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RESEARCH REPORT

January 29, 2020

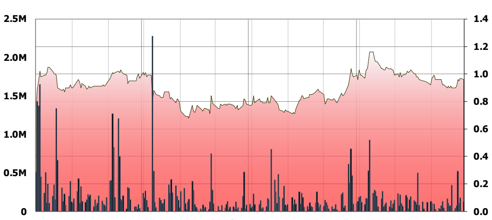
PROTECH HOME MEDICAL CORP. (PTQ – TSXV, $0.90)

Rating: BUY
Target Price: $2.80

ANNUAL RESULTS – MOVING PAST PHM

PROTECH HOME MEDICAL CORP.			TSXV:PTQ
(Currency is C$ unless noted otherwise)			
Last Price ($)			$0.90
Target Price ($)			$2.80
Return to Target			211%
52-Week Trading Range ($)			$0.66 - $1.19
Average Daily Volume (90-Day)			149.5K
MARKET INFO			
Shares Outstanding (M)			83.5
Market Capitalization ($M)			$75
Enterprise Value ($M)			$79
FYE: SEP 30	**F2019A**	**F2020E**	**F2021E**
Revenue ($M)	$81	$103	$112
Gross Margin	71%	71%	71%
Net Income ($M)	($7)	$3	$5
Diluted EPS ($)	($0.09)	$0.04	$0.05
Adj. EBITDA ($M)	$15	$21	$24
Cash ($M)	$13	$16	$28
Debt ($M)	$17	$22	$27
VALUATION	**F2019E**	**F2020E**	**F2021E**
EV/Revenue	1.0x	0.8x	0.7x
EV/EBITDA	5.4x	3.8x	3.4x
RELATIVE VALUATION (EV/EBITDA)	**F2019E**	**F2020E**	**F2021E**
N. American Small Cap Health Care	19.1x	12.0x	11.5x
MAJOR SHAREHOLDERS			
Management & Insiders (4.7%), Claret Asset Management (8.16%), Crawford, Gregory J. (4.39%), Spartan Fund Management (1%), StoneCastle Investment M (0.99%)			
DISCLOSURE CODE:			2
(Please refer to applicable disclosures on the back page)			

Source: M Partners, Capital IQ



Protech Home Medical Corp. is a Kentucky-based distributor of durable medical equipment (DME) across 10 states and 13,000 referring physicians in the U.S. Protech's focus on service offerings that take advantage of favourable demographic trends in the U.S. should support strong organic growth for many years. PTQ can also leverage its financial strength and unique positioning in the market to acquire smaller businesses in a rapidly consolidating industry.

Protech Home Medical released its 2019 annual results yesterday morning. Revenue for the year was $81.0M (not including $3.4M from Patient Home Monitoring, which was sold late in the summer for $4.5M). While Q4/19 revenues of $19.5M were below our expectations of $22.0M and last quarter's figure of $21.1M, taking out the ~$1M in lost revenues from PHM, the decrease was roughly $500K. We do not believe a slight fluctuation is particularly concerning, especially since the majority of revenues are recurring in nature and should be relatively stable quarter to quarter. Further, while the fourth quarter was negatively affected by the absence of PHM for most of the quarter, that business was only able to generate $233K in net income for the full year, even while benefitting from a product recall which boosted inventory levels at no cost. We believe the proceeds from the sale can be put to better use for accretive acquisitions in Protech's target markets.

While this was a slightly weaker quarter in terms of revenue, we see positives in the core business. Respiratory resupply set-ups and/or deliveries increased to 12,727 in Q4 vs. 11,034 in Q3, while resupply revenue was up 17%. Taking out PHM, in Q4 PTQ served 32,797 unique patients vs. 31,306 in Q3. The patients served in the year rose 10% over F2018 to 76,146 patients, and the number of unique set-ups/deliveries increased 7% to 207,762. Recurring revenue increased from $43.6M in F2018 to $55.1M in F2019, and the proportion of total revenue increased from 62% to 68%. Moving forward this should provide stability in financial results, while Protech also benefits from its two acquisitions of Cooley Medical and Acadia Medical in Q1/20 - both expected to be fully integrated by April.

Adj. EBITDA for the year was $14.8M, or 18.3% margin, vs. $10.6M (15.1%) in 2018. We view margin improvement as another positive, including 19% EBITDA margin in Q4. Much of the improvement was driven by scale, higher margin rental revenue, consolidation of vendor accounts, and improved inventory management. We were impressed with the positive cash flow impact in Q4 due to the drop in accounts receivable and inventory. A/R dropped $3.5M QoQ ($1.7M from PHM) and inventory fell $1.7M ($400K from PHM). Management believes these are more sustainable inventory levels moving forward, which should be positive for margins, while accounts receivable benefited from more efficient billing and collections. Cash flow from operations was $10.5M in F2019, and the cash balance was $12.9M (prior to two acquisitions, using $5.2M of cash).

We are maintaining our BUY rating on Protech Home Medical with a $2.80 target price based on 11.0x EBITDA; however, we have shifted our valuation year to 2021 (from 2020).

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INVESTMENT THESIS

An aging population and increasing prevalence of chronic illnesses in the U.S. should support over 5% annual growth in demand for DME over the next 10+ years. As pressure continues to build on the health care system, reimbursement rates are falling, creating a crucial need for home health care and medical equipment. Durable medical equipment is expected to be one of the fastest growing segments of health care spending, and PTQ has consistently grown revenues at a pace faster than the market. Protech focuses on the highest-concentration states for potential respiratory customers.

As demand rises, the number of DME distributors is rapidly falling due to cost cutting and unfavourable pricing conditions for smaller companies. Protech's size makes it one of the few companies capable of acquiring smaller regional operators as the industry consolidates. When it acquires regional businesses, it expands its patient base and can cross-sell new and existing products, while taking advantage of economies of scale and purchasing power. We believe Protech could make at least one more acquisition in the near-term with $10-15M in total revenues at a 0.5x revenue multiple and 4-6x EBITDA multiple pre-integration (2-3x post-integration). On the fiscal 2019 conference call, management also indicated that discussions are ongoing regarding banking facilities to help accelerate the acquisition strategy. Management has over 50 years of M&A experience.

Protech's business model, focused around servicing chronic illnesses on monthly rentals and resupply, provides stable recurring revenues as it approaches $100M in total annual sales. As the patient base and cross-selling opportunities continue to grow, recurring revenues should become an increasingly large proportion of revenue. PTQ's cash flow-positive business can fuel future acquisitions and technology investments.

PTQ shares trade at a substantial discount of 3.8x 2020 EBITDA vs. peers at 12.0x. We believe over time, with Protech's high-margin, recurring revenue business and accretive acquisitions, shares should re-rate closer to peers. In an increasingly uncertain economic environment, Protech provides a compelling value investment opportunity.

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Disclosure Code: 2

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