

# Pacific Edge

## A Game of Patience

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### RESEARCH INSIGHTS

We lower our near-term revenue expectations for Pacific Edge (PEB) ahead of the upcoming FY20 result on 29 May – as key reimbursement milestones in the US market continue to be frustratingly slow and take longer than anticipated, despite a growing body of supportive clinical evidence. The prize of success is material and rationale for commercial use of Cxbladder is arguably getting stronger, however, success with US milestones is needed to drive a well overdue step-change for the business. Our view remains that this is a question of 'when' rather than 'if', although patience continues to be tested.

NZX Code	PEB	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$0.12	NPAT* (NZ\$m)	-17.9	-16.8	-11.3	-4.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	510.9m	EPS* (NZc)	-3.7	-3.3	-1.6	-0.7	EV/EBIT	n/a	n/a	n/a	n/a
Market cap	NZ\$62.3m	EPS growth* (%)	20.3	11.5	50.1	59.9	PE	n/a	n/a	n/a	n/a
Avg daily turnover	403.5k (NZ\$59k)	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	4.3	3.7	14.9	n/a
		Imputation (%)	0	0	0	0	Cash div yld (%)	0.0	0.0	0.0	0.0
		*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	0.0

#### Key near-term considerations

- FY20 result – 29 May:** Near-term results are largely irrelevant to a PEB valuation, with the key focus areas (1) any update on key US reimbursement milestones/large customers, and (2) cash burn. Our revised forecast is for FY20 revenue of NZ\$5.3m. PEB will host a call at 10:30am on 29 May; register at [https://globalmeet.webcasts.com/starthere.jsp?ei=1324889&tp\\_key=aef9148f36](https://globalmeet.webcasts.com/starthere.jsp?ei=1324889&tp_key=aef9148f36).
- Coverage decision from public health insurer, CMS:** PEB has submitted a dossier of evidence for review and was expecting an outcome in "1Q CY20/1Q FY21" (expert opinion; 1H20 report). It is an iterative process, with little transparency, which is reliant on judgement of whether the available evidence is sufficient. As an outsider it is near impossible to pick timing or likelihood of success, although recent evidence additions have been particularly compelling. A positive decision would enable consistent payments from CMS (which covers patients representing ~47% of PEB's US lab throughput) and likely be transformational for the company from a test adoption, revenue and cashflow standpoint. Listed comparatives provide tangible examples of this.
- COVID-19 – potential beneficiary; short-term pain for long-term gain:** Cxbladder is well placed to aid practitioners/patients with remote monitoring and/or diagnosis, with the test able to be performed in the home. Market anecdotes suggest regulatory barriers have been lowered for various remote tools and it could accelerate a pre-existing trend towards home-based healthcare. It is a strong (and growing) advantage for Cxbladder use and has also garnered PEB increased US industry media coverage. Nonetheless, COVID-19 was a shock to the system and we expect there was short-term disruption as practitioners worked through new ways of working – supported by PEB receiving NZ's wage subsidy (NZ\$182,770).
- Any further progress with guidelines:** Cxbladder was recently mentioned in the NCCN guidelines under a category 2B recommendation (July 2019). There is potential for other guidelines and/or a stronger mention, particularly given the strengthening evidence since then. Timeframes are unpredictable and there may be potential for disruption due to COVID-19.

#### Cash check

We forecast an FY20 net cash position of c. NZ\$17m (at 31 March), helped by the recent capital raise, which leaves ~13 months of cash on hand using historic burn rates (~NZ\$1.3m/month). There is upside risk to PEB's cash position given it excludes: (1) private insurance receivables, where payment is being sought (average payment timing 7–12 months), and (2) tests for CMS – if a coverage decision is achieved, tests to date may be partially reimbursed which could provide up to c.US\$13m in cash (using US\$760/test).

## Pacific Edge (PEB)

Priced as at 25 May 2020 (NZ\$)

0.12

### Research Insights

Forsyth Barr Research Insights focuses on qualitative rather than quantitative assessments of an equity investment.

We do not provide valuation, target prices or investment ratings for companies in the Research Insights series. It is targeted at selected smaller cap stocks with typically higher risk attributes, or those under transitional coverage.

Our earnings and cashflow forecasts, together with key valuation and ratios provided on this page should assist investors in determining the relative valuation merits of the company.

