PROGRESSIVE EQUITY RESEARCH

19 September 2016

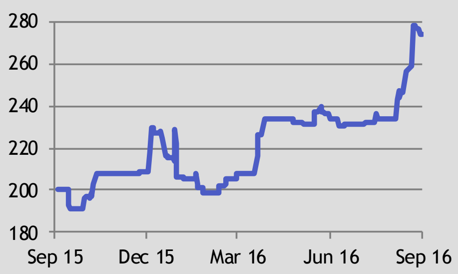
INSTEM
SOFTWARE AND COMPUTER SERVICES

INS.L

274.0p

Market Cap: £42.8m

SHARE PRICE (p)



12m high/low	278.0p / 191.5p

Source: LSE Data

KEY INFORMATION

Enterprise value	£39.0m
Index/market	FTSE AIM
Next news	2016 Y/E Update - Jan 17
Gearing	N/A
Interest cover	N/A

INSTEM IS A RESEARCH CLIENT OF PROGRESSIVE

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Solid interims

Instem has announced solid interim results. Revenues grew by 21% YoY, accompanied by a 34% improvement in EBITDA. Activity in the pre-clinical segment remains strong, as evidenced by the multi-year Charles River Laboratories agreement. The group's submit suite continues to deliver good commercial progress, with over $1.6m of new contracts signed in H1 16. We believe there are good grounds for optimism for the second half and beyond.

- **Solid interim results:** Interim results saw impressive growth in all key metrics. At £9.1m, revenues were up by 21% over H1 15, accompanied by a 34% improvement in EBITDA to £1.2m. Revenue visibility remains high, with recurring revenues around 60% of the total base. Adjusted basic EPS of 6.3p compares with 5.1p in H1 15 (+24%). Operating cash flow saw a traditional seasonal outflow of £1.5m, as many of the support and maintenance renewal receipts are timed during H2.

- **Strong activity levels in pre-clinical:** Pre-clinical revenues represent over 90% of the group total. Management re-iterated that the group's multi-year contract with Charles River Laboratories (CRL) will deliver enhanced cash receipts in 2016 and 2017, and also highlighted the opportunities to provide an extended range of services. Investment in data centre infrastructure maintained margins on the Provantis offering, and Perceptive sales benefitted from cross-selling of its high-value AMES Study Manager and Cyto Study Manager solutions across China and North America.

- **Further commercial progress from submit.** Submit is Instem's FDA-compliant platform for the creation and management of SEND datasets. Following an impressive 2015, submit continues to deliver good commercial progress. Six SEND contracts were signed in the first half of 2016 with an aggregate contract value in excess of US$1.6m. One of the six was with a global top ten pharma company.

In our view, Instem has reported a solid start to 2016 and we believe there are grounds for a degree of optimism over the second half, which will benefit from contributions from the recent Samarind and Notocord acquisitions. Revenue visibility remains high, and anticipated growth is underpinned by both a favourable regulatory environment and a strengthened balance sheet following the £4.7m fundraise in February 2016. Management's positive commentary on the strong pipeline of new business for the remainder of 2016 and going into 2017 further supports our view.

YEAR TO DEC	FY-13A	FY-14A	FY-15A	FY-16E	FY-17E
Revenue	**11.4**	**13.4**	**16.3**	**19.4**	**23.8**
Adjusted EBITDA	**1.8**	**1.9**	**2.5**	**2.9**	**4.0**
Adjusted PBT	**1.2**	**1.1**	**1.7**	**2.3**	**3.3**
Adjusted EPS (p)	**8.6**	**8.3**	**12.9**	**10.3**	**14.5**
EV / Sales	**3.4x**	**2.9x**	**2.4x**	**2.0x**	**1.6x**
EV / Adjusted EBITDA	**22.0x**	**21.0x**	**15.6x**	**13.5x**	**9.7x**
P/E	**31.7x**	**33.2x**	**21.3x**	**26.5x**	**18.9x**

Source: Company Information and Progressive Equity Research estimates

H1 in context

The group has delivered a strong H1 performance, with the successful renegotiation of a major Provantis customer (Charles River Laboratories) and a very strong performance from the regulatory submission SEND product, submit.

Just as importantly, the group has continued to deliver on its strategic promise, with a £4.7m fundraise in February, which allowed the completion of two acquisitions – Samarind, a UK-based provider of Regulatory Information Management software and (post-H1) Notocord, a French software business active in data acquisition and analysis in the pre-clinical study market.

To the extent that challenges arose, they related to the early stage clinical market, and the ALPHADAS product, although this may have been expected given the very strong 2015 that this business enjoyed; new product has now been released, which will hopefully drive further demand.

