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CogState Limited (CGS)

Solid 2H11 Performance; Acquires Remaining 50% of Axon Sports

Outperform

\$0.17

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Key Points

CogState has reported FY11 sales of \$8.1m down 14%, with cc sales down 3% on pcp, per earlier guidance.

FY11 operating break even, with \$0.6m in Axon Sports JV and \$0.2m in FX providing an FY11 NPAT loss of \$0.8m, \$0.3m ahead of estimates.

2H11 clinical sales contracts of US\$5.5m up 44.7% on the 1H11 with \$0.7m in annual cost reductions from FY12 via staff reductions.

Positive operating cash flow of \$0.6m recorded, with closing cash of \$3.3m beating our estimates by 17.9%.

YTD revenue run rate for FY12 stands at US\$3.9m representing 48.1% of FY11 US\$ clinical revenues, providing confidence in the outlook.

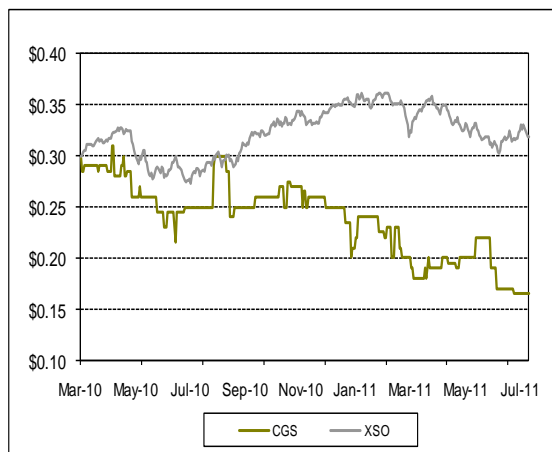
Summary

Market Capitalisation (M)	\$12.7
Shares on Issue (M)	74.6
Share price	\$0.17
Cash (M) as at 30/6/11	\$3.3
Valuation Per Share & Price Target	\$0.52
52 week low	\$0.15
52 week high	\$0.28
Ave Monthly Vol (Yr Rolling)(M)	0.8

Key Financials (A\$'000)

Year End	2010	2011	2012
	Actual	Actual	Est.
Product Sales	9,485	8,133	10,244
EBITDA	1,017	(484)	1,510
EBIT	584	(907)	1,002
Normalised NPAT	1,590	107	1,180
Reported Profit	1,638	(846)	1,120
Normalised EPS (c)	2.4	0.2	1.6
Reported EPS (c)	2.5	(1.3)	1.5
Norm. PE Ratio (x)	7.0	105.7	10.6
Rep. PE Ratio (x)	6.8	n/a	11.1
ROE (%)	27.4%	-12.7%	14.4%

Share Price Graph (A\$)



Our View

- Excellent 2H11 Growth Ensured a Respectable FY Result in Light of FX** – The reported 2H11 growth rate over the 1H was only slightly below our estimates, driven by higher value, later stage clinical trial contracts. Total sales contracts signed during FY11 were US\$9.3m, up 5.4% on pcp, despite a 44.7% decrease in the actual number of contracts signed. We anticipate this will remain a core thematic for FY12 and FY13, particularly given the strength in the number of later stage Alzheimer's Disease (AD) studies on offer.
- Buy Out of Axon Sports JV, Dementia Screening Motors Along** – The Company announced the acquisition of the remaining 50% in Axon Sports LLC for consideration of \$1.27m in scrip. CogState has committed approx. \$0.8m into the JV since FY10. Quixote investment now holds a 17.4% stake. In the US, the vast majority of States now legislate or are considering legislating concussion management programs in high schools. Axon revenues are expected to increase significantly in FY12 onwards. CogState believe the dementia screening opportunity, currently under assessment with the 1,000 patient AIBL study in Australia, is worth potentially US\$500m p/a. In our view, dementia screening will be driven by the progressive introduction of disease modifying drugs for AD, where a "companion" dementia screen will track progress of the patient and the effect of drug intervention in the disease process. CogState has indicated it is in early stage negotiations with two large pharma companies who would seek to market the low cost test to clinicians.
- Outlook** – We are forecasting an FY12 reported NPAT of \$1.1m, on sales growth of 26.0% on pcp. On this basis, CogState trades on a PER of 11.1x and an EV/Sales of just 0.8x, despite the growth potential. Our DCF valuation and 12 month valuation of \$0.52 reflects the outlook for both concussion mgt and clinical trial income. Given the strong start to FY12 from the clinical trials business and progressive contribution from Axon Sports to future earnings, coupled with the blue sky of dementia screening, we maintain our Outperform recommendation.

