

NetScientific

Financial update

Fosun Pharma investing in Glycotest

Pharma & biotech

24 October 2018

Price **29.00p**
Market cap **£23m**

US\$1.40/£

Net cash (£m) at 30 June 2018 7.1

Shares in issue 78.6m

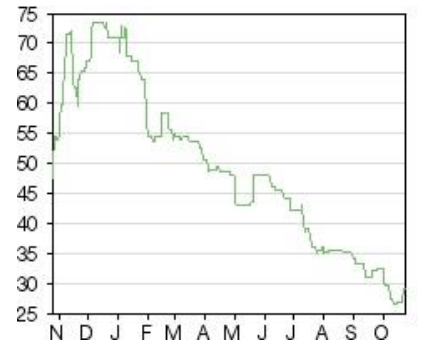
Free float 20.2%

Code NSCI

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (9.4) (19.7) (30.1)

Rel (local) (1.8) (11.3) (24.3)

52-week high/low 73.5p 26.6p

Business description

NetScientific is a healthcare IP commercialisation group with an investment strategy focused on sourcing, funding and commercialising technologies. Its portfolio of four core investments and one material investment is in three main sectors: digital health (Wanda), diagnostics (Vortex, ProAxis, Glycotest) and therapeutics (PDS Biotechnology).

Next event

Regulatory approval of Series A for Glycotest Q418

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NetScientific announced the completion of a \$10m Series A funding for Glycotest with Fosun Pharma, a Chinese pharmaceutical company with a market capitalisation of HK\$71bn. As part of the transaction, Fosun will invest an initial tranche of \$3m, with another \$7m due upon the completion of certain milestones, in return for a 40% interest in Glycotest as well as the China rights for its hepatocellular carcinoma (HCC) panel. The transaction still needs to be approved by regulatory authorities in both China and the US (where Glycotest is based). Approval is expected in around 30 days' time.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	0.5	(12.3)	(20.6)	0.0	N/A	N/A
12/17	0.4	(9.5)	(13.6)	0.0	N/A	N/A
12/18e	0.4	(11.1)	(8.5)	0.0	N/A	N/A
12/19e	2.3	(13.4)	(12.3)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Fosun Pharma receives China rights to HCC panel

Besides the 40% interest in Glycotest, Fosun will receive the exclusive China rights to manufacture and sell Glycotest's panel for HCC as well as its pipeline tests. Glycotest will receive a royalty on sales and retain rights to markets outside of China.

Around 800,000 new cases of HCC per year

HCC is the third leading cause of cancer-related deaths worldwide and the fifth leading cause in the US, with an increasing incidence. According to the International Agency for Research on Cancer, there were 782,000 new cases of HCC worldwide in 2012, with approximately half of them occurring in China.

Glycotest excels in hard-to-find HCC

Recent clinical results confirmed those from earlier studies, which demonstrated that the HCC test could efficiently identify 86% of patients who were missed by an alpha-fetoprotein (AFP) test and even 78% of those who were AFP-negative in the early-stage disease cohort. This supports the commercial proposition for the test, because the ability to catch more patients at an earlier stage will allow them to be treated surgically and significantly reduce downstream costs.

Valuation: £50.6m or 64p per share

We are maintaining our valuation of NetScientific at £50.6m or 64p per share. We will update our valuation upon regulatory approval of this investment from both the Chinese and American authorities. Besides updating NetScientific's ownership stake, we will review our revenue estimates, particularly for the Chinese market.

