

INSTEM

SOFTWARE AND COMPUTER SERVICES

27 September 2022

INS.L

665p

Market Cap: £150.8m

SHARE PRICE (p)



12m high/low 905p/570p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£4.0m (at 30/06/22)
Enterprise value	£146.8m
Index/market	AIM
Next news	Trading update, Dec-22
Shares in Issue (m)	22.7
Chairman	David Gare
Chief Executive	Phil Reason
Chief Financial Officer	Nigel Goldsmith

COMPANY DESCRIPTION

Instem is a leading provider of IT solutions & services to the life sciences market.

www.instem.com

INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

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Another positive period for Instem

Instem has once again delivered a strong set of interim results, in our view, with the outcome consistent with the August 2022 trading update. The growth story remains the key highlight, with all four divisions making a positive contribution. Earnings quality continues to improve, and the group's financial position remains robust. Commentary on the outlook is positive, with price rises and stronger growth in high-margin software business expected to benefit second-half financial performance. We maintain FY22E-FY24E earnings estimates following the release.

- Strong top-line growth.** Group revenue for the six months ending June 2022 increased by 39% to £27.6m, with growth of 34% YoY on a constant currency basis. Adjusted EBITDA was £4.5m (+8% YoY) for H1 22, versus £4.2m for H1 21, reflecting higher salary inflation in the first half and integration of the three acquisitions made during 2021. Operating cash performance was once again solid, with cash generated from operations (before working capital) of £4.1m representing a 17% YoY improvement.
- Earnings quality continues to improve.** The ongoing transition to SaaS delivery is driving growth in recurring revenues; up 62% YoY during the period to £16.0m, a £6.1m improvement (H1 21: £9.9m). SaaS revenues were 29% higher YoY at £6.3m (H1 21: £4.9m).
- Robust financial position.** Instem closed H1 22 with a gross cash balance of £10.3m. The group also retains committed credit facilities (with HSBC) of £10m, with an additional £10m uncommitted. We believe that £30m of financial headroom positions the group strongly to capture growth opportunities in its respective marketplaces, both organically and via further M&A.
- Positive outlook.** With H2 22E performance expected to benefit from price increases and stronger-than-anticipated growth in higher-margin software revenues, the Board remains confident that the business will deliver a FY22E profit outcome in line with its current expectations.
- Earnings estimates unchanged.** We maintain our FY22E-FY24E earnings estimates following the results. However, we trim our FY22E revenue estimate by 1.9% to reflect revised assumptions on the H2 22E revenue mix. Adjusted EBITDA, PBT and EPS are unchanged in all three years. We have also revised working capital assumptions over our forecast period, with our forecast FY24E net cash position c.4% lower than previously.

FYE DEC (£M)	2020	2021	2022E	2023E	2024E
Revenue	28.2	46.0	60.5	68.2	75.1
Adj EBITDA	5.9	8.3	11.0	14.4	16.2
Fully adj PBT	4.0	5.0	7.6	10.0	12.2
Fully adj EPS (p)	19.1	18.0	26.9	35.6	43.5
EV/Sales	5.2x	3.2x	2.4x	2.2x	2.0x
EV/EBITDA	24.8x	17.8x	13.4x	10.2x	9.1x
PER	34.8x	37.0x	24.8x	18.7x	15.3x

Source: Company Information and Progressive Equity Research estimates.

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Please refer to important disclosures at the end of the document.

H1 22 divisional performance

Study Management and Data Collection (43% of revenue H1 22, +22% YoY)

The business continues to see growth in the user base for most of its study management solutions, while adding to the product set.

Of Instem's four business lines, management believes that Study Management is the division with the greatest opportunity to transition existing clients from on-premises delivery to SaaS deployment. The release notes that although progress on the migration has slowed over the past two years, clients are now refocusing on SaaS conversion projects.

Clinical Trial Acceleration (31% of revenue H1 22, +119% YoY)

Post-period end, Instem signed its largest ever single contract, a \$12m multi-year SaaS project for a large CRO. Aspire is the group's modular clinical analysis framework that both accelerates and reduces the cost of drug development, and management expects that this project will become a key reference client for the suite.

For further analysis of the Aspire deal, see [*Instem: Largest ever contract validates growth strategy.*](#)

H1 22 also saw the completion of several large consulting projects, and a lengthening of sales cycles for certain other large projects. The release signals that growth in consulting revenues will be modest over FY22E.

