

INSTEM

SOFTWARE AND COMPUTER SERVICES

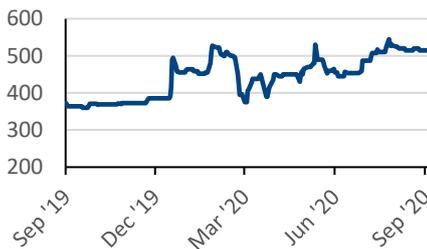
28 September 2020

INS.L

515p

Market Cap: £105.5m

SHARE PRICE (p)



12m high/low 545p/360p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£22.3m (at 31/07/20)
Enterprise value	£83.2m
Index/market	AIM
Next news	Trading Update, Dec-20
Shares in Issue (m)	20.5
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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Momentum remains strong

Instem has delivered strong H1 20A results in our view. Despite the backdrop of COVID-19, all three business areas continue to perform well. Notably, the Informatics business made particularly impressive progress in the period. Management commentary on the outlook is positive and we maintain headline forecasts following the announcement. In addition, we increase our forecast FY 20E closing net cash position by £1m. This reflects revised assumptions on working capital movements in the second half.

- Strong H1 20A results:** Group revenue for the six months ending June 2020 increased by 20% to £14.0m, with an organic revenue growth of 12% YoY. Adjusted EBITDA was £3.0m for the period, versus £1.7m for H1 19A. Operating cash flow more than doubled to £2.7m. The closing H1 20A cash balance of £9.1m was reported prior to the £15.0m July-20 fundraise.
- Solid performances across the board, Informatics a highlight:** Despite the COVID-19 backdrop, all three business areas continue to perform well. The Informatics division performed particularly strongly during H1 20A, with strong organic growth in Target Safety Assessments ("TSAs") and a first full half-year contribution from Leadscope. The Study Management business is experiencing good demand from non-clinical Contract Research Organisations ("CROs"), as they experience record inflow of studies from their pharmaceutical clients. In the Regulatory Solutions segment, management believes that Instem's SEND solutions continue to be market leading.
- M&A progressing:** Instem raised £15.0m net of expenses in July 2020. At the time, management revealed that it was evaluating several prospects in the \$2-\$20m annual revenue range. The release confirms that the Board is currently progressing a range of acquisition opportunities.
- Positive outlook statement:** Instem continues to trade in line with the Board's expectations and the release highlights their expectation that the momentum delivered in H1 20A will continue over the remainder of the year. With a record number of drugs in the global development pipeline, and increasing regulatory-driven growth opportunities, in our view the industry backdrop remains favourable.
- Headline forecasts maintained:** We maintain our headline forecasts following the announcement. However, we increase our forecast of the FY20E closing net cash position by £1.0m to £22.4m, reflecting revised assumptions on working capital movements in H2 20E.

FYE DEC (€M)	2018	2019	2020E	2021E	2022E
Revenue	22.7	25.7	28.8	30.9	32.7
Adj EBITDA	4.1	4.9	5.8	6.3	7.0
Fully adj PBT	3.0	3.7	4.1	4.3	4.8
Fully adj EPS (p)	15.5	18.4	17.3	16.3	18.1
EV/Sales	3.7x	3.2x	2.9x	2.7x	2.5x
EV/EBITDA	20.5x	17.1x	14.3x	13.2x	11.9x
PER	33.2x	28.0x	29.8x	31.6x	28.5x

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.

H1 20A performance

Study Management (-3% YoY, 50% revenue H1 20A)

Strong demand from non-clinical CROs continues to drive growth in licensed users for the group's Study Management and Data Collection solutions. However, underlying growth in this area of the business was offset by the ongoing transition to SaaS delivery, with Instem reporting "steady" progress towards the stated goal of moving all existing on-premise enterprise customers to SaaS deployment by the end of 2023.

On 03 June 2020, Instem announced a \$1m contract win with Korean Clinical Research Organisation Biototech, which is to deploy a package of preclinical data collection, analysis and regulatory submissions management solutions at its R&D facility in South Korea's North Chungcheong Province. Revenues from this contract will be recorded in H2 20E and beyond.

Regulatory Solutions (+32% YoY, 38% revenue H1 20A)

Management believe the group's SEND solutions continue to lead the FDA (US Food and Drug Administration) mandated market. The industry is faced with a backlog of SEND conversion work, in addition to current study volumes.

Post-period end, the group secured a £0.7m contract with a top 30 pharmaceutical client for conversion of historic studies to the SEND format. This is expected to partially offset the loss of a large SEND services contract, which the group had previously flagged as the client had chosen to bring the work in-house.

