

# INSTEM

## SOFTWARE AND COMPUTER SERVICES

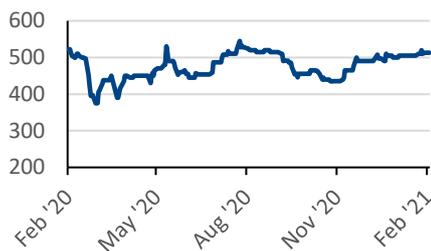
1 March 2021

INS.L

513p

Market Cap: £106.8m

### SHARE PRICE (p)



12m high/low

545p/375p

Source: LSE Data

### KEY DATA

Net (Debt)/Cash	£26.7m (at 31/12/20)
Enterprise value	£80.1m
Index/market	AIM
Next news	FY20 results, April '21
Shares in Issue (m)	20.8
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](http://www.instem.com)

INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

### ANALYSTS

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## Strengthening the position in Discovery

Instem has announced the (*earnings enhancing*) acquisition of UK-based Discovery software solutions provider The Edge Software Consultancy Ltd (“The Edge”) for a total consideration of up to £8.5m. The Edge provides technology and services aimed at improving the efficiency of drug discovery R&D, essentially bridging the gap between research & IT. A strong fit with Instem’s existing Study Management business in our view, the deal appears a well-considered and useful extension to the Instem platform. We increase forecasts following the announcement, with FY 22E revenue and adjusted EPS increased by 9% and 22% respectively.

- Deal structure:** Instem has acquired The Edge, a safety assessment software provider based in the UK. The consideration is £6.0m initially - satisfied by £4.0m in cash from existing reserves and £2.0m via the issuance of new ordinary shares, £0.5m of deferred consideration and up to a further £2.0m payable contingent on the future performance of The Edge. The Edge is both growing and profitable and we estimate the total potential consideration equates to c7x EBITDA in the first full-year of consolidation.
- About The Edge:** The Edge is focused on improving the efficiency of early-stage drug R&D, improving productivity and ensuring high-quality data capture from every study and experiment. The business has an established client base across the pharma, biotech and animal health sectors.
- Potential for growth:** The Edge will be integrated into Instem's Study Management and Data Collection business, with the acquisition extending Instem's reach into the closely adjacent Discovery Study Management market. The release highlights the complementary nature of Instem's and The Edge's solutions and there is significant scope post-acquisition to drive growth by cross-selling new products to existing Instem clients.
- Accretive deal, forecasts increased:** For FY 21E, we upgrade revenue, EBITDA and adjusted EPS by 5%, 9% and 12% respectively. FY 22E, the same metrics increase by 9%, 17% and 22%.

Successful M&A execution is a core Instem strength in our view and the release confirms that the group has a strong pipeline of M&A opportunities. We believe The Edge is a very positive addition to the Instem family and see strong potential for revenue synergies and increased recurring revenue streams.

FYE DEC (€M)	2018	2019	2020E	2021E	2022E
Revenue	22.7	25.7	28.8	32.5	35.7
Adj EBITDA	4.1	4.9	5.8	6.8	8.2
Fully adj PBT	3.0	3.7	4.1	4.9	6.0
Fully adj EPS (p)	15.5	18.4	17.3	18.2	22.2
EV/Sales	3.5x	3.1x	2.8x	2.5x	2.2x
EV/EBITDA	19.8x	16.5x	13.7x	11.7x	9.8x
PER	33.1x	27.9x	29.6x	28.2x	23.1x

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.

## Background on The Edge

Founded in 2005 and based in Guildford, UK, The Edge is focused on improving the efficiency of early-stage R&D in the life sciences, improving productivity and ensuring that the data from every study and experiment are captured with high quality. The business offers a full lifecycle solution for discovery biologists, and the functionality of its key BioRails and Morphit products are summarised in the following graphic.

### The Edge – key products



# BioRails

#### **BioRails Platform – A comprehensive platform for managing processes and data**

BioHub™ - A single consolidated store for all your corporate knowledge

BioRails PTO – Project Tracking and observation

BioRails DM – Data Management

BioRails MT – Material registration for Biospecimens, Biologics, and formulations

BioRails INV – Inventory control, ordering and tracking



# Morphit

#### **Morphit - Spreadsheets evolved**

**Collections** – All you need to analyse your data

Used by leading bio/pharmaceutical companies and their contract research organizations to increase efficiency, ensure quality and drive- up productivity whilst retaining innovation.

