

# NetScientific

Portfolio starting to mature

Earnings update

Pharma & biotech

The NetScientific portfolio steadily marches forward with an increasing number of companies with significant revenue on the horizon. Wanda and ProAxis are currently the only companies with sales, but this is about to change with the first sales of Vortex's VTX-1 occurring and Glycotest opening a CLIA lab in H217. The company reported sales of £0.5m for 2016, which we see expanding to single (c £3m) and double (£12m) digits through 2017 and 2018 as these companies' offerings expand.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	0.1	(11.3)	(24)	0.0	N/A	N/A
12/16	0.5	(12.3)	(21)	0.0	N/A	N/A
12/17e	2.7	(14.3)	(22)	0.0	N/A	N/A
12/18e	11.6	(12.4)	(19)	0.0	N/A	N/A

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

## Wanda expands into hospital system and ACO market

As part of the 2016 results, Wanda admitted that the strategy of launching its product in the home care market has stumbled and it was having difficulty gaining traction. It has therefore realigned its commercial operations to include hospital systems, payers, and accountable care organisations (ACOs). Contracts with these businesses could yield more volume than home care. The company is building out a new sales organisation to target these markets.

## Product launches lined up

The near-term launch of new products is expected for Vortex, ProAxis and Glycotest. Vortex is the furthest along, with the VTX-1 officially available for sale and it will be rolling out to targeted institutions in a soft launch throughout the year. ProAxis is expecting a CE mark for the NEATstik point of care test, and will be launching commercially in H217. Finally, Glycotest is targeting opening a CLIA lab in H217, with a CLIA waiver and launch of its liver cancer test in 2018.

## FY16: Burn up on Vortex and Wanda buildout

The company reported cash used in operations of £12.9m in 2016, up from £10.7m in 2015. The primary reason for this increase was an increase in SG&A due to hiring at Vortex and Wanda, as well as increased working capital. R&D spend was £7.4m in 2016, although we expect this to increase as the companies are financed and we predict £9.7m in R&D spending in 2017.

## Valuation: Decreased to £60.3m or 118p per share

We have decreased our valuation to £60.3m or 118p per share, from £67.8m or 133p per share. The reduction was largely due to adjusting our Wanda sales timelines and increasing the risk for the company. Additionally we have adjusted our R&D timelines to match financing and rolled over our NPVs. We expect to update our valuations based on early sales information from the upcoming launches.

5 May 2017

Price **54.50p**

Market cap **£28m**

\$1.23/£

Net cash (£m) at 31 December 2016 9.2

Shares in issue 51.1m

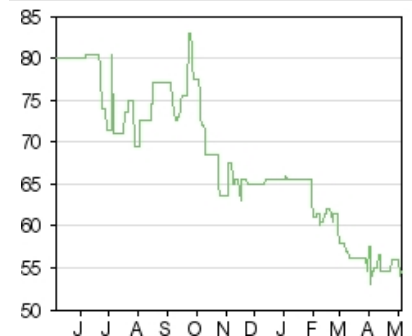
Free float 79%

Code NSCI

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 0.0 (11.4) (31.9)

Rel (local) 0.2 (13.1) (42.6)

52-week high/low 83.0p 53.0p

### Business description

NetScientific is a transatlantic biomedical and healthcare technology group. Its portfolio of five core investments and one material investment is focused on three main sectors: digital health (Wanda), diagnostics (Vortex, ProAxis, Glycotest) and therapeutics (PDS Biotechnology).

### Next events

Glycotest Series A H117

VTX-1 beta launch H117

NEATstik PoC launch H217

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## Wanda realigns

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One of the most significant changes that has occurred in the portfolio is a shift in the commercial plan at Wanda. The company was originally focused on marketing its patient monitoring platform to the home healthcare market. The key value proposition to these companies is that algorithmic patient monitoring can improve outcomes and reduce hospitalisations, thereby extending the value of these services. Wanda complements this market well because the platform is more easily integrated into the patients' routines due to persistent contact with healthcare professionals. Moreover, the monitoring solutions provided by Wanda closely mirror some of the responsibilities of the home healthcare provider. To this end, the company has signed contracts with three such networks (A to Z Home Health Care, 24Hr HomeCare, and Health Resource Solutions) and this market remains important to the company. However, the company has stated it failed to gain significant traction in 2016 by targeting these providers. We suspect that this may be due to the low margin nature of the business and the unclear correlation between patient outcomes and the bottom line.

However, three other players in the healthcare system with significant vested interests in patient outcomes are hospitals, payers, and accountable care organisations. Moreover, due to the nature of their businesses, there is the potential to attract significantly higher volume through these channels and greater recurring revenue. Wanda has shifted its focus to sourcing contracts with these businesses. Although we see a higher barrier to entry into these markets, we believe that the metrics on outcomes gathered in the home healthcare market can be leveraged into larger contracts. A key strategic goal for 2017 is to build out a sales pipeline to target these markets, and Wanda's CTO Foad Dabiri was promoted to CEO to lead the transition, because of his experience in the digital health space. The company has stated a target of \$800k in sales for 2017. Additionally, NetScientific has impaired its £8.8m (to £3.8m) debt payable by Wanda.

