Protech Home Medical (PHM – V)

Like a Coiled Spring Ready to Bounce Hard

Beacon Securities Limited

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- PHM released its Q3/FY18 (June) results that showed much better results than anticipated. Revenue/EBITDA was $19.7m/$3.6m (18%) versus our expectations of $18.7m/$2.5m (13%). We note that this continued the trend of margin improvement that started in Q1 (8%), Q2 (12%) and now Q3 (18%).
- We believe these are excellent results and signify that the company's restructuring efforts are bearing fruit and it now has a strong platform to pursue growth opportunities – both organic and inorganic. In our view, the key take-aways from the quarter are:
  - a) The company reports in C$ yet its business is entirely in the US. On a q/q basis, the C$ weakened by 2%. As such on a US$ basis, we believe **revenue growth** was +3% sequentially (reported +5% in C$) or **12% on an annual basis. This is well in excess of the industry (~4-6%).** We have not modelled such incremental growth v/s the industry in our FY19 forecast (+5%). If the company continues to outperform the industry, this would represent upside to our model;
  - b) Respiratory continues to drive revenue with a 68% contribution with mobility and DME products at 10% and 23% respectively. Of particular interest to us is its respiratory re-supply platform that serviced 10,245 patients in Q3, +21% y/y. **PHM is increasingly using technology to drive efficiencies** such as this automated platform that provides clients with cpap consumables. This platform creates a high margin, recurring revenue stream and has helped drive rev/patient to $466 v/s $433 last quarter. **The platform has significant leverage to add patients both organically and if/when PHM makes acquisitions**;
  - c) The primary drivers of the Q3 margin improvement was a reduction in bad debt expense (-650 basis points as percentage of revenue), payroll (-120 basis points) and professional fees (-100 basis points). This was offset by gross margin reduction of 250 basis points to 70% v/s 72.5% in Q2 due to product mix. Net-net, EBITDA was 18.3% in Q3 v/s 11.9% in Q2. We note that bad debt at 6% of revenue is likely not sustainable and we have modelled 9-10% going forward. If we make that adjustment to the Q3 costs, then quarterly overhead would be ~$10.5 million or $42 million annualized. **Management has indicated that its platform could generate materially more revenue without any additional costs;**
  - d) **PHM's balance sheet continues to improve.** Starting from $3.1m in cash at the end of Q1, period ended June (Q3) cash was $4.4m.
- Taking into consideration the points above (ie. 5% organic growth, maintenance of 70% gross margin and $42 million overhead), we arrive at **FY19 EBITDA of $14.6 million, up from our prior forecast of $12.1m**. We have also increased our FY18 forecast to $10.8m from $9.4m.
- The healthcare service sector in general and the **$60 billion DME business** in particular is being driven by an aging population, which is driving demand for their products/services. Many of these companies with such demographic tailwinds are now trading at 52-week highs with multiples as high as 16x EBITDA (avg 12x). Based on our forecast, PHM trades at under 4x – an unsustainably low multiple. Based on its improving fundamentals, we expect this gap to narrow in the coming quarters. If not, we believe it represents a tremendous acquisition target itself. Either way, investors should benfit. Maintain **Buy and raise target to $0.45 (was $0.40) based on our upwardly revised FY19 EBITDA**.

Q3/FY18 Results

BUY (Unch)	**$0.45** (Was $0.40)
Closing Price	$0.14
12-month Target Price	$0.45
Potential Return	233%
52 Week Price Range	$0.075 - $0.39

Estimates

YE: Sept. 30	FY17	FY18E	FY19E
Revenue ($MM)	$76.4	$77.1	$81.0
EBITDA ($MM)	$1.1	$10.8	$14.6
Adj EPS	-$0.03	-$0.01	-$0.01

Valuation

	FY17	FY18E	FY19E
EV/Sales	0.7x	0.7x	0.7x
EV/EBITDA	52.3x	5.1x	3.8x
P/E	-	-	-

Stock Data (MM)

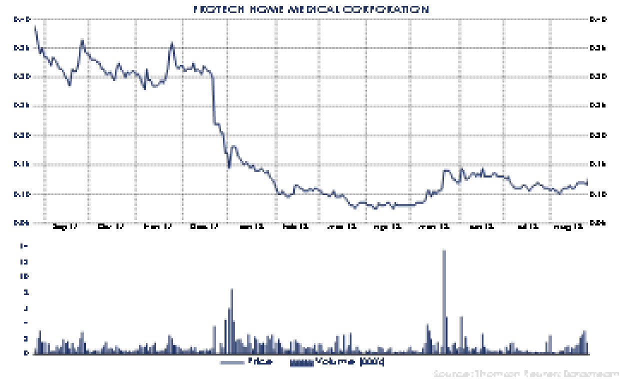
Shares Outstanding	
Basic	380.0
FD	380.0
Market Cap (C$)	
Basic	$51.3
FD	$51.3
Net Debt	$4
EV (C$)	$55

About the Company

PHM is focused on a highly fragmented and developing market of small privately- held US companies servicing chronically ill patients with multiple disease states. PHM is actively working to identify and evaluate profitable, annuity- based companies to acquire their patient databases and technical expertise at favorable prices. PHM's post acquisition organic growth strategy is to increase annual revenue per patient by offering multiple services to the same patient, consolidating the patient's services and making life easier for the patient.

All prices in C$ unless otherwise stated

Stock Performance



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As at July 31, 2018	#Stocks	Distribution
BUY	66	67.3%
Speculative Buy	13	13.3%
Hold	9	9.2%
Sell	0	0.0%
Under Review	9	9.2%
Tender	1	1.0%
Total	98	100%

BUY	Total 12-month return expected to be > 15%
Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	Total 12-month return is expected to be between 0% and 15%
Sell	Total 12-month return is expected to be negative
Under Review	
Tender	Clients are advised to tender their shares to a takeover bid or similar offer

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