*Source: Company data*

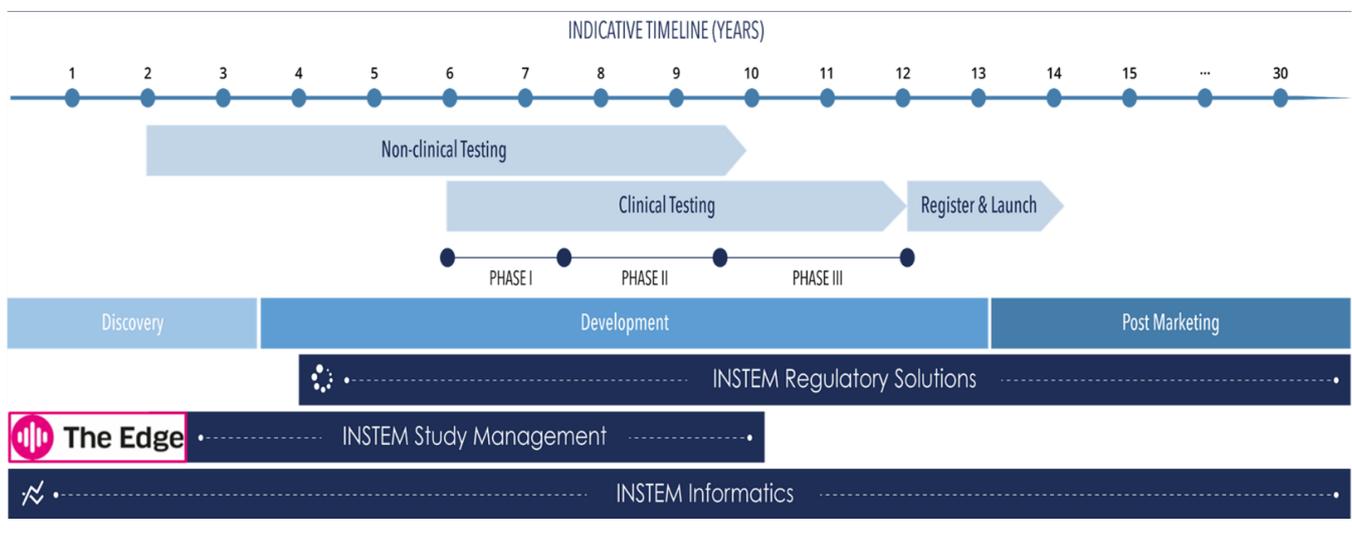
The company currently has 16 employees. The majority are based in Guildford and all are expected to remain with the Instem group post-acquisition, including the four co-founders.

The business is both growing and profitable. For the twelve months ending July 2020, it delivered sales of £2.7m and normalised PBT of £1.7m. Of the £2.7m, £0.8m was recurring revenue.

### Strong strategic and operational fit with Instem

We believe The Edge has a strong fit with the existing Instem business. Instem's solutions have a greater focus on drug development. The Edge is focused on drug discovery. The following graphic matches Instem's product set to the drug development cycle and illustrates where The Edge fits into the Instem group.

**Instem – Position in the drug development lifecycle**



Source: Company materials

As the image demonstrates, The Edge targets an adjacent market to Instem’s Study Management business, and we believe the acquisition to be highly complementary:

- Instem’s Provantis suite can be used in drug discovery but is designed primarily for more structured studies that require the rigorous quality and compliance processes that support regulatory submission. The Edge broadens the Instem suite in early-stage R&D where agility in study design and conduct is much more important, increasing the group’s data management and solutions reach. The Edge has particular strengths in the Drug Metabolism & Pharmacokinetics (DMPK) field.
- The broadened product set offers strong cross-selling opportunities. In particular, many big pharma companies undertake very early-stage R&D in house before outsourcing later stages to CROs (Contract Research Organisations). The Edge acquisition allows Instem to market to pharma clients before they outsource and also provides a solution for CROs, who are increasingly trying to expand their services into the Discovery phase.
- The Edge historically used the common software business model of perpetual licence sales supplemented with support and maintenance. Today the business follows a similar business model to Instem’s Study Management business, charging an annual subscription fee. This brings further recurring software revenues to Instem.

