

Pacific Edge

1H21 Result – Edging Forward

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RESEARCH INSIGHTS

Pacific Edge (PEB) reported strong 1H21 revenue growth and an improved NPAT loss, however, COVID-19 was a larger handbrake to revenue growth momentum than we had forecast. A lot has changed in the past six months, given success with two long awaited transformational milestones in the US market which supports a step-change for the business. COVID-19 has clouded the short-term upside, however, the prize is substantial and headwinds are showing some signs of easing. There was nothing in the result to change our view of the opportunity or PEB's ability to capitalise on this. With the range of justifiable long-term outcomes wide, we expect the share price to be driven by newsflow in the near-term – which is likely to be positively skewed as further commercial progress follows recent success.

NZX Code	PEB	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.69	NPAT* (NZ\$m)	-19.1	-14.4	-3.5	8.1	PE	n/a	n/a	n/a	61.6
Issued shares	725.4m	EPS* (NZc)	-3.7	-2.0	-0.5	1.1	EV/EBIT	n/a	n/a	n/a	60.5
Market cap	NZ\$501m	EPS growth* (%)	-1.0	47.2	75.8	n/a	EV/EBITDA	n/a	n/a	n/a	57.5
Avg daily turnover	1,075k (NZ\$547k)	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	24.6	22.6	26.8	18.7
		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

1H21 – A plethora of moving parts, with COVID-19 and CMS the most notable features

PEB reported 1H21 product sales of NZ\$3.3m, up +46% on the prior year albeit below our expectations – with COVID-19 headwinds larger than anticipated. The combination of COVID-19 and first-time revenue/cash contribution from large US public health insurer, CMS, in 2Q21 complicates the read-through. Disclosure on monthly commercial test volume shows the materiality of the challenges of lockdowns (not helped by patient demographics skewed to those also at high-risk of COVID-19). Recent data points show a steady improvement as the US adapts to living with COVID-19, albeit it remains a handbrake likely moderating growth. Costs were well controlled, and cash receipt has materially improved since CMS coverage (helped by significantly improved payment terms).

Where to from here? We forecast a strong near-term revenue growth profile & operating leverage; quantum the key unknown

The 1H21 result includes two months of cash contribution from CMS, albeit no commercial orders from the recent contract with large US healthcare provider, Kaiser (started from November 2020). Both of these should ramp up meaningfully from 2H21 – to support a strong near-term growth profile. 2H has started well, with October cash receipts +68% and November tracking well. We expect leverage to growing revenue helped by an attractive gross margin (>85% in the key US market), even accounting for a step-up in cost investment. The range of reasonable and justifiable outcomes, particularly for the revenue trajectory, remains wide. That aside, the assumptions required to underpin current market pricing are not uncomfortable. However, there remains risk it takes longer than expected to deliver the required lift in revenue, particularly in the near-term. Potential near-term newsflow includes: new commercial agreement(s), stronger mention/inclusion in clinical guidelines, back payment from CMS, additional clinical evidence.

Off the 'cash watch' list

PEB reported net cash of NZ\$29m at 1H21. This equates to c. 23 months using 1H21 burn rates and significantly longer when considering forecast burn rates. There is also upside risk given it excludes: (1) private insurance receivables (which PEB is still cash accounting), and (2) tests for CMS patients prior to commercial coverage (22,634 tests; or ~US\$17m at US\$760/test) where partial reimbursement is feasible in the near future, albeit the quantum unforecastable. We do not include anything in our forecasts.

Pacific Edge (PEB)

Priced as at 26 Nov 2020 (NZ\$)

