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Toll-Free: 561-391-5555 ♦ www.DawsonJames.com ♦ 101 North Federal Highway - Suite 600 ♦ Boca Raton, FL 33432

ProPhase Labs (NASDAQ: PRPH)

April 23, 2021

BUY: My Hometown: Town of Oyster Bay Steps Up for Testing

ProPhase Labs announced a contract with the Town of Oyster Bay (TOB), representing approximately 300,000 residents across 12 public school districts and multiple private schools for COVID testing services. If in this example we assume 100k tests x \$40/test = \$4M in revenues, and if we assume patients get tested 3x/year = \$12M.

We think TOB is likely the first of many such contracts here on Long Island and across the Northeast.

Highlights:

COVID Evolves. In recent weeks, we have seen the numbers of vaccinated folks rising sharply, raising new questions, some around testing. If you have the vaccine, will testing still be required for travel, hospital visits, and other similar events? All indications are “Yes.” The CDC has said that vaccinated people have an extremely low chance of transmitting the virus, but it is not zero. We have also seen an evolution of at-home testing; how will this impact lab tests such as ProPhase’s? We see little to no impact. If an at-home test is positive, the next step is to confirm with a “lab” test.

Updates for 4Q20: ProPhase reported solid sequential growth in revenues, driven by COVID testing. This was a result of the company’s new 25,000 square foot facility in New York coming online. The existing lab plus the new lab combined have the equipment and infrastructure necessary to provide a capacity of up to 60,000 tests per day. By December 31, 2020, the Company surpassed all previously announced short-term goals, processing 1,500 COVID-19 tests per day based on an average 5-day work week. The company ended the period with \$6.8M and in 1Q21 raised gross proceeds of \$43M. **We are less interested in the 4Q20 results versus what we hope to see this year, as the company’s infrastructure is now in place to capture a share of the testing marketplace.**

The COVID Diagnostic Opportunity: We present some basic assumptions in our model on the market size (U.S.) for COVID. Suffice to say: it’s a multi-billion-dollar market. Even a small piece of the market can be transformative to a company such as ProPhase. Recognizing the opportunity, the company acquired a CLIA lab (October 2020) capable of processing 1,000 samples in 24 hours (& now expanded to 10k/day).

Valuation: We project detailed revenue assumptions in our model out to 2030. We apply a 70% success probability (30% risk cut) to our revenue estimates. On top of this, we apply a 30% risk rate in our Free Cash Flow to the Firm (FCFF), discounted EPS (dEPS), and Sum-of-the-Parts (SOP) models, which are then equal-weighted and averaged and rounded to the nearest whole number to derive our 12-month projected price target of \$25.00.

Risks to our thesis include: (1) commercial; (2) financial; (3) intellectual property; and (4) OEM and/or manufacturing. We review these risks in the Risk Analysis section of this report.

Jason H. Kolbert

Head of Research

646-465-6891

jkolbert@dawsonjames.com

Current Price	\$4.80		
Price Target	\$25.00		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 14,514	\$ 62,337	\$ 87,622
1Q March	\$ 1,888	\$ 11,232	\$ 21,537
2Q June	\$ 3,623	\$ 14,801	\$ 21,059
3Q September	\$ 3,840	\$ 16,674	\$ 22,075
4Q December	\$ 5,163	\$ 19,631	\$ 22,951
	F2020A	F2021E	F2022E
EPS (diluted)	\$ (0.18)	\$ 2.12	\$ 3.03
1Q March	\$ (0.07)	\$ 0.35	\$ 0.75
2Q June	\$ 0.01	\$ 0.50	\$ 0.72
3Q September	\$ (0.04)	\$ 0.58	\$ 0.76
4Q December	\$ (0.08)	\$ 0.70	\$ 0.79
EBITDA/Share	(\$0.18)	\$2.12	\$3.54
EV/EBITDA (x)	-349.3	30.4	18.2
Stock Data			
52-Week Range	\$1.20	-	\$16.04
Shares Outstanding (mil.)	15.2		
Market Capitalization (mil.)	\$73		
Enterprise Value (mil.)	\$64		
Debt to Capital	0%		
Book Value/Share	\$2.86		
Price/Book	-		
Average Three Months Trading Volume (K)	440		
Insider Ownership	18.5%		
Institutional Ownership	4.5%		
Short interest (mil.)	1.2%		
Dividend / Yield	\$0.00/0.0%		



