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CogState Limited (CGS)

Impressive 1H Normalised NPAT of \$2.3m

Outperform
\$0.25

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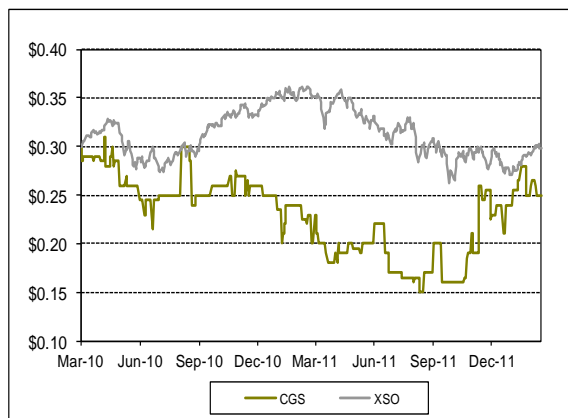
Summary

Market Capitalisation (M)	\$18.3
Shares on Issue (M)	74.8
Share price	\$0.25
Cash (M) as at 31/12/11	\$3.5
Valuation Per Share & Price Target	\$0.57
52 week low	\$0.15
52 week high	\$0.26
Ave Monthly Vol (Yr Rolling)(M)	0.8

Key Financials (A\$'000)

Year End	1H12	2012	2013
	Actual	Est.	Est.
Product Sales	6,941	13,465	14,974
EBITDA	2,686	3,484	4,008
EBIT	2,531	3,198	3,758
Normalised NPAT	2,321	3,059	3,430
Reported Profit	3,402	4,007	3,430
Normalised EPS (c)	3.2	4.2	4.6
Reported EPS (c)	4.6	5.5	4.6
Norm.PE Ratio (x)	n/a	5.9	5.3
Rep. PE Ratio (x)	n/a	4.5	5.3
ROE (%)	n/a	44.8%	25.9%

Share Price Graph (A\$)



1H12 Key Points

Reported NPAT of \$3.4m, an increase of \$4.3m on pcp, in part driven by a non-cash, one-off \$1.27m revaluation gain on Axon Sports.

Normalised NPAT (ex non-recurring items) of \$2.3m was also a substantial improvement on pcp (\$0.3m loss).

Reported sales revenue of \$6.9m was up 75.6% on pcp, with US\$ sales increasing 85.7% on pcp.

Gross margins surged to 72.8%, up from 49.6% in pcp, owing to a ~70% fixed cost component in COGS, with pcp growth of 8.7% in that cost.

Operating expenses (ex R&D) were down 14.7%, a flow through of cost-cutting initiatives implemented in FY11.

Cash on hand of \$3.5m, with \$3.6m in 30-60 day trade receivables.

Our View

- Significant Profit Result, Driven by High Quality Contract Wins, Cost Efficiencies and Margin Expansion** – The 1H12 result highlights the substantial operating leverage in the business, with an additional \$3.0m in sales providing \$2.6m in normalised profit on a 14.7% decline in operating costs. The 1H included a significant US\$2.6m contract to use its cognitive testing technology in a major Phase 2 clinical study. Operating cash flows of \$0.15m were impacted by a ~\$2.4m increase in trade receivables for the period. Consumer market sales (Axon Sports) were small, increasing 1.2% on pcp. We are not forecasting material revenues from this business in FY12-FY14.
- Core Clinical Trials Business Experiencing Solid Demand** – During the 1H12, the Company signed A\$10.2m worth of contracts (+144% on pcp). 2H revenue recognition of \$3.8m from existing contracts signed to date was guided and \$4.1m in FY13. Based on core disease indications applicable for CogState technology, approximately 3,500 Phase 1-4 trials are ongoing and ~1,200 new trials were commenced each year during 2008-2010. With 35 contracts awarded on average, the actual trial penetration rate is ~3%, suggesting further growth is achievable in the medium term. In our view, the growth in the 1H has been driven in part by recent cognitive end point success for new schizophrenia drugs and a surge in Alzheimer's disease clinical studies.
- Outlook** – As a result of the strong 1H12 result, we have upgraded our FY12 reported NPAT forecast by 142.7% to \$4.0m. The Company currently trades on a FY12 EV/Sales of 0.9x, and a normalised P/E of 5.9x. Our revised blended equity valuation (DCF, P/E, EV/EBITDA) and 12 month PT is up 3.0 cps on previous to \$0.57. We do not currently factor dementia screening revenues into our forward model, but note the validation a third party license deal will bring to the business and potential for further re-rating in the 2H12. Though the business is dependent on further contracts to support growth, progressive roll-off of \$9.2m in contracted revenues provides comfort to the FY12, FY13 assumptions. We therefore maintain our Outperform recommendation.

