

# INSTEM

## SOFTWARE AND COMPUTER SERVICES

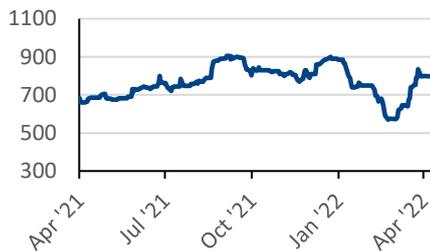
26 April 2022

INS.L

798p

Market Cap: £178.5m

### SHARE PRICE (p)



12m high/low

905p/570p

Source: LSE Data (priced as at prior close)

### KEY DATA

Net (Debt)/Cash	£3.7m (at 30/12/21)
Enterprise value	£174.8m
Index/market	AIM
Next news	Trading Update, Jul-22
Shares in Issue (m)	22.4
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

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## FY21: Strong financial performance, strategic transformation

Instem has reported FY21 results consistent with the January trading statement and in line with our forecasts. Despite the ongoing macroeconomic turbulence from Covid-19, the group continues to report impressive revenue growth, both headline and organic. With three major acquisitions, the group also made a strategic step change in its platform during 2021. While the release contains positive commentary on the outlook, we adjust FY22E and FY23E profit forecasts to reflect revised opex assumptions.

- Strong organic and acquisitive growth.** Group revenue for the year increased 63% to £46.0m, with organic revenue growth of 12% YoY on a constant currency basis. Adjusted EBITDA grew 39% YoY to £8.3m, with adjusted PBT up 25% to £5.0m, in line with our forecast. Cash performance was strong once again, with net cash generated from operations of £10.3m representing a 40% YoY improvement. With c.£17m of cash acquisition consideration paid during the year, the group reported a closing gross cash balance of £15.0m, £3.7m net of financial liabilities.
- Strategic transformation made during 2021.** Instem made three major acquisitions during 2021: The Edge, d-wise (both completed in H1) and PDS (completed in H2). The release confirms that the acquisitions are integrating well. In aggregate, these have been transformational for the size and reach of the group, and represent material progress towards the goal of becoming a one-stop shop to assist life sciences clients in drug discovery and development.
- Positive outlook.** The release highlights the group's good visibility for the current year, with growing recurring SaaS and annual support revenues. The pipeline remains "strong", with the board seeking to augment organic growth with the ongoing acquisition strategy.
- Forecasts revised, FY24E estimates introduced.** Our FY22E and FY23E revenue estimates are slightly higher than previous forecasts. However, our FY22E and FY23E adjusted EBITDA expectations are reduced by 10% and 3%, respectively, to reflect revised opex assumptions, particularly relating to staff costs. We also introduce FY24E estimates reflecting expected further solid revenue and profit growth, with margin expansion and positive cash flow.

FYE DEC (£M)	2020	2021	2022E	2023E	2024E
Revenue	28.2	46.0	61.7	68.2	75.1
Adj EBITDA	5.9	8.3	11.0	14.4	16.2
Fully adj PBT	4.0	5.0	7.6	10.0	12.2
Fully adj EPS (p)	19.1	18.0	26.9	35.6	43.5
EV/Sales	6.2x	3.8x	2.8x	2.6x	2.3x
EV/EBITDA	29.5x	21.2x	15.9x	12.1x	10.8x
PER	41.8x	44.3x	29.7x	22.4x	18.3x

Source: Company Information and Progressive Equity Research estimates.

