

Ergomed

FY22 results

Solid FY22 marked by broad-based growth

Ergomed reported FY22 results broadly in line with our expectations. Group revenues grew 22.5% y-o-y to £145.3m, underpinned by sustained demand for both the CRO and PV segments and supported by the ADAMAS acquisition and foreign exchange benefit. Adjusted EBITDA rose 11.5% y-o-y, although margins were comparatively lower (19.5% versus 21.4% in FY21) due to previously flagged incremental investments in technology and senior management hires. The order book remained robust at £295m (up 23.1% over FY21), boding well for medium-term sales potential. Year-end net cash of £19.1m was an improvement over the £12m reported in H122 (after the £24.2m net cash purchase of ADAMAS in February 2022) and, with £80m in undrawn credit facilities, Ergomed remains well-capitalised to fund future growth. We make minor adjustments to our estimates and roll forward our model. We upgrade our valuation slightly to 1,577p/share from 1,573p/share previously.

Year end	Revenue (£m)	Adjusted EBITDA* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/21	118.6	25.4	41.3	0.0	25.3	N/A
12/22	145.3	28.4	42.9	0.0	24.4	N/A
12/23e	158.3	31.3	45.0	0.0	23.2	N/A
12/24e	176.3	35.3	51.8	0.0	20.2	N/A

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

Steady sales growth with inorganic support

FY22 performance was broad-based, with the clinical research services (CRO) segment growing 22.9% y-o-y growth (14.7% constant exchange rate, CER) to £71.4m and the pharmacovigilance (PV) business recording 22.1% y-o-y growth (14.3% CER) to £73.9m. Both segments benefited from the integration of the ADAMAS business, which contributed £10.2m to the top line. Order book was strong at £295m (up 23.1% y-o-y), although we note the relatively lower incremental growth over the H122 figure of £284.5m.

Resilient margins despite rising overheads

Stringent cost management allowed Ergomed to maintain strong gross margins (40.7% vs 40.8% in FY21), although overall profitability was marginally affected by previously flagged investment in technology and senior hires (adjusted EBITDA margin 19.5% vs 21.4% in FY21). We expect Ergomed's strategy to utilise technology to drive its CRO (increased use of decentralised clinical trials) and PV (improved case processing efficiency) businesses to translate into top-line growth in the medium term.

Valuation: Upgrade to £801m or 1,577p/share

We make minor adjustments to our estimates post FY22 results and roll forward our model, which results in our valuation increasing to £801m or 1,577p/share from £789m or 1,573p/share. Our valuation implies an FY23e EV/EBITDA multiple of 24.9x. Ergomed trades at a premium on FY23e consensus EV/EBITDA of 16.0x versus peers at 13.5x, thanks to its niche positioning and higher-margin profile.

Healthcare services

17 April 2023

Price 1,046p
Market cap £531m

Net cash (£m) at 31 December 2022 excluding leases 19.1

Shares in issue 50.8m

Free float 81%

Code ERGO

Primary exchange AIM

Secondary exchange Frankfurt Xetra

Share price performance



% 1m 3m 12m

Abs (2.1) (16.6) (23.2)

Rel (local) (4.6) (16.3) (24.0)

52-week high/low 1,380p 932p

Business description

Ergomed is a global full-service contract research outsourcing business with a focus on the United States and EU. It provides Phase I-III clinical services in addition to post-marketing pharmacovigilance services through its PrimeVigilance division. Ergomed is predominantly focused on oncology, orphan drugs, rare diseases and pharmacovigilance.

