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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)

June 10, 2021

BUY: Next Step - Genomics

ProPhase Labs announced the formation of two wholly-owned subsidiaries, ProPhase Precision Medicine, Inc., which will focus on genomics testing technologies, and ProPhase Global Healthcare, Inc., which was recently formed to seek to expand the Company's SARS-CoV-2 (COVID-19) testing into other countries and to pursue additional healthcare-related initiatives.

Highlights:

Looking for the Right Acquisition - ProPhase has now “upped the ante” in the company’s push to acquire existing businesses and technology around whole-genome sequencing (WGS). WGS is a comprehensive method for analyzing entire genomes, including the genes and chromosomes in DNA. The data obtained from genomic testing can help to identify inherited disorders, predict disease risk, identify expected drug response, and characterize genetic mutations, including those that drive cancer progression. The costs associated with whole genome sequencing have dropped dramatically in recent years, leading to new services that can provide more detailed testing, better diagnoses, and an ability to predict the viability of therapeutic treatments.

In terms of COVID - ProPhase Diagnostics is now developing antigen and antibody tests to move its product offerings beyond RT-PCR testing. The company stated: “we are considering the acquisition of other laboratories in the U.S. that may provide pathology, toxicology, blood, urine and oncology testing in order to expand beyond COVID-19 testing.”

COVID Evolves - Antigen Testing versus PCR Testing. In recent weeks, with increased vaccinations, the testing rate for COVID has slowed, however antigen testing rates have been rising. We note that antigen testing is not as accurate as PCR testing and positive outcomes likely lead to more 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.

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.

Jason H. Kolbert
 Head of Healthcare Research
 646-465-6891
 jkolbert@dawsonjames.com

| | | | |
|-----------------------------------------|-------------|-----------|-----------|
| Current Price | \$5.31 | | |
| 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) | -391.3 | 68.8 | 29.6 |
| Stock Data | | | |
| 52-Week Range | \$1.20 | - | \$16.04 |
| Shares Outstanding (mil.) | 15.2 | | |
| Market Capitalization (mil.) | \$80 | | |
| Enterprise Value (mil.) | \$72 | | |
| Debt to Capital | 0% | | |
| Book Value/Share | \$2.86 | | |
| Price/Book | - | | |
| Average Three Months Trading Volume (K) | 105 | | |
| Insider Ownership | 17.9% | | |
| Institutional Ownership | 8.6% | | |
| Short interest (mil.) | 1.3% | | |
| 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 FCFF, 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

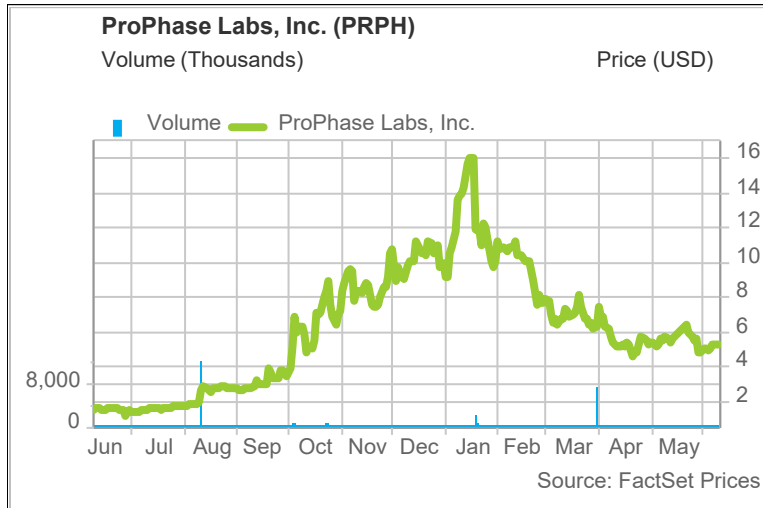
| PRPH., Inc. Income Statement (\$000) | | | | | | | | | | | | | | | |
|-----------------------------------------|----------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| 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 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
- Update – Buy – May 14, 2021 – Price Target \$25.00
- Update – Buy – June 10, 2021 – Price Target \$25.00

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- 1) **Buy:** The analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months.
- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months.
- 3) **Sell:** The analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

The following chart reflects the range of current research report ratings for all companies, followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services.

As of: 17-May-21

| Ratings Distribution | Company Coverage | | Investment Banking | |
|----------------------------|------------------|------------|--------------------|-------------|
| | # of Companies | % of Total | # of Companies | % of Totals |
| Market Outperform (Buy) | 24 | 71% | 5 | 21% |
| Market Perform (Neutral) | 10 | 29% | 0 | 0% |
| Market Underperform (Sell) | 0 | 0% | 0 | 0% |
| Total | 34 | 100% | 5 | 15% |

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