Instem also continues to explore the potential to extend its technology into the closely associated clinical submission standard SDTM.

Informatics (+338%, 12% revenue H1 20A)

The Informatics division performed particularly strongly during H1 20A, with strong organic growth in TSAs and a first full half-year contribution from Leadscope.

Instem continues to invest in the TSA offering, with headcount having doubled since H1 19A, improvements in the technology platform and optimisation of workflow processes.

Key financials

H1 20A revenue increased by £2.3m to £14.0m, an increase of 20% YoY on FY 19A. Organic revenue growth was 12% to £13.1m, excluding the Nov-19 Leadscope acquisition.

Recurring revenues (support & maintenance, SaaS subscriptions) grew by an impressive £1.4m (+19% YoY) during the period, representing 59% of total revenue (60% H1 19A).

Opex remained under control during the period, with 10% YoY growth being half that of revenue. The increase reflects ongoing investment in operational teams and the inclusion of Leadscope. Adjusted EBITDA grew by 76% YoY to £3.0m, giving a margin of 21.3%.

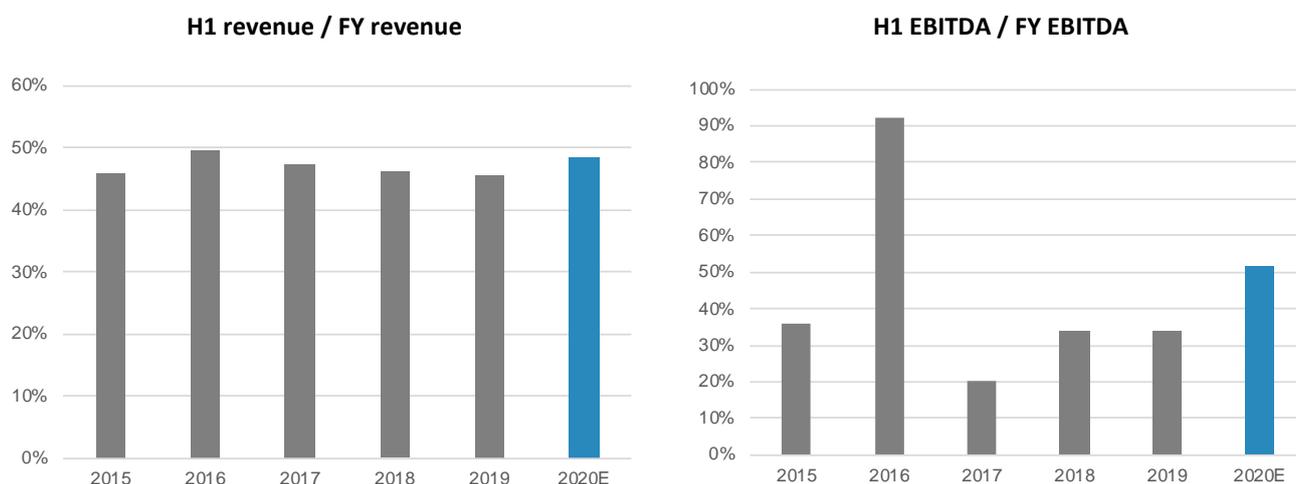
Operating cash flows were strong, with operating cash flow before movements in working capital more than doubling to £2.7m. This was primarily due to cash inflows from key contracts, outsourced services and a £0.6m tax credit claimed in respect of FY 18A. However, H1 20A saw a £1.6m swing in net working capital movements to £0.05m. The group closed H1 20A with a cash balance of £9.1m, a £3.0m improvement on H1 19A. Note the £15.0m fundraise was completed post-period end so is not reflected in this figure.

On track for FY 20E

We believe Instem’s H1 20A results demonstrate that the business is on track to deliver our FY 20E estimates. In the first half, Instem has delivered 49% and 51% of our respective FY 20E revenue and EBITDA forecasts. As shown in the following charts, both of these compare favourably with historical levels. We believe the following points support our positive stance:

- Instem has historically demonstrated seasonality in revenues, with the second half usually being slightly ahead of the first. This has been a stable trend over recent reporting periods – the group has delivered between 46% and 50% of FY revenues in the first half (49% FY 19E).
- With the exception of FY 16A where specific issues in the Clinical business impacted second half performance, the trend for EBITDA is more pronounced. Excluding 2016, Instem has reported between 20% and 39% of FY EBITDA in the first half over recent years. Based on our estimates, Instem has already delivered some 51% of our FY 20E forecast. Whilst we have confidence in our estimates, investment in platform noted during H1 20A will begin to impact the cost base in the second half. For this reason, we believe the H1/H2 profit split may be more balanced in FY 20E than in previous years.

