

INSTEM

SOFTWARE AND COMPUTER SERVICES

12 April 2021

INS.L

680p

Market Cap: £147.8m

SHARE PRICE (p)



12m high/low

680p/390p

Source: LSE Data

KEY DATA

Net (Debt)/Cash £25.3m (at 31/12/20)

Enterprise value £122.5m

Index/market AIM

Next news Trading Update - Jul-21

Shares in Issue (m) 21.7*

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Chief Executive Phil Reason

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COMPANY DESCRIPTION

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

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INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

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FY 20A: Solid growth, despite COVID-19

Instem has reported FY 20A results consistent with its Jan-21 trading statement and in line with our forecasts. Despite the backdrop of COVID-19, the group once again delivered double-digit revenue growth for the year, alongside margin improvement and cash generation. Furthermore, revenue visibility remains high and all three business areas continue to deliver. In our view, the two acquisitions made during the first half of 2021 have transformed the group. So, while the FY 20A results demonstrate Instem's resilience in the face of COVID-19 driven challenges, they do not reflect the group's significant potential incorporated in our unchanged FY 21E and 22E earnings estimates.

- FY 20A: Revenue growth, margin improvement & cash generation:** The release confirms FY 20A revenue at £28.2m (+10% YoY) and adjusted EBITDA of £5.9m (+22% YoY, margin +210bps). Cash flow pre-financing almost doubled during the period to £5.3m. With a current cash position of c£14m (post payment of initial consideration for the d-wise and The Edge acquisitions), the group's financial position remains robust.
- Revenue visibility remains high:** SaaS revenues are the group's fastest growing product line (+25% YoY) and the ongoing transition to SaaS delivery continues to drive improved revenue visibility. Recurring revenues (+13% YoY) now contribute 60% of the total (58% FY 19A).
- Strong momentum across the group:** The group's three business areas continue to report strong momentum, with each reporting EBITDA growth during the period. Operational highlights of FY 20A include a number of contract wins in both the Study Management and Regulatory Solutions businesses and another doubling of revenues in the In Silico Solutions unit.
- Positive outlook:** The release confirms the group has good visibility for the current year, particularly in growing SaaS revenues, and a strong pipeline. Management also signal their confidence in the outlook for revenue growth, margins and cash generation, with the recent (2021) acquisitions of d-wise and The Edge bringing enhanced scale to the group. The announcement also reveals that discussions are continuing with a number of other potential acquisition targets.
- Earnings estimates unchanged:** We leave FY 21E and FY 22E earnings estimates unchanged following the release and introduce FY 23E forecasts for the first time.

* Includes 0.9m Initial Consideration Shares for the d-wise acquisition.

FYE DEC (€M)	2019	2020	2021E	2022E	2023E
Revenue	25.7	28.2	46.0	56.4	60.9
Adj EBITDA	4.9	5.9	8.6	11.3	13.5
Fully adj PBT	3.7	4.4	5.7	7.9	9.7
Fully adj EPS (p)	18.4	19.1	21.0	28.5	34.8
EV/Sales	4.8x	4.3x	2.7x	2.2x	2.0x
EV/EBITDA	25.2x	20.7x	14.2x	10.8x	9.1x
PER	37.0x	35.6x	32.4x	23.9x	19.5x

Source: Company Information and Progressive Equity Research estimates.

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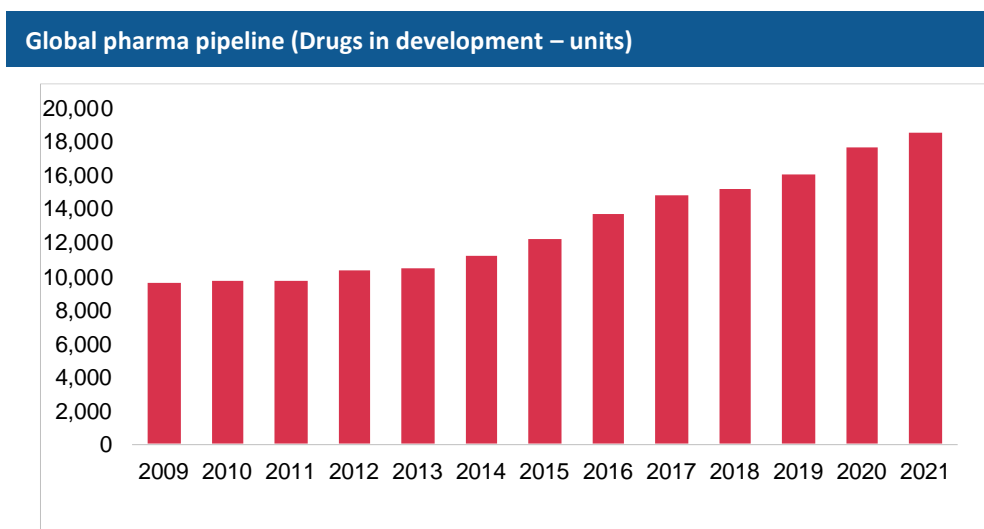
Please refer to important disclosures at the end of the document.