Our Model Preference – A Population-based model. In our population model, we can easily vary the inputs, such as percent of the population that is tested (e.g., 10%, 20%, 100%, 200%) and the net revenue each test generates for the company (e.g., \$30, \$40, \$50, \$60). We assume 20% of the U.S. population is tested just once annually. We believe this is conservative. Some of us will be tested regularly. For example, many college students have been mandated to weekly testing.

We assume \$50.00 per test in net revenue. This results in 2030E revenues of \$255M. This is when washed through the same operating and valuation models (Free Cash Flow to the Firm or FCFE, discounted EPS or dEPS, and Sum of the Parts [SOP]), all at a 30% discount rate, and recall that the revenue models also have a probability of success factor of 70%, so this is like a double discount rate.

Percent Annual Testing of US Population	Inputs	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
U.S. Population		330,000,000	330,000,000	333,300,000	336,633,000	339,999,330	343,399,323	346,833,317	350,301,650	353,804,666	357,342,713	360,916,140
10% Testing (annual)	20%	66,000,000	66,000,000	66,660,000	67,326,600	67,999,866	68,679,865	69,366,663	70,060,330	70,760,933	71,468,543	72,183,228
Market Share of Testing		0%	2%	3%	5%	6%	7%	8%	9%	10%	10%	10%
No. of Tests		0	1,320,000	1,999,800	3,366,330	4,079,992	4,807,591	5,549,333	6,305,430	7,076,093	7,146,854	7,218,323
Net Margin per test	\$50	\$50	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51	\$51
Annual Operating Income (\$M)		0	67	101	170	206	243	280	318	357	361	365
Risk Adjusted		70%	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
Risk Adjusted Operating Income (\$M)		\$0	\$47	\$71	\$119	\$144	\$170	\$196	\$223	\$250	\$253	\$255

Source: Dawson James estimates

20% & \$50.00: The net result of these assumptions is a net present value of \$25.00 per share.

Net Rev. per Test	% Annual Testing						
	10%	20%	30%	40%	50%	100%	200%
\$30	\$15	\$19	\$23	\$27	\$32	\$53	\$95
\$40	\$16	\$22	\$27	\$33	\$39	\$67	\$123
\$50	\$18	\$25	\$32	\$39	\$46	\$81	\$151
\$60	\$19	\$27	\$36	\$44	\$53	\$95	\$179
\$70	\$20	\$30	\$40	\$50	\$60	\$109	\$207

Source: Dawson James estimates

Risk Analysis

Commercial risk. The focus of the company is on successfully developing its products and bringing them to the market. Competition may be intense from external players as well as customers who choose to “build it themselves.”

Financial risk. The company may need to raise capital in the marketplace relatively soon. There can be no assurance that the company will be able to raise capital and do so on favorable terms successfully.

Intellectual property risk. The company may have to defend its patents and technical know-how, and there can be no assurances that the patents will not be infringed or will be held as valid if challenged, and the company may infringe on third parties' patents.

Regulatory Risk. Diagnostic testing is regulated by the government. There can be no assurances that ProPhase’s process will not be interrupted as a result of regulatory requirements.

OEM and/or manufacturing risk. Original Equipment Manufacturers (OEMs) may decide to make products themselves, and, as such, terminate production contracts before completion, creating revenue shortfalls. Manufacturing risks include the ability to produce and do so in a competitive, timely, and efficient way.

