

INSTEM

SOFTWARE AND COMPUTER SERVICES

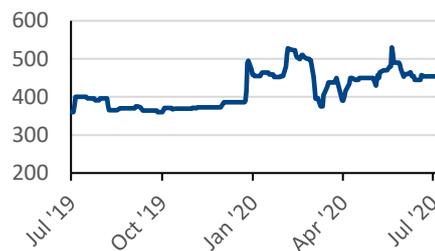
20 July 2020

INS.L

454p

Market Cap: £93m

SHARE PRICE (p)



12m high/low 530p/360p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£21.4m (at 31/12/20)
Enterprise value	£71.6m
Index/market	AIM
Next news	Interims, Sep-20
Shares in Issue (m)	20.5
Chairman	David Gare
Chief Executive	Phil Reason
Finance Director	Nigel Goldsmith

COMPANY DESCRIPTION

Instem is a leading provider of IT solutions & services to the life sciences market.

www.instem.com

INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

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Strong trading, successful fundraise

Instem's H1 20E trading update confirms that trading was in line with the Board's expectations during the period. The group also reported double-digit organic revenue growth and strong operational cash generation for the period. Instem has also now received shareholder approval for the (oversubscribed) placing of 3.6m new ordinary shares at a price of 435p, raising approximately £15.0m net of expenses. Additionally, three members of the Board have sold 0.7m shares at the same price. The placing and the team's sales represent 17.7% and 0.9% respectively of the Group's enlarged share capital, which will significantly increase the free float of the group's shares. The proceeds from the primary placing will be used to advance existing acquisition targets in line with the group's stated M&A strategy.

- H1 20E trading in line, strong revenue growth and cash generation:** The release confirms that H1 20E trading was in line with the Board's expectation and remains so in the early part of the second half. All areas of the business continue to perform well, with H1 20E revenues growing by approximately 20% at the group level. Organic revenue growth (i.e. ex the November 2019 Leadscope acquisition) saw an impressive 12% like-for-like increase YoY. Operational cash generation was strong in H1 20E, with the group seeing a £3.1m improvement in the cash balance to £9.1m. Note this figure excludes the £15.0m fundraise, which was completed post period-end.
- Fundraise to advance the group's growth strategy:** M&A is a key element of the group's growth strategy, with the aim being to consolidate the highly- fractured pharmaceutical software market. The Group has successfully completed six transactions post- IPO (2010), evidencing, we believe, a strong track record in M&A. Having just raised £15m net of expenses, the group has significant firepower to progress acquisitions. We understand that the group has a pipeline of strategic deals ranging from bolt-ons to strategic transformations. All are expected to be earnings enhancing in year one.
- Increased free float a further positive:** In addition to the 3.6m new ordinary shares sold via the placing, Directors David Gare, Phil Reason and David Sherwin have sold a combined 692,066 shares. The aggregate effect of these sales will significantly increase the group's free float, which we believe will be warmly welcomed by the financial community.

FYE DEC (£M)	2018	2019	2020E	2021E	2022E
Revenue	22.7	25.7	28.8	30.9	32.7
Adj EBITDA	4.1	4.9	5.8	6.3	7.0
Fully adj PBT	3.0	3.7	4.1	4.3	4.8
Fully adj EPS	15.5	18.4	17.3	16.3	18.1
EV/Sales	3.2x	2.8x	2.5x	2.3x	2.2x
EV/EBITDA	17.7x	14.7x	12.3x	11.4x	10.2x
PER	29.3x	24.7x	26.3x	27.9x	25.0x

Source: Company Information and Progressive Equity Research estimates

This publication should not be seen as an inducement under MiFID II regulations.

Please refer to important disclosures at the end of the document.

