

stock update
RECOMMENDATION: LONG TERM BUY
Cogstate Ltd

Delivers on contract signings and cash flow; Now for earnings

 Stock Code: CGS
 Last Price: A\$0.93
 Market Cap (fd): A\$120.7m
 Risk Level: High

13 April 2018
EVENT

- Cogstate (CGS) released its 3Q18 Business Update and Appendix 4C Report on 12 April. (Note: All data in this note is in US\$ unless otherwise indicated).

Peter Meichelboeck

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KEY HIGHLIGHTS

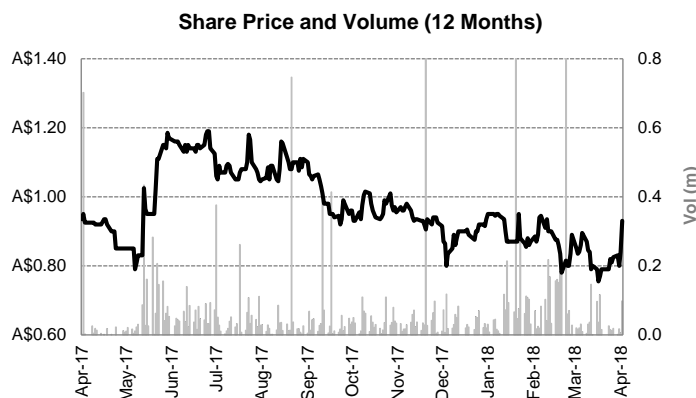
- Ongoing strong performance in new contract signings:** CGS signed \$8.3m in new contracts during 3Q18; slightly ahead of our \$8.0m forecast. The company has produced three good quarters in a row such that new signings YTD (\$29.9m) are 12.5% ahead of the same period last year. This latest result provided further comfort that the particularly weak 2H17 (only \$3.3m average per quarter as two industry trials were put on hold) is now behind CGS. We anticipate another \$7.7m in new contracts during 4Q18.
- Contract book continued to grow:** Contracted revenue outstanding as at Mar-18 was \$35.3m; up \$6.3m over the past year. Our Jun-18 forecast (\$38.6m) remains unchanged.
- Lagging behind the contract book, revenue has started to gain momentum:** 3Q18 revenue of \$8.0m was the highest quarterly result since 1Q17. While YTD revenue (\$21.6m) was only 2% ahead of pcp, we believe this will accelerate to 12% growth for FY18 as 4Q17 was a relatively weak period. Furthermore, we believe a much better revenue performance over 2H18 (coupled with ongoing growth in the contract book) should provide a strong platform for all of FY19.
- Big, positive turnaround in operating cash flow and cash reserves:** So far during FY18 operating cash flow has consistently improved (from -\$2.5m in 1Q, to -\$0.3m in 2Q, to +\$1.5m in 3Q); as the build-up of trade receivables from earlier contract signings flowed through to cash. However, with ongoing growth in the contract book, and with most of CGS' large pharma clients on 90-day payment terms, we continue to expect cash flow to lag earnings. Nevertheless, with cash on the balance sheet now at \$5.7m (versus just \$4.2m three months earlier), we do not believe a capital raising is on the horizon.
- New growth initiatives announced:** CGS has just created a new business unit to focus on opportunities that are emerging in rare diseases and paediatrics. While potentially a significant growth area, we have not factored in anything into our forecasts at this stage. CGS has also added more scientific personnel to drive further contract signings.
- FY18 guidance reconfirmed:** CGS continues to expect an improvement in earnings in 2H18. This is consistent with our FY18 forecasts which remain unchanged.

RECOMMENDATION: Long Term Buy (unchanged)

- We are encouraged with the rate of contract signings, the ongoing move of the LTM book-to-bill ratio above 1.0x, the improvement in cash flow, and the reconfirmation of guidance. While we believe valuation support exists at 3x revenue, we believe investors will also start to look for delivery of greater and more consistent earnings over the long term.