Exhibit 1. Income Statement

PRPH., Inc. Income Statement (\$000)															
YE Dec. 31	2020A	1Q21E	2Q21E	3Q21E	4Q21E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Revenue (\$000)															
OTC Consumer Healthcare Products	14,514	4,232	3,135	4,076	4,232	15,675	16,929	18,283	19,746	21,326	23,032	24,874	26,864	29,014	31,335
Other Business															
COVID & Flu Diagnostics		6,999	11,666	12,599	15,398	46,662	70,693	119,000	144,228	169,948	196,169	222,897	250,140	252,641	255,168
Total Revenues	14,514	11,232	14,801	16,674	19,631	62,337	87,622	137,283	163,974	191,274	219,201	247,771	277,004	281,655	286,502
Expenses															
COGS	9,908	5,616	7,400	8,337	9,815	31,169	39,430	61,777	73,788	86,073	98,640	111,497	124,652	126,745	128,926
% COGS	68%	50%	50%	50%	50%	50%	45%	45%	45%	45%	45%	45%	45%	45%	45%
Gross Profit	4,606	5,616	7,400	8,337	9,815	31,169	48,192	75,506	90,186	105,201	120,560	136,274	152,352	154,910	157,576
Real estate Gain	633														
Sales (Advertising & Marketing) expense	1,287	240	250	250	260	1,000	1,020	1,040	1,061	1,082	1,104	1,126	1,149	1,172	1,195
General and administrative	6,671	1,200	1,250	1,250	1,300	5,000	5,100	5,202	5,306	5,412	5,520	5,631	5,743	5,858	5,975
Research & Development	633	120	125	125	130	500	510	520	531	541	552	563	574	586	598
Total expenses	8,591	1,560	1,625	1,625	1,690	6,500	6,630	6,763	6,898	7,036	7,177	7,320	7,466	7,616	7,768
Operating Profit	(2,093)	4,056	5,775	6,712	8,125	24,669	41,562	68,743	83,288	98,165	113,384	128,954	144,886	147,294	149,808
Oper Margin															
Unrealized gain on debt securities	62					-	-	-	-	-	-	-	-	-	-
Interest expense	(295)					-	-	-	-	-	-	-	-	-	-
Income discontinued ops	201					-	-	-	-	-	-	-	-	-	-
Other (loss)	(9)					-	-	-	-	-	-	-	-	-	-
Pre-tax income	(2,134)	4,056	5,775	6,712	8,125	24,669	41,562	68,743	83,288	98,165	113,384	128,954	144,886	147,294	149,808
Pretax Margin															
Income Tax (Benefit)							6,234	13,749	20,822	27,486	34,015	39,976	46,363	48,607	49,437
Tax Rate							15%	20%	25%	28%	30%	31%	32%	33%	33%
GAAP Net Income	(2,134)	4,056	5,775	6,712	8,125	24,669	35,328	54,995	62,466	70,679	79,369	88,978	98,522	98,687	100,371
GAAP-EPS	(0.18)	0.35	0.50	0.58	0.70	2.12	3.03	4.71	5.33	6.02	6.75	7.55	8.35	8.34	8.47
Non GAAP EPS (dil)	(0.18)	0.35	0.50	0.58	0.70	2.12	3.03	4.71	5.33	6.02	6.75	7.55	8.35	8.34	8.47
Wgtd Avg Shrs (Bas) - '000s	11,595	11,618	11,641	11,665	11,688	11,653	11,747	11,841	11,936	12,032	12,128	12,225	12,324	12,422	12,522
Wgtd Avg Shrs (Dil) - '000s	11,595	11,605	11,628	11,652	11,675	11,640	11,663	11,687	11,710	11,733	11,757	11,780	11,804	11,828	11,851

Source: Dawson James estimates, company reports

Companies mentioned in this report:

Important Disclosures:

Price Chart:



Price target and ratings changes over the past three years:

Initiated – Buy – January 20, 2021 – Price Target \$25.00
 Update – Buy – February 1, 2021 – Price Target \$25.00
 Update – Buy – February 22, 2021 – Price Target \$25.00
 Update – Buy – March 4, 2021 – Price Target \$25.00
 Update – Buy – April 9, 2021 – Price Target \$25.00
 Update – Buy – April 23, 2021 – Price Target \$25.00

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As of: 19-Apr-21

	Company Coverage		Investment Banking	
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Market Perform (Neutral)	10	33%	0	0%
Market Underperform (Sell)	0	0%	0	0%
Total	30	100%	5	17%

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