Positive trading update

In our view, Instem has released a positive update on trading performance in H1 20E, with the following highlights:

- **Strong revenue growth:** Against a macro-economic backdrop impacted by the COVID-19 pandemic, all areas of the Instem business are performing well, continuing a positive trend highlighted in the H1 19A results and repeated in the FY 19A announcement. H1 20E saw 20% YoY headline revenue growth in the first half of 2020E. Organic revenue growth was an impressive 12% YoY.
- **A positive start from Leadscope:** The Leadscope business (acquired November 2019) saw a particularly strong performance, due to revenue synergies being realised earlier than management had originally anticipated. The addition of Leadscope to the group has significantly enhanced the group's abilities in AI-based in-silico R&D.
- **Strong cash performance:** Operational cash generation was strong during the period, with the gross cash balance seeing a £3.1m improvement over the H1 19A level to £9.1m. This figure excludes the £15.0m fundraise, which was completed post-period-end. Note, the £24.1m gross cash position represents over a quarter of the current market capitalisation, and the group currently maintains a significant net cash position.
- **Trading remains in line entering H2 20E:** The release confirms that the group continues to trade in line with management's expectations during the early part of H2 20E. The board is confident that the group is well placed to capture emerging opportunities in both existing and adjacent markets in 2020 and beyond.

Fundraising to advance growth strategy

In raising £15.0 net of expenses – almost twice the closing April-20 cash balance of £8.3m, we believe that Instem has placed itself in a strong position to execute a number of M&A opportunities. M&A is a key element of Instem's growth strategy, with the group aiming to consolidate the highly- fragmented pharma software market. We believe the group has a strong track record of successful M&A, as evidenced by the group having successfully completed six transactions post-IPO.

The group's M&A strategy is to focus on both gaining footholds in adjacent markets, but also increasing presence in existing markets. Management is looking to make acquisitions in three areas:

- INSTEM Regulatory Solutions: Standard for Exchange of Nonclinical Data ("SEND") and corresponding clinical standard Study Data Tabulation Model ("SDTM")
- INSTEM Study Management: Good Laboratory Practice ("GLP") and Non-GLP Study Management
- INSTEM Informatics: expansion in *in-silico* research and development including Predictive Analytics and Insights.

Management is evaluating several prospects generating revenue in the \$2 - \$20m pa range. With the group expected to report FY 20E revenue of £28.8m, this range encompasses bolt-on type deals up to transformational acquisitions. Management believe each would be highly complementary, low-risk and earnings accretive in year one.

Forecast revisions

We make no changes to our underlying operating forecasts following the fundraising, and we incorporate the cash raised and the revised number of shares in issue. In addition, we process an increase to our estimate for the amortisation of right of use assets under IFRS 16. The impact of these changes on forecasts compared to our previous forecasts is contained in the following table, and we believe that our new estimates will be in line with revised consensus expectations following the fundraising. Our revised net cash forecasts, which are presented pre-IFRS 16 liability, are displayed overleaf.

Instem – forecast revisions						
£m unless stated	FY 20E			FY 21E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	28.8	28.8	0.0%	30.9	30.9	0.0%
Adj EBITDA	5.8	5.8	0.0%	6.3	6.3	0.0%
Fully adj PBT	4.7	4.1	-12.9%	4.9	4.3	-12.2%
Fully adj EPS (p)	22.7	17.3	-23.8%	23.3	16.3	-30.3%

Source: Progressive Equity Research estimates

Financial Summary: Instem

Year end: December (£m unless shown)

