Johnson Matthey
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Johnson Matthey announces sale of Health

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Overview

Robert MacLeod

Chief Executive, Johnson Matthey

So good morning, everyone, and thank you for joining this call. And I'm joined today with – by our Chief Financial Officer, Stephen Oxley.

Hopefully, you'll all have seen our announcement this morning that we've agreed the sale of our Health business to Altaris Capital Partners, a leading healthcare investment firm for an enterprise value of £325 million.

During the call this morning, I want to take you through the rationale and transaction details and give you the opportunity to ask any questions you may have.

As the world transitions to more sustainable technologies, we are focusing our portfolio on core growth areas, specifically, businesses driving growth from climate change solutions, including hydrogen technologies, the decarbonisation of chemicals and the creation of a circular economy.

We have a disciplined approach to capital allocation focused on those areas of the business where we can deliver growth and attractive returns. Of course, with an appropriate balance of shareholder return and risk.

Back in April of this year, we announced the strategic review of our Health business. And following this review, we've concluded that Health is no longer core to JM and have today announced its sale. Health operates in different markets from the rest of the Group, and we need to focus our resources on more attractive growth areas.

While this business has good long-term prospects, near-term trading has been challenging, largely due to labour market shortages in the US and to pricing pressure in our speciality opioids generics business.

In addition, we would need to invest significantly, meaning, today's announcement will avoid around £150 million of capital expenditure over the next three years.

Altaris is a specialised investment firm entirely focused on the healthcare industry. It has completed 25 carve-outs and corporate partnership transactions to-date and has a strong track record in building companies that deliver innovation and efficiency to the healthcare system.

We believe that Altaris is an excellent fit for Health's management, employees, customers, and broader stakeholders and also the right partner to drive future value in this business. And we will benefit from future upside by retaining around a 30% interest in the business.

So, looking at the structure of the deal in more detail. We've sold Health for an enterprise value of £325 million, an implied multiple of around ten times EBITDA for the last 12 months to 30th September 2021.

Net cash proceeds are expected to be around £150 million on completion. And there's also a £50 million payment contingent on achievement of certain performance targets in fiscal year '23 and fiscal year '24 and an additional £50 million in deferred consideration, which will accrue interest at 8% per annum.

As mentioned, we want to participate in the future value creation, and have therefore retained around a 30% equity stake in the new holding company, valued today at £75 million.

Altaris has a successful track record, and we would expect significant additional value over time from this equity interest. Completion and expected proceeds are expected in mid-2022 and will be subject to usual regulatory approvals.

So hopefully this gives you some content on the structure of the agreement and that you heard it this time. And hopefully, we can now take questions, if you have any. And apologies once again for the technical problems at the start.

Q&A

Operator: Thank you. To ask questions, you will need to press star one on your telephone. To withdraw your question, please press the pound or hash key. Your question comes from the line of Alex Stewart from Barclays. Please ask your question.

Alex Stewart (Barclays): Hi there. Good morning.

Robert MacLeod: Hi Alex. I hope you heard it the second time.

Alex Stewart: I did. It was all the better for having to wait for it. Thank you very much. I had a few questions actually mostly on the structure of the transaction. So, my maths suggest that the £250, sorry £150 straight up plus £50 contingent on performance plus £50, so that's £50 that's almost 80% in the company rather than 70%. I believe you can clarify that. I'm a little bit confused about this loan note structure and how it works and why you offered that there rather than just receiving the money upfront if you can maybe talk about that. And then you put a note to the release saying Altaris includes the right to a 8% cumulative return in preference to JM's equity interest. I assume that that's the same thing; it's not clear whether that's an 8% return on the whole deal or on that loan note.

And then finally which isn't by the deal structure, you talked to the interim results about some of these issues with Health being transitory, particularly the loss of key personnel, regulated personnel, which is not something which affects sales of your drugs. If it is transitory, why sell the asset now rather than wait until those issues have passed and you can realise a more fair or sustainable level of earnings before you try and sell of the business. So, any thoughts on those would be really interesting. Thank you.

Robert MacLeod: Sure. So, look, I'll start with the sort of why now and then I'll pass over to Stephen to just go through the deal structure, if that's all right.

Look, I think we said a few minutes at the results, yes, that there was some challenges in the business but we absolutely look to the strategic review. We thought – and we concluded that this business was ultimately non-core to JM, and we wanted to focus on these other areas of growth that we have across the business, as I mentioned, already in hydrogen technologies, decarbonisation of chemicals and in circularity. And of course, continuing to deliver the cash flow from clean air.

And the work that will be required to restructure and navigate through the challenges ahead for the Health business, the capital requirements that we had to put into the business meant that we felt that actually it was better for us to sell to a specialist company, who will provide real focus on the health business and give us the opportunity to participate in some of the upside in the future. And that was a better thing for us to do today and allow us to focus, as I said, our resources and our management attention on the other areas of growth across the company. And that's why we decided to do it today.

