

stock update

RECOMMENDATION:

BUY

Cogstate Limited

Remember to buy the dip

 Stock Code: CGS
 Last Price: \$0.60
 Market Cap (fd): \$73m
 Risk Level: High

22 July 2016
EVENT

- Cogstate Ltd (CGS) released its 4Q16 results on 20-Jul-16.

KEY HIGHLIGHTS

- FY16 revenue was A\$27.3m (+69.5%) and contracted future revenue as at 30-Jun-16 was A\$33.9m, up 58.4% from a year ago.
- CGS expects to report a small EBIT loss in 2H16, a downgrade from its previous guidance for a positive number. The result is driven by slower than expected new contract signings in 4Q16 that led to a lower than expected revenue in 2H16, and accelerated investment in service delivery and R&D staffing.
- The slowdown in new contracts signing also resulted in a decrease in the contracted revenue pipeline when compared to 31-Mar-16, as more revenue was recognised in 4Q16 (A\$7.0m) than the value of new contracts signed (A\$6.6m).
- 4Q16 is the first quarter since Jun-2014 when new contract signings have not exceeded revenue. Notwithstanding this, Select Equities notes that contract signings can be volatile, particularly at a quarterly frequency (see table overleaf).
- On a yearly basis, new contracts signed were US\$28.5m in FY16 (+20.2%). We observe that the industry tailwinds, which support a continuation of this growth trend in the short to medium term remain unchanged.
- The company reports that the slower than expected pipeline conversion in 4Q16 is not the result of losses to competitors and that the proposals pipeline has grown since the beginning of the year.
- We revise our revenue forecasts for FY17 and FY18 slightly lower in light of the delay in pipeline conversion and our OpEx forecasts higher in light of the accelerated investment in staffing.
- We note that Precision Recruitment revenue in FY16 of \$1.6m (+207.3%) was higher than our forecast of \$1.3m (+160.0%). We forecast conservative growth of this revenue stream in FY17 and FY18 considering the product is still in commercial pilots and note significant upside if CGS is able to demonstrate empirical evidence to drive more widespread adoption more quickly than we forecast.

 Wayne Ma
 Mark Southwell-Keely

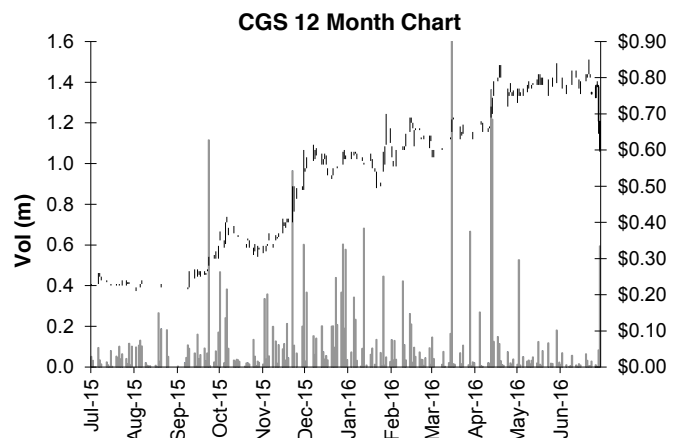
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SELECT EQUITIES RECOMMENDATION

- Select Equities maintains its BUY recommendation. We forecast the company to reach material profitability in FY17 and FY18, and view the stock as undervalued. We view the company's short to medium term growth potential as unchanged and view any weakness in the share price as an entry opportunity.

