

INSTEM

SOFTWARE AND COMPUTER SERVICES

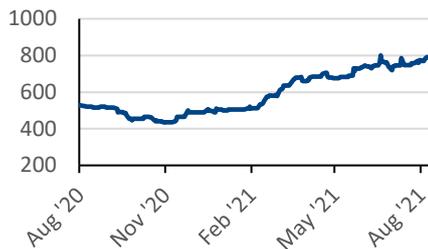
1 September 2021

INS.L

790p

Market Cap: £172.1m

SHARE PRICE (p)



12m high/low

800p/434p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£25.3m (at 31/12/20)
Enterprise value	£146.7m
Index/market	AIM
Next news	Interims, Sep-21
Shares in Issue (m)	21.8
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

INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

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A strategic move in Switzerland

Instem has announced the (*earnings enhancing*) acquisition of PDS Pathology Data Systems Ltd ("PDS") a Swiss-based life sciences software company. The total consideration is up to CHF 14.25m (c£11.4m), subject to adjustments, to be satisfied by a combination of cash and the issue of new Instem shares. We believe the deal is strategically compelling; in addition to removing a key competitor from the marketplace, the acquisition will further strengthen the Instem group's positioning and market share in both Study Management and SEND-related services. We increase forecasts, with FY 22E revenue and adjusted EPS improving by 9% and 4% respectively.

- Deal structure:** Instem is to acquire PDS, a Basel-based provider of life sciences software and services. The consideration is CHF 13.25m initially (c£10.6m), satisfied by CHF 9.75m paid in cash and the issue of CHF 3.5m in new ordinary Instem shares. There is CHF 1m (£0.8m) of deferred consideration, payable in cash upon the 12month anniversary of completion. PDS is both growing and profitable and we estimate the CHF 14.25m maximum potential consideration equates to c2.2x trailing sales.
- About PDS:** PDS has been a direct competitor of Instem for over 25 years. The business provides software and outsourced services for non-clinical study management and regulatory submissions using the SEND standard. PDS has a client list of blue-chip names, with seven of the top ten global pharma companies choosing its solutions.
- Potential for growth:** In our view PDS will further strengthen Instem's leading market position. The release highlights the complementary nature of Instem's and PDS's solutions and with the addition of 30 new clients, we see significant scope post-acquisition to drive growth by cross-selling the wider Instem product and service suite.
- Accretive deal, forecasts increased:** Following the announcement, we upgrade FY 22E (the first full year of consolidation) revenue, EBITDA and adjusted EPS estimates by 9%, 8% and 4% respectively.

Today's announcement confirms Instem's third acquisition of 2021, and we continue to believe that successful M&A execution is a core competence. PDS is a very positive addition to the Instem group in our view and we see strong potential for revenue and cost synergies and increased recurring revenue streams.

FYE DEC (£M)	2019	2020	2021E	2022E	2023E
Revenue	25.7	28.2	47.7	61.5	66.3
Adj EBITDA	4.9	5.9	8.8	12.2	14.9
Fully adj PBT	3.7	4.4	5.8	8.4	10.8
Fully adj EPS (p)	18.4	19.1	21.2	29.7	38.3
EV/Sales	5.7x	5.2x	3.1x	2.4x	2.2x
EV/EBITDA	30.2x	24.8x	16.6x	12.0x	9.9x
PER	42.9x	41.4x	37.3x	26.6x	20.6x

Source: Company Information and Progressive Equity Research estimates.