Stephen, do you want to go through a little bit of the deal structure?

Stephen Oxley: Yeah. Alex, good morning. Let me walk you through that. So, what we've said is that the deal has an enterprise value of £325 million. For us, that's £150 million in cash on completion. There's a £50 million loan note that we pick up and then £50 million contingent consideration. That leaves a balance of £75 million of equity to bring our share at 30%.

That obviously means that the Altaris' share at 70% is worth £175 million. The way that works is that they're giving us £150 million and putting £25 million of working capital into the business. So that's the structure. And as Robert said, we expect the deal to complete in our Q1.

I think Alex you then asked a question about the – I think the preferred stock, which I suspect you picked up in the footnote to our release. So, the way that the deal is structured is that we expect a – to realise significant sort of value to the transaction. That value, of course, when Altaris comes to sell it will be split 70-30.

The deal structure though does have some downside protection for Altaris if the deal or the business does not perform. And that means that their equity has preference over Johnson Matthey's equity, and they have a roll up cumulative 8% return, which protects the downside for them.

Alex Stewart: Okay. So, in other words, you pay out 70-30 once you hit the 8% annualised return ratio?

Stephen Oxley: Yeah. If the – when they come sell the deal, if the deal is obviously more than the value of their equity rolled up, then we'll pay out – each will pay out 70-30.

Alex Stewart: Okay. And on those loan notes, sorry, who is receiving the interest, the 8% interest?

Stephen Oxley: So, we will receive 8% interest cumulative on our £50 million loan note.

Alex Stewart: And why don't they just give you the cash upfront?

Stephen Oxley: Well, from that perspective, they've obviously wanted to limit the day one cash. That's the way that we hope have structured it.

Alex Stewart: Part of negotiation, okay.

Stephen Oxley: Absolutely. Yeah.

Alex Stewart: Thank you very much. It's very helpful.

Stephen Oxley: Okay. Thanks, Alex.

Operator: Your next question is from the line of Andrew Stott from UBS. Please ask your question.

Robert MacLeod: Good morning, Andrew.

Andrew Stott (UBS): Yeah, good morning, Robert. Good morning, Stephen. Yeah, simple question. Steven, the joint venture, which it is, I guess, even if there's a controlling partner. How will it – how much will it be levered? So, on day one, what's the net debt to EBITDA of the JV? I'm just trying to think of the risk of not getting those future payments.

Robert MacLeod: So, in – on day one, we mentioned that they will put in £25 million of equity. So, they will put in £25 million in additional to the £150 million cash. And that's the only initial leverage that will be in the business. So, it will be not very levered at all.

Stephen Oxley: Well, that's on – Robert, that's on day one.

Robert MacLeod: On day one.

Andrew Stott: Presumably there will be a net debt to EBITDA number that you are attached to from day one, right?

Stephen Oxley: Yeah, the way it works, so on day one it won't be levered. I would expect them to lever up the business at some point. After that, that will obviously have no more banking covenants and restrictions around that on normal commercial terms.

Andrew Stott: Yeah.

Stephen Oxley: From our perspective, we will not equity account for this business. We do not have significant influence over the business. So, we'll hold this as a trade investment at £75 million. Obviously, when the business is sold and assuming the business trades well, that's when we'd to expect to realise 30% of our gain opposite the trade investment.

Andrew Stott: Okay. And –

Stephen Oxley: It won't be a complicated JV that affects Johnson Matthey's ongoing accounting.

Andrew Stott: No. Yeah. Okay. I get that. And then just for the earn-outs.

Stephen Oxley: Yeah.

Andrew Stott: As in details, can you detail that?

Stephen Oxley: Yeah. It's an earn-out based on financial performance. It's actually a gross profit performance in the first two years. That's obviously there to recognise the expectation of the business will reflate, given some of the issues that it's seeing in the recent period.

Andrew Stott: Yeah. And then sorry final question. The £75 million equity stake that you're valuing, that's on the ten times EBITDA. Is that how you calculated it or – I mean, I suppose, let me ask it another way. How do we think about the upside and downside risk to that £75 million when you come to sell?

Stephen Oxley: Yeah. Well, the £75 million is essentially the portion of the enterprise value that we're not receiving in cash or other forms of consideration. The way I'd think about the £75 million is that Altaris will target a meaningful return on its investment, over what period that might be, probably four years or so. They are typically targeting three plus times investment, maybe more on the basis that the investment or the business is depressed as of now. So that gives you an indication of where the £75 million could move to.

Andrew Stott: And the earliest point at which you could sell that?

Stephen Oxley: It will be Altaris' sale of the business.

Andrew Stott: It's their decision but do they not have a stock date or –

Robert MacLeod: They don't have a stock date, Andrew. It will be when they think they can maximise their return from their investments.

Andrew Stott: Okay. Okay. Thanks a lot. Thanks for taking the questions.

Robert MacLeod: Thanks, Andrew.