FY11 NPAT Overview

Reported FY11 NPAT loss of \$0.8m.

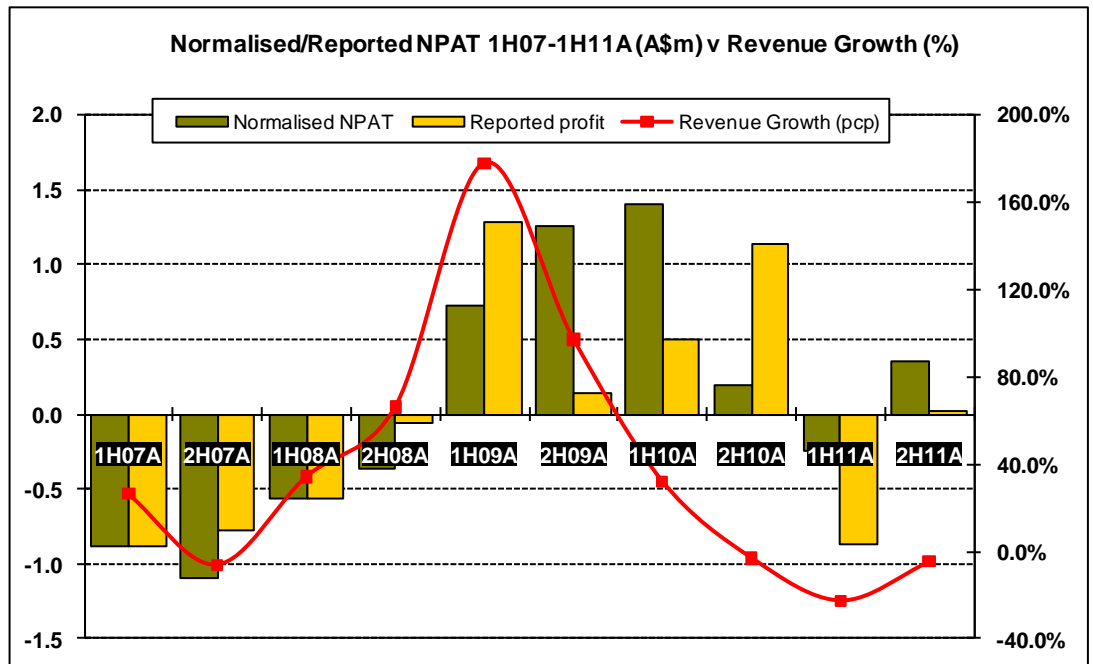
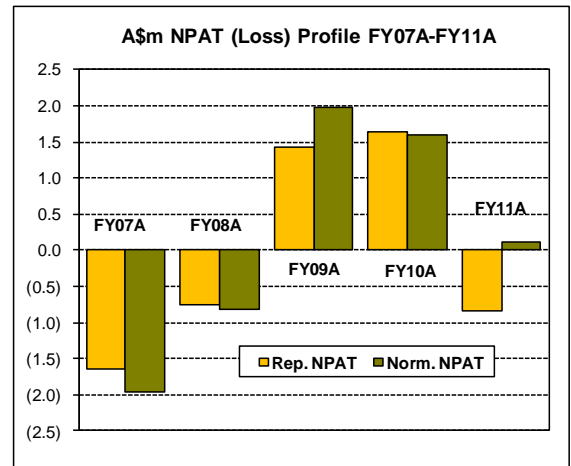
CogState has reported an FY11 NPAT loss of \$0.8m, impacted predominately by FX translations on US\$ revenues, which declined 3% on pcp. Recognised total sales revenues of \$8.1m was down 14.0% on pcp. Normalised NPAT came in at \$0.1m, well down on pcp.

