

Pacific Edge

FY20 Result — No Change in the Script

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RESEARCH INSIGHTS

Pacific Edge's (PEB) FY20 result provided little in the way of new information, with the company largely in a holding pattern until key reimbursement milestones in the US are achieved, which would support a well overdue step-change for the business. Progress continues to be frustratingly slow, despite a growing body of supportive clinical evidence and rationale for use. Our view remains that these milestones remain a question of 'when' rather than 'if', although patience continues to be tested.

NZX Code	PEB	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.12	NPAT* (NZ\$m)	-19.1	-11.2	-2.8	5.1	EV/EBITDA	n/a	n/a	n/a	10.6
Issued shares	510.9m	EPS* (NZc)	-3.7	-1.6	-0.4	0.7	EV/EBIT	n/a	n/a	n/a	11.4
Market cap	NZ\$61.3m	EPS growth* (%)	-1.0	56.8	74.9	n/a	PE	n/a	n/a	n/a	16.3
Avg daily turnover	379.1k (NZ\$54k)	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	4.3	26.2	n/a	15.2
		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

FY20 result — patience still required; underlying costs controlled

PEB reported FY20 product sales of NZ\$4.4m, up +14.5%, albeit below our forecasts. Total revenue of NZ\$5.0m was only modestly higher than FY19, given a material step-down in grant income. Reimbursement complexity, mix of customers and variability in cash collection timing makes underlying progress difficult to monitor. Taking this aside, progress was seen in both NZ and the US, albeit slower than we would like. Costs were well controlled, with constant currency growth ~+2%, slightly higher than our estimates.

COVID-19 saw material disruption to test volumes in April, although recovery in May, helped by growing demand for its in-home sample collection service. The latter is another advantage of Cxbladder over other tests, particularly given bladder cancer patients are also in the high risk category for COVID-19. Wage subsidies (in the US & NZ) will also help offset any short-term impact.

Near-term milestones

- **Coverage decision from public health insurer, CMS:** PEB submitted a dossier of evidence in August 2019 which is still under review. It is an iterative process, reliant on judgement of the available clinical evidence and whether it is sufficient for CMS to fund Cxbladder. As an outsider it is near impossible to pick timing or likelihood of success, however, recent evidence additions from PEB have been particularly compelling. A positive coverage decision would see a step-change in revenue and cashflow for PEB.
 - ~43% of PEB's FY20 US commercial tests were for CMS patients. We estimate if PEB had a positive coverage decision in FY20 then its revenue would have been c. NZ\$10.6m, rather than NZ\$5.0m, yet costs unchanged (as they are already being incurred).
- **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 stronger evidence since then. Timeframes are unpredictable but we understand there is an AUA guidelines meeting in late June 2020.

Cash watch

PEB reported net cash of NZ\$14.8m at FY20, reflecting ~12 months at current burn rates. There is upside risk to PEB's cash position given it excludes: (1) private insurance receivables (conservative estimate of NZ\$3.2m included in PEB's financial statement notes), 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; given 21,789 CMS tests have been performed to date this could provide up to c.US\$16.6m in cash (using US\$760/test). Nonetheless, the cash balance is once again tight.

Pacific Edge (PEB)

