EDISON

Ergomed

H120 interim report

Adj EBITDA upgrade despite industry challenges

Healthcare services

H120 adjusted EBITDA of £9.1m was the main positive surprise for us in Ergomed's full interim report released today. We have increased our adjusted EBITDA forecasts to £18.3m (up 8.6%) in 2020 and £20.1m (up 6.8%) in 2021. A strong order book (£151.4m, up 22.0% from the end of 2019) with high visibility into 2021, continued overall business growth and a strong balance sheet should allow Ergomed to successfully navigate the COVID-19 pandemic, invest in organic growth and look for potential strategic acquisitions. Our valuation is upgraded to £409m or 845p/share.

Year end	Revenue (£m)	Adj. EBITDA* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18	54.1	2.3	1.9	0.0	N/A	N/A
12/19	68.3	12.5	19.8	0.0	30.9	N/A
12/20e	84.1	18.3	23.8	0.0	29.0	N/A
12/21e	96.6	20.1	27.5	0.0	25.0	N/A

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

Adjusted EBITDA estimate increased

H120 revenue numbers were released with the trading update in July 2020, which we reflected in our last update. H120 gross profit increased to £18.5m from £14.5m, with gross margin improving to 45.8% from 41.2%. H120 adjusted EBITDA increased to £9.1m, up from £6.5m in H119. We fine-tuned our expectations and now forecast total revenue of £84.1m (down 1.8% vs previous estimate) in 2020 mainly due to lower pass-through revenues due to COVID-19 pandemic. We slightly raised our PrimeVigilance (PV) segment revenue forecasts but take a more cautious view on the contract research outsourcing (CRO) segment as the COVID-19 pandemic enters the winter season. Better-than-expected H120 adjusted EBITDA led us to upgrade our estimate to £18.3m (up 8.6%) in 2020.

Resilient combination of PV and CRO businesses

Ergomed has proved to be a resilient business, which we attribute to a diversified and well-balanced pharma services offering (pharmacovigilance and CRO). Widespread lockdowns inevitably caused disruptions to the clinical drug development industry; however, demand for pharmacovigilance services remained high. Gross margins across Ergomed's PrimeVigilance and CRO businesses are roughly similar once pass-through costs have been accounted for. As a result of this well-balanced services offering, Ergomed was able to successfully navigate the disruptions caused by the pandemic.

Valuation: £409m or 845p/share

We have refined our peer group valuation methodology. While 2020 and 2021 EV/EBITDA multiples of the broader peer group have contracted 15% and 8% since our last update in July, the market continues to attach a premium to growth stocks. As a result, we believe a better comparison is Medpace, which is has a comparable EV and growth rate and trades at a c 20% premium to the sector average. Applying the same 20% premium to peer multiples we upgrade our valuation to £409m or 845p/share from £345m or 713p/share previously. The H220 trading update should be released in January 2021, as usual.

22 September 2020

Price	**690p**
Market cap	**£334m**

Net cash (£m) at end June 2020	14.1
Shares in issue	48.4m
Free float	78%
Code	ERGO
Primary exchange	AIM
Secondary exchange	Frankfurt (Xetra)

Share price performance

%	1m	3m	12m
Abs	10.4	64.3	139.6
Rel (local)	14.2	76.8	198.9
52-week high/low		705p	280p

Business description

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

Next event

H220 trading update	January 2021

Analyst

Dr Jonas Peciulis +44 (0)20 3077 5728

healthcare@edisongroup.com

Edison profile page

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Strong order book implies high revenue visibility

Ergomed's total H120 revenues increased to £40.4m, up 14.8%, while underlying service fee revenue, which exclude pass-through costs billed to clients, grew by 25.9% (to £36.9m). Like-for-like service fee revenue grew by 18.0% (excluding H120 revenue from the recently acquired PrimeVigilance USA, pass-through revenues and H119 one-off income of £1.6m).

