Progressive EQUITY RESEARCH

INSTEM

SOFTWARE AND COMPUTER SERVICES

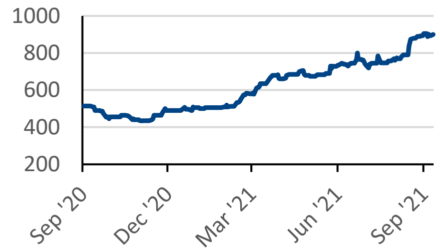
28 September 2021

INS.L

900p

Market Cap: £199.7m

SHARE PRICE (p)



12m high/low	905p/434p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£10.1m *(at 30/06/21)*
Enterprise value	£189.6m
Index/market	AIM
Next news	Trading update, Jan 22
Shares in Issue (m)	22.2
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 organic and acquisitive growth

Instem has once again delivered a strong set of interim results in our view, with the growth story the key highlight. The group has made three major acquisitions during 2021 (including PDS which was completed in the second half) which have transformed the organisation and are integrating well. In addition, the existing business delivered double-digit organic growth during the first half. Improved earnings quality from the ongoing transition to SaaS delivery is a further highlight of the release. Commentary on the outlook is positive, and we maintain FY 22E and FY 23E estimates.

- **Strong organic and acquisitive growth:** Group revenue for the six months ending June 2021 increased by 41% to £19.8m, with organic revenue growth of 16% YoY on a constant currency basis. Adjusted EBITDA was £4.2m for the period, versus £3.0m for H1 20A. Cash performance was once again strong, with net cash generated from operations of £4.1m representing a 48% YoY improvement. With c£11m of cash acquisition consideration paid during the half, the group reported a closing net cash balance of £10.1m (£17.9m on a gross basis).
- **Improved earnings quality:** The ongoing transition to SaaS delivery is driving growth in recurring revenues. Recurring revenues grew 18% YoY during the period, representing a £1.5m improvement on H1 20A. SaaS revenues were 38% higher YoY.
- **M&A integrating well:** Instem has made three major acquisitions during 2021, The Edge, d-wise (both completed in H1 21) and PDS (which completed in H2). In aggregate, these have been transformational for the size and scale of the group. The release notes that all are integrating well, particularly the Edge and d-wise, which have had a "significant" resultant impact on the business during their time as members of the Instem family.
- **Positive outlook:** The release highlights that the margin improvement seen during the period has been sustained into H2 21E. Market conditions remain buoyant and FY 21E trading performance (excluding any fair value adjustments) is expected to be slightly ahead of the Board's previous expectations.
- **FY 22E and FY 23 forecasts maintained:** We maintain FY 22E and FY 23E estimates. We adjust our FY 21E forecasts (revenue -2%, adj EBITDA -9%) to include a fair value reduction to acquired deferred revenue associated with the d-wise acquisition. This is purely a technical accounting adjustment, which has no impact on cash nor underlying trading.

FYE DEC (£M)	2019	2020	2021E	2022E	2023E
Revenue	25.7	28.2	46.7	61.5	66.3
Adj EBITDA	4.9	5.9	8.0	12.2	14.9
Fully adj PBT	3.7	4.4	5.0	8.44	10.8
Fully adj EPS (p)	18.4	19.1	18.3	29.7	38.3
EV/Sales	7.4x	6.7x	4.1x	3.1x	2.9x
EV/EBITDA	39.0x	32.0x	23.6x	15.5x	12.8x
PER	48.9x	47.1x	49.3x	30.3x	23.5x

Source: Company Information and Progressive Equity Research estimates.

H1 21A performance

Study Management and data collection *(49% revenue H1 21A, +39% YoY)*

The group is experiencing strong study demand from non-clinical Contract Research Organisations ("CROs") in its largest business. This has both driven growth in licenced users and also improved take-up of new modules by clients that were not subscribers to those services.

