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CogState Limited (CGS)

FY14 PBT Loss within Guidance; Refocused on Core Strengths

Outperform

\$0.28

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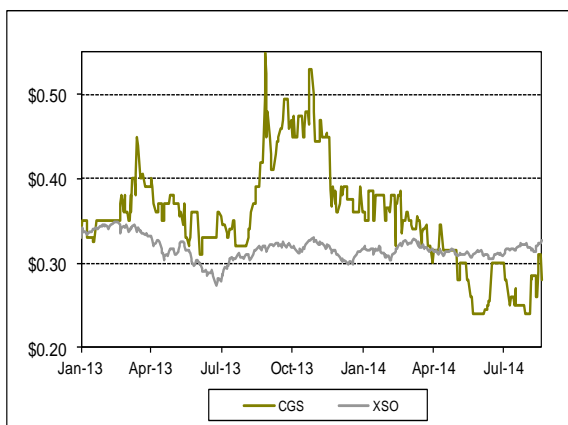
Summary

Market Capitalisation (M)	\$27.7
Shares on Issue (M)	99.0
Share price	\$0.28
Cash (M) as at 30/6/14	\$7.1
Valuation Per Share & Price Target	\$0.52
52 week low	\$0.24
52 week high	\$0.55
Ave Monthly Vol (Yr Rolling)(M)	0.6

Key Financials (A\$'000)

Year End	2014 Actual	2015 Est.	2016 Est.
Product Sales	12,265	15,437	21,316
EBITDA	(3,965)	1,416	4,510
EBIT	(4,649)	586	3,755
Adjusted NPAT	(3,888)	613	3,020
Reported Profit	(3,888)	613	3,020
Adjusted EPS (c)	(4.3)	0.6	3.1
Reported EPS (c)	(4.3)	0.6	3.1
Adj. PE Ratio (x)	n/a	45.2	9.2
Rep. PE Ratio (x)	n/a	45.2	9.2
ROE (%)	-35.6%	4.6%	19.8%

Share Price Graph (A\$)



FY14 Key Points

Reported PBT loss of \$4.5m at the lower end of recent guidance (\$4.5-\$5.0m).

Product sales growth of -1.6% to \$12.3m was within guidance and reflected a decline in new contracts signed and contract completion.

Gross margins slumped to 44.2% from 58.5% in the pcp, reflecting headcount expansion in clinical business without top-line benefits.

Clinical trials EBIT margins contracted to 28.9% from 54.9% in the pcp.

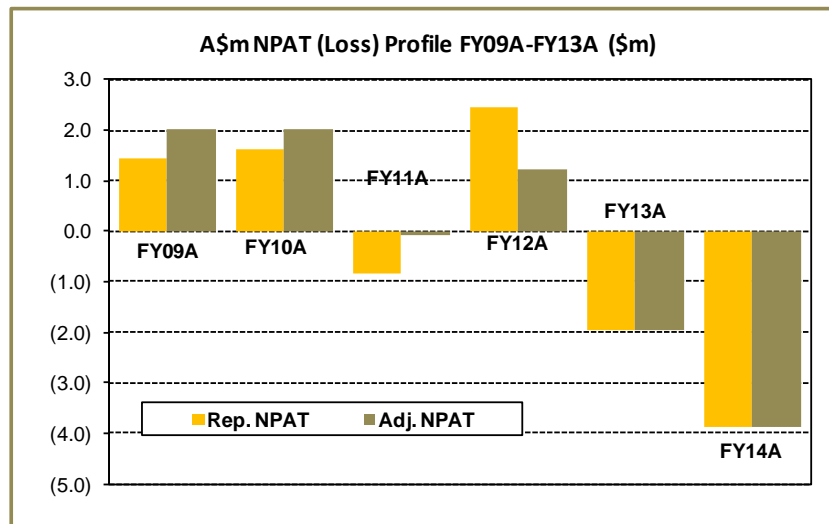
FY14 closing cash and cash equivalents of \$7.1m.

