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RESEARCH NOTE

May 20, 2020

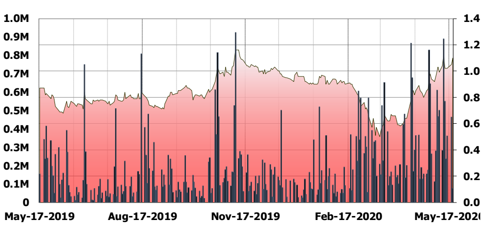
PROTECH HOME MEDICAL CORP. (PTQ – TSXV, $1.05)

Rating: BUY
Target Price: $2.30

A RECORD QUARTER AND EXPECTING MORE TO COME

PROTECH HOME MEDICAL CORP.			TSXV:PTQ
(Currency is C$ unless noted otherwise)			
Last Price ($)			$1.05
Target Price ($)			$2.30
Return to Target			119%
52-Week Trading Range ($)			$0.47 - $1.19
Average Daily Volume (90-Day)			322.2K
MARKET INFO			
Shares Outstanding (M)			83.7
Market Capitalization ($M)			$88
Enterprise Value ($M)			$110
FYE: SEP 30	**F2019A**	**F2020E**	**F2021E**
Revenue ($M)	$81	$99	$111
Gross Margin	71%	73%	73%
Net Income ($M)	($7)	($1)	$5
Diluted EPS ($)	($0.09)	($0.01)	$0.06
Adj. EBITDA ($M)	$15	$21	$24
Cash ($M)	$13	$18	$26
Debt ($M)	$17	$20	$23
VALUATION	**F2019A**	**F2020E**	**F2021E**
EV/Revenue	1.4x	1.1x	1.0x
EV/EBITDA	7.5x	5.3x	4.5x
RELATIVE VALUATION (EV/EBITDA)	**F2019A**	**F2020E**	**F2021E**
N. American Small Cap Health Care	12.0x	8.7x	6.9x
MAJOR SHAREHOLDERS			
Management & Insiders (5%), Claret Asset Management (8.13%), Quadrant Capital Group (3.12%), Greg Crawford (4.58%), StoneCastle Investment M (0.53%)			
DISCLOSURE CODE:			2
(Please refer to applicable disclosures on the back page)			

Source: M Partners, Thomson Eikon



Protech Home Medical Corp. is a Kentucky-based distributor of durable medical equipment (DME) across 10 states, with 85,000 active patients and 17,000 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 Q2/20 financial results last night. We note that preliminary results were released on April 28. Revenue was $24.1M vs. our prior expectation of $23.3M and the $24.0M-$24.3M range released at the end of April. This implies revenue growth of 16% YoY and 4% QoQ. Gross margin was 73%, in line with our expectations and an improvement from 71% in Q2/19. Adjusted EBITDA was $4.9M (20.4% margin) vs. our prior expectation of $4.3M (18.5%) and the range of $4.7M-$5.0M previously provided. Management indicated on the call that it is targeting 22-25% EBITDA margins, which should improve with scale. The net income in the quarter was $1.6M vs. our expectations of a $900K loss, and a loss of $500K in Q2/19. The outperformance on net income was largely driven by a $2.5M change in the fair value of the debentures to reflect the drop in market value. We expect this to mostly revert in Q3 as the price of the debentures has recovered. Cash flow from operations was $6.0M over the first 6 months, vs. $4.1M in H1/19, and the cash balance at quarter-end was $6.2M.

Protech displayed impressive growth in its business, both organically and through its acquisitions increasing its customer base 28% YoY from 31,464 unique patients in Q2/19 to 40,372 in Q2/20. PTQ completed 63,956 unique set-ups/deliveries in Q2/20 vs. 51,676 in Q2/19. Respiratory set-ups/deliveries increased to 13,980 in the quarter vs. 11,641 in Q2/19.

We note that the cash balance was impacted by an increase in accounts receivable (largely collected in Q3) and over $4M in net payments of finance lease liabilities. This reflects a continued higher level of spending on equipment after outlaying $5.0M in Q1, and we anticipate spending levels to stabilize as $8.9M of leases are due in less than one year. In the first quarter, much of the capex was focused on refreshing equipment at newly acquired Cooley Medical and Acadia Medical, while in Q2 there was substantial spending on buying ventilators and other respiratory equipment in an effort to prepare for increased demand spurred by patients shifting to homecare amidst the pressure on hospital capacity with the ongoing COVID-19 pandemic. To support the expanded inventory purchases, PTQ received a C$1.5M grant subsequent to quarter-end as part of the CARES Act Provider Relief Fund. In the same time frame, the Centers for Medicare and Medicaid Services (CMS) removed non-invasive ventilators from the 2021 Competitive Bidding Program to facilitate patient access. These products were to be included in the bidding program for the first time after this past year's hiatus, and the addition would have pressured margins on those products. Ventilators in total account for 17% of Protech's revenues.

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On April 20, the series of positive press releases continued with the announcement of receipt of C$5.97M under the Payroll Protection Program administered by the U.S. Small Business Administration. The loan has a two-year term and bears interest payable at 1% annually after 6 months. Most importantly, the loan is forgiven if the proceeds are used to cover payroll, rent and utilities in the following 8-week period. As a result, management anticipates full loan forgiveness, and these funds cover roughly half of the upcoming quarterly SG&A expenses. We estimate that the current cash balance is over $13M as a result of the two government programs, and anticipate positive operational cash flow to further enhance the balance sheet.

Amidst a very challenging environment, we believe PTQ's position has only strengthened, and it will emerge with a more attractive balance sheet. Further, we also anticipate that once conditions stabilize, Protech will be able to find even more appealing terms for potential acquisition targets, with management indicating that valuations already appear to be cheaper than earlier in the year. We also believe that the COVID-19 pandemic has alerted the wider public to U.S. hospitals' capacity issues and the importance of administering home health care when possible, especially considering the backdrop of a rapidly aging U.S. population. This situation could cause a wider, accelerated shift to home care in which Protech would stand to benefit. In addition, we anticipate that the mass production of ventilators to treat COVID-19 will result in an oversupply once the pandemic subsides, and could push prices down for future inventory purchases.

Despite it's enviable positioning in the uncertain economic environment, Protech continues to trade very cheaply relative to peers at 5.3x our 2020 EBITDA estimate and 4.5x 2021 EBITDA, without accounting for the $7.5M cash injection from the government programs subsequent to quarter-end. As the business approaches a $100M run-rate on revenues, with the balance sheet to make meaningful acquisitions, we do not expect the valuation discount to persist. Protech is also looking at increasing its investor base with a potential OTC listing in the U.S. in the next couple weeks (with the ultimate goal of a NASDAQ/NYSE listing) and is looking at eligibility to up-list to the TSX. **We are maintaining our BUY recommendation and $2.30 target based on 9.0x 2021 EBITDA.**

Disclosure Code: 2

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