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FY22 update: Fundamentally strong

Broad-based growth across both segments

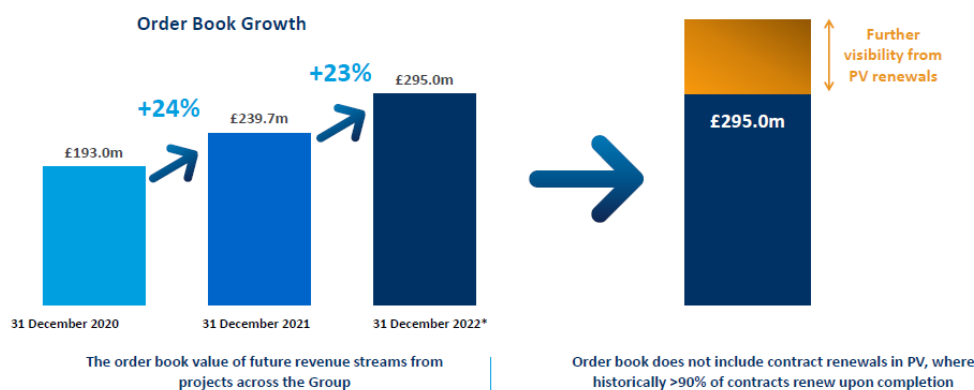
The 22.5% y-o-y revenue growth in FY22 (£145.3m versus £118.6m in the previous year) was driven by a combination of strong sales growth (robust order book and new business contracts), foreign exchange tailwinds (8pp) and a first-time contribution from the acquisition of ADAMAS in February 2022 (£10.2m revenue contribution, or 8.6pp). Importantly, the H222 revenue figure (£75.3m) was higher than H122, continuing the previous trend of a stronger sales performance in the second half of the year and implying business seasonality. Service fee revenue grew 24% y-o-y to £124m (85% of group revenue).

At the segment level, the CRO and PV businesses contributed almost equally to FY22 revenue (49.1% and 50.9% respectively).

- Revenues in the CRO segment increased to £71.4m, up 22.9% (14.7% CER; our estimate was £69.9m), with both pass-through revenues (courtesy of the increasing US presence, contributing two-thirds of FY22 group revenue) and underlying service revenues growing. Notably, service fee revenue rose 27.3% y-o-y (18.9% CER), higher than overall segment growth and benefiting from an improved business mix, although we expect this to have been partially supported by ADAMAS, which we estimate contributed c £4m to the segment's turnover. Excluding ADAMAS, we calculate revenue growth of 16%, driven by new contract wins from speciality pharma/biotech companies. We expect Ergomed's focus on oncology and rare diseases to have benefited it, given that these areas are likely not as affected by the recent funding overhang impacting on development-related activities in the biotech space. For context, 20 of the 37 FDA-approved drugs in FY22 were focused on oncology and rare disease and management has communicated that more than 80% of Ergomed's FY22 revenues were related to these target areas. The oncology and rare disease CRO market is valued at c US\$20bn and, according to Ergomed, is expected to grow at a CAGR of more than 10% in the medium term.
- Revenues in the PV segment increased to £73.9m (including c £6m from ADAMAS, based on our estimates), up 22.1% (14.3% CER; our estimate was £72.1m) and were underpinned by sticky customers and repeat business (with a 90% customer retention rate in the segment). According to management, the business participated in more than 290 regulatory inspections and audits in FY22, more than a 20% increase over FY21. Excluding ADAMAS, we calculate revenue growth of 12% for the segment in FY22.

The order book, a key indicator of future revenue potential, remained strong at £295.0m at end FY22, up 23.1% from £239.7m at end FY21, providing visibility into the near-term revenue stream. The growth in order book was supported by increased orders from both new and existing clients, which also reflects materialisation of cross-selling opportunities and an enhanced geographic presence for new markets including France, Italy, Romania, Portugal and Ireland. However, we note that the incremental growth in the order book over H122 (£284.5m) was a more modest 3.7%, mirroring the trend seen in H221 and indicating that new business and order bookings have been H1 weighted in recent years.

Exhibit 1: Growth in order book value



Source: Ergomed FY22 results presentation. Note: *Includes the benefit of the ADAMAS acquisition in FY22.

As noted above, sales growth was supported by foreign exchange as the company's US-focused business benefited from appreciation in the US dollar against the local currency. North America remains the largest revenue-contributing region based on customer location (62.3% of total revenue), followed by EMEA (20.1%), the UK (13.9%) and Asia and Australia (3.6%). While US recorded revenue growth of 21.7% y-o-y, the UK grew by 42.5%, and EMEA (ex-UK) grew by 29.7%.