0.69

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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	11.6	27.7	43.4	EV/EBITDA (x)	n/a	n/a	n/a	n/a	57.5
Normalised EBITDA	(18.0)	(18.9)	(14.1)	(3.3)	8.3	EV/EBIT (x)	n/a	n/a	n/a	n/a	60.5
Depreciation and amortisation	(0.2)	(0.4)	(0.4)	(0.4)	(0.4)	PE (x)	n/a	n/a	n/a	n/a	61.6
Normalised EBIT	(18.2)	(19.3)	(14.5)	(3.7)	7.9	Price/NTA (x)	24.4	24.6	22.6	26.8	18.7
Net interest	0.3	0.2	0.2	0.2	0.2	Free cash flow yield (%)	-3.5	-3.1	-2.7	-0.9	1.3
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)	(14.4)	(3.5)	8.1	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(0.0)	0.1	0	0	0	Interest cover EBIT (x)	56.4	>100x	76.1	17.3	n/a
Reported NPAT	(17.9)	(19.0)	(14.4)	(3.5)	8.1	Interest cover EBITDA (x)	55.8	>100x	74.0	15.4	n/a
Normalised EPS (cps)	(3.7)	(3.7)	(2.0)	(0.5)	1.1	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	1.7	5.8	n/a
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	3.6	3.1	>100	>100	56.8	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	-381.9	-122.0	-11.9	19.1
Normalised EPS (%)	n/a	n/a	n/a	n/a	n/a	EBIT margin (%)	-379.3	-390.1	-125.5	-13.3	18.2
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	3.2	3.7	1.5	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)	(18.9)	(14.1)	(3.3)	8.3	Pay-out ratio (%)	0	0	0	0	0
Working capital change	0	0	0.6	(1.0)	(1.9)						
Interest & tax paid	0.4	0.2	0.2	0.2	0.2	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	0.2	3.3	0	0	0	NZDUSD cross rate	0.69	0.65	0.68	0.68	0.68
Operating cash flow	(17.5)	(15.4)	(13.4)	(4.1)	6.7						
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	800	800	800
Other	0	0	0	0	0	Cost of test	n/a	n/a	100	100	100
Funding available/(required)	(17.7)	(15.6)	(13.6)	(4.3)	6.5	Gross profit of test	n/a	n/a	700	700	700
Dividends paid	0	0	0	0	0	Gross margin (%)	n/a	n/a	87.5	87.5	87.5
Equity raised/(returned)	14.6	20.1	22.2	0	0						
(Increase)/decrease in net debt	(3.1)	4.6	8.6	(4.3)	6.5	Revenue breakdown (NZ\$m)					
						Cxbladder sales	3.8	4.4	10.6	27.2	42.9
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)	(2.4)	(1.3)	0.5	Total revenue	4.8	5.0	11.6	27.7	43.4
Fixed assets	0.8	0.7	0.7	0.7	0.7						
Intangibles	0.2	0.2	0.2	0.2	0.2	Potential market size - bladder cancer ('000 pa)				US	ANZ
Right of use asset	0	1.6	1.3	1.1	0.8	New patients who present with haematuria				7,000	
Other assets	0.6	0.7	0.7	0.7	0.7	those who are worked up to look for bladder cancer				3,400	50
Total funds employed	1.1	1.3	0.5	1.3	2.9	New incidences of bladder cancer				81	3
Net debt/(cash)	(12.8)	(14.8)	(23.4)	(19.1)	(25.6)	No. of tests monitoring for recurrence				800	36
Lease liability	0.1	1.6	1.6	1.6	1.6	Total work-ups + recurrence monitoring				4,200	86
Other liabilities	0	0	0	0	0	Addressable market used in forecasts				3,000	60
Shareholder's funds	13.9	14.5	22.4	18.9	27.0						
Minority interests	0	0	0	0	0						
Total funding sources	1.1	1.3	0.5	1.3	2.9						

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

1H21 result snapshot

PEB reported a 1H21 NPAT loss of -NZ\$7.1m, better than we forecast despite lower product sales. The key difference versus our expectations is best summed up by COVID-19 – with a material dent in test orders through the initial peak COVID-19 months in the US, offset by a reduction in opex.

Figure 1. Result breakdown (NZ\$m)

NZ\$m	1H20	1H21	% chg	Forsyth Barr
Product sales	2.3	3.3	46%	4.1
Total revenue	2.6	3.9	51%	4.3
Total costs	(11.3)	(10.4)	8%	(12.3)
EBITDA	(8.8)	(6.5)	26%	(8.0)
Underlying NPAT	(9.4)	(7.1)	24%	(8.1)
Underlying EPS (cps)	(1.8)	(1.0)	47%	(1.2)
DPS (cps)	0.0	0.0	n/a	0.0
Net debt (cash)	(4.7)	(29.3)	n/a	(28.5)

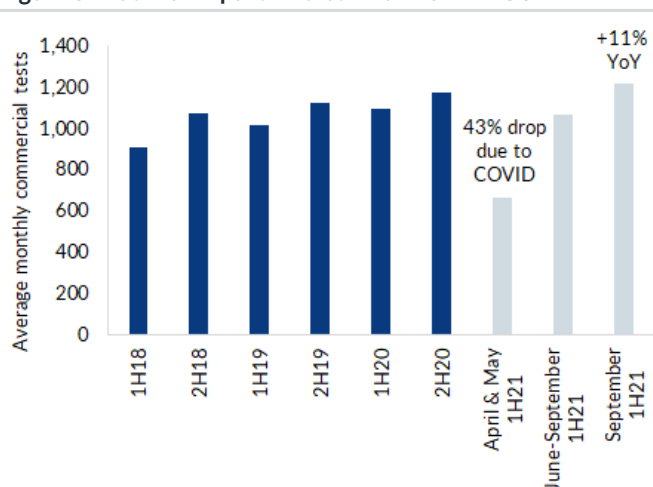
Source: Forsyth Barr analysis, Company reports