### Structure of the deal

The initial consideration for the deal was £4.0m in cash, funded from existing resources. A further £2.0m was paid via the issuance of 392k new ordinary shares in Instem Plc.

The transaction also includes deferred and contingent consideration depending on the future financial performance of The Edge.

The deferred consideration involves the cash payment of £0.5m payable to the vendors on the twelve-month anniversary of completion.

The contingent element (earnout) of £2.0m is payable in cash, contingent on The Edge achieving certain (undisclosed) EBITDA targets in the twelve months post completion. Up to £1m is to be paid on or before the fifteen-month anniversary of completion, with the remainder payable on the twenty-fourth month following completion.

The maximum possible consideration for The Edge acquisition is therefore £8.5m. Of that figure, 71% is payable upfront, 6% is deferred and 23% of the total is contingent on The Edge's financial performance in the twelve months post-completion.

We make two key observations on the deal structure:

- With a maximum consideration of £8.5m, we believe the deal represents a useful bolt-on addition to the Instem group. c47% of the consideration was paid upfront in cash, so cash outflow on the deal in FY 21E will be relatively modest.
- The Edge reported revenue of £2.7m in the twelve months ending July 2020 and normalised PBT of £1.7m. We estimate that Instem is paying c7x EBITDA in the first full year of consolidation (FY 22E) for a business in an exciting area and one, we believe, with an opportunity to turn good growth into exceptional growth. Joining Instem will create further opportunities for The Edge, in particular, the business should have even greater success in winning new contracts as part of the much larger Instem group.

## Forecast changes

Following the deal, we make changes to forecasts as shown in the table below. Note fuller financials are detailed overleaf.

Forecast changes following The Edge acquisition									
£m unless stated	FY 20E			FY 21E			FY 22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	28.8	28.8	0.0%	30.9	32.5	5.3%	32.7	35.7	9.1%
Adj EBITDA	5.8	5.8	0.0%	6.3	6.8	8.9%	7.0	8.2	16.5%
Fully adj PBT	4.1	4.1	0.0%	4.3	4.9	13.3%	4.8	6.0	24.6%
Fully adj EPS (p)	17.3	17.3	0.0%	16.3	18.2	11.6%	18.1	22.2	22.4%

Source: Progressive Equity Research estimates

- The acquisition has been made in the FY 21E financial year, and the group is expected to report FY 20E financials in April 2021. We have made no changes to estimates on the underlying Instem business from those published in our previous research note (January 2021).
- Our model assumes the business will be incorporated for ten months of the current financial year. We have assumed lower perpetual license sales from The Edge going forward, and also that the business continues to deliver higher margins than Instem has historically reported. FY 22E will be the first full-year of consolidation.
- As discussed on page two of this report, The Edge reports impressive profitability and margins. Its addition to the group should therefore accelerate Instem's margin growth towards 25%.
- We forecast the deal to be accretive, with 9%, 17% and 22% respective increases in revenue, EBITDA and EPS in the first full- year of consolidation (FY 22E).

## Summary

- We believe The Edge acquisition is a strategically sensible transaction, with excellent operational fit - particularly with Instem's Study Management division. Based upon our forecasts, the deal is also accretive.
- The Edge itself is an attractive business. In our view joining the Instem platform will provide a major sales boost and global reach.
- Lastly, having made a number of successful acquisitions over the recent past - including BioWisdom (2011), Logos (2013), Perceptive Instruments (2013), Notocord (2016), Samarind (2016) and Leadscope (2019), we believe the Instem Management team has a strong track record on M&A. We look forward to further news post the acquisition, and as The Edge business benefits from its position within the larger group.