1H12 Overview

1H12 NPAT of \$3.4m, normalised NPAT of \$2.3m.

CogState has reported a 1H12 NPAT of \$3.4m, on the back of surging clinical trial product revenues (+75.6%) and a one-off, non-cash revaluation gain from its Axon Sports investment of \$1.27m. The normalised NPAT (excludes FX, UBC termination payments, Axon Sports JV losses and the Axon write-back) was \$2.3m, representing a \$2.5m turnaround on pcp (see below).

Gross margins increased 2,320 bps on pcp, which reflects the low variable cost inputs into COGS, with ~70% related to employee salaries and ~30% the result of variable depreciation (lap tops), travel, freight and project costs.

Substantial margin expansion, highlighting operating leverage.

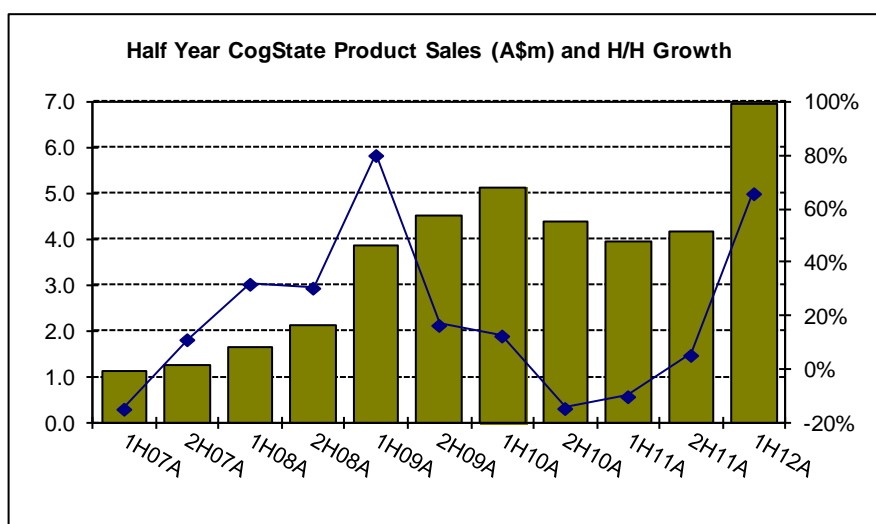
1H12 Results Summary (\$m)

	1H11A	1H12A	Change (%)	TC Est. 1H12	Difference (%)	Comment
Product Revenues	4.0	6.9	75.5%	6.9	0.6%	In-line as expected from recent sales guidance provided, driven by substantial uplift in contracted revenues in the 1H
COGS	1.7	1.9	7.3%	2.1	-11.0%	Better than estimates owing to lower fixed/variable cost inputs
Gross Margin	49.6%	72.8%	+ 2320 bps	69.7%	+ 310bps	Significant Expansion owing to ~70% fixed cost contribution from direct salaries
Operating Exp.	3.1	2.3	-26.4%	2.2	1.0%	In-line
EBITDA	-0.7	2.7	n/a	2.8	-5.6%	
EBITDA Margin	-16.9%	37.7%	n/a	39.1%	- 140 bps	In-line
EBIT	-0.9	2.5	n/a	2.6	-2.7%	
EBIT Margin	-22.5%	35.6%	n/a	37.7%	- 208 bps	Slightly below estimates
Reported NPAT	-0.9	3.4	n/a	2.6	28.4%	Benefited from \$1.3m Axon re-valuation gain
Normalised NPAT*	-0.2	2.3	n/a	2.7	-13.4%	Difference related to income tax charge of \$0.4m for 1H12 (TC est. = \$0)

* Excludes UBC termination payments, FX-derivatives gains/losses, Axon Sports JV gains/losses & revaluation; Source: Company reports, Taylor Collison

1H12 sales revenues up 75.6%, despite a 10.1% FX headwind on pcp.