The pharma market remains buoyant

We continue to believe that the overall industry backdrop for Instem remains favourable. The number of drugs currently in development has once again reached record levels in 2021. A further positive for Instem is that early-stage drug development volumes also continue to grow – this is Instem’s key area of focus.

Record number of drugs in development

Global population growth and increasing life expectancy continue to drive demand for innovative life science solutions. A key indicator of general industry health is the size of drug development pipeline, as illustrated in the following chart.



Source: *Pharmaprojects Annual Review 2021*

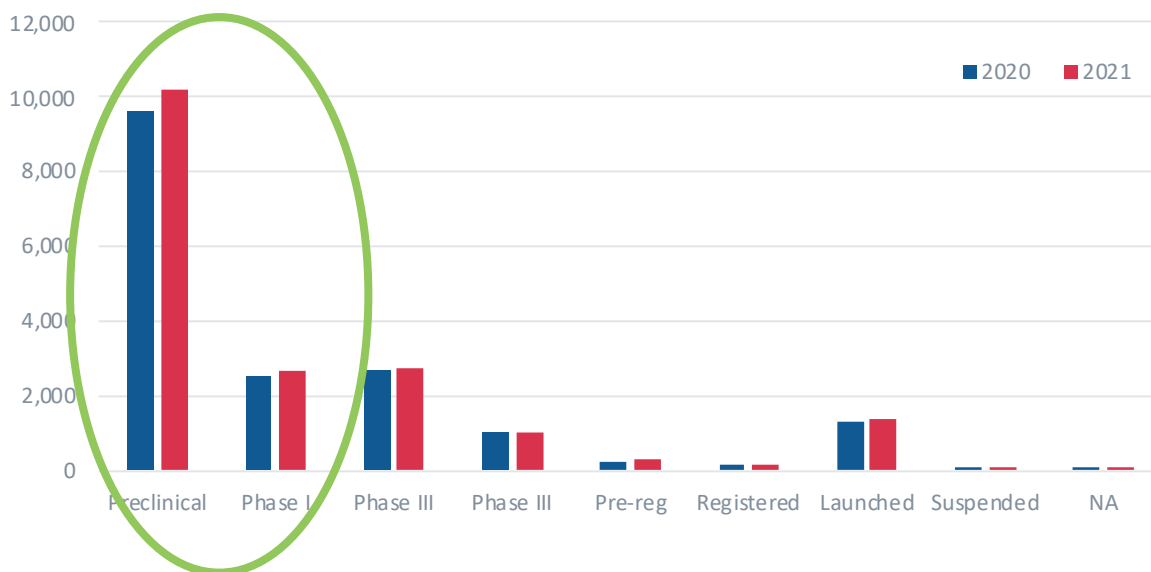
With over 18,500 drugs currently in the global drug development pipeline (+6% YoY), the growth rate has remained solid in 2021. In our view this continues to demonstrate the resilience of the global pharma industry, despite the backdrop of global COVID-19 driven macro- economic uncertainty.

Instem’s solutions allow clients to bring products to market more quickly and at lower cost. The pharma sector represents the largest proportion of the group’s revenue, and as we’ve highlighted in previous research, we believe the size of the pipeline is a key leading indicator of demand trends for the types of software and services provided by Instem. However, in our view growth in the pipeline provides only a general sign of industry health. We note the FY 20A results release highlights the flat revenue performance from Instem’s Study Management division, which was a direct result of the transition to SaaS delivery.

...with good growth in early-stage drug development

Instem focuses on early-stage R&D and the picture here is also positive given that early-stage drug development volumes are both growing and continuing to dominate the overall development pipeline. As demonstrated in the following chart, in 2021 the pre-clinical and Phase I stages continue to report solid growth with both segments reporting a 6% YoY uplift respectively.

Global pharma pipeline (Drugs in development – units)



Source: *Pharmaprojects Annual Review 2021*

FY 20A divisional commentary

The Instem group can be broadly grouped into three areas:

- Study Management & Data Collection
- In Silico Solutions
- Regulatory solutions

The recent d-wise acquisition introduced a fourth business area – “Clinical Trial Acceleration), which will feature in future results releases. In our view Instem’s FY 20A results confirm a continuing favourable trend that we have highlighted in previous post-results commentaries. Each of the three existing business areas continues to demonstrate real momentum – as evidenced by the YoY growth reported in segmental EBITDA for all three segments. Below we present some of the operational highlights recorded during the last financial year.