The growth drivers were the strong order book at the beginning of the year and significant new business won. The order book grew to £151.4m (a record high), up 22.0% from the last reported figure (at the end of FY19) and up 28.0% y-o-y. This provides high visibility for the remainder of 2020 and 2021. Sales of new business increased to £60.2m, up 22.9% y-o-y, which led to a strong period book-to-bill ratio of 1.49x versus 1.22x in FY19. Ergomed indicated new business was won across both segments, including within the newly acquired PrimeVigilance USA.

Adjusted EBITDA increased by 40% in H120 to £9.1m versus £6.5m in H119. Notably, adjusted EBITDA in H119 was boosted by a total of £2.5m one-offs (£0.9m due to new leasing standard IFRS 16 and £1.6m due to the adoption of IFRS 15) meaning in effect that underlying EBITDA has more than doubled.

Net cash was £14.1m at end-H120 versus £14.3m at end-FY19. The strength of H120 cash flow was shown by the fact that cash balances were back up to the start of year position, after paying £8.1m for the PrimeVigilance USA acquisition and associated costs. Reported cash and cash equivalents at end-H120 were £29.1m, which included debt of £15m drawn down as a precautionary measure at the beginning of the pandemic. Due to strong cash generation in H120, however, the debt remained unutilised and was fully repaid in August. Ergomed continues to be debt free, but still has access to facilities of £30m. The company expressed interest in further bolt-on acquisitions to grow the business. Due to the ongoing pandemic, which complicates the due diligence process, we believe new acquisition is less likely in the very near term, but continued growth of existing business, the strong balance sheet and access to debt position Ergomed very well to consider further inorganic growth opportunities.

CRO: Well-managed impact from COVID-19

As expected, the COVID-19 restrictions affected the CRO industry. Ergomed's H120 CRO underlying service fees decrease to £11.1m, down 6.7% y-o-y. Total CRO segment revenues on a reported basis decreased to £14.3m, down 24.7% (however, this takes into account pass-through revenues, which are billed to clients, and the inclusion of the £1.6m one-off income in H119).

With its H120 interim report Ergomed said the COVID-19-related impact was 'due to some delays on a small number of studies, however the majority of projects were largely unaffected thanks to the focus on essential research in rare disease and oncology'. The company responded by focusing on cost control, which enabled it to maintain margins. Ergomed also reported that COVID-19 restrictions were beginning to ease towards the end of H120 and into H220.

PrimeVigilance segment outperforms; US business doubles

Revenues in the PrimeVigilance segment increased to £26.1m, up 62.1% y-o-y. This includes the PrimeVigilance USA business (formerly Ashfield Pharmacovigilance) acquired in January 2020. The integration of the PrimeVigilance USA business was completed rapidly and successfully. As a result, Ergomed's US PV business doubled in H120 to £14.4m from £7m in H119. New awards were won in H120 as well. If excluding the acquisition, comparable PrimeVigilance segment revenues grew 36.0% y-o-y.

Ergomed reported an increased demand for its PV services during the COVID-19 pandemic. It managed to absorb this additional work with existing capacity without increasing headcount, which led to strong margins.

Estimate changes: Adjusted EBITDA upgraded

H120 gross profit increased to £18.5m from £14.5m, with the gross margin improving to 45.8% from 41.2%. SG&A costs were £11.3m versus £9.2m a year ago. This led to H120 adjusted EBITDA of £9.1m, up from £6.5m in H119. Net profit came in at £4.3m versus £3.6m in H119.

Revenues were released with the trading update in July 2020, which we reflected in our last update. With the H120 report released, we further fine-tuned expectations and now forecast total revenues of £84.1m (down 1.8% vs previous estimate) and £96.6m (down 3.9% vs previous estimate) in 2020 and 2021, respectively. This mainly reflects COVID-19 pandemic-related reduced pass-through revenues in the CRO business. We slightly upped our PV segment revenue estimates but took a more cautious view on the CRO segment revenues as the COVID-19 pandemic enters the winter season and effective management measures, such as a vaccine, are still in development.