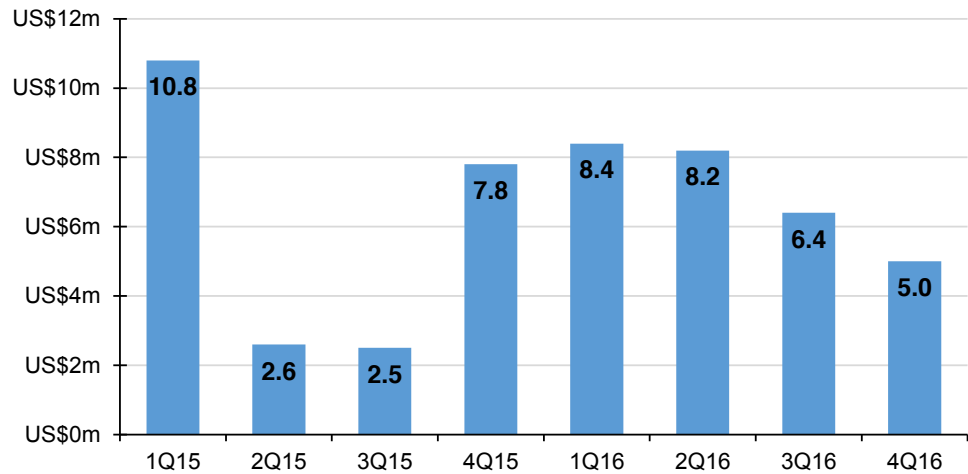
June Year End	FY15A	FY16E	FY17E	FY18E
Net Profit (\$m)	-2.5	1.6	2.9	6.1
Revenue (\$m)	16.1	27.3	37.1	47.6
EBITDA (\$m)	-2.7	1.1	4.5	9.1
EPS (¢)	-2.2	1.4	2.4	4.8
DPS (¢)	0.0	0.0	0.0	1.0
PER (x)	-27.3	44.4	25.5	12.5
PER Rel Small Ords (%)	-182%	296%	170%	83%
Ent. Value/ Revenue (x)	4.1	2.4	1.8	1.4
Ent. Value/ EBITDA (x)	-24.2	58.0	14.7	7.2
Yield (%)	0.0%	0.0%	0.0%	1.7%
# Shares fd (m)				122.0
Avg. Mthly Volume (m)				2.5
Diluted Mkt Cap (\$m)				73.2
Net Debt (\$m)				-7.5
Enterprise Value (\$m)				65.7

Source: Select Equities Research

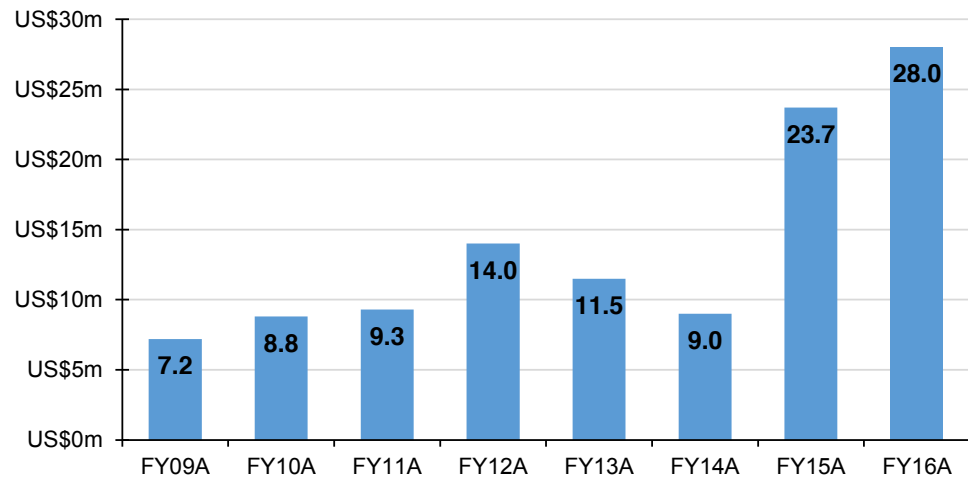


Source: IRESS

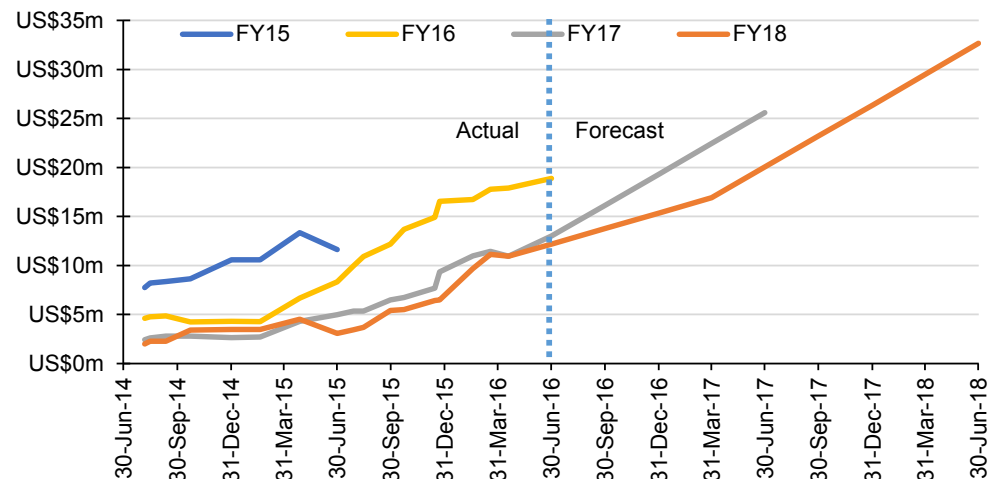
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**QUARTERLY
CLINICAL
TRIALS
CONTRACTS
SIGNED**