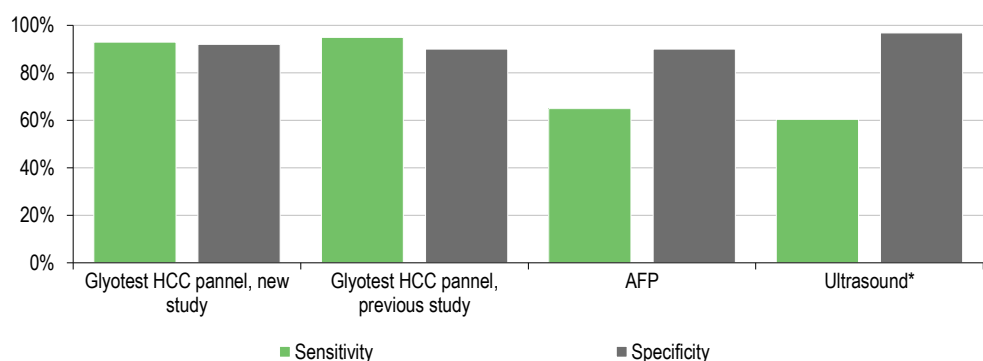
Glycotest Series A financing

NetScientific has announced the completion of a \$10m Series A financing for Glycotest with Fosun Pharma. Glycotest will receive an upfront payment of \$3m, with the remaining \$7m due on the completion of certain milestones, while Fosun Pharma will receive a 40% equity stake in Glycotest as well as the China rights for its HCC panel. The milestones are expected to be completed within the next 18 months. The transaction is contingent on outbound direct investment approval in China, which typically takes around 20 days, as well as approval from the Committee on Foreign Investment in the US. Once approved, NetScientific will retain a controlling interest of 51.5% in Glycotest on a fully diluted basis. Glycotest will use the proceeds to bring the HCC panel towards commercial launch in the US, transfer the HCC panel technology to Fosun and further develop pipeline tests for liver fibrosis and cholangiocarcinoma.

As a reminder, earlier this year Glycotest announced that it had completed a clinical trial measuring the accuracy of its blood-based test for the detection of HCC. The test combines a novel lectin immunoassay with three other biomarkers and demographic data to determine if a patient has developed the disease. The study was performed in China on 149 patients with chronic liver disease under surveillance for the development of HCC. HCC is commonly secondary to other liver diseases, such as hepatitis and non-alcoholic steatohepatitis, and therefore there is a population of known at-risk individuals who require routine screening. The current standard biomarker test for these patients is AFP and the goal of the Glycotest technology is to improve on this standard by detecting both earlier forms of cancer and cancer in those patients with low AFP levels.

The data from this trial are very similar to previous data using the assay (Exhibit 1). It was able to identify patients with HCC with 93% sensitivity at 92% specificity. In a previous study, composed of blood samples of 208 people with either HCC or cirrhosis, the test was able to identify HCC with a 95% sensitivity and 90% specificity. The sensitivity of AFP found in this previous study (65%) is largely in line with what has been reported in the literature: at the 20ng/mL cut-off sensitivities range from 47% to 68% with specificities in the range of 80% to 91%.¹ The Glycotest data also compare attractively to ultrasound, which is another commonly used screening methodology (although there is a wide range of sensitivity for the practice): 60.5% sensitivity and 96.9% specificity.¹ The company has not done a direct comparison to ultrasound yet, however.

Exhibit 1: Comparison of HCC detection methods



Source: Glycotest, Colli, et al. Note: AFP representative statistics from previous Glycotest study. *Ultrasound historical comparison.

¹ Colli A, et al. (2006) Accuracy of Ultrasonography, Spiral CT, Magnetic Resonance, and Alpha-Fetoprotein in Diagnosing Hepatocellular Carcinoma: A Systematic Review. *Am J Gastroenterol* 101, 513-523.

The company provided an additional analysis in the new data: the Glycotest assay was able to identify 86% of patients with HCC that were undetected by AFP (<20ng/mL), which conclusively demonstrates the superiority of the new test. When the same analysis was performed in the cohort of patients with early disease, the HCC panel was able to identify 78% of the patients that were missed by AFP, which indicates it may have considerable clinical utility.

Valuation

We are maintaining our valuation of NetScientific at £50.6m or 64p per share. We will update our valuation upon regulatory approval of this investment from both the Chinese and American authorities. Besides updating NetScientific's ownership stake, we will review our revenue estimates, particularly for the Chinese market as well as the probability of success for Glycotest, as we view the Fosun Pharma deal as validating. Based on preliminary calculations, if we were to increase the probability of success for Glycotest to 25% and added the rNPV for China (with conservative launch assumptions), the value of Glycotest as a whole would increase to £22.6m from £15.4m. However, as the stake for NetScientific would decrease from 66.7% to 51.5%, the value of NetScientific's portion would only increase from £10.3m to £11.7m.

Exhibit 2: Valuation of NetScientific							
Portfolio company	Probability of success	Profitability	Peak sales (£m)	Margin	rNPV (£m)	Ownership	Share value (£m)
Vortex	15.0%	2022	138	42%	12.1	66.1%	8.0
Wanda	7.5%	2020	326	51%	19.8	61.8%	12.3
ProAxis	15.0%	2020	47	50%	15.6	54.0%	8.4
Glycotest	20.0%	2021	113	50%	15.4	66.7%	10.3
PDS	10.0%	2022	270	56%	35.1	13.1%	4.6
Total							43.5
Net cash and equivalents (H118) (£m)							7.1
Total firm value (£m)							50.6
Total shares (m)							78.6
Value per share (p)							64

Source: NetScientific reports, Edison Investment Research

Financials

NetScientific recently reported revenue of £0.13m in H118, down from £0.16m in H117. R&D came in at £1.9m, down 36.1% compared to H117, but down only 8.8% compared to H217. SG&A expense fell 22.3% to £2.3m compared to the same period a year ago, but was up 1.2% sequentially. Loss from operations was £4.6m, down 24.8% compared to H117.