**Financial Summary: Instem**

Year end: December (£m unless shown)

	2018	2019	2020E	2021E	2022E
<b>PROFIT &amp; LOSS</b>					
Revenue	22.7	25.7	28.8	32.5	35.7
Adj EBITDA	4.1	4.9	5.8	6.8	8.2
Adj EBIT	3.2	4.0	4.3	5.1	6.2
Reported PBT	1.7	(0.9)	2.8	3.7	4.8
Fully adj PBT	3.0	3.7	4.1	4.9	6.0
NOPAT	2.4	3.4	3.5	4.1	4.9
Reported EPS (p)	8.7	(5.4)	11.4	12.8	16.9
Fully adj EPS (p)	15.5	18.4	17.3	18.2	22.2
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
<b>CASH FLOW &amp; BALANCE SHEET</b>					
Operating cash flow	1.8	5.7	8.9	3.7	4.2
Free Cash flow	0.6	4.1	6.6	2.1	3.5
FCF per share (p)	3.3	23.8	34.3	9.8	20.2
Acquisitions	(0.2)	(1.3)	(0.3)	(4.3)	(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	22.2	(2.8)	2.7
Cash & equivalents	3.6	6.0	28.2	25.3	28.0
Net (Debt)/Cash	3.6	5.1	26.7	24.1	27.1
<b>NAV AND RETURNS</b>					
Net asset value	16.4	16.8	33.8	40.0	44.7
NAV/share	105.1	106.1	164.8	191.7	213.9
Net Tangible Asset Value	(1.0)	(1.3)	19.0	24.8	28.2
NTAV/share	(6.5)	(8.4)	119.8	120.9	135.0
Average equity	15.1	16.6	25.3	36.9	42.3
Post-tax ROE (%)	9.7%	(5.6%)	8.7%	7.5%	8.6%
<b>METRICS</b>					
Revenue growth		13.3%	12.0%	12.9%	9.7%
Adj EBITDA growth		20.0%	19.8%	17.4%	19.3%
Adj EBIT growth		24.7%	8.4%	18.7%	20.9%
Adj PBT growth		23.4%	9.5%	20.5%	22.3%
Adj EPS growth		N/A	(6.0%)	5.2%	21.8%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		15.4%	14.9%	15.6%	17.2%
<b>VALUATION</b>					
EV/Sales	3.5	3.1	2.8	2.5	2.2
EV/EBITDA	19.8	16.5	13.7	11.7	9.8
EV/NOPAT	33.7	23.3	22.8	19.7	16.3
PER	33.1	27.9	29.6	28.2	23.1
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	0.6%	4.6%	6.7%	1.9%	3.9%

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

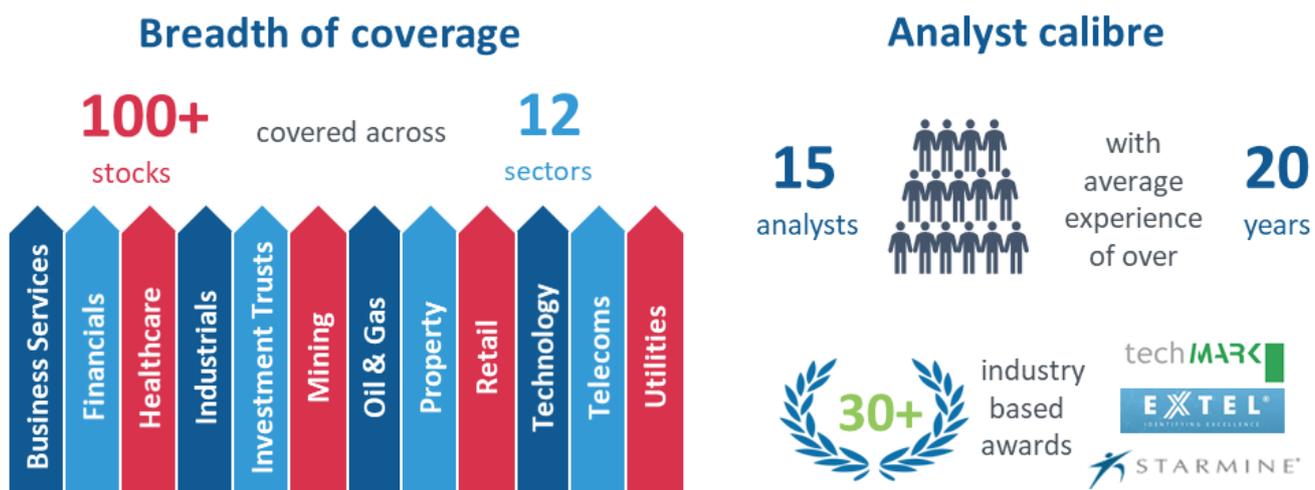
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