Study management and data collection (53% turnover FY 20A)

Growth in the Study management division was impacted by the recognition of revenues from certain contracts being recognised in FY 21E rather than FY 20A. Although revenues were broadly stable at £11.5m, EBITDA performance was strong, with the business delivering a 5pp improvement in margin during the year.

Instem signed Korean non-clinical CRO Biototech as a new client during FY 20A, winning a contract worth approximately \$1m for Instem to supply a comprehensive preclinical data collection, analysis and regulatory submission management solution. In addition, the group won a £2.2m contract with an (unnamed) existing client, which has been extended post-period-end. This includes the expansion of said client's existing Provantis user base by over 25%.

Regulatory Solutions (35% turnover FY 20A)

Demand for SEND services remains strong, as evidenced by Instem's £0.7m contract win with an un-named top-30 pharma client during the period.

Furthermore, the £2.2m contract discussed above combines Study Management and Regulatory Solutions products and services. As part of the deal, Instem will provide SEND staff augmentation support, which will act as an extension of the client's staff to help address both current and future demand for SEND study services.

In Silico Solutions (formerly Informatics - 12% turnover FY 20A)

The 2019 acquisition of Leadscope materially broadened the group's In-silico reach, which now encompasses drug discovery through to early deployment. Acknowledging that Leadscope was only consolidated for six weeks of FY 19A, the In Silico business saw impressive growth in revenue and margin during FY 20A,

Financials

- We leave FY 21E and FY 22E estimates unchanged following the announcement. These are detailed on page six of this report and reflect the impact of the two acquisitions made so far in FY 21E.
- Also detailed on page six are our FY 23E forecasts which we are introducing for the first time. In summary, we expect another year of solid revenue growth, with margin expansion and positive cash flow.
- In this note we present a detailed breakdown of our revenue forecasts for the first time. This is contained in the following table.

Instem – revenues FY 20A – FY 23E

£m unless otherwise stated	FY 20A	FY 21E	FY 22E	FY 23E	CAGR
Annual support fees	8.9	14.3	18.5	19.5	30%
SaaS subscription fees	8.0	10.1	12.0	14.8	23%
Licences	3.5	4.2	3.5	3.1	-4%
Professional services	1.6	4.0	4.3	4.4	41%
Technology-enabled outsourced services	6.2	6.8	8.1	8.6	12%
Consulting	0.0	6.6	9.9	10.5	n/a
TOTAL	28.22	46.0	56.4	60.9	29%
% total	FY 20A	FY 21E	FY 22E	FY 23E	
Annual support fees	32%	31%	33%	32%	
SaaS subscription fees	28%	22%	21%	24%	
Licences	12%	9%	6%	5%	
Professional services	6%	9%	8%	7%	
Technology-enabled outsourced services	22%	15%	14%	14%	
Consulting	0%	14%	18%	17%	
	100%	100%	100%	100%	
Revenue % Recurring*	60%	53%	54%	56%	

Source: Company data and Progressive Equity Research estimates

* Annual support fees + SaaS Subscription fees

- We expect annual support fees and SaaS subscription fees to remain the key product lines during FY 20A – FY 23E, reflecting the ongoing transition to SaaS product delivery.
- The flipside of the transition to SaaS is lower licence revenues. Although a relatively small revenue line, we expect that certain clients will continue to prefer to buy perpetual licences and forecast a decline by the end of our forecast period.
- We model professional services to be the fastest growing revenue line FY 20A – FY 23E, albeit from a relatively small FY 20A base. This is largely a function of increasing client funded software development.
- The recent d-wise acquisition brings a new revenue stream to the group – ‘Consulting’, hence zero revenues being recorded in this segment in FY 20A. Note also, FY 22E represents the first full-year contribution from both 2021 acquisitions, d-wise and The Edge. By FY 23E, we expect Consulting revenues to be the group’s third largest business line.
- We forecast that recurring revenue will contribute over half of revenues throughout our forecast period. The relative decline in FY 21E is a function of the d-wise acquisition. We understand d-wise has a high level of repeating business, but recurring revenues are relatively lower than Instem’s. Going forward, we expect Instem to deliver higher levels of recurring revenues as the transition to SaaS delivery continues, but also new business wins within the d-wise business to focus on higher recurring revenues.