Heavily impacted on FX with US\$ sales base and A\$ cost base.

The result was heavily impacted by FX. However, overall contracts signed during FY11 were US\$9.3m, which was up 5.4% on pcp, providing a reasonable FY12 run rate recognition of US\$3.9m, representing 48.1% of FY11 US\$ contract sales – a solid start.

2H11 was profitable.

Examining the business on a reported v normalised basis, excluding the effects of tax credits, UBC termination payments, product development expenditure, FX, gains on derivatives, restructuring or other one-offs, we note the business recorded a profitable 2H11 and a small 1H11 loss.



Financial Highlights

The financial highlights for FY11 are shown below.

Financial Highlights FY11

	FY10	FY11	Change (%)	TC est. FY11	Difference (%)	Comment
Sales Revenue	9.5	8.1	-14.3%	8.1	0.1%	Was 15.1% below our expectations, prior to guidance in July
SG&A Expenditure	(5.0)	(4.4)	-10.9%	(4.3)	3.8%	
EBITDA	1.0	(0.5)	n/a	(0.4)	29.3%	
Reported NPAT	1.6	(0.8)	n/a	(0.8)	2.8%	Per guidance set in July, was 73% worse than expected
Normalised NPAT*	1.6	0.1	-93.3%	0.4	-69.8%	39% below expectations, but reasonable given FX and rev. decline

* Ex-FX, UBC payments, product dev costs, tax credits; Source: CogState reports; TC est.

The headline results on a half versus half basis are shown below. The split highlights the turnaround in the business from a loss reported for both normalised and reported profit in the 1H. The business recorded positive EBITDA and EBIT in the 2H.

Positive EBIT,
ENITDA in 2H11.

Half on Half Splits					
	FY10		FY11		
	1H	2H	1H	2H	
Total Revenue	5.2	4.5	4.2	4.1	
	<i>1H/2H Split</i>	<i>53.5%</i>	<i>46.5%</i>	<i>50.3%</i>	<i>49.7%</i>
EBITDA	0.9	0.1	-0.7	0.2	
	<i>1H/2H Split</i>	<i>90.0%</i>	<i>10.0%</i>	<i>n/a</i>	<i>n/a</i>
Normalised NPAT *	1.4	0.2	-0.2	0.3	
	<i>1H/2H Split</i>	<i>87.9%</i>	<i>12.1%</i>	<i>n/a</i>	<i>n/a</i>
Reported Profit	0.5	1.1	-0.9	0.0	
	<i>1H/2H Split</i>	<i>30.8%</i>	<i>69.2%</i>	<i>n/a</i>	<i>n/a</i>

* Ex -FX, UBC, product dev costs, tax credits; Source: CogState reports; TC est.

The Company recorded operating cash flow of \$0.6m and net cash flow of \$0.3m for the FY, an excellent result.

Margin Analysis

Gross Margins declined significantly on pcp (870 bps reversal) owing to the high fixed cost (salary) component in A\$, and lower A\$ translated sales as a result of FX headwinds on US\$ sales contracts. Approximately 99% of sales are in US\$ with a 75% A\$ cost base.

Margin Analysis

Gross Margin decline
by 870 bps over pcp.

	FY10	FY11	Change	Comment
Sales Revenue	9.5	8.1	-14.3%	
Cost of Sales	(3.5)	(3.4)	-2.9%	Impacted by FX and higher A\$ fixed cost component
<i>Gross Margin</i>	<i>62.4%</i>	<i>53.7%</i>	<i>-870 bps</i>	
EBITDA	1.0	(0.5)	n/a	
<i>EBITDA Margin</i>	<i>22.2%</i>	<i>-5.8%</i>		Reversal of EBITDA margin on FX effect
EBIT	1.8	(0.9)	n/a	
<i>EBIT Margin</i>	<i>19.4%</i>	<i>-10.9%</i>		
Reported NPAT	1.6	(0.8)	n/a	FY10 aided by \$13m income tax credit
<i>NPAT Margin</i>	<i>17.1%</i>	<i>-10.4%</i>		

Source: CogState reports TC est.