Stable gross margins

Ergomed posted strong gross margins in FY22 despite rising overheads (primarily headcount related in the US) – 40.7% in FY22, similar to 40.8% in FY21 – driven by stringent cost control. Gross margins from service fee revenue (which exclude pass-through revenues and are a better indicator of trading performance) were 47.7% in FY22, slightly lower than 48.4% reported in FY21. While pass-through revenues (certain costs passed through to customers but booked as Ergomed revenues at no profit) are negligible in the PV segment, their mix in the CRO segment is much higher (£20.6m vs £0.7m in the PV segment), which is reflected in the 43.5% service fee gross margin recorded by the CRO segment in FY22 vs 50.6% for the PV business. We expect this trend to continue in the forecast years, with further margin expansion opportunities arising from Ergomed's efforts to enhance automation in the PV segment, thereby generating operational efficiencies.

EBITDA growth in line with our estimates

Ergomed reported FY22 adjusted EBITDA of £28.4m (Edison estimate: £28.1m), 11.5% growth over the FY21 figure of £25.4m, although the margin was slightly lower (19.5% vs 21.4% in FY21) due to the anticipated increase in SG&A expenses as the company invested in new technology, manpower and senior leadership hires. SG&A expenses stood at £41.5m in FY22 (including acquisition-related costs), up 17.9% from the FY21 figure of £34.9m. Ergomed had a cash balance of £19.1m by end FY22 and a debt-free balance sheet, along with undrawn revolving credit facilities worth £80m. We assess that the company remains well capitalised to fund its development and growth plans, including bolt-on acquisitions.

Strong contribution from ADAMAS

Ergomed acquired ADAMAS in February 2022 for an enterprise value of £24.2m. ADAMAS offers a full range of quality assurance services and specialises in auditing pharmaceutical manufacturing processes, clinical trials and pharmacovigilance systems, effectively expanding the scope of PV services provided by Ergomed. In FY22, ADAMAS contributed £10.2m in revenue, c £1.7m in EBITDA and £1m in reported profits to Ergomed (from 9 February to 31 December 2022). On an

annualised basis, this figure stands at £10.8m and £1m for revenue and profits, respectively. Management estimates that the auditing business market is a c £1bn opportunity and the integration of ADAMAS should help Ergomed make further inroads into the target space. For FY23, management expects mid-teens growth in revenues from ADAMAS, which should support both top-line growth and margin expansion for Ergomed.

Estimate revisions

We have updated our model for the FY22 results and made small adjustments to our estimates based on FY22 performance and near-term outlook. FY22 revenues were largely in line with our estimate of £142.1m and we have therefore kept our FY23 revenue estimate unchanged at £158.3. Our revenue estimate for FY23 includes contributions of £79.1m and £79.2m from the CRO and PV segments, respectively. We also introduce FY24 estimates, projecting revenues to rise to £176.3m during the year. We have also kept out FY23 operating expense estimates broadly unchanged (highlighted in Exhibit 2 below). We forecast end-FY23 net cash of £41m, supported by the strong top line and operating performance.

Exhibit 2: Key changes to forecasts

	FY22			FY23e			FY24e
	Estimated	Actual	Change (%)	Old	New	Change (%)	New
Total revenues	142.1	145.3	2.2%	158.3	158.3	0.0%	176.3
– PrimeVigilance	72.1	73.9	2.4%	79.3	79.2	-0.1%	88.0
– CRO	69.9	71.4	2.1%	79.0	79.1	0.1%	88.3
O/W pass-through	19.8	20.6	4.0%	21.3	21.7	1.5%	22.6
Gross profit	59.0	59.1	0.3%	66.1	66.1	0.0%	73.4
– Gross margin	41.5%	40.7%	(0.8) pp	41.7%	41.7%	0.0 pp	41.7%
Adjusted EBITDA	28.1	28.4	0.8%	31.4	31.3	-0.2%	35.3
– Adjusted EBITDA margin	19.8%	19.5%	(0.3) pp	19.8%	19.8%	0.0 pp	20.0%
Adjusted EBIT	22.5	21.5	-4.3%	26.0	25.9	-0.1%	28.9
– Adjusted EBIT margin	15.8%	14.8%	(1.0) pp	16.4%	15.7%	0.0 pp	16.4%
Adjusted EPS (p)	40.4	42.9	6.1%	44.9	45.0	-0.8%	51.8