Instem – H1 revenue and EBITDA vs full-year outcome 2015 - 2020E



Source: Company data and Progressive Equity Research estimates.

Financials

Following the H1 20A results we have maintained our previous headline forecasts. However, we have revised our assumptions on H2 20E working capital movements. The result is a £1m improvement in our forecast closing net cash positions in all three forecast years.

Financial Summary: Instem

Year end: December (£m unless shown)

	2018	2019	2020E	2021E	2022E
PROFIT & LOSS					
Revenue	22.7	25.7	28.8	30.9	32.7
Adj EBITDA	4.1	4.9	5.8	6.3	7.0
Adj EBIT	3.2	4.0	4.3	4.5	5.0
Reported PBT	1.7	(0.9)	2.8	3.1	3.6
Fully adj PBT	3.0	3.7	4.1	4.3	4.8
NOPAT	2.4	3.4	3.5	3.6	4.0
Reported EPS (p)	8.7	(5.4)	11.4	10.9	12.9
Fully adj EPS (p)	15.5	18.4	17.3	16.3	18.1
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	1.8	5.7	4.6	4.9	4.8
Free Cash flow	0.6	4.1	2.3	3.5	4.3
FCF per share (p)	3.3	23.8	12.1	16.4	20.2
Acquisitions	(0.2)	(1.3)	(0.3)	(0.3)	(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	17.9	2.5	3.5
Cash & equivalents	3.6	6.0	23.9	26.4	29.9
Net (Debt)/Cash	3.6	5.1	22.4	25.2	29.1
NAV AND RETURNS					
Net asset value	16.4	16.8	33.8	39.6	43.3
NAV/share	105.1	106.1	164.8	193.2	211.4
Net Tangible Asset Value	(1.0)	(1.3)	19.0	24.3	26.8
NTAV/share	(6.5)	(8.4)	119.8	118.8	131.1
Average equity	15.1	16.6	25.3	36.7	41.4
Post-tax ROE (%)	9.7%	(5.6%)	8.7%	6.3%	6.6%
METRICS					
Revenue growth		13.3%	12.0%	7.2%	5.9%
Adj EBITDA growth		20.0%	19.8%	7.8%	11.4%
Adj EBIT growth		24.7%	8.4%	5.7%	10.3%
Adj PBT growth		23.4%	9.3%	6.5%	11.0%
Adj EPS growth		N/A	(6.2%)	(5.6%)	11.0%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		15.4%	14.9%	14.7%	15.3%
VALUATION					
EV/Sales	3.7	3.2	2.9	2.7	2.5
EV/EBITDA	20.5	17.1	14.3	13.2	11.9
EV/NOPAT	35.0	24.2	23.7	22.9	20.8
PER	33.2	28.0	29.8	31.6	28.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	0.6%	4.6%	2.4%	3.2%	3.9%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

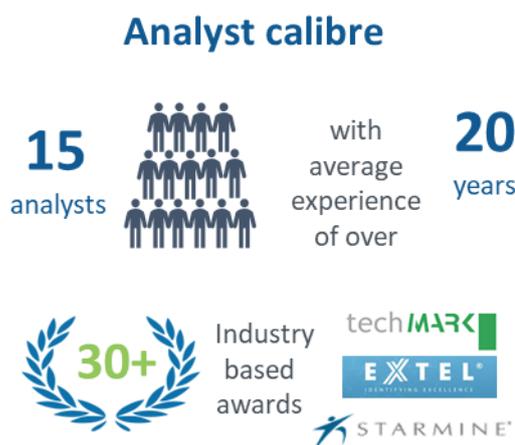
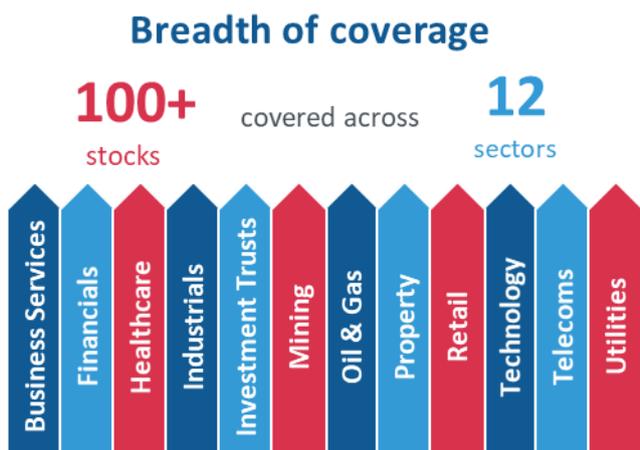
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