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ProPhase Labs (NASDAQ: PRPH)

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BUY: “We Have the Capital, We Have the Platform”- Special Cash Dividend Declared, Driven by a Strong Quarter

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ProPhase Labs reported 1Q21 revenues of \$15.2M with the majority being driven by COVID testing revenues. COGS were below our expectations at 42%, which helped drive \$1M in positive free cash flow to the bottom line. The company closed the period with \$36M in cash on the balance sheet. ProPhase Labs announced that its Board of Directors has declared a special cash dividend in the amount of \$0.30 per share on its common stock.

Highlights:

Updates for 1Q21: ProPhase delivered a strong quarter driven by diagnostics, which supported the declaration of a cash dividend of \$0.30 per share to shareholders. We note that start-up costs hit 1Q, suggesting higher margins than we have been forecasting in diagnostics. Inventory and receivables were also up, indicating potentially strong future results. On the call, management highlighted that expenses were high as a result of start-up costs of the new labs. This implies that profitability could rise in sequential quarters as those expenses go away. High capacity, fast turnaround times, and smart phone results are all translating into contract wins, as is the case for the recent Town of Oyster Bay contract (see “My Home Town – 4.23.2021.”) Also, another recent win is a contract with Dutchess County, New York. These wins are allowing the company to compete for nationwide contracts, which have the potential to transform the company.

COVID Evolves – Antigen Testing versus PCR Testing. In recent weeks, with increased vaccinations, the testing rate for COVID has dropped. This does raise questions on the outlook. Antigen testing has been rising but is not as accurate as PCR testing. Management talked about the possibility of another wave of COVID, perhaps in the fall, seasonal like flu. We do know that having the vaccine likely will not alleviate the burden for testing. We expect testing is likely to be required for travel, hospital visits, and other similar events. The company is evaluating antigen testing (possibly at home, possibly saliva-based) to support its PCR lab testing business.

The Challenge – Diversify Beyond COVID. Management stated “We have the Platform, We have the Capital.” The company is looking to build its diagnostic business and acquisitions (labs) are on the table. Management has an eye on everything from traditional labs to genomic testing, from flu to oncology. Stay tuned.

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; (4) regulatory, and (5) OEM and/or manufacturing. See the Risk Analysis section of this report.

Current Price	\$5.36		
Price Target	\$25.00		
Estimates	F2020A	F2021E	F2022E
Revenues (\$000s)	\$ 14,514	\$ 64,214	\$ 87,622
1Q March	\$ 1,888	\$ 15,271	\$ 21,537
2Q June	\$ 3,623	\$ 14,635	\$ 21,059
3Q September	\$ 3,840	\$ 16,576	\$ 22,075
4Q December	\$ 5,163	\$ 17,732	\$ 22,951
	F2020A	F2021E	F2022E
EPS (diluted)	\$ (0.18)	\$ 0.84	\$ 1.66
1Q March	\$ (0.07)	\$ 0.06	\$ 0.41
2Q June	\$ 0.01	\$ 0.19	\$ 0.39
3Q September	\$ (0.04)	\$ 0.27	\$ 0.42
4Q December	\$ (0.08)	\$ 0.32	\$ 0.44
EBITDA/Share	(\$0.18)	\$1.05	\$2.43
EV/EBITDA (x)	-395.4	69.5	29.9
Stock Data			
52-Week Range	\$1.20	-	\$16.04
Shares Outstanding (mil.)	15.2		
Market Capitalization (mil.)	\$81		
Enterprise Value (mil.)	\$73		
Debt to Capital	0%		
Book Value/Share	\$2.86		
Price/Book	-		
Average Three Months Trading Volume (K)	70		
Insider Ownership	17.9%		
Institutional Ownership	5.3%		
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	1Q21A	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		11,039	11,500	12,500	13,500	48,539	70,693	119,000	144,228	169,948	196,169	222,897	250,140	252,641	255,168
Total Revenues	14,514	15,271	14,635	16,576	17,732	64,214	87,622	137,283	163,974	191,274	219,201	247,771	277,004	281,655	286,502
Expenses															
COGS	9,908	6,344	6,586	7,459	7,980	28,368	39,430	61,777	73,788	86,073	98,640	111,497	124,652	126,745	128,926
% COGS	68%	42%	45%	45%	45%	44%	45%	45%	45%	45%	45%	45%	45%	45%	45%
Gross Profit	4,606	8,927	8,049	9,117	9,753	35,846	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	3,809	2,000	2,000	2,000	9,809	6,866	7,004	7,144	7,287	7,432	7,581	7,733	7,887	8,045
General and administrative	6,671	3,782	2,500	2,000	1,800	10,082	5,000	5,100	5,202	5,306	5,412	5,520	5,631	5,743	5,858
Research & Development	633	115	125	125	135	500	510	520	531	541	552	563	574	586	598
Total expenses	8,591	7,706	4,625	4,125	3,935	20,391	12,376	12,624	12,876	13,134	13,397	13,664	13,938	14,216	14,501
Operating Profit	(2,093)	1,221	3,424	4,992	5,818	15,455	35,816	62,882	77,309	92,067	107,164	122,610	138,415	140,694	143,075
Oper Margin															
Unrealized gain on debt securities	62	87				87	-	-	-	-	-	-	-	-	-
Interest expense	(295)	(251)				(251)	-	-	-	-	-	-	-	-	-
Income discontinued ops	201					-	-	-	-	-	-	-	-	-	-
Other (loss)	(9)					-	-	-	-	-	-	-	-	-	-
Pre-tax income	(2,134)	1,057	3,424	4,992	5,818	15,291	35,816	62,882	77,309	92,067	107,164	122,610	138,415	140,694	143,075
Pretax Margin															
Income Tax (Benefit)		11					5,372	12,576	19,327	25,779	32,149	38,009	44,293	46,429	47,215
Tax Rate							15%	20%	25%	28%	30%	31%	32%	33%	33%
GAAP Net Income	(2,134)	1,046	3,424	4,992	5,818	15,280	30,443	50,306	57,982	66,288	75,015	84,601	94,122	94,265	95,861
GAAP-EPS	(0.18)	0.07	0.19	0.27	0.32	0.85	1.66	2.74	3.16	3.60	4.07	4.58	5.08	5.08	5.16
Non GAAP EPS (dil)	(0.18)	0.06	0.19	0.27	0.32	0.84	1.66	2.74	3.16	3.60	4.07	4.58	5.08	5.08	5.16
Wgtd Avg Shrs (Bas) - '000s	11,595	14,563	14,592	14,621	14,651	14,607	14,724	14,842	14,961	15,081	15,202	15,324	15,447	15,571	15,696
Wgtd Avg Shrs (Dil) - '000s	11,595	18,200	18,236	18,273	18,309	18,255	18,291	18,328	18,364	18,401	18,438	18,475	18,512	18,549	18,586

Source: Dawson James estimates, company reports

Companies mentioned in this report:

Important Disclosures:



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
- Update – Buy – May 14, 2021 – Price Target \$25.00

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