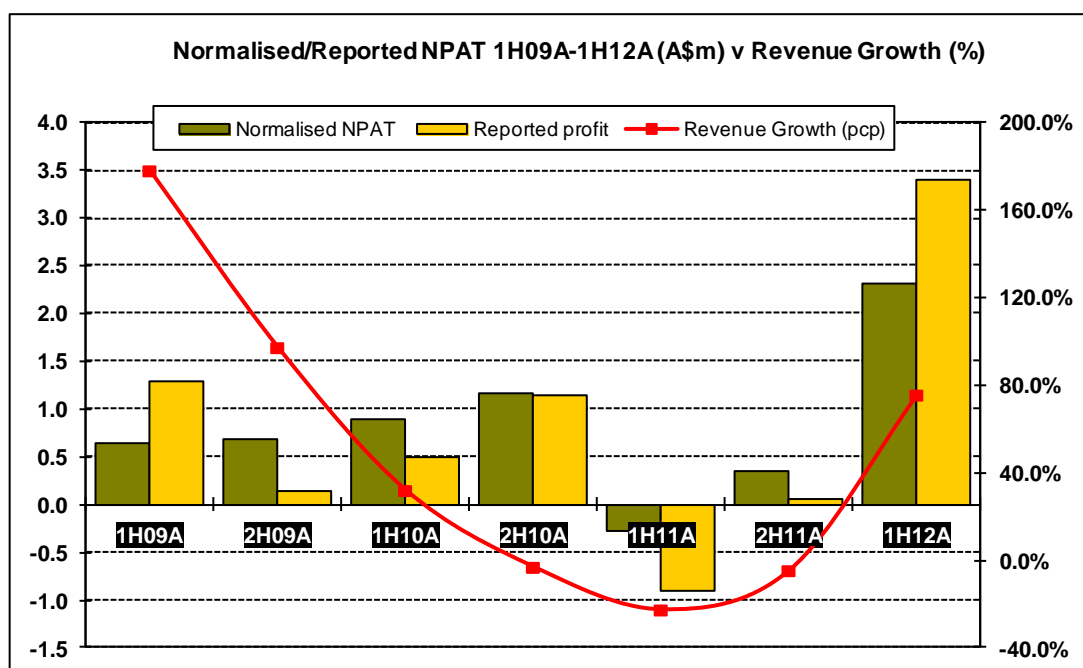
As indicated, sales revenue for the 1H12 of \$6.9m was up 75.6% on pcp despite a 10.1% FX headwind and 66.1% on the 2H11. The growth in revenues since 1H07A is shown, below.



Source: Company Reports, Taylor Collison

We have plotted normalised and reported NPAT from 1H09 to 1H12 against product revenue growth, which highlights the underlying performance of the business when normalised for FX gains/losses, UBC termination payments and other one-offs including the Axon Sports revaluation and JV losses.

Normalised and Reported NPAT showed a significant turnaround on pcp.



Source: Company Reports, Taylor Collison

Both normalised and reported NPAT showed a very significant turnaround on pcp, highlighting the leverage effect of contract wins on a largely fixed cost base.

The Company significantly increased its investment in R&D over the period to \$0.24m as it seeks to invest in new applications of its core product offering. Such new applications of its cognitive testing battery include HIV dementia, Alzheimer's Disease dementia and concussion management.

Don't Forget Dementia Screening

CogState has indicated it remains in discussions with two large pharmaceutical companies over the community dementia screening tool, which will provide demonstrable future upside if successfully transacted. Though we have not modelled the incremental benefit of such a tool in terms of **CogState** revenues, we note **CogState** estimate this market to be worth over US\$500m p/a in the US alone, assuming annual assessment for the over 50s. Drivers to this market opportunity include an ageing population, spiralling dementia-related healthcare costs and disease modifying drugs in development, which are expected to slow progression.

CogState's own validation studies has shown a correlation in the decline in memory function with abnormally high levels of cerebral amyloid (a brain protein important in the pathology of Alzheimer's disease) in a subgroup of otherwise healthy older people.

Outlook

We have made the following changes to our forecasts:

A\$m	FY12E			FY13E			FY14E**		
	Prev	New	% Change	Prev	New	% Change	Prev	New	% Change
Sales Revenue	11.0	13.5	22.6%	13.7	15.0	9.3%	16.9	16.9	0.0%
EBITDA	2.0	3.5	70.8%	3.1	4.0	31.2%	5.0	5.0	0.0%
EBIT	1.5	3.2	108.7%	2.6	3.8	43.1%	4.8	4.8	0.0%
NPAT reported	1.7	4.0	142.7%	2.8	3.4	20.6%	4.5	4.5	0.0%
EPS Reported (c)	2.3	5.5	142.7%	3.8	4.6	20.5%	6.0	6.0	0.0%
NPAT Norm.*	1.7	3.1	78.8%	2.8	3.4	20.6%	4.5	4.5	0.0%
EPS Norm.* (c)	2.3	4.2	78.8%	3.8	4.6	20.5%	6.0	6.0	0.0%

* Ex FX, restructuring and other one-offs; ** Initial forecasts; Source: Taylor Collison estimates

(note: the FY12 changes reflect the estimates before the Company provided 1H sales guidance in late Jan, which provided the basis of our amended assumptions in the 1H12 results summary).