Our View

- Thematic of Flat Revenue and Double Digit Operating Expenditures Continued in FY14** – Additional investment into the Clinical Trials segment magnified a 48% decline in segment EBIT to \$3.4m despite only a 2% decline in revenues. Additional investments were made into launching the Precision Recruitment web tool for streamlining patient recruitment into clinical trials (\$0.3m), which delivered a US\$1.8m contract in late 4Q14, along with investment into Axon Sports (\$1.3m) and COGNIGRAM (\$0.6m). Pleasingly, following such a tough year, where the Company was also forced to raise an additional \$7.5m in capital to fund its operations, contracted revenue in 1Q15 to be recognised over future periods is a healthy \$19.7m up 104% on the pcp, highlighting the strong start to FY15.
- Axon Sports, COGNIGRAM™ Segments EBIT Losses Grow** – CogState intends to divest Axon Sports, with expressions of interest currently sought. Axon recorded an FY14 EBIT loss of \$1.4m (up 13.2% on pcp) on a -30% sales result. COGNIGRAM™ recorded an EBIT loss of \$0.6m (up 11.2% on pcp), with negligible sales to date. Merck returned COGNIGRAM™ to CogState in the Canadian market during 2H14. While an exciting tool for detecting subtle cognitive changes over time and therefore of great clinical interest, uptake has been slower than anticipated from the GP community reflecting the lack of effective (and approved) Alzheimer's Disease (AD) drugs.
- Outlook** – Since executing a \$7.3m pharma contract, CogState has signed an additional \$0.8m contract, taking the value of contracts signed to over \$9.0m, with \$9.1m of revenues to be recognised for FY15 (up 40% on the pcp). With a tight focus on costs, and momentum building across its key AD franchise and the highly scalable Precision Recruitment tool, we expect a major turnaround in performance during FY15. Of note will be the low comp cycling effects in 1H and 2H, which should deliver strong double digit top-line performance. We also view the cessation of investment into the loss making Axon Sports favourably. We maintain our Outperform recommendation and \$0.52 price target. Risks include an appreciating AUD, and a slowdown in clinical trial contract wins and changes to regulatory guidelines on cognition testing or monitoring.

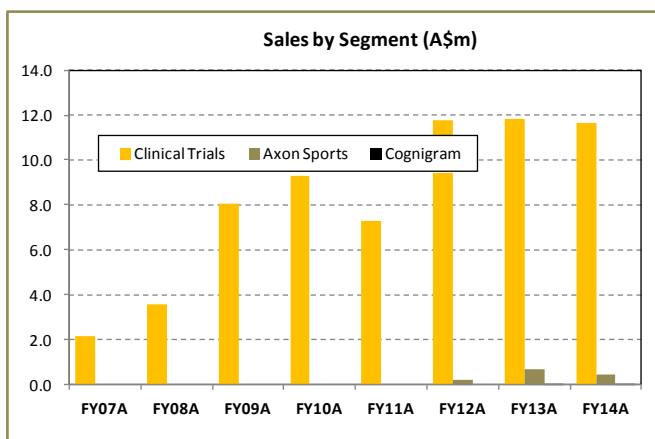
FY14 Overview

CogState has delivered an FY14 NPAT loss of \$3.9m, which was better than we anticipated, owing to an income tax credit received (\$0.7m). The result is a reflection of flat top-line growth and double digit increases (18%) in expenditure, commensurate with investment in one new opportunity (Precision Recruitment) and two existing opportunities, namely the dementia screening test, COGNIGRAM™ and Axon Sports. With particular reference to Axon Sports, the result was sub par with a 30% decline in revenues and a 13.2% increase in EBIT losses. **CogState** intends to divest this business, and has appointed advisors to undertake a sale process.

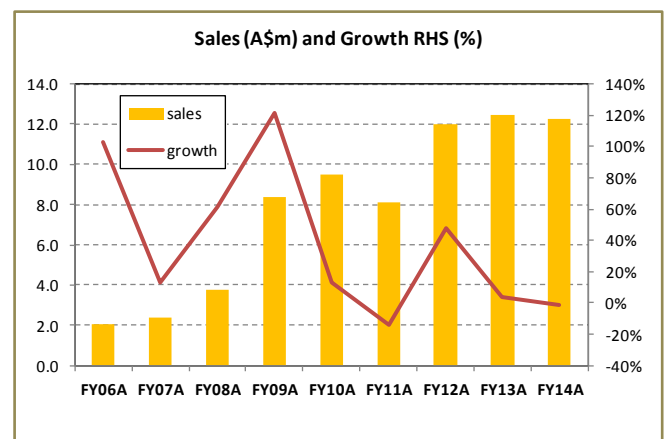


Source: Company reports, Taylor Collison

In terms of product sales mix, the clinical trials business accounted for 95% of group sales with clinical sales down 1.5% on the pcp. As mentioned Axon Sports sales were off 30% on the pcp and COGNIGRAM™ sales were negligible. Clinical trial sales have averaged \$11.7m over the last three FY, as shown below.