Figure 2. Divisional detail (NZ\$m)

NZ\$m	1H20	1H21	% chg	Share of total
<u>Test numbers</u>				
US	5,293	3,970	-25%	71%
Rest of World	1,374	1,621	18%	29%
Total commercial tests	6,573	5,591	-15%	100%
<u>Revenue breakdown</u>				
US	2.0	2.9	46%	87%
Rest of World	0.3	0.4	40%	13%
Total product sales	2.3	3.3	46%	100%

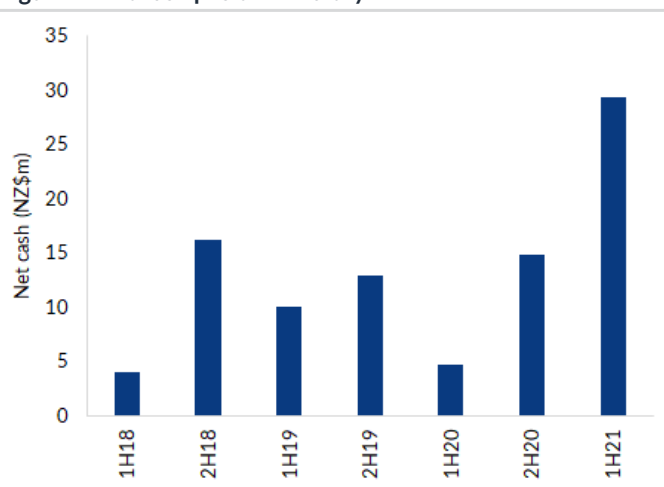
Source: Forsyth Barr analysis, Company reports

Figure 3. Material impact on test volumes from COVID-19



Source: Forsyth Barr analysis, Company reports

Figure 4. Net cash position healthy



Source: Forsyth Barr analysis, Company reports

Earnings revisions

We have lowered our near-term revenue path for the US to take into account a larger impact on test volumes from COVID-19. Our medium-term changes are more modest in USD, albeit a stronger NZ dollar has amplified the change.

Despite costs being lower than we anticipated in 1H21, messaging was clear that PEB is planning to lift investment (primarily in personnel) in the near-term. This aligns with our modelling, which already assumed a step-up in cost (particularly sales reps), hence, our forecast cost trajectory is broadly unchanged.

Figure 5. Earnings revisions (NZ\$m)

NZ\$m	FY20A		FY21E		FY22E			FY23E		
	Actual	Old	New	chg	Old	New	chg	Old	New	chg
Total revenue	4.4	15.2	11.6	(3.6)	31.0	27.7	(3.4)	46.6	43.4	(3.2)
Underlying NPAT	(19.0)	(10.9)	(14.4)	(3.4)	0.7	(3.5)	(4.2)	12.6	8.1	(4.5)
Underlying EPS (cps)	(2.8)	(1.6)	(2.0)	(0.4)	0.1	(0.5)	(0.6)	1.8	1.1	(0.7)
DPS (cps)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Forsyth Barr analysis, Company reports

What does the share price imply?

There remains a lot we don't know and the revenue trajectory is still highly uncertain. Putting that aside, the assumptions required to underpin current market pricing are not uncomfortable. However, we continue to see risk it takes longer than expected to deliver the required ramp in revenue, particularly in the near-term. This was reinforced by the weaker 1H21 revenue versus our expectations.

Our analysis suggests the current market price (NZ\$0.69) implies:

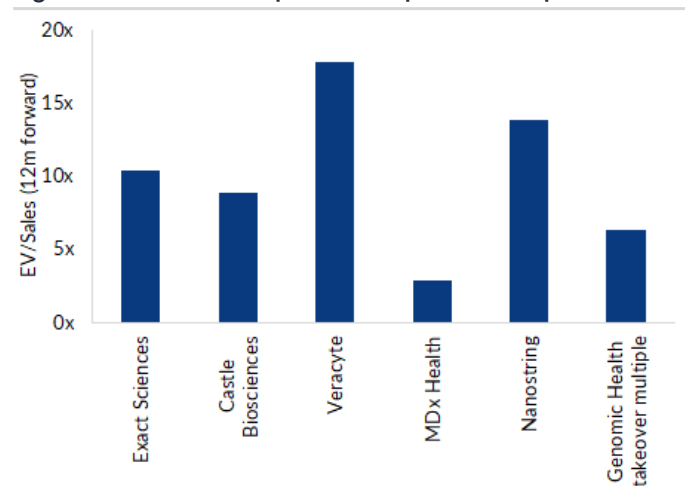
- Using a DCF: Unsurprisingly, a DCF valuation on PEB (using a WACC of 7.4%) is highly sensitive to the earnings path, particularly in latter years (with valuation highly weighted to the terminal). Back-solving, the current share price implies a longer-term EBIT margin of 45% and revenue reaching NZ\$120m in our terminal year (or <5% of our assessed US market revenue opportunity).
- Using peer multiples: At the current price, investors are paying for PEB to reach c. NZ\$50-55m of revenue (using an average EV/sales multiple of ~10x). For reference, we forecast the company to reach this level of revenue by FY24E.