Regulatory Solutions (20% of revenue H1 22, +19% YoY)

Despite the impressive growth in revenues delivered during the period (+19% YoY), in H1 22 the Regulatory Solutions business was impacted by the twin effects of 1) client studies failing to deliver as many data sets ready for SEND conversion as they had anticipated and 2) a significant change in the commercial terms of a third-party SEND verification package used by Instem.

We believe these to be short-term phenomena. First, management has developed in-house verification software, which will be implemented during Q4 22E. Second, the release signals a 'growing' order book for SEND conversion.

In Silico Solutions (6% of revenue H1 22, +11% YoY)

The group's Leadscope predictive analytics solution continued to grow strongly during the period. New predictive assays (investigative procedures in laboratory medicine) have been licenced and deployed, and the division continues to develop new in-silico models, some of which will replace animal-based studies.

Demand for Instem's Knowledgescan target safety assessment business slowed during the height of the Covid crisis. The release confirms that business has picked up during Q2 22 and continued to grow strongly in Q3 as scientists return to their labs.

H1 22 key financials

H1 22 revenue increased by £7.8m to £27.6m, a 39% YoY increase (H1 21: £19.8m). Revenue growth was 34% YoY on a constant currency basis, with the consolidated revenue figure reflecting the first full-period contributions from The Edge, PDS and d-wise to group financials (all were acquired during 2021). We note that the group has delivered material revenue growth against a backdrop of the ongoing transition to SaaS delivery, where revenues are typically recorded over a longer timeframe and are initially lower.

Recurring revenues (support & maintenance, SaaS subscriptions) grew by £6.1m to £16.0m (+62% YoY). Recurring revenues now contribute 58% of total revenue (H1 21: 50%), with H1 22 seeing solid growth during the period from both annual support fees and SaaS subscription revenues.

Opex grew 47% during the period, ahead of the 39% growth in revenue. The increase reflects ongoing investment in operational teams, the integration of 2021 acquisitions into the group (The Edge, PDS and d-wise) and increased salary costs. Adjusted EBITDA grew 8% YoY to £4.5m, giving a margin of 16.3% (H1 21: 21%).

Operating cash flows remain solid, with pre-working capital cash flow from operations of £4.1m representing a £0.6m (+17%) YoY improvement. However, H1 22 saw a £2.8m swing in working capital, leaving net cash generated from operations £2.3m lower than the comparable period at £1.8m.

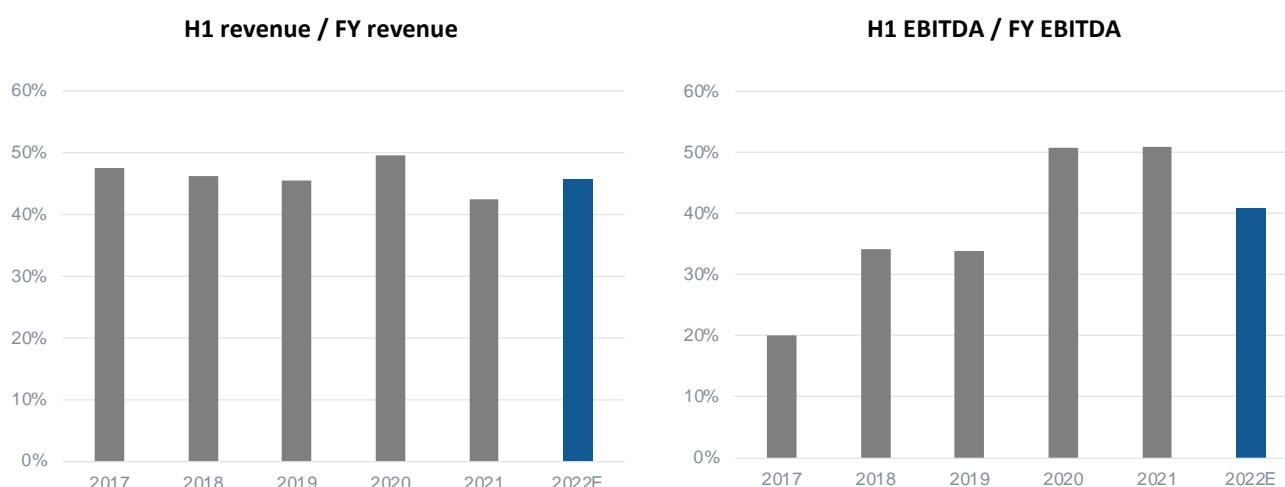
H1 22 closed with a gross cash balance of £10.3m (£4.0m net of financial liabilities). Although a decline on the H1 21 gross cash balance of £17.9m, the decrease reflects the adverse working capital movement and also £4.5m of (anticipated) contingent and deferred consideration payments made during the period.