June Year End	FY17A	FY18E	FY19E	FY20E
Net Profit (US\$m)	-0.7	-0.1	2.1	3.2
EBITDA (\$USm)	0.1	0.5	3.3	4.8
EBIT (US\$m)	-0.7	-0.1	2.5	3.8
EPS (US¢)	-0.6	0.0	1.6	2.4
DPS (US¢)	0.0	0.0	0.0	0.5
PER (x)	na	na	45.3	29.6
PER Rel Small Ords (%)	na	na	263%	171%
Ent. Value / Revenue (x)	4.0	3.0	2.2	1.8
Ent. Value / EBITDA (x)	1067.2	161.1	26.0	17.5
Yield (%)	0.0%	0.0%	0.0%	0.7%
# Shares (m) (fd)				129.8
Monthly Volume (m)				1.6
Diluted Mkt Cap (A\$m)				120.7
Net Debt (A\$m)				-12.2
Enterprise Value (A\$m)				108.5

Source: Company data and Select Equities Research



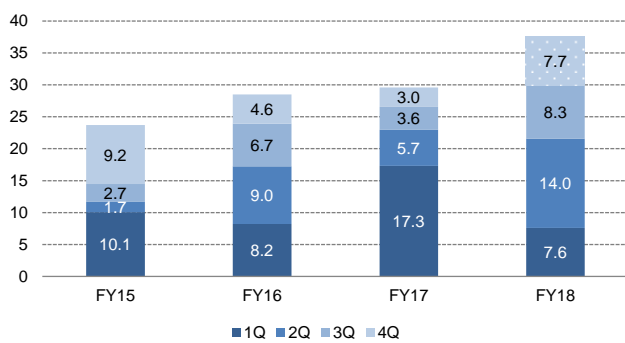
Source: IRESS

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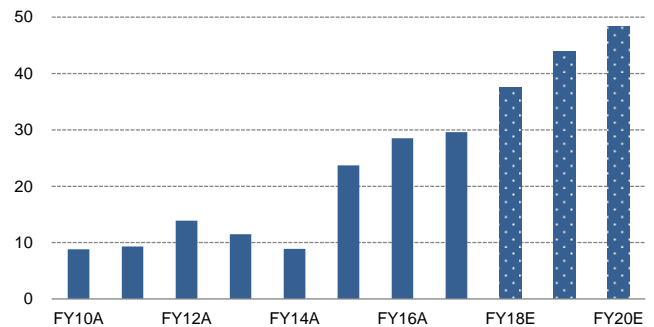
CONTRACT BOOK LOOKING GOOD...

- \$8.3m in new contracts were signed during 3Q18, which was slightly ahead of our \$8.0m forecast but a significant improvement on pcp (\$3.6m). This leaves CGS needing just \$7.7m during 4Q18 to achieve our unchanged FY18 forecast.
- As noted in our previous CGS research, we believe it is better to look at the book-to-bill ratio on a LTM (last 12 months) basis rather than a quarterly basis, in order to remove the quarterly volatility in new contract signings. Despite the 3Q18 result producing a book-to-bill ratio of just 1.04 for the quarter, we view the continuing move of this ratio back above 1.0 times on a LTM basis as providing a strong signal for solid revenue growth over the next two years.

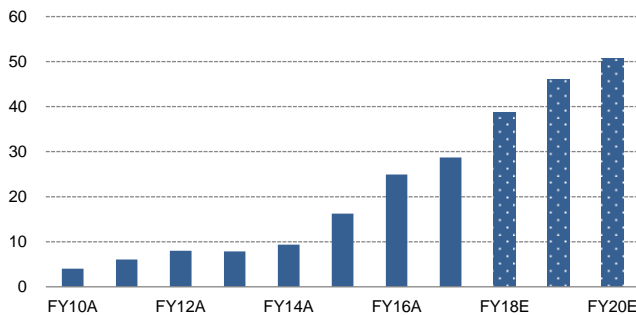
New Contracts Signed During Quarter (US\$m)



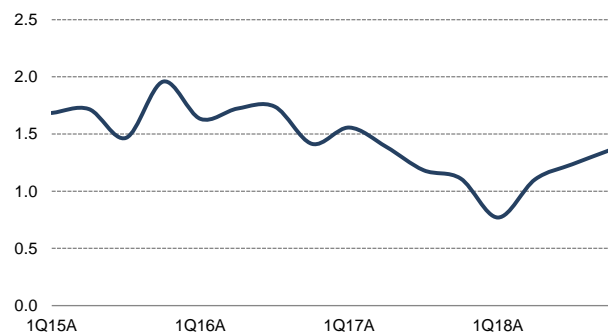
New Contracts Signed During Year (US\$m)



Outstanding Contract Book (US\$m)



Book-to-Bill Ratio (LTM) (x)