Figure 6. Valuation highly sensitive to EBIT path

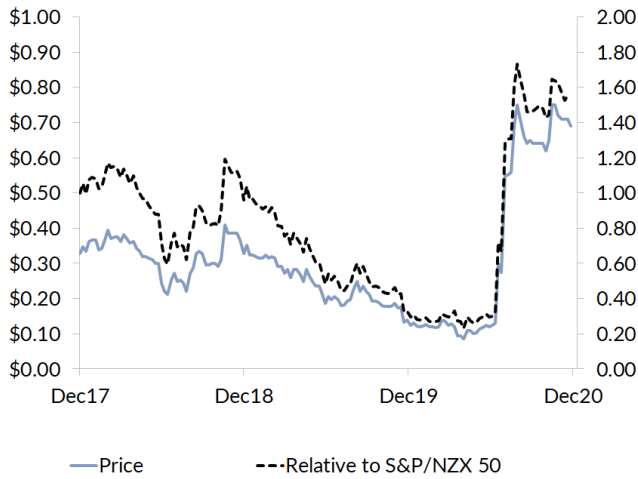
		Revenue in Yr 10				
		80	100	120	140	160
	35%	0.38	0.46	0.53	0.61	0.68
EBIT margin	40%	0.43	0.52	0.60	0.69	0.77
Yr 5-10	45%	0.48	0.57	0.68	0.77	0.86
	50%	0.53	0.63	0.74	0.85	0.95
	55%	0.57	0.69	0.81	0.93	1.04

Source: Forsyth Barr analysis

Figure 7. Valuation multiples for comparative companies



Source: Forsyth Barr analysis, Company reports

Figure 8. Price performance


Source: Forsyth Barr analysis

Figure 9. Substantial shareholders

Shareholder	Latest Holding
Harbour Asset Management & Jarden Securities Limited	14.5%
Salt Funds Management	12.0%
AMP Capital Investors NZ	5.2%
ANZ NZ Investments	5.1%

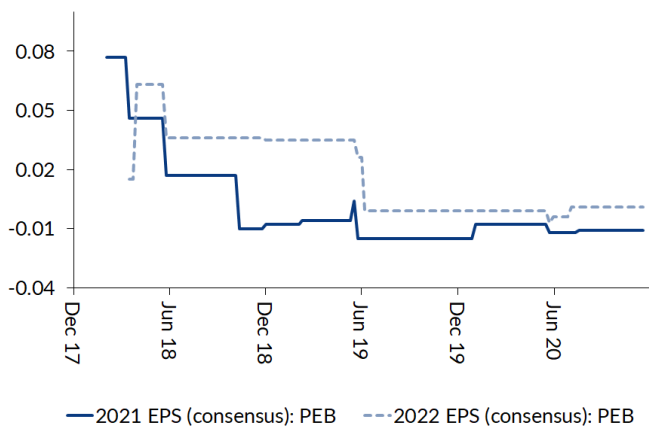
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

Company (metrics re-weighted to reflect PEB's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Pacific Edge	PEB NZ	NZ\$0.69	NZ\$501	<0x	<0x	<0x	<0x	<0x	<0x	0.0%
EXACT SCIENCES CORP	EXAS US	US\$115.23	US\$18,325	<0x	<0x	>75x	>75x	<0x	>75x	0.0%
CASTLE BIOSCIENCES INC	CSTL US	US\$48.08	US\$957	<0x	<0x	<0x	<0x	<0x	>75x	n/a
MDXHEALTH	MDXH BB	€0.88	€80	<0x	<0x	<0x	<0x	<0x	<0x	n/a
MYRIAD GENETICS INC	MYGN US	US\$17.21	US\$1,294	<0x	8.8x	<0x	<0x	<0x	<0x	n/a
Comppo Average:				n/a	8.8x	n/a	n/a	n/a	n/a	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

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

Figure 11. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

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