CogState trades on an EV/Sales of 0.9x, and Normalised P/E of 5.9x.

As a result of the strong 1H12 result, we have upgraded our FY12 reported NPAT forecast by 142.7% to \$4.0m. The Company currently trades on FY12 EV/Sales of 0.9x, and a normalised P/E of 5.9x. Our revised blended equity valuation (DCF, P/E, EV/EBITDA) and 12 month PT is up 3.0 cps on previous to \$0.57. We do not currently factor dementia screening revenues into our forward model, but note the validation a third party license deal will bring to the business and potential for further re-rating in the 2H12.

Upgraded blended PT by 3.0 cps to \$0.57.

Maintain Outperform.

Though the business is dependent on further contracts to support growth, progressive roll-off of \$9.2m in contracted revenues provides comfort to the FY12, FY13 assumptions. We therefore maintain our Outperform recommendation.

CGS - Summary of Forecasts

CGS \$ 0.25

PROFIT & LOSS SUMMARY (A\$000s)

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
Product Sales	9,485	3,953	8,133	6,941	13,465	14,974	16,943
Growth (pcp)	13.1%	-22.6%	-14.3%	75.6%	65.6%	11.2%	13.1%
Total Revenue	9,747	4,180	8,304	7,117	13,614	15,274	17,415
Cost of Sales	(3,484)	(1,742)	(3,383)	(1,869)	(4,124)	(4,972)	(5,691)
Gross Margin (%)	62.4%	49.6%	53.7%	72.8%	69.0%	66.4%	65.9%
EBITDA	1,017	(732)	(484)	2,686	3,484	4,008	4,981
Dep'n/Other Amort'n	(433)	(210)	(423)	(155)	(285)	(250)	(180)
EBIT	584	(942)	(907)	2,531	3,198	3,758	4,801
Net Interest	101	64	115	42	123	300	472
Pre-Tax Profit	685	(878)	(792)	2,573	3,321	4,058	5,273
Tax Expense	1,257	75	72	(396)	(514)	(628)	(816)
Minorities	0	0	0	0	0	0	0
Adjusted NPAT*	1,942	(803)	(720)	2,177	2,807	3,430	4,457
Growth (pcp)	-3.2%	310.0%	-137.1%	n/a	489.9%	22.2%	29.9%
Normalised NPAT**	2,043	(285)	53	2,321	3,059	3,430	4,457
Growth (pcp)	31.9%	310.0%	-97.4%	n/a	5671.8%	2.1%	29.9%
Net Adjustments	(304)	(92)	(126)	1,225	1,200	0	0
Reported Profit	1,638	(895)	(846)	3,402	4,007	3,430	4,457

PER SHARE DATA

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
Adjusted EPS (c)	2.9	(1.2)	(1.1)	3.0	3.8	4.6	6.0
Growth (pcp)	-6.3%	-206.8%	n/a	n/a	n/a	19.9%	29.9%
Reported EPS (c)	2.5	(1.3)	(1.3)	4.6	5.5	4.6	6.0
Growth (pcp)	10.8%	-275.3%	n/a	n/a	n/a	-16.0%	29.9%
Normalised EPS (c)	3.1	(0.4)	0.1	3.2	4.2	4.6	6.0
Growth (pcp)	27.6%	-131.8%	-97.4%	n/a	5133.9%	10.0%	29.9%
Dividend (c)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%	0%	0%
Gross CF per Share (c)	2.4	(1.4)	0.0	1.5	4.2	4.6	5.6
NTA per share (c)	10.0	8.8	8.9	14.2	15.3	19.4	25.0

KEY RATIOS

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
EBITDA/Sales Margin %	10.4%	-17.5%	-5.8%	37.7%	25.6%	26.2%	28.6%
EBIT/Sales Margin %	6.0%	-22.5%	-10.9%	35.6%	23.5%	24.6%	27.6%
Current ratio (x)	3.1	3.5	3.2	4.5	3.6	4.8	6.5
Net Debt : Equity (%)	-44.0%	-38.7%	-52.4%	-31.9%	-57.5%	-70.6%	-79.7%
ROE (%)	27.4%	n/a	-12.7%	n/a	44.8%	25.9%	26.3%
Dividend Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