The group continues to make steady progress towards the goal of moving all existing on-premise enterprise software clients to SaaS delivery by the end of 2023, or at least having firm commitments from clients with perpetual licences to do so.

H1 21A also saw the acquisition of The Edge, a leading provider of Discovery technology solutions. The deal extended Instem's reach in the Discovery Study Management market and provides scope for cross-selling opportunities.

In Silico Solutions *(8% revenue H1 21A, -13% YoY)*

Although this business area reported a YoY revenue decline in H1 21A, Instem's computational toxicology business performed ahead of management expectations during the half. Clients use these solutions to enhance or replace laboratory-based studies. December 2020 saw the launch of the Predict™ suite which combines powerful computation models and expert reviews to help clients assess chemical safety more quickly, efficiently and comprehensively. Initial engagements of the suite were successfully completed during H1 21A and the release signals further opportunities for Instem to expand the service offering in this area, some in combination with the group's existing Knowledgescan™ Target Safety Assessment services.

Regulatory Solutions *(24% revenue H1 21A, -11% YoY)*

The September 2021 PDS deal saw Instem's market-leading provision in SEND service delivery enhanced with the acquisition of the number two player in the market.

SEND has been mandatory for the submission of new study data to the US FDA since 2016. The standard is therefore well- established, and the life sciences industry has become increasingly familiar with it. The release flags a resulting structural shift in demand for SEND services. Demand for SEND creation work is moderating, as CROs in particular are undertaking more of this work in house. The release notes however, that the "overwhelming" majority of this work uses Instem technology. In offset, demand for conversion work for non-submission legacy studies is growing, as clients seek to leverage harmonised data for insight generation.

The Regulatory solutions business saw a YoY revenue decline during the period. We understand that H1 20A was a tough comparator. That period included c£0.6m of revenues from Envigo which were lost once Enivgo was acquired by Covance (now Labcorp). Excluding these revenues, revenues from the Regulatory solutions unit were broadly stable vs H1 20A.

Clinical Trial Acceleration Solutions *(19% revenue H1 21A, n/m% YoY)*

(Note, this business unit was created with the d-Wise acquisition in April 2021, YoY growth comparisons are therefore invalid).

The release confirms that Initial integration of d-wise is largely complete, with the second (final) phase scheduled for H2 21E. The group has a two-pronged growth strategy in this segment: 1) Gaining further commercial traction with the existing offering of standardised, next-generation Statistical Computing Environments ("SCEs") within client's custom configurations; and 2) increased marketing focus on the group's developing Aspire™ suite. This offers next-generation productised SCE components to all sizes of pharma companies and CROs. The customer value proposition in both is the same – Instem solutions allow accelerated deployment times, at reduced cost while increasing recurring revenues and project profitability.

Key financials

H1 21A revenue increased by £5.8m to £19.8m, an increase of 41% YoY on H1 20A. Organic revenue growth was 16% on a constant currency basis, with the consolidated revenue figure reflecting initial contributions of The Edge and d-wise to group financials. Note, this revenue growth was reported against a backdrop of the transition to SaaS delivery, where revenues are typically recorded over a longer timeframe, but are initially lower.

Recurring revenues (support & maintenance, SaaS subscriptions) grew by an impressive £1.5m (+18% YoY) during the period, representing 50% of total revenue (59% H1 20A). Although a decline on the comparable period as a proportion of the total, consulting revenues in the d-wise unit are recorded as being non-recurring, even though, we understand, that some of these revenue streams are "repeating" in nature given they arise from existing clients.

Opex remained under control during the period, with 42% YoY growth in line with that of revenue. The increase reflects ongoing investment in operational teams and the inclusion of The Edge and d-wise. Adjusted EBITDA grew by 39% YoY to £4.2m, giving a margin of 21.0% (21.3% H1 20A).

Operating cash flows were strong, with net cash generated from operations of £4.1m representing a 48% YoY improvement. The group continues to invest in the platform, with capex £0.3m higher than the comparable period at £0.96m. H1 21A closed with a gross cash balance of £17.9m, an £8.8m improvement on H1 20A.