Source: Company Reports

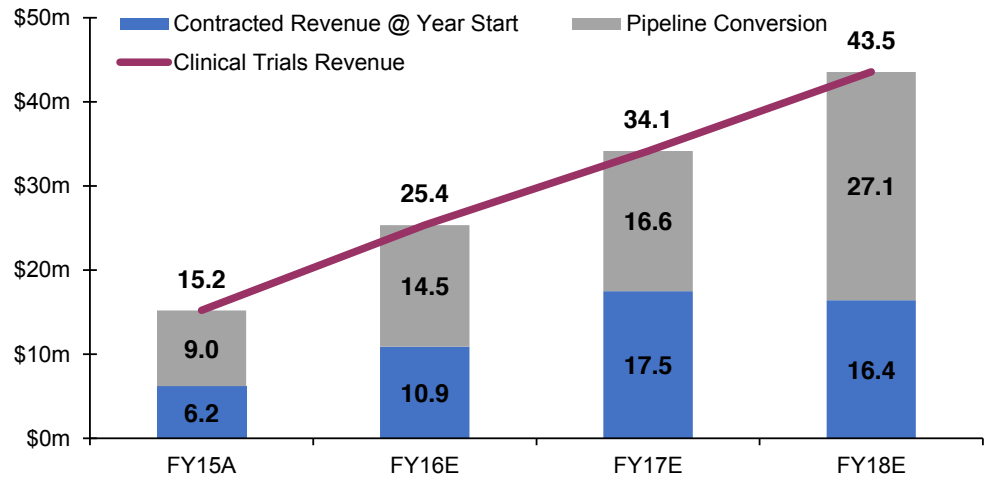
**YEARLY
CLINICAL
TRIALS
CONTRACTS
SIGNED**


Source: Company Reports

**CONTRACTED
CLINICAL
TRIALS
REVENUE**


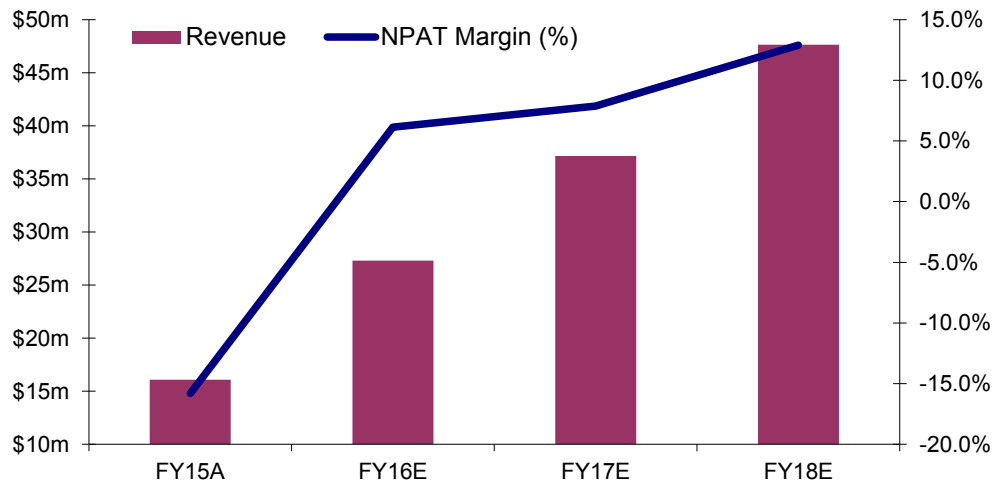
Source: Company Reports and Select Equities Research