VALUATION MULTIPLES

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
Adjusted PE Ratio (x)	8.3	n/a	n/a	n/a	6.4	5.3	4.1
Normalised PE Ratio (x)	7.9	n/a	307.6	n/a	5.9	5.3	4.1
Reported PE Ratio (x)	9.9	n/a	n/a	n/a	4.5	5.3	4.1
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EV/Sales (x)	1.6	n/a	1.8	n/a	0.9	0.5	0.2
EV/EBITDA (x)	15.0	n/a	n/a	n/a	3.3	2.0	0.6
EV/EBIT (x)	26.1	n/a	n/a	n/a	3.6	2.1	0.7

CAPITAL RAISING ASSUMPTIONS

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
Shares Issued (m)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Issue Price (A\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Cash Raised (A\$m)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

* Excludes UBCTerm payment + re-valuation gain; ** Normalised additionally for FX gains/losses, derivatives gain/losses, Axon JV losses;

BALANCE SHEET SUMMARY

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
Cash	3,092	2,420	3,306	3,458	6,668	10,484	15,148
Receivables	1,623	1,570	1,203	3,622	2,693	2,995	3,389
Pre Payments	59	0	0	0	0	0	0
Inventories	0	0	0	0	0	0	0
Other	212	386	410	362	362	362	362
Total Current Assets	4,986	4,376	4,919	7,442	9,723	13,840	18,899
Investments in JV	563	121	116	0	0	0	0
Property Plant & Equip	1,236	1,103	905	992	684	635	534
Intangibles	402	402	402	401	381	344	310
Other (inc. goodwill)	2,020	1,640	1,632	3,677	3,559	2,931	2,199
Total Non-Current Assets	3,658	3,145	2,939	5,070	4,624	3,910	3,044
TOTAL ASSETS	8,644	7,521	7,858	12,512	14,346	17,750	21,943
Accounts Payable	1,132	815	1,027	1,240	2,020	2,096	2,033
Provisions	406	408	491	404	673	749	847
Other	47	10	10	13	45	45	45
Total Current Liab	1,585	1,233	1,528	1,657	2,738	2,890	2,925
Borrowings	0	0	0	0	0	0	0
Provisions	38	37	25	11	11	11	11
Other	0	0	0	0	0	0	0
Total Non-Current Liab	38	37	25	11	11	11	11
TOTAL LIABILITIES	1,623	1,270	1,553	1,668	2,749	2,901	2,936
TOTAL EQUITY	7,021	6,251	6,305	10,844	11,597	14,849	19,006

CASH FLOW SUMMARY

Period	FY 10A	1H11A	FY 11A	1H12A	FY 12E	FY 13E	FY 14E
EBIT (excl Abs/Extr)	584	(942)	(907)	2,531	3,198	3,758	4,801
Add: Depreciation	433	210	423	155	266	232	173
Change in Pay.	(67)	(317)	(105)	425	993	77	(63)
Less: Tax paid	0	0	72	0	0	(628)	(816)
Net Interest	101	64	115	42	123	300	472
Change in Rec.	523	53	420	(2,053)	(1,493)	(305)	(401)
Gross Cashflows	1,574	(932)	18	1,100	3,106	3,451	4,173
Capex	(933)	(85)	(103)	(122)	(200)	(200)	(199)
Free Cashflows	641	(1017)	(85)	978	2,906	3,251	3,974
Other	(521)	522	386	(761)	520	565	691
Dividends Paid	0	0	0	0	0	0	0
Net Cash Flow	120	(495)	301	217	3,427	3,816	4,664
Effect of FX on Cash	(58)	(177)	(87)	(65)	0	0	0

CURRENCY FORECASTS

	FY 12E	FY 13E	FY 14E
AUD/USD	0.99	0.91	0.85

CGS - VALUATION METHODOLOGY

	Applied Multiple	Weight	Valuation (A\$ps)	Blended Val. (A\$ps)
DCF Valuation	n/a	33.3%	\$0.59	\$0.20
P/E Valuation	17.0x FY13	33.3%	\$0.65	\$0.22
EV/EBITDA	12.0x FY13	33.3%	\$0.47	\$0.15
Blended Equity Valuation		100.0%		\$0.57

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