Overall, H1 appears to have been delivered well on plan (or slightly ahead of plan), with genuine positive momentum in a number of areas, and well-planned acquisitions augmenting the group's position. There is also a comment within the release around "forward investment in staff and facilities to maximise the SEND opportunity". As described below, this suggests that some of the current outperformance will be used to intensify efforts around the emerging regulation-driven SEND marketplace.

Changes to estimates

Given these comments in the RNS, we elect to increase our 2016 revenue and cost estimates, as the group's ongoing strength in sales is becoming clear, but there is a clear expectation that some of the benefit will be re-invested (especially around the SEND opportunity).

We therefore take this opportunity to make the changes below to our estimates for 2016 and 2017:

FORECAST REVISIONS

£m unless stated	FY16E Old	FY16E New	FY16E Change (%)	FY17E Old	FY17E New	FY17E Change (%)
Revenue	18.8	19.4	3.3%	21.8	23.8	9.2%
Adj EBITDA	2.9	2.9	0.0%	4.0	4.0	0.0%
Fully adj PBT	2.3	2.3	0.0%	3.3	3.3	0.0%
Fully adj EPS (p)	10.3	10.3	0.0%	14.5	14.5	0.0%

Source: Progressive Equity Research estimates.

Previous forecasts were published 08 September 2016.

Our expectation of increased costs for FY16 and FY17 exactly offsets the higher revenue forecasts. As the table shows, key profit and cash flow metrics are unchanged compared with our previously published estimates.

SUMMARY FINANCIALS

Year ended December	**FY-13A**	**FY-14A**	**FY-15**	**FY-16E**	**FY-17E**
£m unless stated					
Profit & Loss					
Revenue	**11.4**	**13.4**	**16.3**	**19.4**	**23.8**
Adj EBITDA	1.8	1.9	2.5	2.9	4.0
Adj EBIT	**1.1**	**1.1**	**1.7**	**1.6**	**2.3**
Reported PBT	0.7	0.2	(0.4)	1.3	2.4
PBT before exceptionals and AAG	1.2	0.9	0.3	2.3	3.6
Fully adj PBT	**1.2**	**1.1**	**1.7**	**2.3**	**3.3**
NOPAT	0.8	0.8	1.2	1.1	1.6
Reported EPS (p)	4.5	1.2	(3.5)	5.5	9.6
EPS before exceptionals and AAG (p)	7.3	4.9	1.5	10.3	15.9
Fully adj EPS (p)	**8.6**	**8.3**	**12.9**	**10.3**	**14.5**
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Cash flow & Balance sheet					
Operating cash flow	2.4	1.3	2.7	1.5	3.4
Free Cash flow £m	1.9	0.9	2.3	0.3	1.8
FCF per share p	15.7	7.2	17.7	1.8	11.3
Acquisitions	(1.6)	(0.3)	(0.9)	(3.4)	(2.2)
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	4.7	0.0
Net cash flow	**0.3**	**0.6**	**1.0**	**1.6**	**(0.4)**
Overdrafts / borrowings / other	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	**2.1**	**1.7**	**2.2**	**3.8**	**3.4**
Net (Debt)/Cash	**2.1**	**1.7**	**2.2**	**3.8**	**3.4**
NAV and returns					
Net asset value	5.0	5.4	6.6	12.2	13.7
NAV/share (p)	**42.3**	**45.2**	**53.3**	**78.1**	**87.9**
Net Tangible Asset Value	(7.9)	(7.0)	(5.4)	(0.4)	1.7
NTAV/share (p)	**(67.3)**	**(58.5)**	**(43.7)**	**(2.8)**	**10.6**
Average equity	5.0	5.2	6.0	9.4	12.9
Post-tax ROE (%)	**10.6%**	**2.9%**	**-7.1%**	**9.2%**	**11.8%**
Metrics	**FY-13A**	**FY-14A**	**FY-15**	**FY-16E**	**FY-17E**
Adj EBIT growth		*-4.6%*	*56.8%*	*-5.1%*	*44.5%*
Adj PBT growth		*-9.7%*	*59.2%*	*35.4%*	*42.8%*
Adj EPS growth		*-4.3%*	*55.7%*	*-19.6%*	*40.4%*
Dividend growth	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*
Adj EBIT margins	*10.1%*	*8.1%*	*10.5%*	*8.3%*	*9.8%*
Valuation	**FY-13A**	**FY-14A**	**FY-15**	**FY-16E**	**FY-17E**
EV/Sales	3.4	2.9	2.4	2.0	1.6
EV/EBITDA	22.0	21.0	15.6	13.5	9.7
EV/NOPAT	48.8	51.2	32.7	34.4	23.8
PER	31.7	33.2	21.3	26.5	18.9
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%
FCF yield	5.7%	2.6%	6.5%	0.6%	4.1%

Source: Company information, Progressive Equity Research estimates

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