Better-than-expected H120 adjusted EBITDA of £9.1m was the main positive surprise for us. We have upgraded our adjusted EBITDA forecasts to £18.3m (up 8.6%) and £20.1m (up 6.8%) in 2020 and 2021, respectively. Our adjusted EBIT and EPS forecasts are lower mainly due to upward adjustments in depreciation and amortisation.

We have refined our peer group valuation methodology. While 2020 and 2021 EV/EBITDA multiples of the broader peer group have contracted 15% and 8% since our last update in July, the market continues to attach a premium to growth stocks. As a result, we believe a better comparison is Medpace, which is of a comparable EV and growth rate and trades at a c 20% premium to the sector average. Applying the same 20% premium to peer multiples to Ergomed, we upgrade our valuation to £409m or 845p/share from £345m or 713p/share previously

Exhibit 1: Key changes to forecasts

£m	FY19	FY20e			FY21e		
	Actual	Old	New	*Change (%)*	Old	New	*Change (%)*
Total revenues	68.3	85.7	84.1	-1.8	100.5	96.6	-3.9
– PrimeVigilance	35.4	53.6	54.1	0.9	58.4	62.5	6.9
– CRO	32.8	32.1	30.0	-6.5	42.1	34.1	-18.9
O/W pass-through	8.5	6.7	6.6	-1.7	8.8	8.1	-7.7
Adjusted EBITDA	**12.5**	**16.9**	**18.3**	**8.6**	**18.8**	**20.1**	**6.8**
– Adj. EBITDA margin	*18.3%*	*19.7%*	*21.8%*	*2.1pp*	*18.7%*	*20.8%*	*2.1pp*
Adjusted EBIT	8.8	15.4	14.2	-8.1	17.3	16.4	-5.4
– Adj. EBIT margin	*12.9%*	*18.0%*	*16.8%*	*-1.2pp*	*17.2%*	*17.0%*	*-0.3pp*
Adjusted EPS (p)	19.8	27.7	23.8	-14.2	29.8	27.5	-7.6

Source: Ergomed H120 trading update, Edison Investment Research. Note: Adjustments mainly exclude share-based payments.

Exhibit 2: Comparable companies

	EV ($m)	EV/EBITDA (x)	EV/sales (x)	P/E (x)	P/book (x)
FY20e					
Syneos Health	8,218	13.33	1.82	16.92	1.87
PRA Health Sciences	7,613	16.53	2.46	23.33	5.40
ICON	9,284	20.78	3.42	28.83	5.99
Medpace	3,992	21.61	4.42	29.64	5.26
Average	**7,277**	**18.06**	**3.03**	**24.68**	**4.63**
FY21e					
Syneos Health	8,218	11.56	1.63	14.09	1.71
PRA Health Sciences	7,613	13.37	2.22	18.05	4.59
ICON	9,284	17.37	3.05	23.38	5.55
Medpace	3,992	18.26	3.61	25.71	4.53
Average	**7,277**	**15.14**	**2.63**	**20.31**	**4.10**

Source: Refinitiv. Note: Prices at 18 September 2020.