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

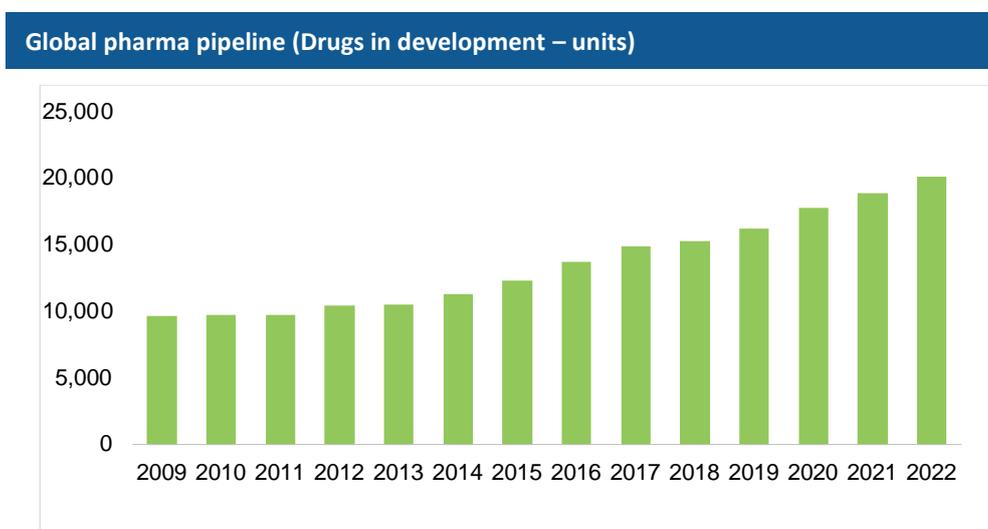
Please refer to important disclosures at the end of the document.

## 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 2022. A further positive for Instem is that early-stage drug development volumes 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 the drug development pipeline, as illustrated in the following chart.



Source: *Pharmaprojects Annual Review, January 2022*

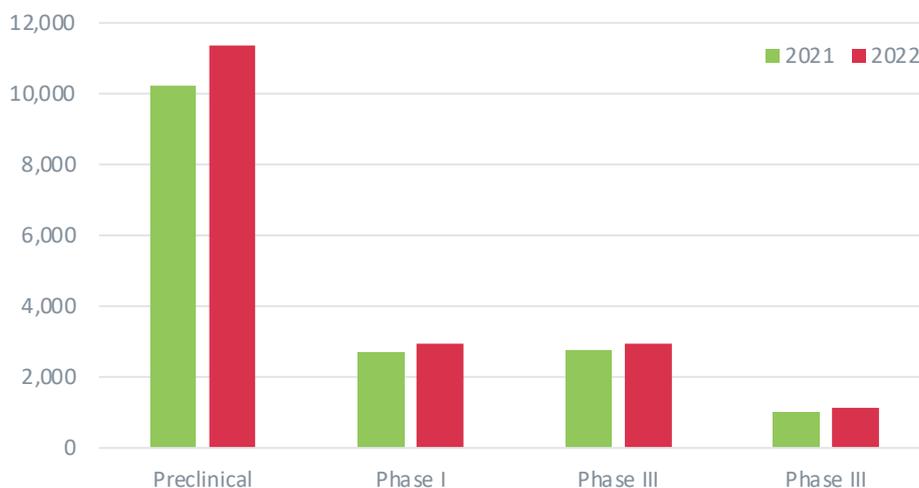
There are currently over 20,000 drugs in the global drug development pipeline (+8% YoY). The pipeline has almost doubled since 2012, with the growth rate accelerating in 2022 vs the 4.7% reported for 2021. In our view, this continues to demonstrate the resilience of the global pharma industry, despite the backdrop of global Covid-driven macroeconomic 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 highlighted in our 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.

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

Instem focuses on early-stage R&D, and the picture here also remains positive. As the following chart demonstrates, early-stage drug development volumes are both growing and continuing to dominate the overall development pipeline. The Preclinical stage and Phases I-III represent over 90% of the current global pipeline, and each of the four segments continue to report solid growth in 2022.

**Early-stage global pharma pipeline (Drugs in development – units)**



Source: Pharmaprojects Annual Review, January 2022

Note: Pharmaprojects divides drug development into 10 stages. We have presented the first four in the chart. In our view, these are the stages most relevant to Instem.