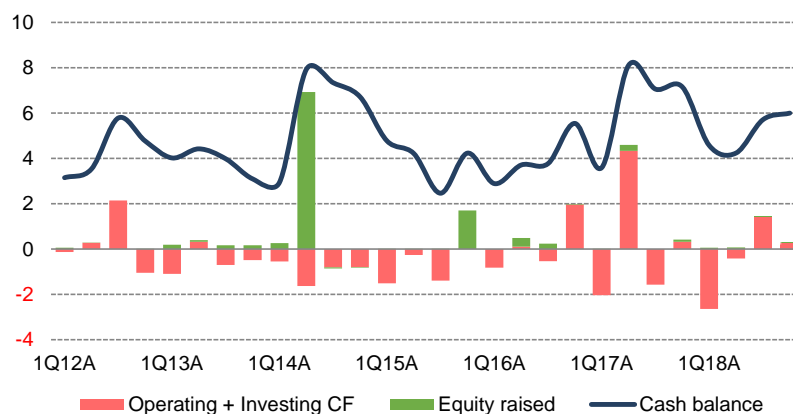


Source (all four charts): Company data and Select Equities Research

...AND NOW FLOWING THROUGH TO CASH

- A key highlight of the 3Q18 result was the ongoing turnaround in the company's operating cash performance as the build-up of trade receivables began to reverse.

Quarterly Cash Flow and Cash Balance (US\$m)



Source: Company data and Select Equities Research

- Dealing largely with global pharma giants, CGS has an extremely high-quality customer base with a long history of virtually no bad debts. As such, we believe it is worthwhile looking at the combination of CGS's cash plus trade receivables, and note that this balance has been very stable over the last few quarters.



Source: Company data (3Q18 Report)

FORECAST REVISIONS

- Our FY18 forecasts have remained unchanged; while we have also published our FY20 forecasts for the first time.

Date	18-Oct-16	9-Mar-17	20-Jul-17	8-Sep-17	24-Jan-18	26-Feb-18	12-Apr-18
Event	1Q17 Update [^]	1H17 Result [^]	4Q17 Update [^]	FY17 Result [^]	2Q18 Update	1H18 Result	3Q18 Update
Price (A\$)	\$1.03	\$1.05	\$1.10	\$1.09	\$0.88	\$0.88	\$0.93
AUD/USD	0.763	0.753	0.796	0.799	0.801	0.785	0.775
Revenue (US\$m)	37.4	35.9	30.2	30.5	30.2	29.7	29.7
Gross Profit (US\$m)	21.0	20.3	17.4	17.9	16.6	15.9	15.9
EBITDA (US\$m)	5.1	2.9	0.7	1.8	1.5	0.5	0.5
NPAT (US\$m)	3.3	1.8	0.3	0.6	0.6	-0.1	-0.1
EPS (US¢)	2.7¢	1.4¢	0.2¢	0.6¢	0.4¢	-0.1¢	0.0¢
DPS (US¢)	0.0¢	0.0¢	0.0¢	0.0¢	0.0¢	0.0¢	0.0¢
P/E (x)	29.0x	56.1x	363.0x	165.1x	157.9x	na	na
EV / EBITDA (x)	17.7x	31.5x	141.0x	58.7x	55.7x	153.7x	161.1x
EV / Revenue (x)	2.4x	2.5x	3.4x	3.3x	2.8x	2.8x	3.0x
Recommendation	LT BUY	LT BUY	HOLD	HOLD	LT BUY	LT BUY	LT BUY

Source: Company data and Select Equities Research

BUSINESS DESCRIPTION

- Cogstate Limited (CGS) is a niche CRO (contract research organisation) specialising in cognitive assessment that services global pharmaceutical and biotechnology companies. Key clients include Eli Lilly, Eisai and Johnson & Johnson.
- The company's core expertise is its proprietary computerised tests, originally developed in 2001. While computerised cognition tests are not difficult to replicate, the barrier to entry is clinical acceptance. The efficacy of CGS's computerised tests is supported by over 400 peer review articles, and they have been used in over 255 clinical trials.
- Cognitive assessment is used in the diagnosis and monitoring of patients suffering a range of conditions including chronic disorders like Alzheimer's disease, depression and temporary conditions such as sports-related concussions. There are 44m people worldwide with Alzheimer's disease, with this number projected to reach 100m by 2050.
- CGS is seeking to enter the US Healthcare Market in FY18 by providing cognitive assessment tools to hospitals, physicians and consumers. The company estimates that there is potential for over 25m tests to be conducted annually in the US.
- The Precision Recruitment segment is an emerging part of the business that was launched in 2014. It is a self-administered pre-screening assessment tool that lets pharmaceutical and biotech firms filter volunteers who are more likely to be recruited as candidates into a clinical trial enabling cost savings for the end client.
- The company is headquartered in Melbourne (Australia) and Connecticut (USA), was listed on the ASX in 2004, and has 160 full time equivalent employees.