Cash as of 30 June was £7.1m and we estimate that the company will need to raise additional funds in the next six months. We record a financing shortfall as £5.8m in illustrative debt in 2018 and currently estimate the need to raise an additional £10m in 2019 and £5m in 2020. Once approved by regulatory authorities, the Glycotest Series A will reduce the financing shortfall by \$3m immediately and then another \$7m as the milestones are completed over the next 18 months.

Exhibit 3: Financial summary

£000s	2016	2017	2018e	2019e
	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Year end 31 December				
Revenue	518	386	377	2,295
Cost of Sales	(255)	(245)	(188)	(653)
Gross Profit	263	141	188	1,642
Research and development	(7,443)	(5,177)	(4,924)	(5,114)
Selling, general & administrative	(5,001)	(5,281)	(5,570)	(8,301)
EBITDA	(12,570)	(10,814)	(11,347)	(12,019)
Operating Profit (before amort. and except.)	(12,429)	(10,593)	(11,101)	(11,773)
Intangible Amortisation	0	0	0	0
Exceptionals/Other	(666)	0	0	0
Operating Profit	(13,095)	(10,593)	(11,101)	(11,773)
Net Interest	86	1,058	29	(1,586)
Other (change in fair value of warrants)	(49)	(45)	0	0
Profit Before Tax (norm)	(12,343)	(9,535)	(11,072)	(13,359)
Profit Before Tax (IFRS)	(13,058)	(9,580)	(11,072)	(13,359)
Tax	(18)	202	22	281
Deferred tax	0	0	0	0
Profit After Tax (norm)	(12,361)	(9,333)	(11,050)	(13,079)
Profit After Tax (IFRS)	(13,076)	(9,378)	(11,050)	(13,079)
Minority interest	1,881	1,060	4,647	3,393
Profit After Tax after minority interest (FRS 3)	(11,195)	(8,318)	(6,403)	(9,686)
Average Number of Shares Outstanding (m)	51.1	61.0	75.8	78.6
EPS - normalised (p)	(20.6)	(13.6)	(8.5)	(12.3)
EPS - IFRS (p)	(21.9)	(13.6)	(8.5)	(12.3)
Dividend per share (p)	0	0	0	0
BALANCE SHEET				
Fixed Assets	4,054	3,805	7,734	9,867
Intangible Assets	0	0	0	0
Tangible Assets	779	891	1,058	1,211
Other	3,275	2,914	6,676	8,656
Current Assets	11,034	7,968	7,064	3,801
Stocks	0	86	331	287
Debtors	1,578	1,014	1,057	229
Cash	9,456	6,868	5,676	3,285
Other	0	0	0	0
Current Liabilities	(2,172)	(905)	(1,112)	(2,646)
Creditors	(2,044)	(777)	(978)	(2,512)
Short term borrowings	(128)	(128)	(134)	(134)
Long Term Liabilities	(80)	(70)	(5,864)	(15,864)
Long term borrowings	(80)	(70)	(5,864)	(15,864)
Other long term liabilities	0	0	0	0
Net Assets	12,836	10,798	7,822	(4,842)
Minority Interest	(3,875)	(4,573)	(9,220)	(12,613)
Shareholder Equity	8,961	6,225	(1,398)	(17,455)
CASH FLOW				
Operating Cash Flow	(12,939)	(10,479)	(11,251)	(8,706)
Net Interest	43	(11)	(13)	(1,586)
Tax	112	(131)	24	281
Capex	(457)	(399)	(399)	(399)
Acquisitions/disposals	(1,261)	1,310	0	(1,980)
Financing	0	8,083	5,000	0
Dividends	0	0	0	0
Other	66	(574)	0	0
Net Cash Flow	(14,436)	(2,201)	(6,639)	(12,391)
Opening net debt/(cash)	(23,189)	(9,248)	(6,670)	322
HP finance leases initiated	0	0	0	0
Exchange rate movements	(603)	387	0	0
Other	1,098	(764)	(353)	0
Closing net debt/(cash)	(9,248)	(6,670)	322	12,714

Source: NetScientific reports, Edison Investment Research

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