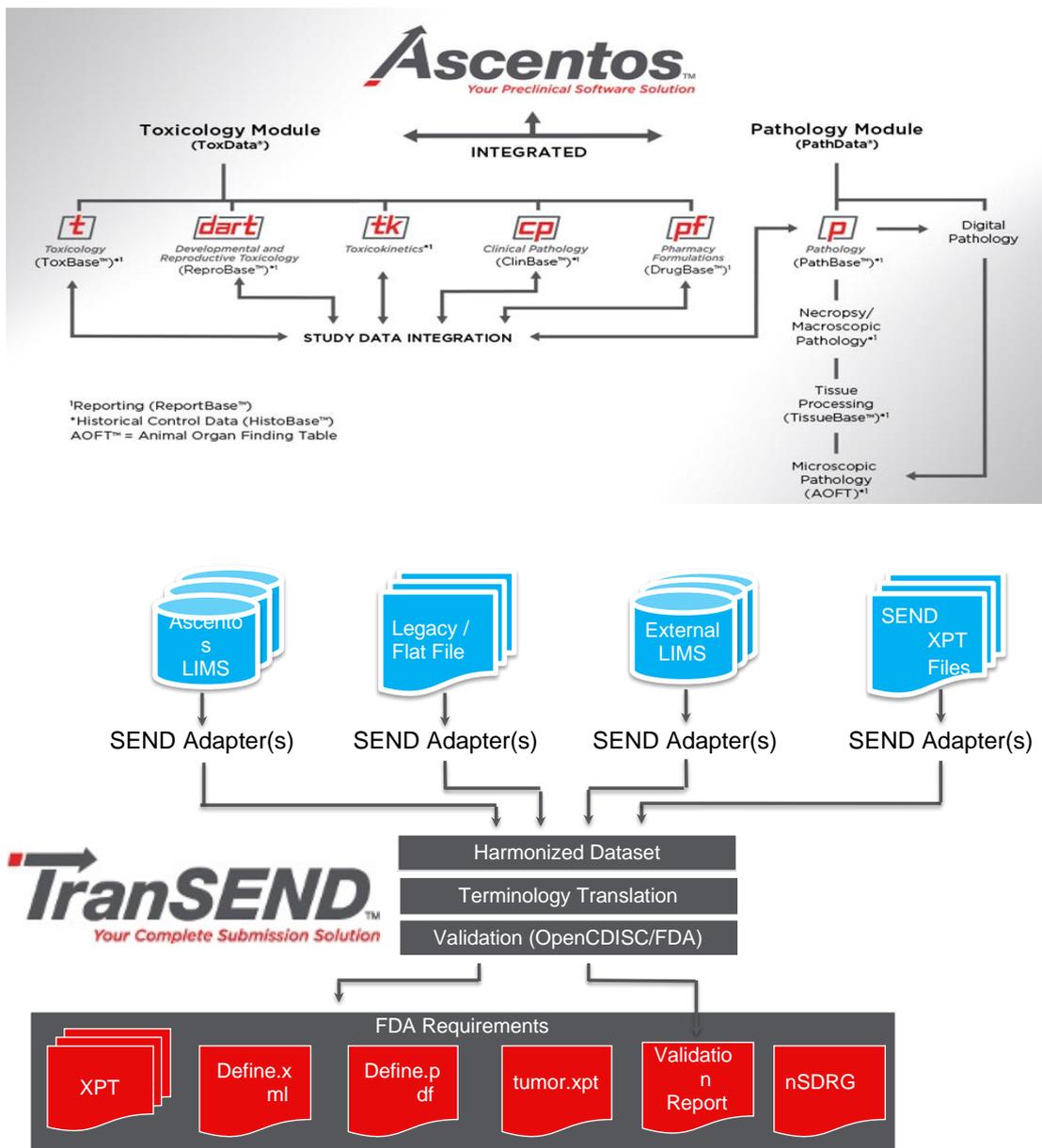
This publication should not be seen as an inducement under MiFID II regulations.

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

Background on PDS

PDS has a history of over 40 years in providing software and services to the life sciences industry. Over recent years, the business has focussed on the two areas of pre-clinical study management and regulatory submission solutions (particularly with the FDA's SEND standard), and PDS is a key competitor to Instem in these areas. The following graphic summarises the key features of PDS's key Ascentos™ and TranSEND™ offerings.

PDS – Core product and service offerings



Source: PDS Company materials

Ascentos™ is PDS's fully-scalable, multi-lingual, SaaS-based Laboratory Information Management Solution ("LIMS") for pre-clinical research. Via ready-made APIs, the platform allows for accelerated integration with other LIMS systems involved in preclinical data collection (e.g. bioanalytical, safety pharmacology, IV infusion). This ensures accelerated setup, elimination of double-entry, improved compliance & accuracy, and synchronized research conduct.

TranSEND™ is an End-to-End ("E2E") SEND submission solution, effectively aggregating and translating data from multiple organizations and LIMS to produce a set of harmonized and validated SEND files, including define.xml, as required by the FDA.

PDS's offerings compete directly with two key Instem solutions:

- Provantis®, Instem's pre-clinical toxicology study management solution competes directly with Ascentos™.
- Instem provides a number of software solutions and services in the pre-clinical SEND space in competition with TranSEND™. These include
 - Submit™ (software for SEND dataset creation and version-controlled file storage)
 - SENDView™ (enables simplified data review and quality control)
 - SEND Explorer (sophisticated data visualization and analytics) and
 - SEND outsourced services (outsourced study services, consulting and training).

Growing and profitable

PDS delivered revenue of CHF 6.5m (c£5.2m) in the twelve months ending December 2020 and normalised PBT of CHF 0.75m (c£0.6m). Of the CHF 6.5m, approximately 35% was recurring SaaS and software maintenance revenue.

The company currently has c.35 employees. The majority are based in the US and bar retiring CEO Vicente Nogués, most are expected to remain with the Instem group post-acquisition. The release highlights Instem's expectation that the deal provides the opportunity to combine teams operating in the key US, Swiss and Japanese markets.