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	4.6	4.8	5.3	14.8	27.8	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
<b>Normalised EBITDA</b>	<b>(19.7)</b>	<b>(18.0)</b>	<b>(16.9)</b>	<b>(11.3)</b>	<b>(5.2)</b>	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	PE (x)	n/a	n/a	n/a	n/a	n/a
<b>Normalised EBIT</b>	<b>(20.0)</b>	<b>(18.2)</b>	<b>(17.1)</b>	<b>(11.5)</b>	<b>(5.4)</b>	Price/NTA (x)	3.1	4.2	3.6	14.7	75.1
Net interest	0.2	0.3	0.3	0.2	0.1	Free cash flow yield (%)	-30.1	-28.8	-26.2	-19.4	-7.6
Associate income	0	0	0	0	0	Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Tax	0	(0.0)	0	0	0.8	Gross dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>(19.8)</b>	<b>(17.9)</b>	<b>(16.8)</b>	<b>(11.3)</b>	<b>(4.5)</b>	<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Abnormals/other	0.0	(0.0)	0	0	0	Interest cover EBIT (x)	86.6	56.4	51.9	47.9	94.5
<b>Reported NPAT</b>	<b>(19.7)</b>	<b>(17.9)</b>	<b>(16.8)</b>	<b>(11.3)</b>	<b>(4.5)</b>	Interest cover EBITDA (x)	85.3	55.8	51.4	47.1	91.2
Normalised EPS (cps)	(4.7)	(3.7)	(3.3)	(1.6)	(0.7)	Net debt/ND+E (%)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	0	0	0	0	0	Net debt/EBITDA (x)	0.8	0.7	1.0	0.4	0.0
<b>Growth Rates</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Revenue (%)	7.6	3.6	10.2	>100	87.2	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	Return on equity (%)	n/a	n/a	n/a	n/a	n/a
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	n/a	n/a	n/a	n/a	n/a	EBITDA margin (%)	-424.4	-375.2	-319.1	-76.4	-18.7
Normalised EPS (%)	n/a	n/a	n/a	n/a	n/a	EBIT margin (%)	-430.9	-379.3	-322.7	-77.7	-19.4
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	7.2	3.2	3.6	1.3	0.7
						Capex to depreciation (%)	201	131	168	168	168
<b>Cash Flow (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Imputation (%)	0	0	0	0	0
<b>EBITDA</b>	<b>(19.7)</b>	<b>(18.0)</b>	<b>(16.9)</b>	<b>(11.3)</b>	<b>(5.2)</b>	Pay-out ratio (%)	0	0	0	0	0
Working capital change	1.5	0	0.7	(0.6)	(0.1)						
Interest & tax paid	0.1	0.4	0.3	0.2	0.1	<b>Operating Performance</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Other	(0.1)	0.2	0	(0.0)	0.8	NZDUSD cross rate	0.71	0.68	0.64	0.60	0.60
<b>Operating cash flow</b>	<b>(18.1)</b>	<b>(17.5)</b>	<b>(15.9)</b>	<b>(11.7)</b>	<b>(4.4)</b>						
Capital expenditure	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	<b>US market assumptions (US\$)</b>					
(Acquisitions)/divestments	0	0	0	0	0	Test - average sale price	n/a	n/a	850	850	850
Other	0	0	0	0	0	Cost of test	n/a	n/a	100	100	100
<b>Funding available/(required)</b>	<b>(18.4)</b>	<b>(17.7)</b>	<b>(16.1)</b>	<b>(11.9)</b>	<b>(4.6)</b>	Gross profit of test	n/a	n/a	750	750	750
Dividends paid	0	0	0	0	0	Gross margin (%)	n/a	n/a	88.2	88.2	88.2
Equity raised/(returned)	21.3	14.6	20.0	0	0						
<b>(Increase)/decrease in net debt</b>	<b>2.9</b>	<b>(3.1)</b>	<b>3.9</b>	<b>(11.9)</b>	<b>(4.6)</b>	<b>Revenue breakdown (NZ\$m)</b>					
						Cxbladder sales	3.4	3.8	5.1	14.6	27.6
<b>Balance Sheet (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Other	1.2	1.0	0.2	0.2	0.2
Working capital	(1.1)	(0.5)	(1.2)	(0.5)	(0.4)	<b>Total revenue</b>	<b>4.6</b>	<b>4.8</b>	<b>5.3</b>	<b>14.8</b>	<b>27.8</b>
Fixed assets	0.9	0.8	0.8	0.8	0.8						
Intangibles	0.3	0.2	0.2	0.2	0.2	<b>Potential market size - bladder cancer ('000 pa)</b>				<b>US</b>	<b>ANZ</b>
Right of use asset	0	0	0	0	0	New patients who present with haematuria				7,000	
Other assets	0.5	0.6	0.6	0.6	0.6	those who are worked up to look for bladder cancer				3,400	50
<b>Total funds employed</b>	<b>0.5</b>	<b>1.1</b>	<b>0.4</b>	<b>1.1</b>	<b>1.2</b>	New incidences of bladder cancer				81	3
Net debt/(cash)	(16.2)	(12.8)	(16.8)	(4.9)	(0.2)	No. of tests monitoring for recurrence				800	36
Lease liability	0	0	0	0	0	Total work-ups + recurrence monitoring				4,200	86
Other liabilities	0.1	0.1	0.1	0.1	0.1	<b>Addressable market used in forecasts</b>				<b>3,000</b>	<b>60</b>
Shareholder's funds	16.6	13.9	17.1	5.9	1.3						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>0.5</b>	<b>1.1</b>	<b>0.4</b>	<b>1.1</b>	<b>1.2</b>						

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

## Investment Summary

Pacific Edge (PEB) is a cancer diagnostics company in the early stages of commercialising its first product, Cxbladder. Investors continue to require patience, with the large US market challenging to secure reimbursement. Changing established clinical processes takes time, albeit the product remains well placed and clinical data continues to build. PEB is a speculative risk stock, reliant on converting key groups to commercial customers, with timing highly unpredictable (and outside of PEB's control). It has been painfully slow to date, however, the prize is large and things could change quickly.