Post Reporting Events – Buy Out of Axon JV

CogState has gained
100% control in its
Axon Sports JV.

CogState recently announced the buyout of the remaining 50% of its Axon Sports LLC joint venture with Quixote investments, LLC for \$1.3m in scrip, implying a valuation of Axon of ~\$2.6m with \$2.4m in goodwill/intangibles upon acquisition. Both parties invested ~\$1.6m to date into the JV, with only modest sales to date. Quixote has also obtained additional scrip (5.5m) in **CogState** via the exit of the long standing shareholder, GBS ventures which has resulted in a net stake of 17.4% in the Company.

Consideration of
\$1.3m in scrip.

CogState has commented it will be able to progress current discussions with large pharma companies using the **CogState** technology available as a low cost, non-invasive screening tool for clinicians.

Outlook

As with previous years, the profit driver for FY12 remains further contracts in the clinical trials business. We see an emerging business opportunity in Alzheimer's Disease clinical trials, which is an area of intense interest to pharmaceutical and biotechnology companies. There are approximately 75-100 clinical trials being undertaken globally, with **CogState** providing a highly validated and emerging tool (NTB test) used in such trials.

The clinical interest has led to the development by **CogState** of its dementia screening tool, which is being utilised in a large clinical study. Early stage discussions with two large pharmaceutical companies provide some comfort if transacted. **CogState** estimate this market to be worth over US\$500m p/a in the US alone, assuming annual assessment for the over 50s. We note the compulsory screening using cognitive measures in the US commencing from 2011.

We are forecasting an FY12 reported NPAT of \$1.1m, on sales growth of 26.0% on pcp. On this basis, CogState trades on a PER of 11.1x and an EV/Sales of just 0.8x, despite the growth potential. Our DCF valuation and 12 month valuation of \$0.52 reflects the outlook for both concussion mgt and clinical trial income moving forward. Given the strong start to FY12 from the clinical trials business and progressive contribution from Axon Sports to future earnings, coupled with the blue sky of dementia screening, we maintain our Outperform recommendation.

*Maintain Outperform.
PT of \$0.52.*

CGS - Summary of Forecasts

CGS \$ 0.17

PROFIT & LOSS SUMMARY (A\$000s)					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
Product Sales	8,387	9,485	8,133	10,244	13,964
<i>Growth (pcp)</i>	217%	13.1%	-14.3%	26.0%	36.3%
Total Revenue	9,103	9,747	8,304	10,392	14,163
Cost of Sales	(2,576)	(3,484)	(3,383)	(3,945)	(4,978)
<i>Gross Margin (%)</i>	68.0%	62.4%	53.7%	58.9%	61.6%
EBITDA	2,019	1,017	(484)	1,510	3,267
Dep'n/Other Amort'n	(257)	(433)	(423)	(508)	(428)
EBIT	1,762	584	(907)	1,002	2,839
Net Interest	106	101	115	149	199
Pre-Tax Profit	1,868	685	(792)	1,150	3,038
Tax Expense	138	1257	72	0	0
Minorities	0	0	0	0	0
Normalised NPAT*	1,987	1,590	107	1,180	3,038
NPAT Adj.**	2,006	1,942	(720)	1,150	3,038
<i>Growth (pcp)</i>	n/a	-3.2%	-137.1%	259.8%	164.1%
Net Adjustments	(576)	(304)	(126)	(30)	0
Reported Profit	1,430	1,638	(846)	1,120	3,038