Exhibit 3: Financial summary

Accounts: IFRS, year-end 31 December (£000s)	2017	2018	2019	2020e	2021e
INCOME STATEMENT					
Total revenues	47,624	54,112	68,255	84,149	96,591
Cost of sales	(22,398)	(26,788)	(29,790)	(38,226)	(44,942)
Reimbursable expenses	(7,609)	(8,070)	(8,940)	(7,343)	(9,027)
Gross profit	17,617	19,254	29,525	38,580	42,622
Gross margin %	37%	36%	43%	46%	44%
SG&A (expenses)	(19,784)	(28,152)	(23,513)	(24,439)	(27,001)
R&D costs	(2,689)	(1,578)	(545)	(199)	(203)
Other income/(expense)	952	30	51	(233)	0
Exceptionals and adjustments	5,062	10,165	3,265	466	976
Reported EBITDA	(2,278)	(7,912)	9,230	17,858	19,092
Depreciation and amortisation	1,626	2,534	3,712	4,149	3,674
Reported EBIT	(3,904)	(10,446)	5,518	13,709	15,418
Finance income/(expense)	(543)	(599)	(245)	(360)	(240)
Other income/(expense)	0	277	(286)	(686)	0
Reported PBT	(4,447)	(10,768)	4,987	12,663	15,178
Income tax expense (includes exceptionals)	(57)	(89)	583	(1,687)	(3,036)
Reported net income	(4,504)	(8,980)	5,570	10,976	12,143
Basic average number of shares, m	41.1	44.7	46.6	48.1	48.4
Basic EPS (p)	(11.0)	(20.1)	12.0	22.8	25.1
Adjusted EBITDA	2,784	2,253	12,495	18,324	20,068
Adjusted EBIT	1,158	(281)	8,783	14,175	16,394
Adjusted PBT	1,782	960	8,637	13,118	16,354
Adjusted EPS (p)	4.2	1.9	19.8	23.8	27.5
Adjusted diluted EPS (p)	4.2	1.9	19.8	22.5	26.3
Order book	88,200	109,200	124,100	169,404	218,349
BALANCE SHEET					
Property, plant and equipment	1,078	1,344	1,110	428	418
Right-of-use assets	-	-	5,171	5,630	5,630
Goodwill	15,269	13,659	13,380	17,895	17,895
Intangible assets	20,229	3,740	2,755	4,508	4,308
Other non-current assets	2,367	2,646	2,616	3,184	3,184
Total non-current assets	38,943	21,389	25,032	31,645	31,435
Cash and equivalents	3,218	5,189	14,259	22,189	34,164
Trade and other receivables	16,807	16,429	14,359	19,354	22,574
Other current assets	2,945	3,857	5,665	4,957	4,957
Total current assets	22,970	25,475	34,283	46,500	61,694
Lease liabilities	0	0	3,716	4,015	4,015
Long term debt				0	0
Other non-current liabilities	13,201	1,314	635	1,149	1,149
Total non-current liabilities	13,207	1,314	4,351	5,164	5,164
Trade and other payables	10,717	10,989	10,373	13,744	16,585
Lease liabilities	0	0	1,718	2,000	2,000
Other current liabilities	3,134	6,192	6,053	7,237	7,237
Total current liabilities	13,863	17,187	18,144	22,981	25,822
Equity attributable to company	34,843	28,363	36,820	50,001	62,143
CASH FLOW STATEMENT					
Profit before tax	(4,447)	(10,768)	4,987	12,663	15,178
Cash from operations (CFO)	70	1,044	11,788	16,481	15,438
Capex	(1,425)	(1,587)	(996)	(650)	(3,474)
Acquisitions & disposals net	(1,932)	(398)	(107)	(7,589)	10
Other investing activities	(559)	(751)	(1,728)	0	0
Cash used in investing activities (CFIA)	(3,916)	(2,736)	(2,831)	(8,232)	(3,464)
Net proceeds from issue of shares	2,676	3,790	1,427	0	0
Movements in debt	10	(12)	(1,677)	0	0
Other financing activities	(2)	(4)	0	(1,210)	0
Cash from financing activities (CFF)	2,684	3,774	(250)	217	0
Increase/(decrease) in cash and equivalents	(1,162)	2,082	8,707	8,466	11,974
Currency translation differences and other	(44)	(111)	363	(536)	0
Cash and equivalents at start of period	4,424	3,218	5,189	14,259	22,189
Cash and equivalents at end of period	3,218	5,189	14,259	22,189	34,164
Net (debt) cash	3,218	5,189	14,259	22,189	34,164

Source: Ergomed accounts, Edison Investment Research

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