	2018	2019	2020E	2021E	2022E
PROFIT & LOSS					
Revenue	22.7	25.7	28.8	30.9	32.7
Adj EBITDA	4.1	4.9	5.8	6.3	7.0
Adj EBIT	3.2	4.0	4.3	4.5	5.0
Reported PBT	1.7	(0.9)	2.8	3.1	3.6
Fully adj PBT	3.0	3.7	4.1	4.3	4.8
NOPAT	2.4	3.4	3.5	3.6	4.0
Reported EPS	8.7	(5.4)	11.4	10.9	12.9
Fully adj EPS	15.5	18.4	17.3	16.3	18.1
Dividend per share	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	1.8	5.7	3.6	4.9	4.8
Free Cash flow	0.6	4.1	1.3	3.5	4.3
FCF per share	3.3	23.8	6.9	16.4	20.2
Acquisitions	(0.2)	(1.3)	(0.3)	(0.3)	(0.4)
Disposals	0.0	0.0	0.0	0.0	0.0
Capex	(1.6)	(1.4)	(1.4)	(1.4)	(1.4)
Shares issued	0.1	0.6	15.0	0.0	0.0
Net cash flow	0.5	2.4	16.9	2.5	3.4
Cash & equivalents	3.6	6.0	22.9	25.4	28.9
Net (Debt)/Cash	3.6	5.1	21.4	24.2	28.0
NAV AND RETURNS					
Net asset value	16.4	16.8	33.8	39.6	43.3
NAV/share	105.1	106.1	164.8	193.2	211.5
Net Tangible Asset Value	(1.0)	(1.3)	19.0	24.3	26.8
NTAV/share	(6.5)	(8.4)	119.8	118.8	131.1
Average equity	15.1	16.6	25.3	36.7	41.4
Post-tax ROE (%)	9.7%	(5.6%)	8.7%	6.3%	6.6%
METRICS					
Revenue growth		13.3%	12.0%	7.2%	5.9%
Adj EBITDA growth		20.0%	19.8%	7.8%	11.4%
Adj EBIT growth		24.7%	8.4%	5.7%	10.3%
Adj PBT growth		23.4%	9.3%	6.4%	11.4%
Adj EPS growth		N/A	(6.2%)	(5.7%)	11.4%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		15.4%	14.9%	14.7%	15.3%
VALUATION					
EV/Sales	3.2	2.8	2.5	2.3	2.2
EV/EBITDA	17.7	14.7	12.3	11.4	10.2
EV/NOPAT	30.1	20.8	20.4	19.7	17.9
PER	29.3	24.7	26.3	27.9	25.0
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	0.7%	5.2%	1.5%	3.6%	4.5%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

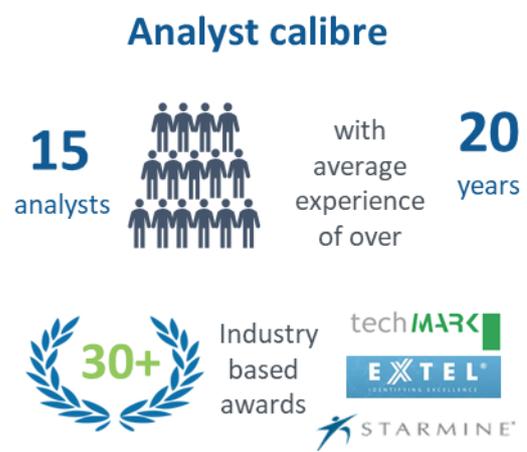
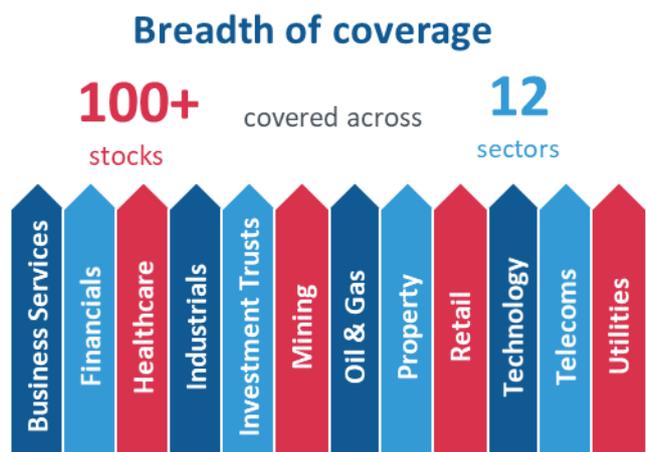
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