RISK FACTORS

- Uncontracted pipeline conversion makes up a significant portion of our revenue forecasts.
- Demand from clinical trials in the Alzheimer's focus area may be subdued while future studies are reassessed as a result of the recent failure of promising drug trials in this area.
- Entering the fragmented healthcare market may prove to be more costly and difficult than anticipated.
- CGS had three customers in FY17 that collectively represented 68% of revenue.
- 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.
- Academic recognition of CGS's competitors could eventuate and result in less demand for the company's services.
- Reduction in the size of the market for clinical trials that require an assessment of cognition.
- Difficulty in obtaining reimbursement for Cognigram

Cogstate Ltd

Select Equities Research

						Financial Model											
Code	CGS					June Year End	FY16A	FY17A	FY18E	FY19E	FY20E						
Last sale (A\$)	12-Apr-18					\$0.93	Financial Position (US\$m)										
# Shares (m)						114.4	Cash	5.5	7.2	6.0	7.1	9.2					
# Performance Rights & Options (m)						15.5	Accounts Receivable	3.9	3.9	5.6	7.6	8.9					
Diluted Mkt Cap (A\$m)						120.7	Accrued Revenue	0.1	0.1	0.3	0.4	0.5					
Net Debt (A\$m)						-12.2	Inventory	0.0	0.0	0.0	0.0	0.0					
Enterprise Value (A\$m)						108.5	PPE	1.3	1.6	1.5	1.9	2.3					
June Year End	FY16A	FY17A	FY18E	FY19E	FY20E	Goodwill	0.0	0.0	0.0	0.0	0.0						
Financial Performance (US\$m)						Other Intangibles	0.3	0.3	0.3	0.3	0.3						
Clinical Trials	19.8	26.2	27.7	36.7	43.6	Other Assets	3.4	3.7	3.7	3.7	3.7						
Other segments	0.1	0.2	2.0	3.1	3.4	Total Assets	14.6	16.8	17.5	21.0	24.9						
Revenue	19.8	26.4	29.7	39.8	47.0	Accounts Payable	2.3	2.6	3.0	4.0	4.7						
EBITDA	1.3	0.1	0.5	3.3	4.8	Unearned Revenue	0.2	0.9	1.2	1.6	1.9						
D&A	-0.6	-0.8	-0.7	-0.8	-1.0	Borrowings	0.0	0.0	0.0	0.0	0.0						
EBIT	0.7	-0.7	-0.1	2.5	3.8	Other Liabilities	1.8	2.1	2.8	2.8	2.8						
PBT	0.8	-0.6	-0.1	2.6	4.0	Total Liabilities	4.3	5.7	7.0	8.4	9.4						
NCI	0.0	0.0	0.0	0.0	0.0	Net Assets	10.2	11.1	10.5	12.6	15.5						
NPAT (normalised)	0.4	-0.7	-0.1	2.1	3.2	Ordinary Equity	10.2	11.1	10.5	12.6	15.5						
Abnormals	1.6	0.0	-0.7	0.0	0.0	NCI	0.0	0.0	0.0	0.0	0.0						
NPAT (reported)	1.9	-0.6	-0.7	2.1	3.2	Total Equity	10.2	11.1	10.5	12.6	15.5						
EPS (US¢)	0.3	-0.6	0.0	1.6	2.4	Cash Flows (\$m)											
DPS (US¢)	0.0	0.0	0.0	0.0	0.5	Net Receipts	1.7	1.2	-0.8	2.7	4.4						
NTA/ Share (US\$)	0.08	0.08	0.08	0.09	0.12	Net Interest	0.1	0.1	0.1	0.1	0.2						
BV/ Share (US\$)	0.08	0.09	0.08	0.10	0.12	Tax Received/(Paid)	-0.4	0.0	0.0	-0.5	-0.8						
Contracted Revenue						24.9	28.7	38.6	45.9	50.7	Other Operating	0.6	0.8	0.0	0.0	0.0	