On track for FY22E

We believe Instem's H1 22 results demonstrate that the business is on track to deliver our FY22E estimates. As demonstrated in the charts below, Instem has delivered 46% and 41% of our respective FY22E revenue and EBITDA forecasts in the first half. As shown in the charts, both are consistent with historical levels. We believe the following points support our positive stance:

- Instem has historically demonstrated seasonality in revenues, with the second half usually being slightly ahead of the first. This has been a stable trend over recent reporting periods – the group has delivered between 42% and 50% of FY revenues in the first half (46% of FY22E).
- EBITDA has followed a similar trend. Instem has reported between 20% and 51% of FY EBITDA in the first half over recent years. Based on our estimates, Instem has already delivered some 41% of our FY22E forecast. With price increases and growth in higher-margin software revenues expected to benefit H2 22E performance, we believe the group remains on track to deliver our forecast FY22E outcome.

Instem – H1 revenue and EBITDA vs full-year outcome 2017-2022E



Source: Company data and Progressive Equity Research estimates.

Forecast commentary

Estimate changes

Following the announcement, we make changes to estimates as shown in the table below. Fuller financials are detailed on page six.

Estimate changes following H1 22 results announcement

£m unless stated	FY22E			FY23E			FY24E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	61.7	60.5	-2%	68.2	68.2	0%	75.1	75.1	0%
Adj EBITDA	11.0	11.0	0%	14.4	14.4	0%	16.2	16.2	0%
Fully adj PBT	7.6	7.6	0%	10.0	10.0	0%	12.2	12.2	0%
Fully adj EPS (p)	26.9	26.9	0%	35.6	35.6	0%	43.5	43.5	0%
Net cash/(debt)	8.4	7.0	-16%	13.7	12.5	-9%	26.2	25.0	-4%

Source: Progressive Equity Research estimates

- With the industry backdrop remaining favourable and a significantly enhanced platform and product set following the three acquisitions made during 2021, we continue to expect the business to deliver solid growth over our forecast period. However, our FY22E revenue estimate is trimmed by 1.9%, reflecting revised assumptions on the revenue mix in the current year (see overleaf). Note our FY23E and FY24E revenue expectations are unchanged from previously published forecasts.
- Our profitability estimates are unchanged in all three forecast years, where we continue to forecast solid growth in adjusted EBITDA, PBT and EPS.

- While we expect (strong) positive cash flow in each of the next three years, our expectations of the group's cash position are lower than previously forecast. This reflects a cash outflow from the settlement of the legal claim confirmed in the announcement and also revised H2 22E working capital assumptions. These adjustments flow through into FY23E and FY24E.

Revenue progression

Below we present our expectations of Instem's revenue progression 2021 to 2024E

Instem – Revenues FY21A-FY24E					
£m unless otherwise stated	2021	2022E	2023E	2024E	CAGR
Annual support fees	14.4	20.8	20.3	21.9	15%
SaaS subscription fees	9.7	13.6	19.1	22.9	33%
Licences	4.6	6.1	4.7	4.5	-1%
Professional services	3.7	4.0	4.9	5.2	13%
Technology-enabled outsourced services	6.4	8.8	10.5	11.3	21%
Consulting	7.3	7.2	8.7	9.3	8%
TOTAL	46.0	60.5	68.2	75.1	18%
Growth %		31.5%	10.5%	10.1%	
% of total					
Annual support fees	31%	34%	30%	29%	
SaaS subscription fees	21%	22%	28%	30%	
Licences	10%	10%	7%	6%	
Professional services	8%	7%	7%	7%	
Technology-enabled outsourced services	14%	15%	15%	15%	
Consulting	16%	12%	13%	12%	
TOTAL	100%	100%	100%	100%	
Revenue % Recurring*	52%	57%	58%	60%	

Source: Company data and Progressive Equity Research estimates

* Annual support fees + SaaS Subscription fees

- We have revised assumptions of the FY22E revenue mix. We have increased our forecasts of SaaS, licences and consulting sales, offset by reduced technology-enabled outsourced services revenues.
- As stated on the previous page, our FY23E and FY24E revenue expectations are unchanged. Our forecasts of the revenue mix in both years is also unaltered.