Additionally, as part of this transition Wanda has sold its equity in OncoVerse, its cancer patient monitor platform in development with Dignity Health. The project was sold to BTG for an undisclosed amount, but NetScientific management stated that it represented a "strong return on NetScientific's initial investment."

## Getting products on the market

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Vortex's circulating tumour cell (CTC) isolation system, the VTX-1, is commercially available in the US and EU. The company received a CE mark and a class 1 designation from the FDA and launched the product for research purposes in February 2017. Management has informed us that manufacturing hurdles have been surmounted and that it is currently targeting its key researchers and centres for a soft rollout. The inclusion of the technology in prominent scientific publications continues to bolster its utility among scientists. The latest such publication is the use of the system to perform a single-cell western blot of a CTC.<sup>1</sup> A small number of sales have already occurred and we expect the first revenue for this company to be reported in the next earnings release. The company may be able to enter the broader cancer screening market via adding its technology to existing 510(k) market approvals. This would involve validating VTX-1 as an alternative to biopsy in established biochemical assays. To this end, the company is doing a study in collaboration with UCLA comparing the ability to assess epidermal growth factor receptor (EGFR) status in patients with non-small cell lung cancer (NSCLC) using CTCs and comparing data with traditional biopsy.

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<sup>1</sup> SinKala E, et al. (2017) Profiling protein expression in circulating tumour cells using microfluidic western blotting. *Nature Comm.* 14622.

ProAxis is also expanding its commercial footprint. The company's neutrophil elastase tests have been commercially available since August 2015 for research use, but it has been in the development of its NEATstik point-of-care test for the broader diagnostic market. NEATstik is a one-use crossflow device for monitoring cystic fibrosis (CF) and chronic obstructive pulmonary disease (COPD) patients for exacerbations. The company is targeting a CE mark in H117 and a commercial launch of the product in H217. The company is also launching two new immunoassays for the research market (plasmin and trypsin) in late 2017, although we see the potential of these products as very incremental.

Finally, Glycotest has also announced its near-term commercialisation timeline. The company is currently in a Series A financing in China, which it intends to use to open a CLIA lab in H217. A CLIA waiver (expected in early to mid-2018) should enable the company to launch its hepatocellular carcinoma (HCC) test in H218.

## Valuation

We have decreased our valuation to £60.3m or 118p per share from £67.8m or 133p per share. This was largely due to an adjustment in our valuation of Wanda. We have reduced the value of the share of the company from £18.7m to £8.0m. We have adjusted the sales ramp for the company to reflect the new target market, and removed OncoVerse from the model, which amounted to approximately £2m of our NPV. Additionally, we have decreased the probability of success for the company to 5% from 7.5% because of the commercialisation difficulties seen in 2016. We have also adjusted our research and development spending timelines to reflect updated financing timelines for all companies, as no Series A financings concluded in 2016. These adjustments are partially offset by advancing our NPVs. We expect to update our valuations following early reports from the launches of the Vortex, ProAxis and Glycotest products. We also expect to update our valuations following the completion of Series A financings.

<b>Exhibit 1: NetScientific valuation</b>							
Development programme	Probability of success	Profitability	Peak sales (£m)	Margin	rNPV (£m)	Ownership	Share value (£m)
Vortex	15.0%	2020	150	44%	18.0	95.0%	17.1
Wanda	5.0%	2019	352	52%	11.3	70.9%	8.0
ProAxis	10.0%	2020	50	51%	8.6	56.5%	4.9
Glycotest	10.0%	2019	123	51%	16.4	87.5%	14.4
PDS	10.0%	2021	302	57%	38.7	17.4%	6.7
Total							51.0
Net cash and equivalents (YE16) (£m)							9.2
<b>Total firm value (£m)</b>							<b>60.3</b>
Total shares (m)							51.1
<b>Value per share (p)</b>							<b>118</b>

Source: NetScientific reports, Edison Investment Research

## Financials

The company reported a small amount of revenue (£518k) for 2016, although we expect this value to be eclipsed by increasing sales of the Vortex and Wanda products in 2017 (£2.7m total revenue) and the launch of the Glycotest HCC test in 2018 (£11.6m total revenue). Operational cash burn for 2016 was £12.9m compared to £10.7m for 2015, with the increase due to a combination of increased SG&A costs (£5.0 vs £2.8m from continued programmes in 2015) attached to building out Wanda and Vortex as well as increases in working capital. R&D spending for 2016 was £7.4m, significantly lower than our estimate of £9.7m. Our R&D spending estimates are coupled to the financing of the portfolio companies and we have adjusted both of these timelines. We expect

Glycotest to complete its Series A in 2017, which should result in a concurrent increase in spending for that programme. We forecast £9.7m in R&D spending in 2017 as the portfolio programmes expand their research operations seeking broader marketing approval. NetScientific ended 2016 with £9.2m in net cash. For illustrative purposes, we have included £24m in debt in 2017 to finance the operations of the portfolio companies to profitability in 2019, although we expect these financing requirements to be met through outside investments. After accounting for approximately £6m in obligations from minority interests, this corresponds to a total obligation of £18m (up from £15m).