## FY21 divisional performance

### Study Management and data collection (44% of revenue FY21, +35% YoY)

Instem’s largest business area saw impressive headline and organic growth during the period. Headline revenue growth (+35% YoY) benefitted from a 10-month contribution from The Edge and four months from PDS. Organic growth was an impressive 17% YoY.

The Study Management business continues to benefit from favourable industry tailwinds. As discussed above, the number of drugs in the regulatory stages of global R&D grew to a record level during 2021, with the pre/early-stage clinical segment the star performer. The double-digit growth in preclinical compounds has driven growth in business for CROs specialising in this area, which in turn has increased demand for Instem’s Study Management solutions.

The acquisition of The Edge (acquired March 2021) deepened the group’s reach into the Discovery Study Management market and provides scope for cross-selling, particularly in the Drug and Metabolism Pharmacokinetics field.

### Clinical Trial Acceleration (28% of revenue FY21, +nm YoY)

The release highlights that all areas of the Clinical Trials Acceleration solutions business made solid progress during 2021, with two product lines making a material contribution to growth: 1) productised integration of leading technology tools, hosted by Instem, for SME pharma and CRO clients, and 2) large custom projects for bigger clients.

2021 also saw significant investment in the Aspire solution, the group’s next-generation clinical analytics framework.

The Clinical Trials business also saw lower-than-expected demand for clinical trial transparency and outsourced services solutions, due to some Covid-related relaxation of submission requirements to the European and Canadian regulatory authorities.

### **Regulatory Solutions (22% of revenue FY21, +2% YoY)**

Demand for SEND services remains strong, as evidenced by Instem's £0.7m contract win with an unnamed top-30 pharma client during the period. The contract was for the conversion of historical studies to the SEND standard. Subsequently, the contract was extended to include data warehousing and exploration technology platform to house this data.

### **In Silico Solutions (7% of revenue FY21, -8% YoY)**

The In Silico Solutions business is typically driven by attendances at scientific conferences, many of which were cancelled during the pandemic. The release signals that demand picked up during H2 21, with Instem seeing strong interest for the group's disruptive solutions at the recent (post period-end) Society of Toxicology annual meeting.

The latest version of the Leadscope Model Applier computer toxicology solution was released in November 2021. The suite is designed to meet the growing demand for in silico solutions.

## **Key financials**

FY21 revenue increased by £17.8m to £46.0m, a 63% YoY increase. Organic revenue growth was +12% YoY on a constant currency basis, with the consolidated revenue figure reflecting initial contributions from The Edge, PDS and d-wise to group financials (all were acquired during 2021). It is worth noting that this revenue growth was reported against a backdrop of the ongoing transition to SaaS delivery, where revenues are typically recorded over a longer timeframe and are initially lower.

Recurring revenues (support & maintenance, SaaS subscriptions) grew by an impressive £7.2m to £24.1m (+43% YoY) during the period, representing 52% of total revenue (FY20: 60%). Although a clear 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 our understanding is that some of these revenue streams are 'repeating' in nature given that they arise from existing clients.

Opex grew 70% during the period, ahead of the 63% growth in revenue. The increase reflects ongoing investment in operational teams and the integration of The Edge, PDS and d-wise into the group. Adjusted EBITDA grew 39% YoY to £8.3m, giving a margin of 18% (FY20: 21%).

Operating cash flows remain strong, with net cash generated from operations of £10.3m representing a £3.0m (+40% YoY) improvement. The group continues to invest in the platform, with capex £1.0m higher than the comparable period at £2.4m.

FY21 closed with a gross cash balance of £15.0m (£3.7m net of financial liabilities). Although a £11.7m decline on FY20, we note the £17.2m of acquisition consideration paid during the period.

## Forecast commentary

Following the announcement, we make changes to forecasts as shown in the table below. Fuller financials are detailed on page 7.