Strong strategic logic

Including PDS, Instem has now made three transactions during 2021 to date. While PDS may not be the largest of the three, we believe the strategic and industrial logic behind the deal is compelling. We present the following in support of our view:

- The acquisition removes a key, longstanding competitor from the marketplace in two of Instem's core business areas.
- Seven of the world's top ten pharmaceutical companies have used PDS's solutions, alongside a number of leading Contract Research Organisations (CROs), chemical companies, universities and regulatory bodies. Furthermore, 70% of PDS's top 20 clients are already clients of Instem. The deal therefore deepens the group's relationships with some of its largest customers
- PDS brings 30 new clients to Instem, offering the potential to sell existing solutions to these new customers
- With a significant overlap in product and service offerings, we see good potential for cost savings from product and service rationalisation

- The US is the key market for both Instem and, we understand, PDS. However, PDS brings additional presence in other key territories to the Instem group, particularly in Eastern Europe and Japan.

Structure of the deal

The initial consideration for the deal is CHF 13.25m (c£10.6m), satisfied by CHF 9.75m (c£7.8m) paid in cash and via the issue of CHF 3.5m (c£2.8m) in new ordinary Instem shares.

The share element of the deal involves the issue of 0.3m new shares, at a deemed price of 777p/share. The cash component is being funded from the group's existing resources.

In addition, there is CHF 1m (c£0.8m) of (non-contingent) deferred consideration, payable in cash upon the 12m-anniversary of completion.

The maximum possible consideration is therefore CHF 14.25m (c£11.4m). With the deferred consideration being non-contingent, we assume this will be paid.

We estimate that Instem is paying c2.2x trailing sales and c11x trailing EBITDA for a business in an exciting area and one, we believe, with strong growth prospects.

Forecast changes

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

Forecast changes following PDS acquisition									
£m unless stated	FY 21E			FY 22E			FY 23E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	46.0	47.7	4%	56.4	61.5	9%	60.9	66.3	9%
Adj EBITDA	8.6	8.8	2%	11.3	12.2	8%	13.5	14.9	10%
Fully adj PBT	5.7	5.8	1%	7.9	8.4	6%	9.7	10.8	11%
Fully adj EPS (p)	21.0	21.2	1%	28.5	29.7	4%	34.8	38.3	10%

Source: Progressive Equity Research estimates

- Aside from incorporating PDS into our forecasts, our financial expectations for the existing Instem business are unchanged from previously published estimates.
- Our model assumes the business will be consolidated for four months of the current financial year. FY 22E will be the first full- year of consolidation.
- We forecast the deal to be accretive, with 9%, 8% and 4% respective increases in revenue, adjusted EBITDA and adjusted EPS in the first full- year of consolidation (FY 22E).

The following table details our revised expectations of the group's revenue progression FY 20A – FY 23E.

Instem – revenues FY 20A – FY 23E					
£m unless otherwise stated	FY 20A	FY 21E	FY 22E	FY 23E	CAGR
Annual support fees	8.9	14.7	19.4	20.4	32%
SaaS subscription fees	8.0	10.4	13.3	16.2	26%
Licences	3.5	4.2	3.5	3.1	-4%
Professional services	1.6	4.1	4.6	4.7	43%
Technology-enabled outsourced services	6.2	7.7	10.8	11.4	22%
Consulting	0.0	6.6	9.9	10.5	n/a
TOTAL	28.2	47.7	61.5	66.3	33%
% of total	FY 20A	FY 21E	FY 22E	FY 23E	
Annual support fees	32%	31%	32%	31%	
SaaS subscription fees	28%	22%	22%	24%	
Licences	12%	9%	6%	5%	
Professional services	6%	9%	7%	7%	
Technology-enabled outsourced services	22%	16%	18%	17%	
Consulting	0%	14%	16%	16%	
	100%	100%	100%	100%	
Revenue % Recurring*	60%	53%	53%	55%	