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 H1 21A results announcement

£m unless stated	FY 21E Old	FY 21E New	FY 21E Change (%)	FY 22E Old	FY 22E New	FY 22E Change (%)	FY 23E Old	FY 23E New	FY 23E Change (%)
Revenue	47.7	46.7	-2%	61.5	61.5	0%	66.3	66.3	0%
Adj EBITDA	8.8	8.0	-9%	12.2	12.2	0%	14.9	14.9	0%
Fully adj PBT	5.8	5.0	-14%	8.4	8.4	0%	10.8	10.8	0%
Fully adj EPS (p)	21.2	18.3	-14%	29.7	29.7	0%	38.3	38.3	0%
Net cash/(debt)	-1.9	0.0	n/m	3.8	5.7	49%	9.0	10.9	21%

Source: Progressive Equity Research estimates

- We adjust our FY 21E revenue estimate (-2%) to include a fair value reduction to acquired deferred revenue associated with the d-wise acquisition. The adjustment has a £0.8m impact on EBITDA, a 9% reduction on our previous estimates. This is purely a technical accounting adjustment, which has no impact on trading nor cash generation.
- We have also adjusted our H2 21E working capital forecasts, reflecting an increase in the cash acquired with the acquisitions made during 2021. The outcome is a c£1.9m uplift in our closing FY 21E net debt forecast to a neutral position. Our modelling assumes this uplift flows through into the future years, with our revised FY 22E and FY 23E estimates also being c£1.9m higher than previously published.
- Our FY 22E and FY 23E estimates are unchanged following the release.

Following the announcement, we have also made revisions to our forecasts of the group's revenue progression FY 20A – FY 21E. These are summarised 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	13.9	19.4	20.4	32%
SaaS subscription fees	8.0	10.0	13.3	16.2	26%
Licences	3.5	4.8	3.5	3.1	-4%
Professional services	1.6	3.5	4.6	4.7	43%
Technology-enabled outsourced services	6.2	7.7	10.8	11.4	22%
Consulting	0.0	6.8	9.9	10.5	n/a
TOTAL	**28.2**	**46.7**	**61.5**	**66.3**	**33%**
Growth %		65.5%	31.7%	7.8%	
% of total	**FY 20A**	**FY 21E**	**FY 22E**	**FY 23E**	
Annual support fees	32%	30%	32%	31%	
SaaS subscription fees	28%	21%	22%	24%	
Licences	12%	10%	6%	5%	
Professional services	6%	7%	7%	7%	
Technology-enabled outsourced services	22%	16%	18%	17%	
Consulting	0%	15%	16%	16%	
TOTAL	**100%**	**100%**	**100%**	**100%**	
Revenue % Recurring*	**60%**	**51%**	**53%**	**55%**	

Source: Company data and Progressive Equity Research estimates

** Annual support fees + SaaS Subscription fees*

- Our FY 22E and FY 23E revenue forecasts are unchanged in absolute terms.
- However, we have revised assumptions on the FY 21E revenue mix, with licence sales being slightly nudged up, offset by a slight reduction in services and SaaS revenues. As discussed on the previous page. These revisions reflect the fair value adjustment on the d-wise acquisition.

Financial Summary: Instem

Year end: December (£m unless shown)