Source: Ergomed company filings, Edison Investment Research

Valuation

After adjusting our estimates and rolling forward our model, we increase our valuation of Ergomed slightly to £801m or 1,577p/share from £789m or 1,573p/share previously. This is derived from our DCF model using a 10% discount rate and 2% terminal growth rate. Our valuation implies an EV/EBITDA multiple of 24.9x based on our FY23 forecasts. We note that Ergomed trades at a premium on FY23e consensus EV/EBITDA of 16.0x compared to the peer average of 13.5x, which can be attributed to its niche positioning and higher-margin profile versus peers.

Exhibit 3: Ergomed base case DCF model

£'000s	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Revenue	158,327	176,284	196,862	226,391	260,067	298,427	342,071	391,672
Growth (%)		11.3%	11.7%	15.0%	14.9%	14.8%	14.6%	14.5%
Adjusted EBITDA	31,338	35,316	39,680	49,806	61,116	74,607	90,649	109,668
Margin (%)	19.8%	20.0%	20.2%	22.0%	23.5%	25.0%	26.5%	28.0%
Tax	(5,089)	(5,578)	(6,432)	(7,697)	(9,297)	(11,191)	(13,426)	(16,059)
rate (%)	-20%	-20%	-20%	-20%	-20%	-20%	-20%	-20%
Working capital	(1,365)	(1,144)	(2,417)	(2,296)	(2,181)	(2,072)	(1,969)	(1,870)
Capex*	(3,000)	(3,000)	(3,000)	(2,850)	(2,708)	(2,572)	(2,444)	(2,321)
Free cash flow	21,884	25,594	27,832	36,963	46,930	58,771	72,811	89,418
						Value (£m)	Value/share (p)	
DCF for forecast period (2023 to 2025)						63.7	125.5	
DCF for transition period (2026 to 2030)						171.3	337.3	
Terminal value						546.6	1,076.6	
Enterprise value						781.6	1,539.3	
Net cash at end December 2022						19.1	37.6	
Equity value						800.7	1,576.9	

Source: Edison Investment Research. Note: 10% WACC. *Includes acquisition of ADAMAS in February 2022.

Exhibit 4: Ergomed comparable companies

Company	Price	EV	EV/EBITDA (x)			EV/sales (x)			P/E (x)		
			2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
Ergomed*	1046p	£512m	16.0x	14.2x	12.6x	3.2x	2.9x	2.6x	23.1x	20.4x	17.7x
Syneos Health	\$40.2	\$6,721m	9.8x	8.7x	8.1x	1.3x	1.3x	1.3x	12.2x	10.2x	9.1x
ICON	\$209.8	\$21,508m	13.0x	12.0x	10.9x	2.6x	2.5x	2.3x	16.6x	14.4x	12.4x
Medpace	\$192.1	\$5,938m	17.8x	15.6x	13.9x	3.5x	3.1x	2.7x	24.8x	21.2x	18.0x
Average			13.5x	12.1x	11.0x	2.5x	2.3x	2.1x	17.8x	15.3x	13.2x

Source: Edison Investment Research, Refinitiv. Note: *Edison estimates. Prices at 14 April 2023.