**Exhibit 2: Financial summary**

	£000s	2014	2015*	2016	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		24	122	518	2,682	11,630
Cost of Sales		0	(6)	(255)	(656)	(4,130)
Gross Profit		24	116	263	2,025	7,500
Research and development		(3,098)	(7,256)	(7,443)	(9,677)	(10,081)
Selling, general & administrative		(3,212)	(4,260)	(5,001)	(6,063)	(7,397)
EBITDA		(6,352)	(11,530)	(12,570)	(13,856)	(10,119)
Operating Profit (before GW and except.)		(6,286)	(11,400)	(12,429)	(13,715)	(9,978)
Intangible Amortisation		0	0	0	0	0
Exceptionals/Other		(948)	(1,518)	(666)	0	0
Operating Profit		(7,234)	(12,918)	(13,095)	(13,715)	(9,978)
Net Interest		77	78	86	(602)	(2,408)
Other (change in fair value of warrants)		0	0	(49)	0	0
Profit Before Tax (norm)		(6,209)	(11,322)	(12,343)	(14,317)	(12,386)
Profit Before Tax (IFRS)		(7,157)	(12,840)	(13,058)	(14,317)	(12,386)
Tax		30	94	(18)	72	62
Deferred tax		0	0	0	0	0
Profit After Tax (norm)		(6,179)	(11,229)	(12,361)	(14,245)	(12,325)
Profit After Tax (IFRS)		(7,127)	(12,746)	(13,076)	(14,245)	(12,325)
Minority interest		702	1,905	1,881	3,216	2,596
Profit After Tax after minority interest (FRS 3)		(6,425)	(10,842)	(11,195)	(11,030)	(9,729)
Average Number of Shares Outstanding (m)		35.9	38.2	51.1	51.1	51.1
EPS - normalised (p)		(15)	(24)	(21)	(22)	(19)
EPS - IFRS (p)		(18)	(28)	(22)	(22)	(19)
Dividend per share (p)		0	0	0	0	0
<b>BALANCE SHEET</b>						
Fixed Assets		3,040	2,946	4,054	5,063	7,029
Intangible Assets		10	1	0	0	0
Tangible Assets		348	285	779	638	497
Other		2,681	2,660	3,275	4,425	6,532
Current Assets		17,720	23,799	11,034	20,859	7,263
Stocks		0	0	0	894	2,326
Debtors		853	560	1,578	268	1,163
Cash		16,867	23,239	9,456	19,696	3,774
Other		0	0	0	0	0
Current Liabilities		(1,324)	(2,206)	(2,172)	(2,947)	(3,273)
Creditors		(1,281)	(2,156)	(2,044)	(2,947)	(3,273)
Short term borrowings		(43)	(50)	(128)	0	0
Long Term Liabilities		(740)	0	(80)	(24,080)	(24,080)
Long term borrowings		(687)	0	(80)	(24,080)	(24,080)
Other long term liabilities		(53)	0	0	0	0
Net Assets		18,696	24,538	12,836	(1,106)	(13,061)
Minority Interest		(1,098)	(1,805)	(3,875)	(7,091)	(9,686)
Shareholder Equity		17,598	22,733	8,961	(8,196)	(22,747)
<b>CASH FLOW</b>						
Operating Cash Flow		(6,698)	(10,752)	(12,939)	(11,952)	(11,469)
Net Interest		67	38	43	(602)	(2,408)
Tax		19	83	112	72	62
Capex		(336)	(299)	(457)	0	0
Acquisitions/disposals		(2,181)	(144)	(1,261)	(1,150)	(2,108)
Financing		0	18,208	0	0	0
Dividends		0	0	0	0	0
Other		119	39	66	0	0
Net Cash Flow		(9,010)	7,172	(14,436)	(13,632)	(15,923)
Opening net debt/(cash)		(25,069)	(16,136)	(23,189)	(9,248)	4,384
HP finance leases initiated		0	0	0	0	0
Exchange rate movements		(140)	(212)	(603)	0	0
Other		218	92	1,098	0	0
Closing net debt/(cash)		(16,136)	(23,189)	(9,248)	4,384	20,307

Source: NetScientific reports, Edison Investment Research. Note: \*Not restated.

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