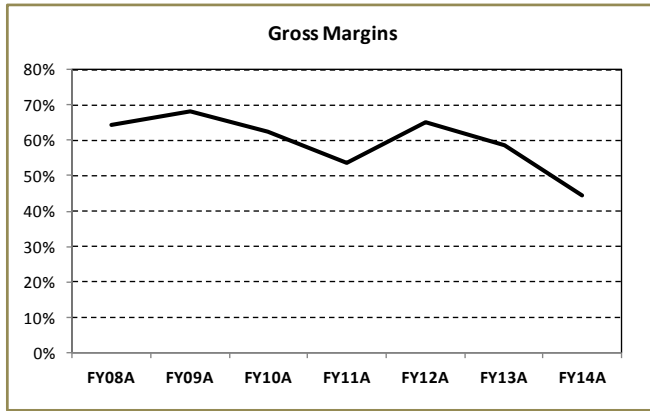
Source: Company reports, Taylor Collison



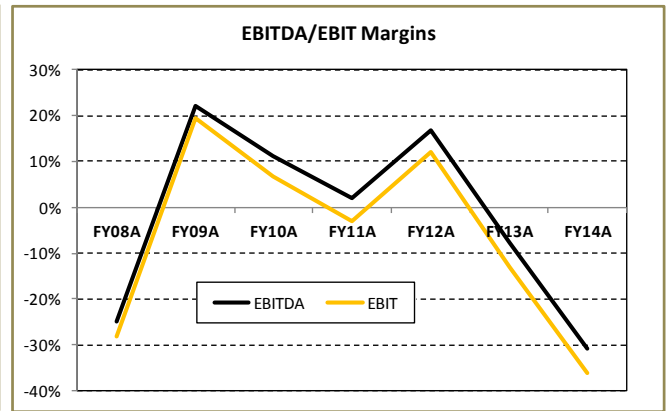
Source: Company reports, Taylor Collison

Margins

Group gross margins were down sharply in FY14 versus the pcp, as shown below, reflecting investments in COGS (new FTE in clinical trials business) and EBITDA/EBIT margins also declined strongly due to additional OPEX investments into Precision Recruitment, Axon Sports and COGNIGRAM™.



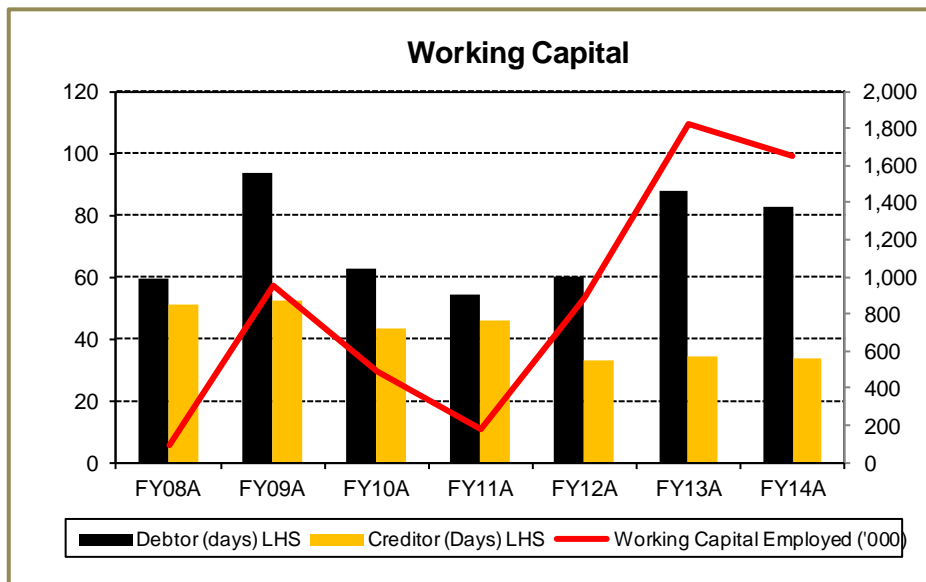
Source: Company reports, Taylor Collison



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Working Capital & Cash flow

Working capital employed declined slightly on the pcp to \$1.6m, reflecting a decrease in debtor days by 5 days and stable creditor days.