- Recognised in 1 yr						13.0	14.6	19.3	23.0	25.3	Operating Cash Flow	1.9	2.0	-0.7	2.3	3.8	
- Recognised in 2 yrs						7.2	6.7	7.7	9.2	10.1	PPE (net)	-1.2	-1.0	-0.6	-1.2	-1.4	
- Recognised in 3+ yrs						4.7	7.4	11.6	13.8	15.2	Intangibles (net)	0.0	0.0	0.0	0.0	0.0	
Valuation/Performance Ratios						Acquisition+Investment	0.0	0.0	0.0	0.0	0.0	Other Investing	0.0	0.0	0.0	0.0	
PER (x)	189.2	na	na	45.3	29.6	Investing Cash Flow	-1.2	-1.0	-0.6	-1.2	-1.4	Change in Debt (net)	0.0	0.0	0.0	0.0	0.0
EV/ Revenue (x)	3.3	4.0	3.0	2.2	1.8	Change in Equity (net)	0.6	0.4	0.2	0.0	0.0	Dividends	0.0	0.0	0.0	0.0	-0.3
EV/ EBITDA (x)	49.0	1067.2	161.1	26.0	17.5	Other Financing	0.0	0.0	0.0	0.0	0.0	Financing Cash Flow	0.6	0.4	0.2	0.0	-0.3
Revenue Growth (%)	48%	33%	12%	34%	18%	Change in Cash	1.4	1.4	-1.2	1.1	2.1	Cash at Start of Year	4.2	5.5	7.2	6.0	7.1
EBITDA Growth (%)	na	-93%	446%	511%	46%	Net FX Effect on Cash	0.0	0.2	0.0	0.0	0.0	Cash at End of Year	5.5	7.2	6.0	7.1	9.2
NPAT Growth (%)	na	-288%	na	na	53%	Free Cash Flow (\$m)											
EPS Growth (%)	na	-293%	na	na	53%	Operating Cash Flow	1.9	2.0	-0.7	2.3	3.8	Change in WC	0.3	1.1	-1.3	-0.6	-0.4
P/NTA (x)	7.1	10.5	9.2	7.6	6.2	Normalised OCF	2.3	3.1	-2.1	1.7	3.3	Less Maint. Capex	-0.6	-0.8	-0.7	-0.8	-1.0
P/BV (x)	6.9	10.2	8.9	7.4	6.0	Free Cash Flow	1.6	2.3	-2.7	0.9	2.3	FCF/NPAT (%)	457%	-350%	5211%	41%	72%
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.7%	P/FCF (x)	74.1	51.7	-43.9	141.4	52.6	Substantial Shareholders					
Payout Ratio (%)	0%	0%	0%	0%	20%						* No. (m)	%					
Franking (%)	na	na	na	na	100%						Dagmar Dolby (director)	19.8	17.3%				
EBITDA Margin (%)	6.7%	0.4%	1.8%	8.4%	10.3%						Martin Myer (chair, co-founder)	19.6	17.1%				
EBIT Margin (%)	3.5%	-2.5%	-0.4%	6.2%	8.1%						Fidelity	↑	11.4	10.0%			
NPAT Margin (%)	1.8%	-2.5%	-0.2%	5.2%	6.7%						Alan Finkel (former director)	↑	9.0	7.9%			
Tax Rate (%)	53%	-8%	20%	20%	20%						Anacacia	↑	6.2	5.5%			
Current Ratio (x)	2.7	2.3	2.2	2.2	2.4						Total		66.1	57.8%			
Interest Cover (x)	na	na	na	na	na						* Change over last 12 months						
Net Debt/ EBITDA (x)	-4.2	-71.8	-11.0	-2.1	-1.9												
ROE (%)	4%	-6%	0%	18%	23%												
ROIC (%)	12%	-11%	-2%	35%	45%												
Interim Results (US\$m)						1H17A	2H17A	1H18A	2H18E								
Revenue						14.0	12.4	13.4	16.3								
EBITDA						1.4	-1.3	-0.2	0.8								
D&A						-0.3	-0.4	-0.3	-0.4								
EBIT						1.1	-1.7	-0.5	0.4								
PBT						1.1	-1.7	-0.5	0.5								
NPAT (normalised)						0.7	-1.4	-0.6	0.6								
NPAT (reported)						0.7	-1.3	-1.3	0.6								

Note: All data in US\$ unless otherwise indicated

Source: Company data and Select Equities Research

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