CLINICAL TRIALS REVENUE FORECAST



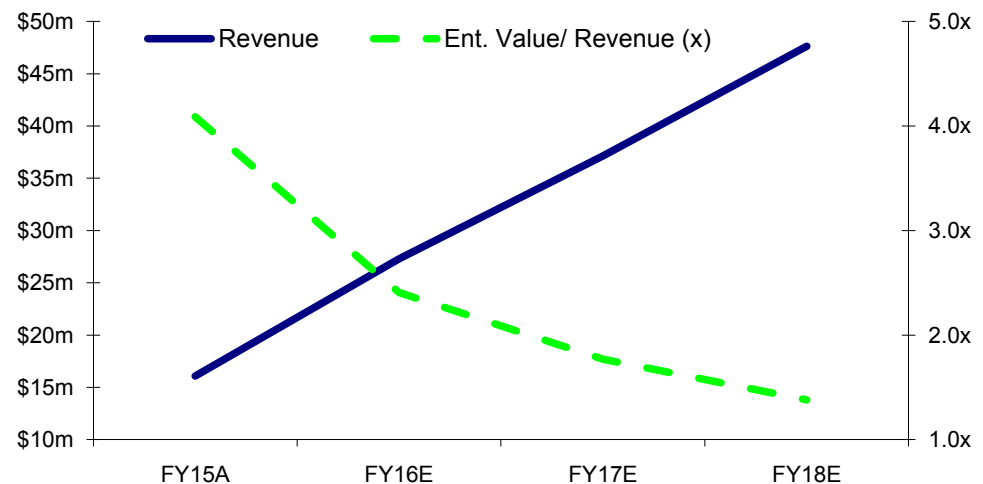
Source: Company Reports and Select Equities Research

OPERATING LEVERAGE



Source: Company Reports and Select Equities Research

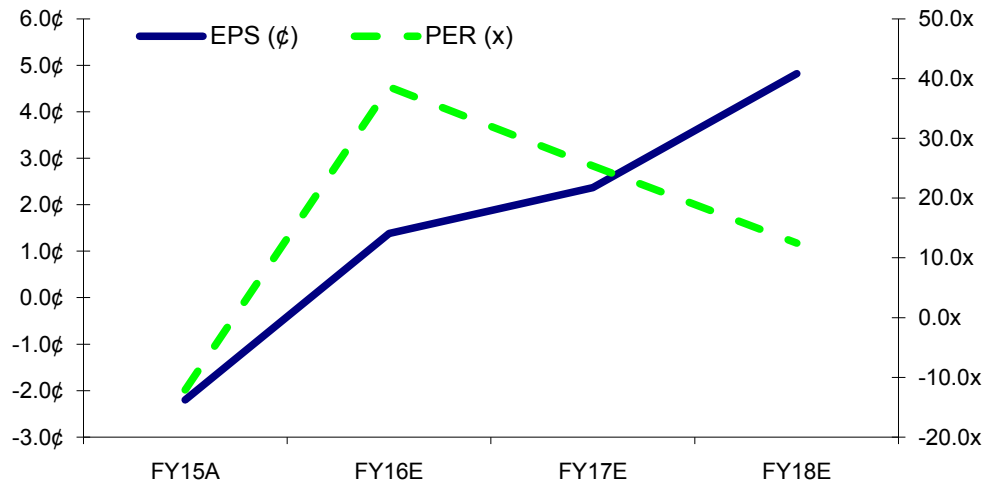
VALUATION – REVENUE MULTIPLE



Source: Company Reports and Select Equities Research

**VALUATION –
EARNINGS
MULTIPLE**

- CGS is close to its profit/loss inflection point, and we forecast the company to experience material operating leverage over the next two years. As a result, we expect the stock to start to generate material earnings beginning from FY17E to show a meaningful P/E multiple.