### Business quality

- **Speculative risk:** Changing longstanding clinical practice is challenging and time consuming.
- **Strong clinical evidence:** PEB has a growing body of clinical data showing strong test performance, outperformance versus incumbent tests (including the 'gold standard') and strong clinical utility data.

### Earnings and cashflow outlook

- **Growing commercial adoption in its home market:** It has been painstakingly slow, however, strong progress is now being seen in New Zealand – with growing adoption and reimbursement for Cxbladder, including being introduced into Canterbury DHB's clinical guidelines for the assessment of haematuria.
- **Still waiting on key reimbursement milestones in the US to drive a well over-due step change for the business:** The market in the US is sizeable and indicative test prices highly attractive, albeit commercialisation is challenging and slow given a highly complex reimbursement landscape. The rate of conversion to commercial customers, particularly large customer groups, will be the key driver of the revenue/earnings path, however, is challenging to forecast. Lab throughput shows evidence of growing market awareness, albeit off a low base.
- **Attractive model as revenue builds:** High product margins and a highly scalable model means cash flow positive could occur fairly quickly with an acceleration in commercial test volumes.

### Financial structure

- **Small net cash position:** Cash burn remains a key focus and metric to monitor.

### Risk factors

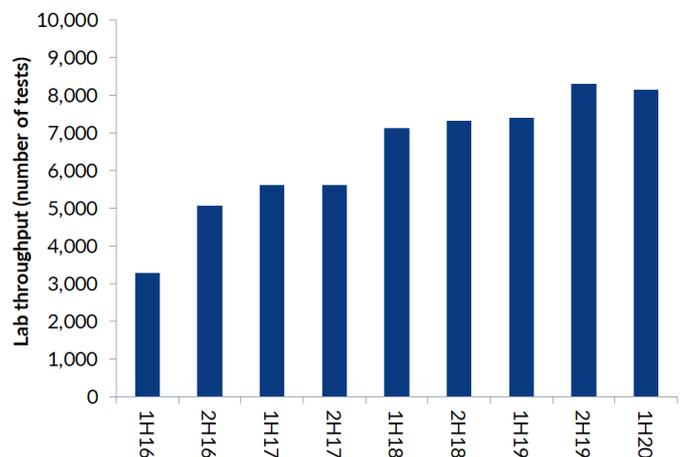
- **Long adoption curve:** Gaining acceptance and reimbursement from the medical community is critical to success but takes time. This is a risk, but also provides a high barrier to entry for competition.
- **New test/competing product:** Or a shift away from molecular diagnostics.

Figure 1. Cxbladder products and timing

<b>Detect</b>	• Rule in/out presence of bladder cancer
<b>Triage</b>	• Segregate patients w/out bladder cancer
<b>Monitor</b>	• Recurrence of bladder cancer
<b>Resolve</b>	• Classify tumour as low or high grade

Source: Forsyth Barr analysis, Company reports

Figure 2. Lab throughput (commercial & user programmes)



Source: Forsyth Barr analysis, Company reports

**Figure 3. Price performance**


Source: Forsyth Barr analysis

**Figure 4. Substantial shareholders**

Shareholder	Latest Holding
Harbour Asset Management	16.5%
Salt Funds Management	12.0%
AMP Capital Investors NZ	5.5%

Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 5. International valuation comparisons**

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect PEB's balance date - March)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
<b>Pacific Edge</b>	<b>PEB NZ</b>	<b>NZ\$0.12</b>	<b>NZ\$62</b>	<0x	<0x	<0x	<0x	<0x	<0x	<b>0.0%</b>
EXACT SCIENCES CORP	EXAS US	US\$83.59	US\$12,517	<0x	<0x	<0x	<0x	<0x	<0x	0.0%
CASTLE BIOSCIENCES INC	CSTL US	US\$37.93	US\$653	>50x	<0x	38.7x	<0x	>75x	>75x	n/a
MDXHEALTH	MDXH BB	€0.83	€58	<0x	n/a	<0x	<0x	<0x	<0x	n/a
MYRIAD GENETICS INC	MYGN US	US\$14.73	US\$1,098	<0x	<0x	<0x	<0x	<0x	<0x	n/a
<b>Compc Average:</b>				<b>n/a</b>	<b>n/a</b>	<b>38.7x</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>0.0%</b>
<b>PEB Relative:</b>				<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (PEB) companies fiscal year end

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