Priced as at 01 Jun 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)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	4.8	5.0	14.5	27.7	42.9	EV/EBITDA (x)	n/a	n/a	n/a	n/a	10.6
Normalised EBITDA	(18.0)	(19.0)	(10.9)	(2.4)	5.4	EV/EBIT (x)	n/a	n/a	n/a	n/a	11.4
Depreciation and amortisation	(0.2)	(0.4)	(0.4)	(0.4)	(0.4)	PE (x)	n/a	n/a	n/a	n/a	16.3
Normalised EBIT	(18.2)	(19.4)	(11.3)	(2.8)	5.0	Price/NTA (x)	4.2	4.3	26.2	>100x	15.2
Net interest	0.3	0.2	0.2	0.0	0.0	Free cash flow yield (%)	-28.8	-25.4	-18.1	-5.0	6.8
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	Gross dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Minority interests	0	0	0	0	0						
Normalised NPAT	(17.9)	(19.1)	(11.2)	(2.8)	5.1	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(0.0)	0.1	0	0	0	Interest cover EBIT (x)	56.4	77.9	68.0	72.9	n/a
Reported NPAT	(17.9)	(19.0)	(11.2)	(2.8)	5.1	Interest cover EBITDA (x)	55.8	76.2	65.6	62.4	n/a
Normalised EPS (cps)	(3.7)	(3.7)	(1.6)	(0.4)	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)	0.7	0.8	0.3	0.3	n/a
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	3.6	3.1	>100	91.0	54.8	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 (%)	-375.2	-383.2	-75.4	-8.8	12.7
Normalised EPS (%)	n/a	n/a	n/a	n/a	n/a	EBIT margin (%)	-379.3	-391.4	-78.2	-10.3	11.7
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	3.2	3.7	1.2	0.6	0.4
						Capex to depreciation (%)	131	53	51	51	51
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	0	0	0	0	0
EBITDA	(18.0)	(19.0)	(10.9)	(2.4)	5.4	Pay-out ratio (%)	0	0	0	0	0
Working capital change	0	0	(0.1)	(0.5)	(1.1)						
Interest & tax paid	0.4	0.2	0.2	0.0	0.0	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	0.2	3.4	(0.0)	0	0	NZDUSD cross rate	0.69	0.65	0.60	0.60	0.60
Operating cash flow	(17.5)	(15.4)	(10.9)	(2.9)	4.4						
Capital expenditure	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	US market assumptions (US\$)					
(Acquisitions)/divestments	0	0	0	0	0	Test - average sale price	n/a	n/a	900	900	900
Other	0	0	0	0	0	Cost of test	n/a	n/a	100	100	100
Funding available/(required)	(17.7)	(15.6)	(11.1)	(3.1)	4.2	Gross profit of test	n/a	n/a	800	800	800
Dividends paid	0	0	0	0	0	Gross margin (%)	n/a	n/a	88.9	88.9	88.9
Equity raised/(returned)	14.6	20.1	0	0	0						
(Increase)/decrease in net debt	(3.1)	4.6	(11.1)	(3.1)	4.2	Revenue breakdown (NZ\$m)					
						Cxbladder sales	3.8	4.4	13.5	27.2	42.4
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Other	1.0	0.6	1.0	0.5	0.5
Working capital	(0.5)	(1.8)	(1.7)	(1.2)	(0.1)	Total revenue	4.8	5.0	14.5	27.7	42.9
Fixed assets	0.8	0.7	0.4	0.2	(0.0)						
Intangibles	0.2	0.2	0.2	0.2	0.2						
Right of use asset	0	1.6	1.6	1.6	1.6	Potential market size - bladder cancer ('000 pa)				US	ANZ
Other assets	0.6	0.7	0.7	0.7	0.7	New patients who present with haematuria				7,000	
Total funds employed	1.1	1.3	1.2	1.5	2.4	those who are worked up to look for bladder cancer				3,400	50
Net debt/(cash)	(12.8)	(14.8)	(3.7)	(0.6)	(4.8)	New incidences of bladder cancer				81	3
Lease liability	0.1	1.6	1.6	1.6	1.6	No. of tests monitoring for recurrence				800	36
Other liabilities	0	0	0	0.0	0.0	Total work-ups + recurrence monitoring				4,200	86
Shareholder's funds	13.9	14.5	3.3	0.5	5.6	Addressable market used in forecasts				3,000	60
Minority interests	0	0	0	0	0						
Total funding sources	1.1	1.3	1.2	1.5	2.4						

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

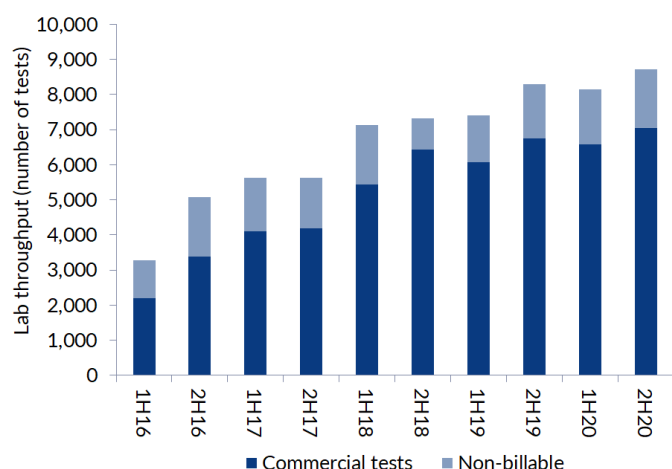
Key tables and charts

Figure 1. Result breakdown (NZ\$m)

NZ\$m	FY19	FY20	% chg	Forsyth Barr
Product sales	3.8	4.4	14.5%	5.1
Total revenue	4.8	5.0	3.1%	5.3
Underlying NPAT	(17.9)	(19.0)	-6.2%	(16.8)
Net debt (cash)	(12.8)	(14.8)	-15.1%	(16.8)
Net operating cash flow	(17.5)	(15.4)	12.1%	(15.9)
<u>Product sales</u>				
US	3.3	3.8	14.6%	4.4
Rest of World	0.5	0.6	13.6%	0.7
Total product sales	3.8	4.4	14.5%	5.1

