacts, and we would suggest that close to a zero percent risk-adjustment for a transaction in either product indeed appears an over-reaction.

Valuation sensitivity to AorTech's revenue multiple

In our initiation note, we derived a 9.78 x multiple for AorTech's revenues based on the average of two other life science services businesses (Evotech and AbCam). In addition, our slightly revised valuation on the announcement of the RUA acquisition used the 1.50 x acquisition multiple that AorTech were paying for RUA as the revenue multiple used to value RUA Medical's sales incorporated into the combined business. We have not included any growth in revenues in our valuation of the combined business but reserve judgement on including this based on AorTech's FY 2020 results commentary. In the short-term, and due to the coronavirus pandemic, the absence of growth in our revenue forecasts for valuation purposes, and in our financials, appears prudent.

The Table below determines the effect of the change in revenue multiples from our current assumptions (9.78 x for AorTech and 1.50 x for RUA Medical) on our per share valuation of the combined company. As we have suggested in the past, **the revenues** of AorTech, and now the combined company, **are not key drivers of our valuation**.

If the multiple applied to RUA Medical was the same as AorTech's, which may be achieved by cross-selling RUA Medical's services to AorTech's existing customers and the combination of the two companies commercial expertise, then the table below suggests that a useful, if marginal valuation increase could be generated.

Per share sensitivity of to changes in revenue multiples (£)			
AorTech's revenue multiple		RUA's revenue multiple	
6.00	6.77	0.50	6.78
7.00	6.80	1.00	6.83
8.00	6.83	1.50	6.89
9.00	6.96	2.00	6.94
9.78	6.89	2.50	7.00
10.00	6.90	3.00	7.05
11.00	6.93	9.78	7.80

Source: ED estimates

Our valuation and financials remain unchanged

It is clear from the difference between our per share valuation of the AorTech business combined with RUA Medical and the current share price, that the stock-market's expectations for a transaction on either the vascular or heart valve businesses are very low.

This is a combination of the lack of appetite for loss-making life science companies in the midst of the coronavirus epidemic, and perhaps the long history of AorTech. The acquisition of RUA Medical brings a refreshed management team and competences to the combined company.

Consequently, over the medium term as progress is made on RUA Life Sciences' product portfolio, we would expect those advances to be reflected in the market's valuation of the company. We have not made changes to our valuation and have only amended the timing of the cash component of the transaction, and flat revenues between FY 2020 and FY 2021 in our financial estimates since our prior note on the acquisition of RUA Medical.

Our valuation overleaf for the combined business remains unchanged at £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%		
Lerner's VC heart valve valuation	118.8	Intrinsic valuation	92.4
Risk adjustment	30%		
Risk-adjusted heart valve valuation	35.6	Implied AorTech Royalty valuation	4.5
		Implied RUA Medical sales valuation	2.4
Comparable exit valuation vascular	227	Estimated FY 2020 Cash	1.9
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, 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	2164
Administration expenses	-559	-474	-841	-994	-2486
Other income (expense)		255	7	7	7
Depreciation & amortisation	-292	-219	-218	-92	-144
Reported EBIT	-237	-34	-631	-579	-958
Reported profit before tax	-237	-34	-609	-579	-958
Taxation					100
Reported Net income	-237	-34	-609	-597	-858
Basic EPS (c before 2019, p after 2019)	-4.26	-0.61	-4.72	-3.94	-5.30
Diluted EPS (c before 2019, p after 2019)	-4.26	-0.61	-4.72	-3.94	-5.30

Source: Company historic data, ED estimates, 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	590
Total current assets	506	556	2650	2104	977
Total assets	1420	1083	3099	2461	3691
Equity and liabilities					
Equity					
Ordinary shares	15189	12118	12574	12574	12649
Share Premium	3133	2500	4550	4550	5645
Retained earnings	-2511	-11599	-12208	-12787	-12799
Foreign exchange reserve	8752				
Other reserve	-23245	-2003	-1916	-1916	-1916
Equity attributable to the company	1318	1016	3000	2421	3579
Total equity	1318	1016	3000	2421	3579
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	3467

Source: Company historic, ED estimates, from 2020 onwards, pro forma numbers of the combined businesses are shown

Consolidated Cash flow Statement & Forecasts

£'000s, y/e 31 March	2017A	2018A	2019A	2020E	2021E
Profit before taxation	-237	-34	-609	-1212	-1163
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	-755
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		-525
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	590

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



Investor Access

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