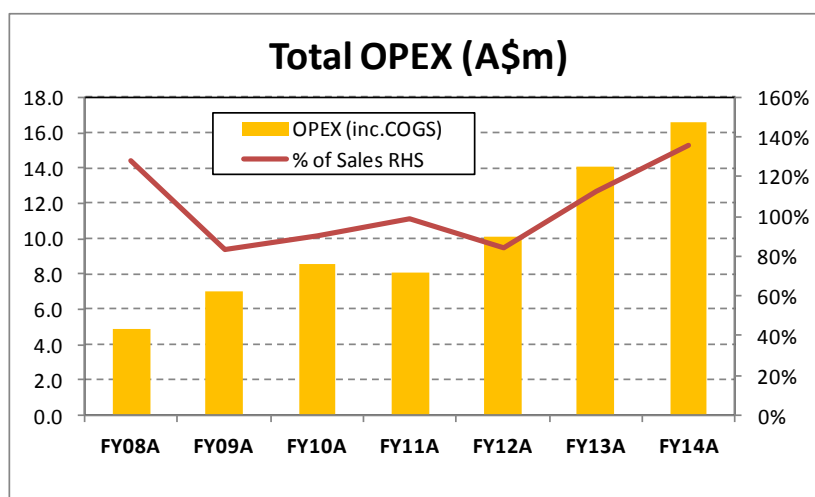


Source: Company reports, Taylor Collison

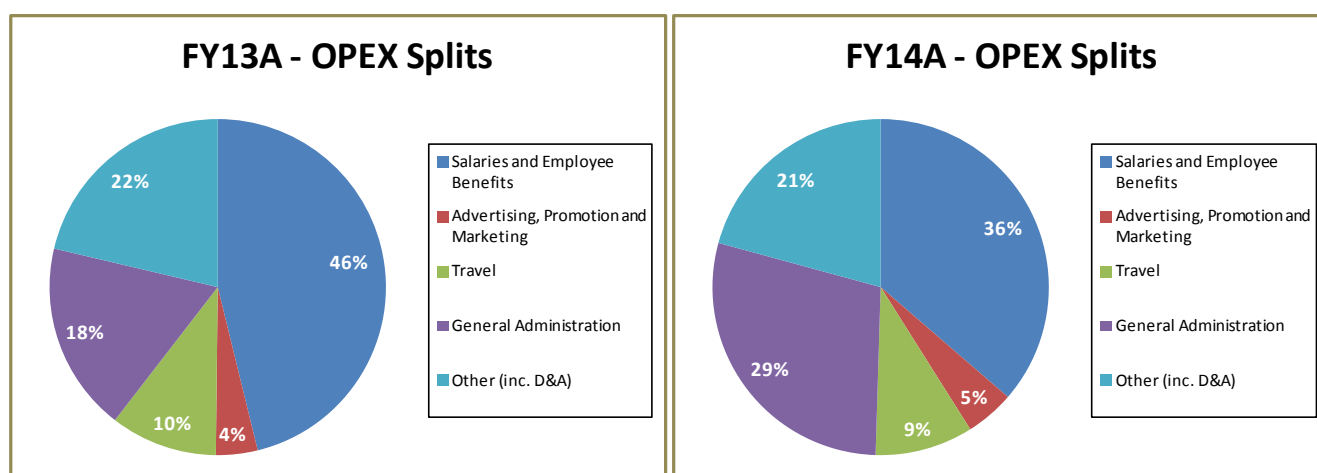
Operating cash flow of -\$3.3m reflects the investments made into the business over the period and a slight decline in revenues. OCF benefited from a \$0.7m government R&D tax rebate. Closing cash of \$7.1m increased over the pcp, due to a \$7.5m capital raise. CAPEX was up 100% on the pcp to \$0.8m, ahead of expectations.