PER SHARE DATA					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
Adjusted EPS (c)	3.1	2.9	(1.1)	1.6	4.1
<i>Growth (pcp)</i>	n/a	-6.32%	-136.74%	-244.89%	159.69%
Reported EPS (c)	2.2	2.5	(1.3)	1.5	4.1
<i>Growth (pcp)</i>	n/a	10.8%	-151.2%	-220.1%	166.6%
Normalised EPS (c)	3.1	2.4	0.2	1.6	4.1
<i>Growth (pcp)</i>	n/a	-22.6%	-93.3%	900.4%	153.1%
Dividend (c)	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%
Gross CF per Share (c)	2.3	2.4	0.0	1.8	4.2
NTA per share (c)	7.1	10.0	8.9	9.3	13.3

KEY RATIOS					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
EBITDA/Sales Margin %	22.2%	10.4%	-5.8%	14.5%	23.1%
EBIT/Sales Margin %	19.4%	6.0%	-10.9%	9.6%	20.0%
Current ratio (x)	3.5	3.1	3.2	3.3	3.9
Net Debt : Equity (%)	-61.4%	-44.0%	-52.4%	-47.8%	-62.4%
ROE (%)	41.7%	27.4%	-12.7%	14.4%	28.7%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
Adj. PE Ratio (x)	5.4	5.8	n/a	10.8	4.2
Normalised PE Ratio (x)	5.5	7.0	10.7	10.6	4.2
PE Ratio (x)	7.6	6.8	n/a	11.1	4.2
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EV/Sales (x)	12	10	12	0.8	0.4
EV/EBITDA (x)	4.8	9.4	n/a	5.5	1.6
EV/EBIT (x)	5.5	16.4	n/a	8.2	1.9

CAPITAL RAISING ASSUMPTIONS					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
Shares Issued (m)	13.7	0.0	0.0	0.0	0.0
Issue Price (A\$)	0.10	0.00	0.00	0.00	0.00
Cash Raised (A\$m)	14	0.0	0.0	0.0	0.0

BALANCE SHEET SUMMARY					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
Cash	3,030	3,092	3,306	4,425	7,410
Receivables	2,146	1,623	1,203	2,049	2,793
Pre Payments	29	59	0	0	0
Inventories	0	0	0	0	0
Other	60	212	410	410	410
Total Current Assets	5,265	4,986	4,919	6,884	10,612
Investments in JV	0	563	116	0	0
Property Plant & Equip	698	1,236	905	684	635
Intangibles	402	402	402	2,417	1,958
Other	108	2,020	1,632	1,398	1,398
Total Non-Current Assets	1,208	3,658	2,939	4,499	3,991
TOTAL ASSETS	6,473	8,644	7,858	11,382	14,603
Accounts Payable	1,199	1,132	1,027	1,537	1,955
Provisions	271	406	491	512	698
Other	41	47	10	42	42
Total Current Liab	1,511	1,585	1,528	2,091	2,695
Borrowings	0	0	0	0	0
Provisions	26	38	25	25	25
Other	0	0	0	0	0
Total Non-Current Liab	26	38	25	25	25
TOTAL LIABILITIES	1,537	1,623	1,553	2,116	2,720
TOTAL EQUITY	4,936	7,021	6,305	9,267	11,883

CASH FLOW SUMMARY					
Period	FY09A	FY10A	FY11A	FY12E	FY13E
EBIT (excl Abs/Extr)	1,762	584	(907)	1,002	2,839
Add: Depreciation	257	433	423	266	232
Change in Pay.	673	(67)	(105)	510	418
Less: Tax paid	205	0	72	0	0
Net Interest	106	101	115	149	199
Change in Rec.	(1533)	523	420	(849)	(747)
Gross Cashflows	1,470	1,574	18	1,319	3,138
Capex	(495)	(933)	(103)	(200)	(200)
Free Cashflows	975	641	(85)	1,119	2,938
Other	891	(521)	386	(0)	47
Dividends Paid	0	0	0	0	0
Net Cash Flow	1,866	120	301	1,119	2,985
Effect of FX on Cash	116	(58)	(87)	0	0

CURRENCY FORECASTS			
	FY11A	FY12E	FY13E
AUD/USD	0.96	0.98	0.85

* Excludes UBC termination payments, FX gains/losses, one-off product dev, one-off tax credits, Axon JV losses; ** Ex-UBC payments only

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