Source: Company data and Progressive Equity Research estimates

* Annual support fees + SaaS Subscription fees

- We forecast annual support fees and SaaS subscription fees (i.e. recurring revenue) 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 however, reduced licence revenues. Following the PDS acquisition, our aggregate forecast CAGR for recurring revenues is c2pp higher than previous estimates.
- 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. Our revised forecast CAGR for this revenue line is also c2pp higher than previous estimates.
- The PDS acquisition has a material impact on Technology-enabled outsourced service revenues. Our revised forecasts assume this revenue will contribute 17% of the total by FY 23E (vs 14% previously) at an implied CAGR of 22% (vs 12% previously).
- Our model calculates that recurring revenue will contribute over half of revenues throughout our forecast period. We expect Instem to deliver higher levels of recurring revenues as the transition to SaaS delivery continues, but also new business wins within PDS (and the recent d-wise acquisition) 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	47.7	61.5	66.3
Adj EBITDA	4.9	5.9	8.8	12.2	14.9
Adj EBIT	4.0	5.0	6.0	8.4	10.8
Reported PBT	(0.9)	2.5	3.0	7.1	9.3
Fully adj PBT	3.7	4.4	5.8	8.4	10.8
NOPAT	3.4	4.1	4.8	6.7	8.7
Reported EPS (p)	(5.4)	11.6	11.2	25.0	33.2
Fully adj EPS (p)	18.4	19.1	21.2	29.7	38.3
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	6.6	9.0	14.1
Free Cash flow	4.1	5.8	4.6	7.2	9.7
FCF per share (p)	23.8	29.7	21.3	31.5	43.0
Acquisitions	(1.3)	(0.3)	(25.4)	(6.0)	(5.0)
Disposals	0.0	0.0	0.0	0.0	0.0
Capex	(1.4)	(1.4)	(2.1)	(2.5)	(2.5)
Shares issued	0.6	15.4	2.6	0.0	0.0
Net cash flow	2.4	20.8	(18.8)	0.8	4.7
Cash & equivalents	6.0	26.7	7.9	8.6	13.3
Net (Debt)/Cash	5.1	25.3	(1.9)	3.8	9.0
NAV AND RETURNS					
Net asset value	16.8	33.2	37.3	42.9	50.4
NAV/share	106.1	162.3	173.4	197.0	231.2
Net Tangible Asset Value	(1.3)	15.2	23.1	29.3	36.5
NTAV/share	(8.3)	74.3	107.4	134.6	167.5
Average equity	16.6	25.0	35.2	40.1	46.7
Post-tax ROE (%)	(5.6%)	9.1%	6.9%	14.2%	16.0%
METRICS					
Revenue growth		9.7%	69.2%	28.8%	7.8%
Adj EBITDA growth		21.7%	49.1%	38.3%	21.7%
Adj EBIT growth		27.6%	19.1%	39.5%	29.4%
Adj PBT growth		18.5%	31.7%	46.0%	27.7%
Adj EPS growth		N/A	11.0%	40.1%	29.1%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		17.9%	12.6%	13.6%	16.4%
VALUATION					
EV/Sales	5.7	5.2	3.1	2.4	2.2
EV/EBITDA	30.2	24.8	16.6	12.0	9.9
EV/NOPAT	42.7	35.5	30.5	21.9	16.9
PER	42.9	41.4	37.3	26.6	20.6
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	3.0%	3.8%	2.7%	4.0%	5.4%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

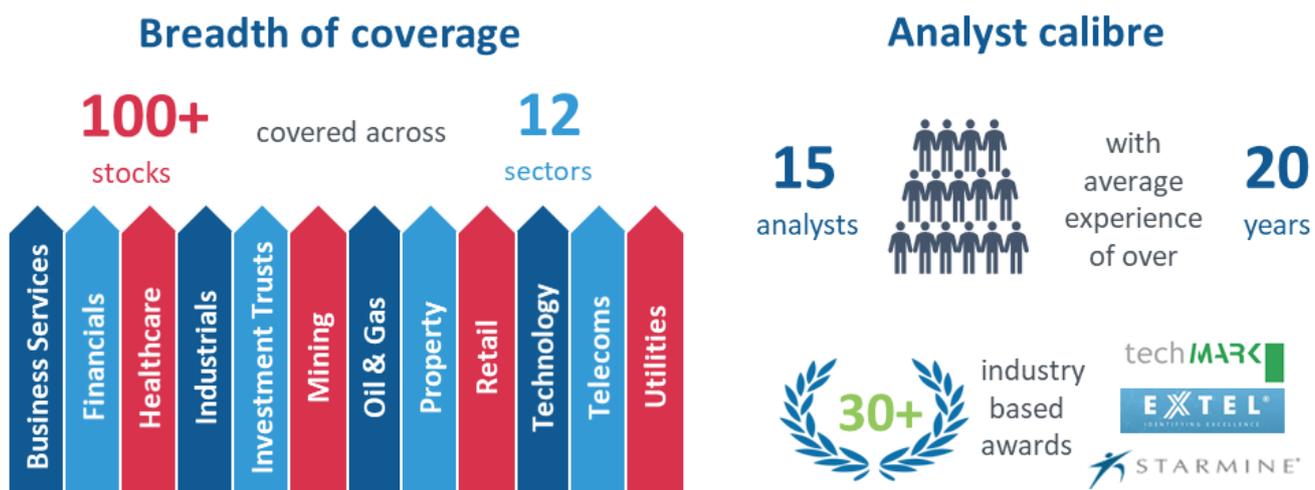
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