OPEX Outpaced Sales Significantly Again in FY14

As can be seen below, total operating expenditures (inclusive of COGS) as a % of sales grew from 113% in the pcp to 136% in FY14, reflecting a sizeable expansion in the cost base and a slight decline in sales, as shown below. OPEX grew 18% v the 39% growth recorded in FY13.



OPEX mix (excluding COGS expenses) comprises predominately of salaries and employee expenses and general administration, as shown below. General admin grew in light of the expansion of the Connecticut, USA office and European set up in Barcelona and investments into key segments.



Source: Company reports, Taylor Collison

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Segments

Segment sales and EBIT contributions of the Three distinct segments are summarised below. We note the addition of the Precision Recruitment segment in FY14, which though not shown showed top-line revenues of \$0.08m and an EBIT loss of \$0.3m.

Sales By Segment (\$'000)

	FY11	FY12	FY13	FY14
Clinical Trials	7,979	11,794	11,803	11,631
growth (%)	-21.14%	61.43%	0.08%	-1.46%
Sports	153	220	656	463
growth (%)	n/a	43.79%	198.18%	-30%
Healthcare	0	0	4	29
growth (%)	n/a	n/a	n/a	1056%
Corporate	0	0	0	142
growth (%)	n/a	n/a	n/a	n/a
Total	8,132	12,014	12,463	12,265
growth (%)		47.72%	3.74%	-1.59%

EBIT* By Segment (\$'000)

	FY11	FY12	FY13	FY14
Clinical Trials	3,762	7,104	6,484	3,357
Sports	(473)	(1,254)	(1,200)	(1,358)
Healthcare	0	(93)	(534)	(594)
Corporate	(3,550)	(4,295)	(6,490)	(5,951)
Total	(261)	1,462	(1,740)	(4,546)

* Ex one-offs

Outlook

We have made the following changes to our forecasts:

Changes to Forecasts

A\$m	FY15E			FY16E		
	Prev	New	% Change	Prev	New	% Change
Sales Revenue	15.4	15.4	0.0%	21.3	21.3	0.0%
EBITDA	1.1	1.4	32.8%	4.3	4.5	3.9%
EBIT	0.5	0.6	12.2%	3.9	3.8	-3.2%
NPAT reported	0.6	0.6	8.5%	3.1	3.0	-2.9%
EPS Reported (c)	0.6	0.6	8.5%	3.1	3.1	-2.9%
NPAT Adjusted*	0.6	0.6	8.5%	3.1	3.0	-2.9%
EPS Adj.* (c)	0.6	0.6	8.5%	3.1	3.1	-2.9%

* First time presentation of estimates

Since executing a \$7.3m pharma contract, CGS has signed an additional \$0.8m contract, taking the value of contracts signed to over \$9.0m, with \$9.1m of revenues to be recognised for FY15 (up 40% on the pcp). With a tight focus on costs, and momentum building across its key AD franchise and the highly scalable Precision Recruitment tool, we expect a major turnaround in performance during FY15. Of note will be the low comp cycling effects in 1H and 2H, which should deliver strong double digit top-line performance. We also view the cessation of investment into the loss making Axon Sports favourably.

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Cogstate Ltd - Summary of Forecasts

CGS \$ 0.28

PROFIT & LOSS SUMMARY (A\$000s)					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
Product Sales	12,014	12,467	12,265	15,437	21,316
Growth (pcp)	47.7%	3.8%	-1.6%	25.9%	38.1%
Total Revenue	12,274	13,149	12,841	15,668	21,588
EBITDA	2,047	(1,029)	(3,965)	1,416	4,510
Dep'n/Other Amort'n	(585)	(712)	(684)	(829)	(756)
EBIT	1,462	(1,741)	(4,649)	586	3,755
Net Interest	105	81	104	232	272
Pre-Tax Profit	1,567	(1,660)	(4,545)	818	4,027
Tax Expense	(340)	(297)	657	(204)	(1,007)
Minorities	0	0	0	0	0
Adjusted NPAT*	1,227	(1,957)	(3,888)	613	3,020
Growth (pcp)	1758.1%	n/a	-98.7%	115.8%	392.3%
Net Adjustments	1,225	0	0	0	0
Reported Profit	2,452	(1,957)	(3,888)	613	3,020