Exhibit 5: Financial summary

Accounts: IFRS, year end 31 December (£000s)	2020	2021	2022	2023e	2024e
INCOME STATEMENT					
Total revenues	86,391	118,581	145,262	158,327	176,284
Cost of sales	(38,686)	(52,191)	(64,712)	(69,822)	(79,328)
Reimbursable expenses	(8,055)	(18,028)	(21,405)	(22,438)	(23,516)
Gross profit	39,650	48,362	59,145	66,067	73,440
Gross margin %	46%	40.8%	40.7%	41.7%	41.7%
SG&A (expenses)	(27,518)	(34,877)	(41,506)	(40,498)	(45,427)
R&D costs	(152)	(130)	(121)	(122)	(123)
Other income/(expense)	1,554	1,269	1,355	0	0
Exceptionals and adjustments	993	5,753	3,598	500	1,000
Reported EBITDA	18,378	19,670	24,711	30,838	34,316
Depreciation and amortisation	4,844	5,046	5,838	5,392	6,426
Reported EBIT	13,534	14,624	18,873	25,446	27,890
Finance income/(expense)	(395)	(360)	0	0	0
Other income/(expense)	(511)	0	0	0	0
Reported PBT	12,628	14,264	17,953	25,446	27,890
Income tax expense (includes exceptionals)	(2,946)	(1,590)	(2,971)	(5,089)	(5,578)
Reported net income	9,682	12,674	14,982	20,357	22,312
Basic average number of shares, m	48.3	48.5	49.8	50.8	50.8
Basic EPS (p)	20.0	26.2	30.1	40.1	43.9
Adjusted EBITDA	19,371	25,423	28,356	31,338	35,316
Adjusted EBIT	14,527	20,166	21,544	25,946	28,890
Adjusted PBT	14,442	21,616	24,314	27,946	31,890
Adjusted EPS (p)	23.8	41.3	42.9	45.0	51.8
Adjusted diluted EPS (p)	22.8	39.6	41.6	44.5	51.2
Order book	1,93,000	2,39,700	2,95,000	3,37,715	3,65,068
BALANCE SHEET					
Property, plant and equipment	1,742	1,966	2,466	2,074	1,647
Right-of-use assets	4,715	2,691	2,864	2,864	2,864
Goodwill	24,605	23,903	41,404	41,404	41,404
Intangible assets	9,618	7,653	15,844	13,844	10,844
Other non-current assets	4,898	9,433	8,530	8,530	8,530
Total non-current assets	45,578	45,646	71,108	68,716	65,289
Cash and equivalents	18,994	31,243	19,096	40,980	66,574
Trade and other receivables	22,224	25,143	34,450	37,304	41,052
Other current assets	5,553	3,958	4,695	4,695	4,695
Total current assets	46,771	60,344	58,241	82,979	1,12,322
Lease liabilities	3,128	1,432	1,672	1,672	1,672
Long term debt	0	0	0	0	0
Other non-current liabilities	2,743	1,939	4,035	4,035	4,035
Total non-current liabilities	5,871	3,371	5,707	5,707	5,707
Trade and other payables	15,702	15,207	17,640	19,129	21,734
Lease liabilities	1,978	1,249	1,236	1,236	1,236
Other current liabilities	15,932	18,924	20,017	20,017	20,017
Total current liabilities	33,612	35,380	38,893	40,382	42,987
Equity attributable to company	52,866	67,239	84,749	1,05,606	1,28,917
CASH FLOW STATEMENT					
Profit before tax	12,628	14,264	17,953	25,446	27,890
Cash from operations (CFO)	18,048	18,683	14,849	24,884	28,594
Capex	(974)	(983)	(1,916)	(3,000)	(3,000)
Acquisitions & disposals net	(11,985)	103	(24,211)	0	0
Other investing activities	183	(3,266)	23	0	0
Cash used in investing activities (CFIA)	(12,776)	(4,146)	(26,104)	(3,000)	(3,000)
Net proceeds from issue of shares	1,869	546	472	0	0
Movements in debt	0	0	0	0	0
Other financing activities	(2,346)	(2,660)	(2,845)	0	0
Cash from financing activities (CFF)	(477)	(2,114)	(2,373)	0	0
Increase/(decrease) in cash and equivalents	4,795	12,423	(13,628)	21,884	25,594
Currency translation differences and other	(60)	(175)	1,481	0	0
Cash and equivalents at start of period	14,259	18,995	31,243	19,096	40,980
Cash and equivalents at end of period	18,995	31,243	19,096	40,980	66,574
Net (debt)/cash	18,993	31,243	19,096	40,980	66,574

Source: Ergomed accounts, Edison Investment Research

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