PROFIT & LOSS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue	25.7	28.2	46.7	61.5	66.3
Adj EBITDA	4.9	5.9	8.0	12.2	14.9
Adj EBIT	4.0	5.0	5.2	8.4	10.8
Reported PBT	(0.9)	2.5	2.3	7.1	9.3
Fully adj PBT	3.7	4.4	5.0	8.4	10.8
NOPAT	3.4	4.1	4.2	6.7	8.7
Reported EPS (p)	(5.4)	11.6	8.3	25.0	33.2
Fully adj EPS (p)	18.4	19.1	18.3	29.7	38.3
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Operating cash flow	5.7	7.7	8.4	9.0	14.1
Free Cash flow	4.1	5.8	6.5	7.2	9.7
FCF per share (p)	23.8	29.7	30.0	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	(17.0)	0.8	4.7
Cash & equivalents	6.0	26.7	9.8	10.5	15.2
Net (Debt)/Cash	5.1	25.3	0.0	5.7	10.9
NAV AND RETURNS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Net asset value	16.8	33.2	36.6	42.3	49.8
NAV/share	106.1	162.3	170.5	194.1	228.4
Net Tangible Asset Value	(1.3)	15.2	22.4	28.7	35.9
NTAV/share	(8.3)	74.3	104.4	131.7	164.6
Average equity	16.6	25.0	34.9	39.5	46.0
Post-tax ROE (%)	(5.6%)	9.1%	5.2%	14.4%	16.2%
METRICS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue growth		9.7%	65.5%	31.7%	7.8%
Adj EBITDA growth		21.7%	35.8%	51.9%	21.7%
Adj EBIT growth		27.6%	3.4%	60.6%	29.4%
Adj PBT growth		18.5%	13.6%	69.3%	27.6%
Adj EPS growth		N/A	(4.3%)	62.5%	29.0%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		17.9%	11.2%	13.6%	16.4%
VALUATION	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EV/Sales	7.4	6.7	4.1	3.1	2.9
EV/EBITDA	39.0	32.0	23.6	15.5	12.8
EV/NOPAT	55.1	45.8	45.4	28.3	21.9
PER	48.9	47.1	49.3	30.3	23.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	2.6%	3.3%	3.3%	3.5%	4.8%

Source: Company information and Progressive Equity Research estimates

28 September 2021

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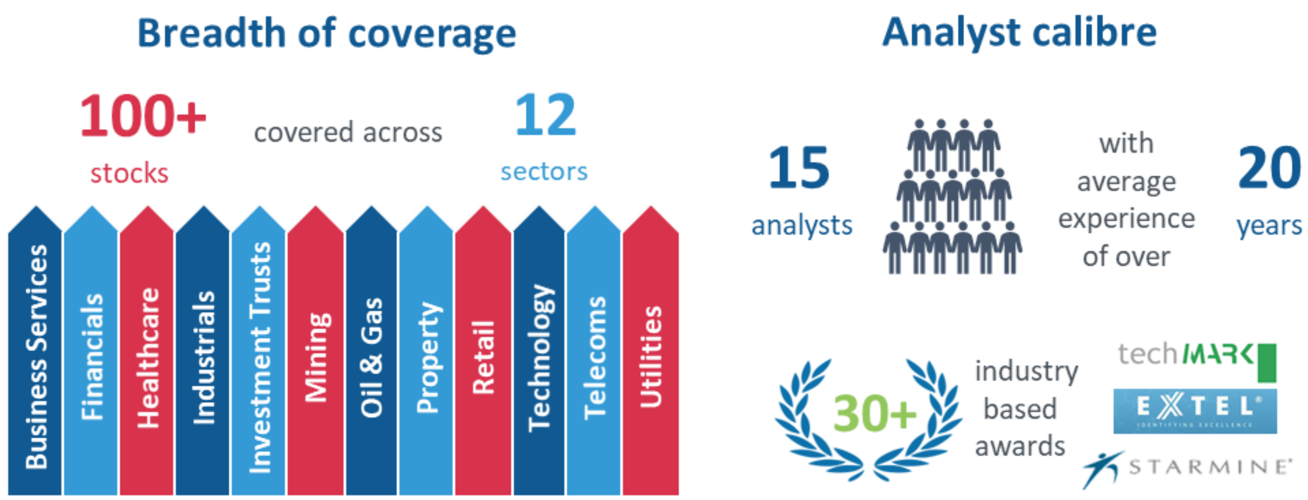

To arrange a meeting with the management team, or for further information about Progressive, please contact:
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