Financial Summary: Instem

Year end: December (£m unless shown)

	2020	2021	2022E	2023E	2024E
PROFIT & LOSS					
Revenue	28.2	46.0	60.5	68.2	75.1
Adj EBITDA	5.9	8.3	11.0	14.4	16.2
Adj EBIT	5.0	7.1	6.8	10.1	12.4
Reported PBT	2.5	3.0	5.4	8.5	10.7
Fully adj PBT	4.0	5.0	7.6	10.0	12.2
NOPAT	4.1	5.7	5.5	8.1	9.9
Reported EPS (p)	11.6	9.2	18.4	29.5	37.2
Fully adj EPS (p)	19.1	18.0	26.9	35.6	43.5
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	7.7	10.3	6.8	14.7	17.8
Free Cash flow	5.8	6.8	4.8	10.0	12.5
FCF per share (p)	29.7	29.7	21.0	44.7	55.6
Acquisitions	(0.3)	(17.5)	(6.0)	(5.0)	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Capex	(1.4)	(2.4)	(2.8)	(2.8)	(2.8)
Shares issued	15.4	0.0	0.0	0.0	0.0
Net cash flow	20.8	(11.6)	(1.6)	5.1	12.5
Cash & equivalents	26.7	15.0	13.4	18.5	31.0
Net (Debt)/Cash	25.3	3.7	7.0	12.5	25.0
NAV AND RETURNS					
Net asset value	33.2	47.7	49.8	56.5	64.8
NAV/share	162.3	222.2	228.6	259.0	297.4
Net Tangible Asset Value	15.2	(10.6)	(7.4)	(0.8)	5.6
NTAV/share	74.3	(49.3)	(34.1)	(3.8)	25.5
Average equity	25.0	40.5	48.8	53.1	60.6
Post-tax ROE (%)	9.1%	5.2%	8.6%	12.5%	13.8%
METRICS					
Revenue growth		63.1%	31.5%	12.7%	10.1%
Adj EBITDA growth		39.4%	33.1%	31.2%	12.3%
Adj EBIT growth		40.5%	(3.7%)	47.9%	22.6%
Adj PBT growth		24.4%	52.5%	31.0%	22.1%
Adj EPS growth		N/A	49.3%	32.5%	22.1%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		15.4%	11.3%	14.8%	16.5%
VALUATION					
EV/Sales	5.2	3.2	2.4	2.2	2.0
EV/EBITDA	24.8	17.8	13.4	10.2	9.1
EV/NOPAT	35.5	25.9	26.9	18.2	14.8
PER	34.8	37.0	24.8	18.7	15.3
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	4.5%	4.5%	3.2%	6.7%	8.4%

Source: Company information and Progressive Equity Research estimates

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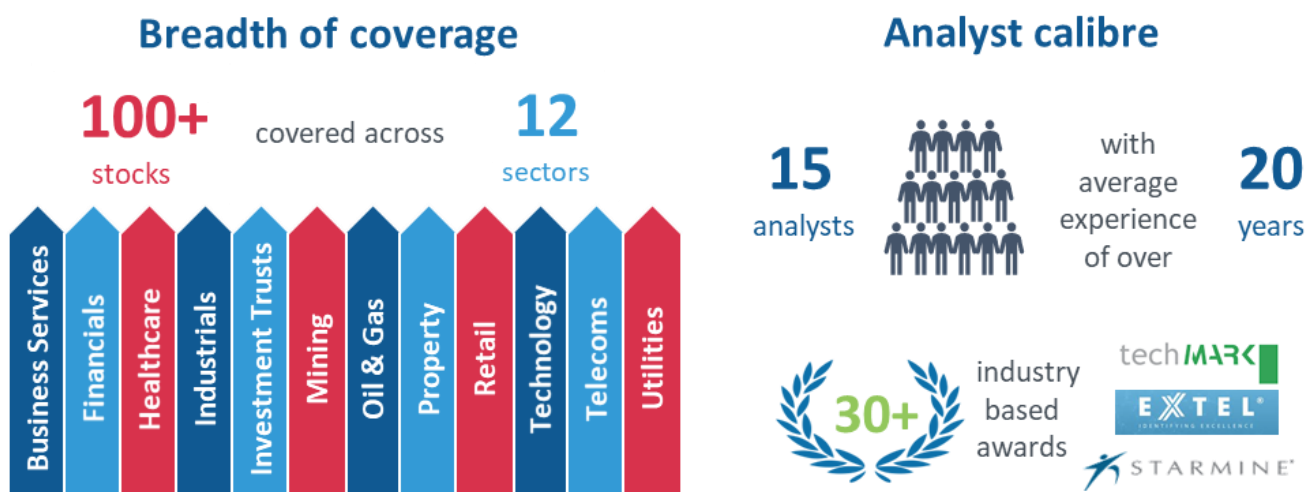
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