Financial Summary: Instem

Year end: December (£m unless shown)

	2019	2020	2021E	2022E	2023E
PROFIT & LOSS					
Revenue	25.7	28.2	46.0	56.4	60.9
Adj EBITDA	4.9	5.9	8.6	11.3	13.5
Adj EBIT	4.0	5.0	6.0	8.2	9.9
Reported PBT	(0.9)	2.5	3.4	6.7	8.5
Fully adj PBT	3.7	4.4	5.7	7.9	9.7
NOPAT	3.4	4.1	4.8	6.5	7.9
Reported EPS (p)	(5.4)	11.6	12.5	24.1	30.5
Fully adj EPS (p)	18.4	19.1	21.0	28.5	34.8
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	5.7	7.7	6.5	8.5	12.8
Free Cash flow	4.1	5.8	4.2	6.5	8.6
FCF per share (p)	23.8	29.7	19.3	29.1	38.3
Acquisitions	(1.3)	(0.3)	(14.8)	(5.2)	(5.0)
Disposals	0.0	0.0	0.0	0.0	0.0
Capex	(1.4)	(1.4)	(2.3)	(2.4)	(2.4)
Shares issued	0.6	15.4	0.0	0.0	0.0
Net cash flow	2.4	20.8	(11.3)	0.9	3.6
Cash & equivalents	6.0	26.7	15.4	16.3	19.9
Net (Debt)/Cash	5.1	25.3	5.7	11.5	15.6
NAV AND RETURNS					
Net asset value	16.8	33.2	34.9	40.3	47.1
NAV/share	106.1	162.3	163.7	186.1	217.5
Net Tangible Asset Value	(1.3)	15.2	20.6	25.8	32.0
NTAV/share	(8.3)	74.3	96.3	119.1	147.5
Average equity	16.6	25.0	34.1	37.6	43.7
Post-tax ROE (%)	(5.6%)	9.1%	8.0%	14.3%	15.6%
METRICS					
Revenue growth		9.7%	63.0%	22.6%	8.0%
Adj EBITDA growth		21.7%	46.0%	30.9%	19.5%
Adj EBIT growth		27.6%	19.1%	36.1%	20.8%
Adj PBT growth		18.5%	30.5%	38.6%	22.7%
Adj EPS growth		N/A	10.0%	35.8%	22.3%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		17.9%	13.1%	14.5%	16.2%
VALUATION					
EV/Sales	4.8	4.3	2.7	2.2	2.0
EV/EBITDA	25.2	20.7	14.2	10.8	9.1
EV/NOPAT	35.6	29.6	25.5	18.7	15.5
PER	37.0	35.6	32.4	23.9	19.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	3.5%	4.4%	2.8%	4.3%	5.6%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

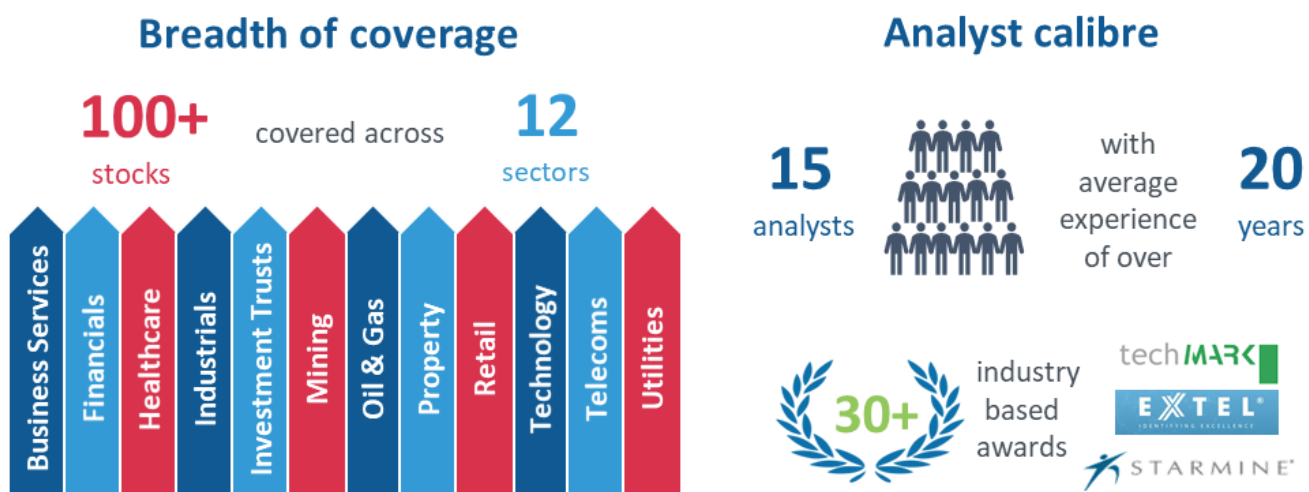
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