Source: Company Reports and Select Equities Research

**SER FORECAST
REVISIONS**

	31-Mar-16		22-Jul-16	
	Date	Event	Date	Event
FY16E Forecasts	Price (\$)	\$0.60	\$0.60	
	AUD/USD	0.7661	0.7500	
	Revenue (\$m)	26.2	27.3	
	Gross Profit (\$m)	15.1	15.5	
	EBITDA (\$m)	1.5	1.1	
	EBIT (\$m)	1.2	0.9	
	NPAT (\$m)	1.1	1.6	
	EPS (¢)	0.9¢	1.4¢	
	EV/Revenue (x)	2.6x	2.4x	
	P/E (x)	64.8x	44.4x	
Recommendation	BUY			
FY17E Forecasts	Price (\$)	\$0.60	\$0.60	
	AUD/USD	0.7661	0.7500	
	Revenue (\$m)	37.7	37.1	
	Gross Profit (\$m)	22.0	21.3	
	EBITDA (\$m)	5.8	4.5	
	EBIT (\$m)	5.4	4.0	
	NPAT (\$m)	3.8	2.9	
	EPS (¢)	3.1¢	2.4¢	
	EV/Revenue (x)	1.8x	1.8x	
	P/E (x)	19.5x	25.5x	
Recommendation	BUY			

RISK FACTORS

- Uncontracted pipeline conversion makes up a significant portion of SER's revenue forecasts
- CGS is a net exporter (98% of revenue and 78% of expenses are denominated in USD) and is negatively exposed to a rising AUD
- Lack of a track record of profitability and profit growth
- Failure to adequately protect the company's intellectual property
- Inability to maintain scientific/technological competitive advantage of the company's proprietary computerised tests and clinical trial knowhow
- CGS's competitors have more academic recognition and/or are bigger
- Inability of the commercial pilots of Precision Recruitment to lead to broader adoption
- Reduction in the size of the clinical trials market for indications where cognition assessment plays a part
- Regulatory approval and reimbursement risk for Cognigram