PER SHARE DATA					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
Adjusted EPS (c)	1.7	(2.6)	(4.3)	0.6	3.1
Growth (pcp)	n/a	n/a	68.0%	-114.3%	392.3%
Reported EPS (c)	3.3	(2.6)	(4.3)	0.6	3.1
Growth (pcp)	n/a	n/a	68.0%	-114.3%	392.3%
Dividend (c)	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%
Gross CF per Share (c)	2.0	(2.4)	(3.3)	1.8	3.9
NTA per share (c)	10.2	8.4	12.1	12.1	15.2

KEY RATIOS					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
EBITDA/Sales Margin %	16.7%	-7.8%	-30.9%	9.0%	20.9%
EBIT/Sales Margin %	11.9%	-13.2%	-36.2%	3.7%	17.4%
Current ratio (x)	4.3	3.4	5.1	5.1	5.5
Net Debt : Equity (%)	-45.6%	-37.5%	-54.8%	-60.5%	-70.5%
ROE (%)	29.7%	-20.6%	-35.6%	4.6%	19.8%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
Adjusted PE Ratio (x)	16.7	n/a	n/a	45.2	9.2
Reported PE Ratio (x)	8.4	n/a	n/a	45.2	9.2
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EV/Sales (x)	1.9	2.0	1.7	1.3	0.7
EV/EBITDA (x)	11.3	n/a	n/a	13.7	3.5
EV/EBIT (x)	15.8	n/a	n/a	33.0	4.2

* Excludes UBC term payment; Axon JV losses +re-valuation gain

CURRENCY FORECASTS			
Period	FY14A	FY15E	FY16E
AUD/USD	0.91	0.92	0.85

BALANCE SHEET SUMMARY					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
Cash	4,660	3,393	7,126	8,376	11,751
Receivables	1,979	2,991	2,767	3,087	4,263
Pre Payments	0	0	0	0	0
Inventories	0	0	0	0	0
Other	336	686	433	433	0
Total Current Assets	6,975	7,070	10,326	11,896	16,014
Investments in JV	0	0	0	0	0
Property Plant & Equip	977	925	1,318	1,238	1,181
Intangibles	2,704	2,422	2,140	1,883	1,657
Other	1,250	638	1,328	1,173	731
Total Non-Current Assets	4,931	3,985	4,786	4,294	3,569
TOTAL ASSETS	11,906	11,055	15,112	16,190	19,582
Accounts Payable	1,087	1,173	1,121	1,544	1,812
Provisions	532	821	912	772	1,066
Other	0	91	0	32	32
Total Current Liab	1,619	2,085	2,033	2,347	2,910
Borrowings	0	0	0	0	0
Provisions	7	0	0	0	0
Other	58	160	64	0	0
Total Non-Current Liab	65	160	64	0	0
TOTAL LIABILITIES	1,684	2,245	2,097	2,347	2,910
TOTAL EQUITY	10,222	8,810	13,015	13,843	16,673

CASH FLOW SUMMARY					
Period	FY12A	FY13A	FY14A	FY15E	FY16E
EBIT (excl Abs/Extr)	1,462	(1,741)	(4,649)	586	3,755
Add: D&A	585	712	684	829	756
Change in Pay.	60	86	(52)	423	268
Less: Tax paid	0	0	707	0	0
Net Interest	130	138	104	232	272
Change in Rec.	(776)	(1,012)	224	(320)	(1,176)
Gross Cashflows	1,461	(1,817)	(2,982)	1,750	3,875
Capex	(343)	(406)	(819)	(500)	(500)
Free Cashflows	1,118	(2,223)	(3,801)	1,250	3,375
Other	166	913	7,697	0	0
Dividends Paid	0	0	0	0	0
Net Cash Flow	1,284	(1,310)	3,896	1,250	3,375
Effect of FX on Cash	69	44	47	0	0

CGS - VALUATION METHODOLOGY

	Applied Multiple	Weight	Valuation (A\$ps)
Equity Valuation (Core Bus.)- DCF	WACC - 12%	100%	\$0.41
Dementia (Cognigram)	rDCF	100%	\$0.08
Axon Sports	BV	100%	\$0.03
TOTAL Equity Valuation/PT			\$0.52

* Valuation on Core business (ex-R&D work for dementia screening, Axon Sports).

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