Source: Forsyth Barr analysis, Company reports

Figure 3. Lab throughput trajectory



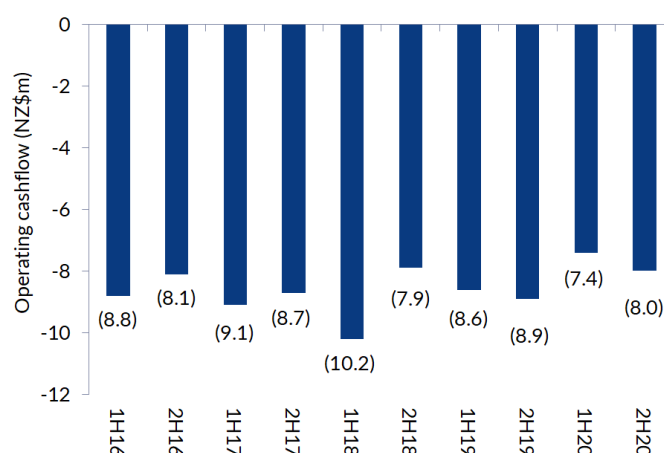
Source: Forsyth Barr analysis, Company reports

Figure 2. Other metrics of interest

NZ\$m	FY19	FY20	% chg
<u>Test numbers</u>			
Lab throughput	15,697	16,861	7.4%
Commercial tests	12,830	13,627	6.2%
CMS tests in the period (incl. in totals above)	4,727	4,774	1.0%
<u>Product sales (Cxb bladder)</u>			
As reported	3.8	4.4	14.5%
Implied CMS revenue (@ US\$760/test)	5.2	5.6	7.3%
Product sales (including CMS revenue)	9.1	10.0	10.3%
Total revenue (including CMS revenue)	10.1	10.6	5.2%

Source: Forsyth Barr analysis, Company reports

Figure 4. Cash burn



Source: Forsyth Barr analysis, Company reports

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 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. 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 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 is a key focus and metric to monitor.

Risk factors

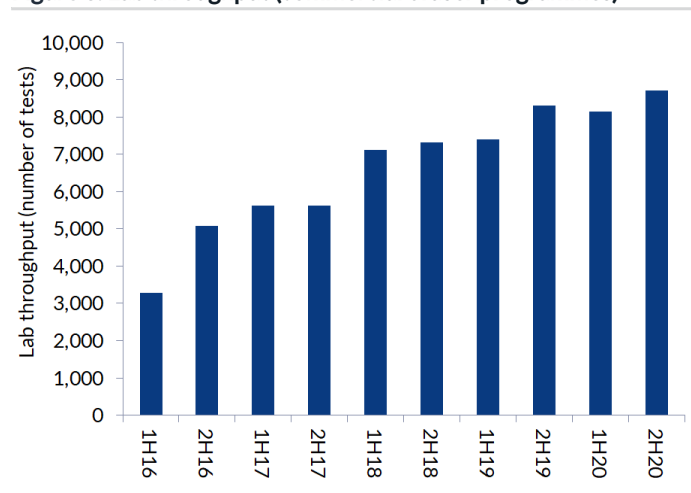
- **Long adoption curve:** Gaining acceptance and reimbursement from the medical community is critical to success but takes time. This is a risk, but also provides a high barrier to entry for competition
- **New test/competing product:** Or a shift away from molecular diagnostic.

Figure 5. Cxbladder products and timing

Detect	• Rule in/out presence of bladder cancer
Triage	• Segregate patients w/out bladder cancer
Monitor	• Recurrence of bladder cancer
Resolve	• Classify tumour as low or high grade. Commercial launch: late FY21 target.

Source: Forsyth Barr analysis, Company reports

Figure 6. Lab throughput (commercial & user programmes)



Source: Forsyth Barr analysis, Company reports

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. 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 9. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect PEB's balance date - March)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Pacific Edge	PEB NZ	NZ\$0.12	NZ\$61	<0x	<0x	<0x	<0x	<0x	<0x	0.0%
EXACT SCIENCES CORP	EXAS US	US\$83.59	US\$12,517	<0x	<0x	<0x	>75x	<0x	<0x	0.0%
CASTLE BIOSCIENCES INC	CSTL US	US\$37.93	US\$653	<0x	<0x	<0x	<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	23.6x	<0x	19.9x	<0x	19.8x	n/a
Compco Average:				n/a	23.6x	n/a	19.9x	n/a	19.8x	0.0%
PEB Relative:				n/a	n/a	n/a	n/a	n/a	n/a	n/a
EV = Current Market Cap + Actual Net Debt										

EV = Current Market Cap + Actual Net Debt

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

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