Cogstate Ltd

Select Equities Research

Small Caps

Code	CGS				June Year End	FY15A	FY16E	FY17E	FY18E
Last sale (\$)	22-Jul-16				\$0.60				
# Shares (m)					111.9				
# Options (m)					10.2				
Diluted Mkt Cap (\$m)					73.2				
Net Debt (\$m)					-7.5				
Enterprise Value (\$m)					65.7				
June Year End	FY15A	FY16E	FY17E	FY18E	Financial Position (\$m)				
Financial Performance (\$m)					Cash	5.5	7.5	10.2	16.4
Revenue	16.1	27.3	37.1	47.6	Accounts Receivable	5.4	6.3	8.9	11.7
Gross Profit	7.9	15.5	21.3	27.6	PPE	1.1	2.5	3.3	4.0
OpEx	-10.6	-14.3	-16.8	-18.5	Deferred Tax Assets	1.9	3.6	2.3	0.0
EBITDA	-2.7	1.1	4.5	9.1	Intangibles	0.4	0.4	0.4	0.4
D & A	-0.5	-0.3	-0.4	-0.6	Total Assets	14.3	20.3	25.0	32.5
EBIT	-3.2	0.9	4.0	8.5	Accounts Payable	2.5	4.0	4.7	5.2
PBT	-3.1	1.0	4.2	8.7	Borrowings	0.0	0.0	0.0	0.0
NPAT (pre-NCI & abs)	-2.5	1.6	2.9	6.1	Provisions	1.1	1.6	1.8	2.0
NCI	0.0	0.0	0.0	0.0	Other Liabilities	0.5	0.0	0.0	0.2
Normalised NPAT	-2.5	1.6	2.9	6.1	Total Liabilities	4.2	5.6	6.6	7.4
Abnormals	-2.5	1.5	0.0	0.0	Net Assets	10.1	14.7	18.5	25.2
Reported NPAT	-5.1	3.2	2.9	6.1	Issued Capital	26.6	27.4	28.3	28.9
EPS (¢)	-2.2	1.4	2.4	4.8	Reserves	0.9	1.4	1.4	1.4
DPS (¢)	0.0	0.0	0.0	1.0	Retained Earnings	-17.3	-14.1	-11.2	-5.1
NTA / Share (¢)	8.1	11.7	14.4	19.2	NCI	0.0	0.0	0.0	0.0
Book Value / Share (¢)	8.4	12.0	14.7	19.5	Total Equity	10.1	14.7	18.5	25.2
Valuation/Performance Ratios					Cash Flows (\$m)				
PER (x)	-27.3	44.4	25.5	12.5	Net Receipts	-3.3	2.1	2.9	6.9
Ent. Value/ Revenue (x)	4.1	2.4	1.8	1.4	Net Interest	0.1	0.1	0.1	0.2
Ent. Value/ EBITDA (x)	-24.2	58.0	14.7	7.2	Tax Received/(Paid)	0.5	0.6	0.0	-0.2
Revenue Growth (%)	41.9%	69.5%	36.2%	28.2%	Operating Cash Flow	-2.7	2.8	3.0	6.9
Gross Profit Growth (%)	57.4%	95.6%	37.7%	29.6%	Acquisitions & Investments	0.0	0.0	0.0	0.0
OpEx Growth (%)	13.5%	34.9%	17.3%	10.0%	Net Purchase of PPE	-1.0	-1.6	-1.2	-1.3
EBITDA Growth (%)	-37.3%	-141.6%	295.0%	103.2%	Net Purchase of Intangibles	0.0	0.0	0.0	0.0
NPAT Growth (%)	-23.2%	-164.3%	78.3%	109.9%	Investing Cash Flow	-1.0	-1.6	-1.2	-1.3
EPS Growth (%)	-33.9%	-161.5%	74.3%	104.2%	Net Change in Equity	2.1	0.9	0.9	0.6
P/NTA (x)	7.4	5.1	4.2	3.1	Net Change in Debt	0.0	0.0	0.0	0.0
P/BV (x)	7.1	5.0	4.1	3.1	Dividends	0.0	0.0	0.0	0.0
Yield (%)	0.0%	0.0%	0.0%	1.7%	Financing Cash Flow	2.1	0.9	0.9	0.6
Payout Ratio (%)	0%	0%	0%	21%	Net Inc/Dec Cash	-1.7	2.0	2.7	6.3
Franking (%)	0%	0%	0%	100%	Cash at Beginning of Year	7.1	5.5	7.5	10.2
Gross Margin (%)	49.2%	56.8%	57.4%	58.0%	Net FX Effect on Cash	0.1	0.0	0.0	0.0
EBITDA Margin (%)	-16.9%	4.2%	12.1%	19.1%	Cash at End of Year	5.5	7.5	10.2	16.4
EBIT Margin (%)	-19.8%	3.2%	10.9%	17.9%	Free Cash Flow (\$m)				
NPAT Margin (%)	-15.8%	6.0%	7.9%	12.9%	Operating Cash Flow	-2.7	2.8	3.0	6.9
Current Ratio (x)	3.0	2.5	2.9	3.8	Δ Working Capital	0.7	-0.5	1.8	2.2
Interest Cover (x)	26.7	-8.7	-30.0	-37.2	Normalised OCF	-2.0	2.3	4.9	9.2
Net Debt/Equity (%)	-54.3%	-51.1%	-55.2%	-65.3%	Less Maintenance CapEX	-0.6	-0.7	-0.7	-0.7
ROE (%)	-22.0%	13.2%	17.6%	28.1%	Free Cash Flow	-2.6	1.6	4.2	8.4
ROIC (%)	-50.0%	26.6%	36.5%	70.1%	FCF/NPAT Conversion (%)	104%	97%	143%	138%
Interim Results (\$m)					Revenue Breakdown (\$m)				
	2H14A	1H15A	2H15A	1H16A	Clinical Trials	15.2	25.4	34.1	43.5
Revenue	5.9	6.1	9.9	13.0	Growth (%)	42.0%	66.9%	34.7%	27.6%
Gross Profit	3.2	2.2	5.7	7.4	Precision Recruitment	0.5	1.6	2.7	3.7
EBITDA	-1.6	-2.7	0.0	1.2	Growth (%)	507.0%	207.3%	67.5%	40.3%
D & A	-0.2	-0.2	-0.3	-0.1	Other Revenue	0.4	0.3	0.3	0.3
EBIT	-1.8	-2.9	-0.2	1.1	Contracted Revenue YTD	17.5			16.4
PBT	-1.6	-2.9	-0.2	1.1	Substantial Shareholders				
Normalised NPAT	-0.9	-2.5	-0.1	1.0		No. (m)			%
Reported NPAT	-1.2	-2.7	-2.4	2.6	Dagmar Dolby (Director)	19.8			17.7%
					Martyn Myer (Chairman)	18.9			16.9%
					Alan Finkel	9.0			8.0%

Source: Company Reports and Select Equities Research

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