Forecast changes following FY21 results announcement						
£m unless stated	Old	FY22E New	Change (%)	Old	FY23E New	Change (%)
Revenue	61.5	61.7	0%	66.3	68.2	3%
Adj EBITDA	12.2	11.0	-10%	14.9	14.4	-3%
Fully adj PBT	8.4	7.6	-10%	10.8	10.0	-7%
Fully adj EPS (p)	29.7	26.9	-10%	38.3	35.6	-7%
Net cash/(debt)	5.7	8.4	nm	10.9	13.7	26%

Source: Progressive Equity Research estimates

- Our revenue estimates are slightly increased in both years. With the industry backdrop remaining favourable and a significantly enhanced platform and product set following the three 2021 acquisitions, we continue to expect the business to deliver solid growth.
- In common with most software companies, staff costs are the group's major expense line. The 10% and 3% respective reductions in FY22E and FY23E adjusted EBITDA reflect increased expectations of staff costs.
- Following the announcement, we have also made minor revisions to our forecasts of the group's revenue progression FY21A-FY24E. These are summarised in the following table.
- We are introducing FY24E forecasts, as detailed on page 7. In summary, we expect another year of solid revenue and profit growth, with margin expansion and positive cash flow.

<b>Instem – Revenues FY21A-FY24E</b>					
<b>£m unless otherwise stated</b>	<b>FY21A</b>	<b>FY22E</b>	<b>FY23E</b>	<b>FY24E</b>	<b>CAGR</b>
Annual support fees	14.4	19.4	20.3	21.9	15%
SaaS subscription fees	9.7	14.1	19.1	22.9	33%
Licences	4.6	4.6	4.7	4.5	-1%
Professional services	3.7	4.7	4.9	5.2	13%
Technology-enabled outsourced services	6.4	10.3	10.5	11.3	21%
Consulting	7.3	8.6	8.7	9.3	n/a
<b>TOTAL</b>	<b>46.0</b>	<b>61.7</b>	<b>68.2</b>	<b>75.1</b>	<b>18%</b>
Growth %		34.1%	10.5%	10.1%	
<b>% of total</b>	<b>FY21A</b>	<b>FY22E</b>	<b>FY23E</b>	<b>FY24E</b>	
Annual support fees	31%	31%	30%	29%	
SaaS subscription fees	21%	23%	28%	30%	
Licences	10%	7%	7%	6%	
Professional services	8%	8%	7%	7%	
Technology-enabled outsourced services	14%	17%	15%	15%	
Consulting	16%	14%	13%	12%	
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	
<b>Revenue % Recurring*</b>	52%	54%	58%	60%	

Source: Company data and Progressive Equity Research estimates

\* Annual support fees + SaaS Subscription fees

- Our FY22E and FY23E revenue forecasts are slightly higher than previously published.
- However, we have revised assumptions of the revenue mix. For FY22E, we have increased our forecasts of SaaS, licences and consulting sales, offset by reduced Technology-enabled outsourced services revenues. SaaS sales are expected to remain the key growth driver in FY23E, where we have again made a minor revision to the Technology-enabled outsourced services line.

**Financial Summary: Instem**

Year end: December (£m unless shown)