Operator: Once again, for any questions, please press star one on your telephone. Your next question comes from the line of Sebastian Bray from Berenberg. Please ask your question.

Sebastian Bray (Berenberg): Hello.

Robert MacLeod: Good morning, Sebastian.

Sebastian Bray: Hello, good morning, Robert, and thank you for taking my questions. I would have two please. Just to come back to Andrew's earlier point on upside/ downside scenarios for the stake. Is there – if this deal looks like it's going to go well for Altaris, my understanding of how this mid market piece sometimes works is that the original owners of a company can be progressively bought out, i.e., let's say after two years Altaris could come back to Johnson Matthey and say, well, we like what's happening here, let's give you some cash for the remaining purchases and as opposed to waiting for an external buyer. Could this happen in this case?

And my second question is more on Johnson Matthey as a potential acquirer. Are there any – how to put this? Do you have your nose in the air, so to speak, for smaller bolt-on technological acquisitions, given the balance sheet that is improving and net proceeds coming in? Or are all of these sort of activities effectively on hold until the new CEO joins? Thank you.

Robert MacLeod: So, look, thank you, Sebastian, for your questions. Look, as far as JM is concerned at the moment, we're carrying on business as usual. We're not stopping. And of course, if we see attractive technologies and things that makes sense for our business focusing on our three pillars that we talked about before, obviously, we would look to invest in those.

On the small sort of – small bolt-on technology type areas, I do think a larger deal or anything like that, which is not our core area anyway is unlikely to happen. But absolutely from a technology point of view from bolt-ons we would continue to look at those and indeed are. Stephen, do you want to answer the question about the sales process?

Stephen Oxley: Yeah, of course. Morning, Sebastian. In answer to your question, no, there are not any buyout provisions in the sale agreement. Of course, Altaris would come to us any point with an offer, and we just assess that if and when that came.

Sebastian Bray: Thank you. Could I just ask one more on buyback? Can I firstly just confirm it's still the intention in calendar 2022 as opposed to fiscal 2022 to start £200 million? And there is no change to the plan either this size or plan timing? And in terms of timing, what time of the year, calendar year 2022 are we talking about for this? Thank you.

Stephen Oxley: Yeah. So, there's absolutely no change to the buyouts I announced with our half year results, the £200 million. That will commence – well, we said it would commence in the new year. Actually, we can commence now on that. We were holding back given this transaction for obvious reasons. We will conclude that, Sebastian, as quickly as we can through FY22.

But nothing changes as a result of that. The reason I've not updated that, of course, is that this transaction will complete in FY23, which is after our new Chief Executive has joined. So, I think it's appropriate that we review the strategic options for the business including investment opportunities and indeed capital allocation again at that stage. But you should certainly expect the £200 million buyback to fully conclude.

Sebastian Bray: And just to clarify, you're going to start buying back stock Monday next week or what is the way you think about –

Stephen Oxley: Yeah, we will look to start straight away.

Robert MacLeod: Well, let's not be precise on the exact date but we are absolutely now pre-unencumbered to start the process and we'll work with our brokers to do so.

Sebastian Bray: That's understood. Thank you for helping with my questions.

Robert MacLeod: Are there any other questions?

Operator: Once again for any questions, please press star one on your telephone keypad. We have one more just waiting for the name to be taken sir.

Robert MacLeod: Okay. Thank you.

Operator: Once again for any questions, you may press star one on your telephone keypad. Your question is from the line of Riya Kotecha. Please ask your question.

Riya Kotecha: Hi. Thanks for the conference call this morning.

Robert MacLeod: Good morning.

Riya Kotecha: I'm asking about the performance targets that you must achieve by '23, '24. Are you able to give us some colour on this? At the previous results, you abandoned the £100 million operating profit by 2026. And given sort of the equity structure of 70-30, who is then sort of responsible for hitting these targets, and just some more colour on what they sort of look like if you're able to give that, please?

Stephen Oxley: Yeah, look, so the targets have been set obviously in the sale and purchase agreement. The business will be run from completion under Altaris' ownership as the majority holder. The targets are struck on a gross profit number over those two years. In other words, this is a trading business as opposed to anything that somebody can do with the cost base below trading. I'm not going to give you the precise – we're not going to give you the targets, but that's the way we've structured it to make sure that we can benefit from the reflating and early performance of the business as it turns around.

Riya Kotecha: Okay. Thank you.

Robert MacLeod: Okay. Unfortunately, I don't think we can give you any more details on that one. And we'll – it was based on the business plan, but that's all we can say at the moment. Operator, any other questions? I don't think the team can see any more.

Operator: There are no further questions. Please continue.

Robert MacLeod: Well, look, thank you very much for dialling in. I – once again, sincere apologies for the problem at the start of the call. But thank you very much for dialling in, and we're all in slightly difference places working from home in this strange world. Let's hope next time we can be together. And thank you very much. So, you all have a very happy holidays and see you in the new year. Take care.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

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