	2020	2021	2022E	2023E	2024E
<b>PROFIT &amp; LOSS</b>					
Revenue	28.2	46.0	61.7	68.2	75.1
Adj EBITDA	5.9	8.3	11.0	14.4	16.2
Adj EBIT	5.0	7.1	6.8	10.1	12.4
Reported PBT	2.5	3.0	6.3	8.6	10.8
Fully adj PBT	4.0	5.0	7.6	10.0	12.2
NOPAT	4.1	5.7	5.5	8.1	9.9
Reported EPS (p)	11.6	9.2	21.7	29.8	37.5
Fully adj EPS (p)	19.1	18.0	26.9	35.6	43.5
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
<b>CASH FLOW &amp; BALANCE SHEET</b>					
Operating cash flow	7.7	10.3	8.4	14.6	17.8
Free Cash flow	5.8	6.8	6.2	9.8	12.5
FCF per share (p)	29.7	29.7	27.1	43.8	55.5
Acquisitions	(0.3)	(17.5)	(6.0)	(5.0)	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Capex	(1.4)	(2.4)	(2.8)	(2.8)	(2.8)
Shares issued	15.4	0.0	0.0	0.0	0.0
Net cash flow	20.8	(11.6)	(0.2)	4.9	12.5
Cash & equivalents	26.7	15.0	14.8	19.7	32.2
Net (Debt)/Cash	25.3	3.7	8.4	13.7	26.2
<b>NAV AND RETURNS</b>					
Net asset value	33.2	47.7	50.6	57.3	65.7
NAV/share	162.3	222.2	232.0	262.8	301.5
Net Tangible Asset Value	15.2	(10.6)	(6.7)	0.0	6.4
NTAV/share	74.3	(49.3)	(30.7)	0.0	29.6
Average equity	25.0	40.5	49.1	53.9	61.5
Post-tax ROE (%)	9.1%	5.2%	10.1%	12.4%	13.7%
<b>METRICS</b>					
Revenue growth		63.1%	34.1%	10.5%	10.1%
Adj EBITDA growth		39.4%	33.1%	31.2%	12.3%
Adj EBIT growth		40.5%	(3.7%)	47.9%	22.6%
Adj PBT growth		24.4%	52.5%	31.1%	22.1%
Adj EPS growth		N/A	49.3%	32.5%	22.1%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		15.4%	11.1%	14.8%	16.5%
<b>VALUATION</b>					
EV/Sales	6.2	3.8	2.8	2.6	2.3
EV/EBITDA	29.5	21.2	15.9	12.1	10.8
EV/NOPAT	42.2	30.8	32.0	21.6	17.6
PER	41.8	44.3	29.7	22.4	18.3
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	3.7%	3.7%	3.4%	5.5%	7.0%

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

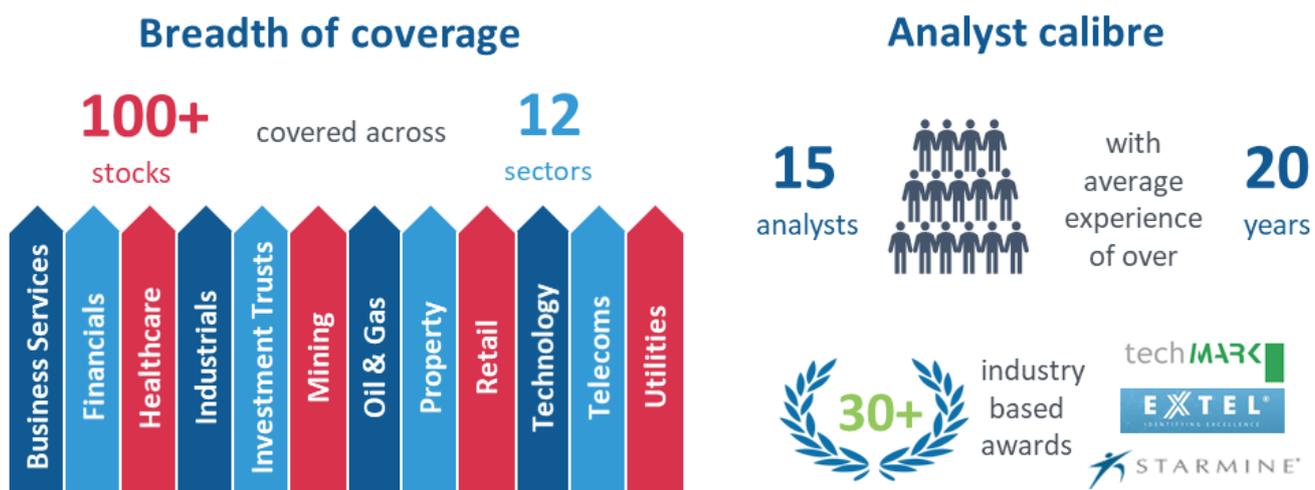
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